



KCCC Alcohol Inventory Follow-Up Audit

June 2013

CITY OF KILLEEN

A Report to the City
of Killeen Audit
Committee

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Report Summary

An internal audit of the Killeen Civic and Conference Center Alcohol Inventory in September 2012 revealed a number of significant control deficiencies including misappropriation of City funds. The follow-up audit has reported significant improvement; however, there are areas that require additional improvement. These include review and reporting processes, and documentation requirements.

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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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AUDIT REPORT HIGHLIGHTS

Why This Audit Was Conducted

This audit was conducted in order to follow up on the findings noted in the August 2012 Internal Audit of Alcohol Inventory.

What Was Recommended

It was recommended that KCCC staff follow through on review processes, ensure that the proper adjustments are made each month on inventory reports, ensure that supporting documentation is adequate, calculate cost of goods sold correctly, and ensure that the monthly inventory reports are complete and accurate.

Mayor and Council,

I am pleased to present this follow-up audit on the Killeen Civic and Conference Center (KCCC) Alcohol Inventory.

BACKGROUND

- The City of Killeen contracts with Jesters, an outside company, to manage the City's alcohol 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 the August 2012 Internal Audit of Alcohol Inventory. The audit scope included the alcohol operations between September 2012 and June 2013.

WHAT WAS FOUND

While significant improvement was noted since the August 2012 internal audit, there were still some irregularities in procedures and implementation of procedures that are documented in this report and are summarized as follows:

- KCCC staff has not been diligent in signing off on reviewed documents.
- The proper adjustments as noted in the audit report are not regularly reported on the monthly inventory reports to account for spills, over/underpours, and adjustments for doubles.
- Register tapes are not regularly date-stamped, which is essential for validation purposes.
- Cost of Goods Sold is not accurately reported. This is an important aspect of financial reporting and should be calculated and reported correctly.
- Lastly, there were three instances in which the beginning inventory amounts did not agree to the ending inventory amounts from the previous month.

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 contracts with Jesters to manage its mixed beverage service at the Killeen Civic and Conference Center (KCCC). 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 Texas Alcoholic Beverage Commission.

The City pays for the cost of procurement of 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 at KCCC.

An internal audit was completed in August 2012 of the Alcohol Inventory at KCCC, which revealed several significant control deficiencies including a loss of funds. This follow-up audit was completed in order to determine whether KCCC implemented the necessary controls needed to safeguard the City's assets as recommended in the August 2012 Internal Audit of Alcohol Inventory.

OBJECTIVE, SCOPE, AND METHODOLOGY

The KCCC Alcohol Inventory Follow-Up Audit was conducted in order to follow up on the findings noted in the August 2012 KCCC Alcohol Inventory Internal Audit. This audit was also included in the FY2013 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 the August 2012 Internal Audit of Alcohol Inventory.

Scope

The audit scope included the alcohol operations between September 2012 and June 2013.

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

While significant improvement was noted since the August 2012 Internal Audit of KCCC Alcohol Inventory, there were still some irregularities in procedures and implementation of procedures that are documented in this report.

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 20 events with alcohol was tested during the audit. For each of these 20 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.

Four months were selected at random to test with regard to inventory records and monthly deposit records – December, February, April and June. In these four months, the monthly revenue report provided by Jesters was compared to the final inventory reports provided by Jesters. Additionally, it was noted that special orders and host amounts were appropriately included in the monthly inventory reports with sales for the four months tested.

An inventory analysis was completed during the audit for each month from September 2012 through June 2013. Each month was reviewed with regard to the sales reported, deposits received, spills reported, and any variance between the sales and the deposits. In the analysis, an adjustment equal to 2% of total sales was used to account for spills and over/underpours (See Additional Observation following the findings). Also, in reviewing the inventory records for the four randomly selected months (December, February, April and June) an average of the adjustment for doubles was determined to be approximately 6% of the monthly sales. This percentage was extrapolated over the entire audit period to provide for an estimate each month. This estimate was used, for analysis purposes, as the adjustment for doubles that should be reported on the monthly inventory reports as noted below in Finding 2. The completed analysis revealed positive variances in nearly every month between September 2012 and June 2013.

Finding 1: KCCC staff does not physically sign/initial documents upon review.

Jesters counts all inventory on-hand on a monthly basis. These inventories are observed by KCCC staff in order to ensure that Jesters staff accurately reports the City's inventory. Even though these counts are observed by KCCC staff, they are not physically signed or initialed by KCCC staff denoting their approval/review of the document. This is an important step in the review process, which provides proof of observation as well as the necessary audit trail. A copy

of the initial inventory count documents should be retained by KCCC staff with the final monthly inventory reports. It was also noted in the audit that KCCC staff reviews the final inventory/deposit records provided by Jesters; however, they do not sign/initial the reports denoting proof of the review. Proof of the review is as important as the actual review process itself.

Finding 2: The adjustments for doubles are not reported accurately on the monthly inventory reports provided by Jesters.

In managing the city's alcohol operation, Jesters makes an adjustment for double servings of liquor sold in a single mixed beverage. This adjustment is essentially a discount and is accounted for via a separate sale item on the cash registers. The monthly inventory reports are prepared based on each serving sold (shot of liquor, glass of wine, or bottle/glass of beer), which is multiplied by the dollar amount charged per drink. This process does not take into consideration the discount allowed for doubles purchased; therefore, an adjustment must be calculated and reported on the inventory reports. The adjustment is calculated by multiplying the number of doubles sold by 2 to determine the number of singles sold. The average price charged to a customer for a mixed beverage is \$5.50, which is multiplied by the number of singles sold as determined above. The result is then subtracted from the dollar amount of doubles sold as reported on the register tape. This adjustment is reported on the monthly inventory report as a reduction to the calculated sales. There were four months in which the adjustment for doubles was tested as part of the audit procedures. The adjustment reported in each of these months did not agree to the calculations as figured in the audit test. These calculations must be reported accurately on the monthly inventory reports.

Finding 3: Register tapes are not consistently date-stamped, and spills tapes are not consistently signed by Jesters staff.

A best practice with regard to using cash registers is to use the automated function which stamps the date on the register tape at the time of the transaction. In KCCC's alcohol operation, register tapes are not consistently date-stamped due to the fact that often the bars must be moved during an event, which requires staff to unplug the registers. The date must be reprogrammed each time the registers are unplugged, which is not feasible during an event. KCCC staff is considering the replacement of the registers, which will allow the register tapes to be consistently date-stamped. Additionally, it was noted in the audit that spills tapes were not consistently signed by Jesters staff. The spills tapes, much like the register tapes for each bar, should be signed by the bar manager in order to establish accountability for spills/breakages.

Finding 4: Cost of Goods Sold is not accurate.

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 does it then get reported on the income statement as an expenditure, COGS. The inventory reports provided by Jesters include a section for the COGS calculation; however, the calculation is rarely accurate. Most of the discrepancies noted in the audit had to do with the formula in the worksheet not being set up properly, or the purchase price of the inventory not being entered. The current worksheet will provide accurate figures if it is utilized properly. Jesters and KCCC staff should review the monthly reports and ensure that the COGS is calculated correctly each month. This will in turn ensure that the financial reports provided to the City Council on a monthly basis are accurate.

Finding 5: The beginning inventory should agree to the ending inventory from the previous month for each inventory item.

Proper inventory practice requires that the beginning inventory amount of a given month agrees to the ending inventory amount from the previous month. There were three instances noted in the audit in which the beginning inventory amount on an inventory item did not agree to the ending inventory amount from the previous month. This does not seem to be a widespread disregard of proper practice, but it is important for these figures to be reported accurately; therefore, it was noted in the audit.

Additional Observation: Monthly variances between the calculated sales and the deposits were inconsistent.

In the August 2012 Internal Audit of KCCC Alcohol Inventory, Finding 5 discussed the issue regarding variances, and it was suggested that variances in excess of \$200 should be rare and should be researched thoroughly. After further review of the process, it is not clear as to what should be reasonable with regard to variances. When a bartender measures a serving of a given beverage, it is not feasible to assume that each serving is measured exactly equal to the last. This is commonly referred to as over/underpouring, and it is expected in the bartending industry. A reasonable percentage should be included as an adjustment on the monthly inventory reports to account for these expected differences. Jesters and KCCC staff should determine what is reasonable with regard to over/underpours and should include in their monthly inventory report an adjustment as discussed along with an adjustment for doubles as recommended in Finding 2 above and an adjustment for the spills that occur. Taking these adjustments into consideration on the monthly inventory reports will provide for more accurate variances between the calculated sales and the deposits each month.

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. **KCCC staff should sign/initial the count records, indicating observation of the inventory counts. KCCC staff should also sign/initial the monthly inventory/deposit reports provided by Jesters upon review of these documents.**
2. **The adjustment for doubles should be reported accurately and consistently on the monthly inventory reports.**
3. **Register tapes should be date-stamped for each event and spills tapes should be signed/initialed by Jesters staff.**
4. **Cost of Goods Sold should be calculated correctly and consistently on the monthly inventory reports.**
5. **Beginning inventory amounts should agree to the ending inventory amounts from the previous month.**

Additional Observation: KCCC staff and Jesters should mutually determine a reasonable percentage to account for over/underpours on the monthly inventory reports. This adjustment as well as an adjustment for doubles and an adjustment for spills should be reported each month in order to determine the variance between monthly sales reported and deposits received.

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

APPENDIX A

MANAGEMENT RESPONSE



TO: Amanda Wallace, City Auditor
VIA: Glenn Morrison, City Manager *fm*
VIA: John Sutton, Assistant City Manager, External Services *JWS 8/14/13*
From: Connie Kuehl, KCCC Director
Re: 2013 KCCC Alcohol Inventory Follow-Up Audit
Date: August 14, 2013

KCCC staff has been advised on improvements needed for managing the alcohol license and monitoring the Jester's contract. The following actions have been addressed regarding the Findings of the Audit.

Finding 1: Staff has been observing Jester's Manager when conducting an alcohol inventory monthly and has begun signing off and keeping a copy of the Jester's inventory form to denote proof of the review.

Finding 2: Staff has determined that the adjustments for reporting "Doubles" (which is two shots in one glass) is complicated to report and the one dollar mark up is not profitable. Staff recommends discontinuing orders for "Doubles" which is in agreement with other Convention Center policies.

Finding 3: KCCC is an eleven year-old facility and we are replacing multiple pieces of equipment that fail or when parts to repair are not available. The cash registers are the originals purchased when opening. They have the capability of programming for multiple drinks of varied prices, which simplifies ringing up drinks for the bartenders. When the event ends, register tapes should reflect a tally of the number of specific drinks served, which should match the cash drawer and show a date stamp at the bottom near the total. We have determined that the battery back-up feature has failed on several registers necessitating re-programming when they are moved during an event. We see this issue primarily during the very large events where bars are stationed in the foyer for the social hour and moved inside for the dinner. Bar tenders are rushing to re-program registers and serve patrons, and sometimes make programming errors. Replacing batteries is expensive, and newer models will allow more functions. We have ordered new cash registers to solve this issue and are having each bartender sign their tape when cashing out at the end of the event.

Finding 4: The Cost of Goods formula from Jesters had a formula error and has been corrected.

Finding 5: Inventory reported at the end of one month and beginning of the next should be the same. Jester's made a copy error which will be monitored closer in the future.

Connie Kuehl

Connie Kuehl, Director, KCCC

APPENDIX B

CURRENT STATUS OF PRIOR YEAR AUDIT COMMENTS

1. **FINDING:** After performing a detailed analysis of the inventory over the past two fiscal years, I have discovered a revenue shortage of approximately \$25,000 reported to the City by Jesters. This was discovered by analyzing the sales reported on the inventory reports and comparing those figures to the actual cash deposits made to the City by Jesters.
RECOMMENDATION: The City must be more diligent in reviewing the reports provided by Jesters. The sales figures should be compared to cash receipts on a monthly basis to determine if the City is actually receiving all the revenue it is due.
CURRENT STATUS: KCCC staff has implemented appropriate review procedures to ensure that the City is receiving all revenue due.
2. **FINDING:** Due to the fact that Jesters has under-reported revenues to the City of Killeen by approximately \$25,000, the applicable mixed beverage taxes were not remitted to the State of Texas accordingly.
RECOMMENDATION: The appropriate mixed beverage taxes must be paid immediately. There is a possibility of penalties that the State of Texas may impose on the City for not remitting the appropriate taxes. This will need to be discussed with the Texas State Comptroller in order to determine whether the City will owe penalties and/or interest.
CURRENT STATUS: The City has not been imposed any penalties or interest to date.
3. **FINDING:** City of Killeen staff does not verify the accuracy of the inventory reports provided by Jesters.
RECOMMENDATION: City of Killeen staff must be present for the monthly inventory in order to verify the accuracy of the reports provided by Jesters. Staff must compare the purchases reported by Jesters with City of Killeen records to ensure that all purchases are appropriately and accurately reported on the inventory reports. Additionally, staff must verify that the beginning inventory amounts are correctly carried forward from the previous month.
CURRENT STATUS: KCCC staff observes each monthly inventory, and verifies the purchases reported by Jesters. There were three instances noted in the current audit in which the beginning inventory amount did not agree to the ending inventory amount from the previous month. See current year Finding 5.
4. **FINDING:** Jesters staff does not include special orders on its inventory report.
RECOMMENDATION: Special orders should be included on the inventory report in order to ensure that the City is paying the correct amount of mixed beverage tax on revenues received.
CURRENT STATUS: Special orders are included on the inventory reports and in the mixed beverage tax calculations each month.
5. **FINDING:** City of Killeen staff does not consistently research or question large variances on the inventory report.

RECOMMENDATION: Staff must research all variances in excess of \$200. A small amount of variance is normal due to spills/over-pours and breakages, but variances in excess of \$200 are not acceptable.

CURRENT STATUS: KCCC Staff is accounting for and reviewing large variances. Staff is also in the process of implementing a reasonable variance figure. See Additional Observation following the current year findings.

6. **FINDING:** Jesters staff reports an adjustment for doubles on its inventory report.

RECOMMENDATION: There should not be an adjustment for doubles. Doubles should be correctly reflected as two shots of liquor sold.

CURRENT STATUS: There is an adjustment for doubles that is reasonable and is accounted for via a separate item on register tapes. The adjustment is then recorded on the monthly inventory reports. It was noted in the current audit that the adjustments for doubles reported on the inventory reports did not agree with the re-calculated adjustments in the audit. See current year Finding 2.

7. **FINDING:** Jesters does not consistently provide supporting documentation for spills/breakages.

RECOMMENDATION: There must be sufficient supporting documentation detailing the amount of spills for each event. The total amount of spills reported at each event should tie to the spills figure reported on the inventory report.

CURRENT STATUS: Spills are properly documented on a register tape and reported on the monthly reports provided by Jesters. The spill figures do not include an adjustment for over/under pours.

8. **FINDING:** Jesters does not deposit revenues and supporting documentation with City of Killeen staff on a timely basis.

RECOMMENDATION: Jesters should deposit revenues and supporting documentation with City of Killeen staff the following business day after the event takes place.

CURRENT STATUS: Jesters deposits revenues and supporting documentation timely.

9. **FINDING:** Jesters staff explained to me that the revenues received at each event are taken to her home and counted before being brought back to City of Killeen staff at KCCC.

RECOMMENDATION: This is unacceptable. There is a safe in the liquor closet where all revenues should be placed while awaiting deposit. Revenues should not be removed from the liquor closet except by the bar manager employed by Jesters en route to be deposited with City of Killeen staff at the KCCC business office.

CURRENT STATUS: Revenues are not removed from the liquor closet except for deposit with KCCC staff.

10. **FINDING:** Jesters provides register tapes for each bar's register for each event to City of Killeen staff. There is an option on each register to include the date at the bottom of the register tape. The majority of the register tapes received by City of Killeen staff did not have the date stamped on them.

RECOMMENDATION: This is unacceptable. The dates must be stamped on each register tape, and the number of register tapes must coincide with the number of bars the City of Killeen has on record for each event.

CURRENT STATUS: See current year finding 3 regarding date stamps. It was noted in the current audit that the number of register tapes coincides with the number of bars per KCCC records.

11. **FINDING:** Register tapes are not initialed or signed by the bartenders or the bar manager (each employed by Jesters).

RECOMMENDATION: Each register tape must be initialed/signed and dated by the bartender and the bar manager on the night of the event.

CURRENT STATUS: Each register tape is signed by the bartender for each event.

12. **FINDING:** City of Killeen staff did not have accurate records concerning the number of bars and the amounts provided by the hosts in some of the event files.

RECOMMENDATION: Each event file should have accurate records concerning the number of bars and the amounts provided by the hosts for each event. If changes are made outside business hours on the day of the event, the bar manager (employed by Jesters) must provide City of Killeen staff with the appropriate pre-made form detailing the change. The form must be signed by the bar manager and the event host as well as the City of Killeen Event Coordinator. This form must be placed in the event file.

CURRENT STATUS: There were no findings in the current audit concerning this issue. A form was implemented to address this, and is consistently used to account for these changes.