



# KCCC Liquor Operation Audit

August 2014

*CITY OF KILLEEN*

A Report to the City  
of Killeen Audit  
Committee

Committee Chair  
Scott Cosper

Committee Members  
Wayne Gilmore  
Juan Rivera

Internal Audit  
Department

City Auditor  
Amanda R. Wallace  
CPA

## 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**

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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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August 2014



## 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 staff obtain appropriate approvals from TABC when required, submit deposits daily, ensure calculations for variances and cost of goods sold are accurate and record activity in the proper accounts throughout the fiscal year.

# KCCC Liquor Operation Audit

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 June 2013 and August 2014.

### WHAT WAS FOUND

The audit findings are summarized as follows:

KCCC staff did not obtain prior approval from TABC for an event that was catered off-premises. The event was also not city-affiliated, so should not have been catered.

During a 3-week period in December, deposits were not submitted, causing more than \$13,000 in revenue to be delayed in posting.

Calculations for variances and cost of goods sold were not accurate.

All liquor activity is recorded in a liability line item throughout the fiscal year, instead of recording it in the proper accounts at the time of each transaction.

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

*Amanda R. Wallace*

Amanda R. Wallace, City Auditor

## BACKGROUND

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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 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.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

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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 FY2014 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 June 2013 and August 2014.

### **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

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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 16 events with alcohol was tested during the audit. For each of these 16 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 – November, February, May and July. In these four 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. 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 June 2013 through August 2014. 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 positive variances in all but two months in the audit period.

### **Finding 1: Catering Permit not obtained from TABC for one tested event.**

The City maintains a catering permit in order to provide an alcoholic beverage service at each of its conference facilities. The City's catering permit requires the City to obtain approval from the Texas Alcoholic Beverage Commission (TABC) prior to catering any event. In July 2014, KCCC catered an event at a location that was not City-affiliated for an event that was not City-affiliated. KCCC staff did not obtain approval from TABC for this event. Furthermore, while it is not necessarily against policy, it is not appropriate for KCCC to cater events that are not City-affiliated or on City property. The City is not an alcoholic beverage business; it simply offers these services to customers who reserve rooms at one of the City's conference locations. Staff should refrain from catering similar events in the future.

### **Finding 2: KCCC did not submit any deposits between 12/17/13 and 1/6/14 despite numerous events held during that time.**

The cash management policy requires KCCC to submit deposits daily, the purpose of which is to ensure that revenues are recorded timely and that large sums do not accumulate at any given cash collection point. The last deposit in December submitted by KCCC was on 12/17/13;

however, there were five events after this date, for which funds were not deposited until 1/6/14. The staff member who normally prepares the deposits was out of the office, and the remaining staff did not prepare deposits during this time. The total revenue held in the safe for these five events was approximately \$13,548. The practice of accumulating large sums is unsafe and poor management of the City's revenue.

**Finding 3: Cost of Goods Sold is not calculated for special orders.**

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. Jesters prepares a monthly inventory report, which includes cost of goods sold calculations for each inventoried item except for special orders. Because they are ordered upon request for specific events, special orders are entered into inventory and deducted from inventory in the same month. Cost of goods sold should be calculated for special orders as well as other inventoried items in order to ensure that the most accurate information is reported in the monthly financial reports.

**Finding 4: Variances are not consistently calculated correctly.**

The monthly inventory report includes the expected sales based on how many ounces of each product were sold. These expected sales are then compared to the cash received for the month, and any variance is noted on the inventory report. It is not reasonable to assume that every drink that is poured is exactly the same number of ounces, which means it is reasonable for there to be a variance. The variance on several of the monthly inventory reports was not calculated correctly due to an error in the spreadsheet formula, often amounting to large differences between the actual variance and the variance reported by Jesters. The total difference for the period under audit was \$8,373 (4% of total sales). The variances each month should be calculated correctly, and KCCC staff should verify the accuracy. The percentage of the actual variance to the total sales each month ranged from 1% to 13%, with an average variance of 3%. The average variance of 3% is acceptable; however, large variances in any given month should be investigated and the reasons for the variances should be clearly documented.

**Finding 5: An escrow account is used for all liquor activity.**

All activities for the liquor operation run through an escrow account throughout the year, which means it is shown as a liability line item in the City's general ledger. Then a journal entry is prepared by Finance at year-end to record the revenues and expenditures in the proper line items and to adjust inventory to actual. These activities should be recorded in the proper line items throughout the fiscal year to allow for accurate reporting in the monthly financial reports and to eliminate these unnecessary manual adjustments.

## RECOMMENDATIONS

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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. **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.**
2. **Deposits should be submitted daily or after each event.**
3. **COGS should be calculated for all sales, to include special order sales.**
4. **Variances should be calculated correctly, and any large or unusual variances should be investigated and clearly documented.**
5. **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.**

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

APPENDIX A

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MANAGEMENT'S RESPONSE



CITY OF KILLEEN  
CIVIC AND CONFERENCE CENTER  
CONVENTION AND VISITORS BUREAU

December 18, 2014

Mr. Glenn Morrison, City Manager  
Ms. Amanda Wallace, City Auditor

Please see the below responses to the Liquor Operation Audit. All previous year audit findings have been corrected. I've spoken to staff, bar manager, management company and Finance regarding notes we received. We are working toward no findings in next year's audit.

1. 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.  
**Staff neglected to get TABC approval for an event affiliated with the Chamber of Commerce. It is agreed and understood that KCCC will only cater for City of Killeen sponsored events. Management staff will ensure that all permits are obtained prior to any catered event.**
2. Deposits should be submitted daily or after each event.  
**Management staff will ensure that back-up staff is available to make deposits when the staff performing this duty is not available or is out on leave or away from the office for an extended period of time.**
3. COGS should be calculated for all sales, to include special order sales.  
**The spreadsheet has been updated and the formula for special orders now reflects the total cost of goods sold.**
4. Variances should be calculated correctly, and any large or unusual variances should be investigated and clearly documented.  
**Variances will always occur in small amounts attributed to breakage, spillage or over/under-pouring. The bar manager is now doing an inventory before and after each event to ensure inventory control. New pour spouts were ordered to measure correctly and the worksheet was updated. We will continue to monitor any variances after each event.**
5. 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.  
**We are working with Finance on how we code our checks to be in compliance with proper accounting procedures. Finance assures us that journal entries will be made monthly, rather than annually.**

Connie Kuehl, KCCC Director

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## APPENDIX B

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### CURRENT STATUS OF PRIOR YEAR AUDIT RECOMMENDATIONS

1. **FINDING:** KCCC staff does not physically sign/initial documents upon review.  
**RECOMMENDATION:** 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.  
**CURRENT STATUS:** There were no findings in the current audit concerning this issue.
  
2. **FINDING:** The adjustments for doubles are not reported accurately on the monthly inventory reports provided by Jesters.  
**RECOMMENDATION:** The adjustments for doubles should be reported accurately and consistently on the monthly inventory reports.  
**CURRENT STATUS:** There is no longer an adjustment for doubles. Requests for doubles are charged to the customer as two servings.
  
3. **FINDING:** Register tapes are not consistently date-stamped, and spills tapes are not consistently signed by Jesters staff.  
**RECOMMENDATION:** Register tapes should be date-stamped for each event and spills tapes should be signed/initialed by Jesters staff.  
**CURRENT STATUS:** There were no findings in the current audit concerning this issue.
  
4. **FINDING:** Cost of Goods Sold is not accurate.  
**RECOMMENDATION:** Cost of Goods Sold should be calculated correctly and consistently on the monthly inventory reports.  
**CURRENT STATUS:** Cost of Goods Sold is calculated correctly for all inventory items except for special orders. See current year finding 4.
  
5. **FINDING:** The beginning inventory should agree to the ending inventory from the previous month for each inventory item.  
**RECOMMENDATION:** Beginning inventory amounts should agree to the ending inventory amounts from the previous month.  
**CURRENT STATUS:** There were no findings in the current audit concerning this issue.