UNIVERSITY OF HAWAI‘I AT MĀNOA
ATHLETICS DEPARTMENT

H-ZONE

Comments and Observations

Period from May 1, 2014 (Commencement of Operations) through December 31, 2014
To the Management of
University of Hawai‘i at Mānoa Intercollegiate Athletics (dba H-Zone)

In connection with planning and performing our examination of the Schedule of Gross Sales of the H-Zone at Ward Center for the period May 1, 2014 (commencement of operations) through December 31, 2014, we observed improvement opportunities with respect to certain operational matters and internal control processes. Accordingly, we are submitting the accompanying comments, observations and recommendations for the H-Zone’s consideration.

This letter is intended solely for the information and use of management and is not intended to be and should not be used by anyone other than the specified party.

Sincerely,
University of Hawai‘i at Mānoa Athletics Department – H-Zone
Comments and Observations
Period from May 1, 2014 (Commencement of Operations) through December 31, 2014

Background

The University of Hawai‘i at Mānoa Athletic Department (UHAD) commenced operations of the H-Zone at Ward Center on May 1, 2014 pursuant to a lease and related amendments between Victoria Ward Center, L.L.C. (Victoria Ward) and the University of Hawai‘i (University). The lease agreement requires an annual calendar year examination of the Schedule of Gross Sales (as defined in the lease), as UHAD pays Victoria Ward monthly minimum rent in addition to percentage rent if Gross Sales exceed the monthly break point of $68,430. The Office of Internal Audit (Internal Audit) agreed to examine and report on the H-Zone’s Schedule of Gross Sales for the period May 1, 2014 (commencement of operations) through December 31, 2014.

During September 2014, Internal Audit met with UHAD and H-Zone management to discuss the scope, timing and information request listing prepared by Internal Audit. Guidance and assistance in connection with the information requested were provided to H-Zone personnel by Internal Audit and the Assistant Athletics Director for Business Operations. However, H-Zone personnel were inexperienced and lacked the skill set to prepare and gather the requested information in the requested form and content by the agreed upon due dates. Accordingly, Internal Audit performed additional and unanticipated examination procedures in order to issue the examination report prior to the February 28, 2015 deadline. The improvement opportunities described below result from the challenges encountered by H-Zone personnel and the additional procedures performed by Internal Audit.

Comments/Observations and Recommendations

Retail Management System
H-Zone utilizes Retail Pro, a retail management software, to track, analyze and manage its sales, purchasing, and inventory functions. Internal Audit noted errors in the recording of online sales, inventory transfers between stores, and inventory valuation. In addition, UHAD and H-Zone management are unfamiliar with the software’s baseline and elective computer controls and security settings. Finally, Internal Audit noted that the H-Zone Director and Manager perform daily operational tasks (e.g., ringing sales, issuing refunds, processing receipt of inventory, etc.) and have unlimited program access rights to privileged IT functions, such as adjusting inventory quantities or sales prices. Accordingly, operational information may be withheld from and not disclosed to UHAD management.

Internal Audit believes that the primary cause of the matters described above was insufficient planning prior to commencing operations. Presently, UHAD and H-Zone management remain unfamiliar with the functionalities, reporting capabilities and the integrated computer controls of Retail Pro.

Recommendation
Internal Audit believes that UHAD and H-Zone management should read the Retail Pro User’s Guide and view Retail Pro webinars to familiarize themselves with the functions and capabilities
of Retail Pro and request training if necessary. A comprehensive understanding of Retail Pro should improve operational efficiencies and the accuracy and completeness of managerial data and accounting records. Further, UHAD IT personnel should evaluate the computer controls, security settings and performance of incompatible IT functions within H-Zone’s IT environment and implement changes as necessary.

**Contract Compliance**

A Memo of Understanding (MOU) between a vendor and UHAD was entered into on May 8, 2014 allowing the vendor to sell H-Zone purchased Under Armour merchandise (on a consignment basis) at the seven 2014 UHM football home games. The vendor was provided with approximately $16,000 of merchandise and returned $9,000 to the H-Zone during January 2015. The MOU required the vendor to pay UHAD for items sold (wholesale cost plus 10% of the retail sales price less general excise tax) following each home game. However, H-Zone management did not monitor or enforce this provision and other MOU provisions. According to H-Zone personnel, the vendor has not been billed nor has any payments been received from the vendor during February 2015.

A Corporate Partner Agreement (effective July 1, 2014 – June 30, 2015) provided $30,000 of merchandise (at wholesale pricing) in exchange for certain advertising rights and UHAD sporting event tickets. Based on discussion with H-Zone management and review of invoices, Internal Audit noted that H-Zone management did not monitor on-hand inventory obtained through the Corporate Partner Agreement resulting in additional merchandise orders and payments totaling approximately $27,000. As of December 31, 2014, the value of on-hand inventory associated with the Corporate Partner approximated $41,000.

**Recommendation**

H-Zone management should monitor and enforce contract compliance to prevent instances of unbilled and uncollected cash related to inventory provided to and sold by external parties as well as paying for merchandise in excess of customer demand.

**Inventory Management**

During November 2014, a full count of on-hand inventory was conducted at the Ward location. Based on review of the on-hand inventory compilation report by location/zone, Internal Audit noted that approximately 60% of on-hand inventory was not displayed on the sales floor. According to H-Zone management, there is no policy, practice or methodology to purchase and manage inventory including a review of inventory and sales reports generated from Retail Pro. Internal Audit also determined that H-Zone is in noncompliance with University policy as unapproved purchase orders are submitted to vendors to purchase inventory.

**Recommendation**

As inventory purchases and sales have a significant impact to H-Zone’s cash flows, H-Zone management should develop and document policies to manage and control inventory purchases. Further, H-Zone should comply with University policies (Administrative Procedures Manual A8.836 “Purchase Orders and Related Forms” and A8.250 “Small Purchases”) and submit only
purchase orders approved by UHAD management to vendors, rather than unapproved purchase orders generated by Retail Pro.

In addition to performing annual on-hand inventory observations and counts, H-Zone should consider performing periodic cycle counts by merchandise class (e.g., aloha attire, children apparel, etc.) to ensure completeness and accuracy of inventory records throughout the year. Differences between cycle counts and quantities per Retail Pro should be investigated, adjusted and remediated immediately. Cycle counts will allow H-Zone management to closely manage inventory variances and update accounting records as cycle counts are performed rather than waiting until the performance of the annual count.

**Financial Reporting and Analysis**

Based on discussion with H-Zone management, Internal Audit noted that there are no policies and procedures with respect to the preparation and analysis of periodic financial/operational reports, such as a budget to actual analysis of sales, cost of inventory sold and other expenses. Further, Internal Audit determined errors and inconsistencies with the valuation of inventory recorded in Retail Pro. Specifically, Internal Audit noted inventoriable costs, such as freight and royalty fees, not included in the value of inventory. In addition, damaged and unsalable merchandise not returned to the vendor was not written down to net realizable value.

**Recommendation**

H-Zone management, with the assistance of the Assistant Athletics Director for Business Operations should develop policies and procedures with respect to preparing and analyzing periodic financial/operational reports. Examples include a gross margin analysis by merchandise class and location that is measured against expectations and established benchmarks and a budget to actual report containing a written analysis of significant variances of sales, cost of inventory sold, and other expenses. These reports should be prepared monthly by the H-Zone Director and reviewed by both the Associate Athletics Director for External Affairs and the Assistant Athletics Director for Business Operations. In addition, UHAD and H-Zone management should identify and generate Retail Pro reports that will be useful in assessing financial/operational results against expectations and to assist with operational decision-making.

**Untimely Recordation of Sales in KFS**

As a result of procedures to gain an overall understanding of H-Zone’s sales process and related controls, Internal Audit noted that August and September 2014 cash/check receipts and credit card transactions for the H-Zone’s Stan Sheriff Center store were deposited, but not recorded in KFS (the University’s general ledger) until October 2014. Administrative Procedures Manual A8.701 (“Receipting and Depositing of Funds Received by the University”) requires cash/check receipts and credit card transactions be recorded daily in KFS.

**Recommendation**

Internal Audit recommends H-Zone comply with University policy and record cash/check receipts and credit card transactions daily in KFS.
April 24, 2014

TO: Benjamin Kudo, Chair, Board of Regents Audit Committee

VIA: David Lassner, President
      Kalbert Young, Vice President for Budget and Finance, CFO
      Robert Bley-Vroman, Chancellor

FROM: Ben Jay, Director of Athletics

SUBJECT: Response to FY 2015 Internal Audit of H-Zone

The following are responses to the Internal Auditor’s FY 2015 H-Zone Comments and Observations.

Retail Management System:

From Internal Audit Report: Internal Audit believes that UHAD and H-Zone management should read the Retail Pro User’s Guide and view Retail Pro webinars to familiarize themselves with the functions and capabilities of Retail Pro and request training if necessary. A comprehensive understanding of Retail Pro should improve operational efficiencies and the accuracy and completeness of managerial data and accounting records.

Further, UHAD IT personnel should evaluate the computer controls, security settings and performance of incompatible IT functions within H-Zone’s IT environment and implement changes as necessary.
Comments/Corrective Action:

The initial start-up of the new H-Zone retail store location at the Ward Center and start-up operations in general have been quite successful but have also experienced some growing pains in its first year. Slated to open on July 1, 2015, we experienced longer than anticipated system processing time to access the retail space and to acquire the Retail Pro point-of-sale system software. Acquisition of the software and training of our personnel on the Retail Pro system was pushed to two weeks prior to opening. Then, H-Zone Director Sarah Hutz, who was brought over from the Rainbowtique operation, resigned three days before the H-Zone at Ward Center’s opening. She was replaced by assistant manager Kelly Toyama, who resigned eight months later. Both Sarah and Kelly took positions with the University Bookstore.

We have been in contact with our Retail Pro vendor to train our new H-Zone staff members on the functions and capabilities of the Retail Pro POS system. We have hired a new H-Zone Director, Felix Calvo, who has significant retail experience with Hilo Hattie. Megan Brown, who worked previously with Rainbowtique, will serve as H-Zone Manager.

Our H-Zone management team and business office staff member will better familiarize themselves with the Retail Pro User Guide and participate in Retail Pro webinars to get a clearer understanding of the Retail Pro POS system and reporting software. Our Retail Pro vendor will supply in-person training (not simply telephone support) for our staff members, so they have a comprehensive understanding of Retail Pro. This will improve the operational efficiencies and enhance the accuracy and completeness of managerial data and accounting records.

Our UHAD IT personnel will also be involved in training sessions, so they can better evaluate computer controls and security settings within the H-Zone’s IT environment to better ensure POS security.

Responsible Person: John McNamara, Felix Calvo, Megan Brown, Tiffany Kuraoka and Chris Kumagai.

Corrective Action Completion Date: May 31, 2015

Contract Compliance:

From Internal Audit Report: H-Zone management should monitor and enforce contract compliance to prevent instances of unbilled and uncollected cash related to inventory provided to and sold by external parties as well as paying for merchandise in excess of customer demand.
Comments/Corrective Action:

Moving forward, our H-Zone management team will monitor and enforce consignment agreement terms, record out-going and returned consignment H-Zone goods, and keep close track of payments due from external third parties.

The H-Zone Director and H-Zone Manager will closely monitor and keep track of any corporate partner trade agreements with external parties where the H-Zone is receiving (trade) goods in lieu of cash. The H-Zone will not exceed the amount of allotted trade goods in the agreement unless we intend on purchasing additional inventory for resale.

Responsible Person: John McNamara, Felix Calvo and Megan Brown

Corrective Action Completion Date: Ongoing

Inventory Management:

From Internal Audit Report: As inventory purchases and sales have a significant impact to H-Zone’s cash flows, H-Zone management should develop and document policies to manage and control inventory purchases. Further, H-Zone should comply with University policies (Administrative Procedures Manual A8.836 “Purchase Orders and Related Forms” and A8.250 “Small Purchases”) and submit only purchase orders approved by UHAD management to vendors, rather than unapproved purchase orders generated by the Retail Pro POS system.

In addition to performing annual on-hand inventory observations and counts, H-Zone should consider performing periodic cycle counts by merchandise class (e.g., aloha attire, children apparel, etc.) to ensure completeness and accuracy of inventory records throughout the year. Differences between cycle counts and quantities per Retail Pro should be investigated, adjusted and remediated immediately. Cycle counts will allow H-Zone management to closely manage inventory variances and update accounting records as cycle counts are performed rather than waiting until the performance of the annual count.

Comments/Corrective Action:

When purchasing inventory for the H-Zone, a purchase order (PO) will first be processed to create a record in the Retail Pro system. Then, an actual University purchase requisition will be created in the University’s Kuali Financial System (KFS) for the outside vendor. H-Zone management will then wait for an approved KFS purchase order before placing an order for merchandise with the external vendor.
The H-Zone staff will perform periodic cycle counts on merchandise classes/departments bi-weekly to ensure that the correct inventory count matches the inventory totals in the Retail Pro POS system.

Responsible Person: Felix Calvo and Megan Brown

Corrective Action Completion Date: April 30, 2015

Financial Reporting and Analysis:

From Internal Audit Report: H-Zone management, with the assistance of the Assistant Athletics Director for Business Operations, should develop policies and procedures with respect to preparing and analyzing periodic financial/operational reports. Examples include a gross margin analysis by merchandise class and location that is measured against expectations and established benchmarks and a budget to actual report containing a written analysis of significant variances of sales, cost of inventory sold, and other expenses. These reports should be prepared monthly by the H-Zone Director and reviewed by both the Associate Athletics Director for External Affairs and the Assistant Athletics Director for Business Operations. In addition, UHAD and H-Zone management should identify and generate Retail Pro reports that will be useful in assessing financial/operational results against expectations and to assist with operational decision-making.

Comments/Corrective Action:

Our H-Zone management team will implement a scheduled procedure checklist for weekly and monthly financial reports & reconciliations that will be turned into the Athletics Business Office.

Responsible Person: Felix Calvo and Megan Brown

Corrective Action Completion Date: April 30, 2015

Untimely Recordation of Sales in KFS:

From Internal Audit Report: Internal Audit recommends H-Zone comply with University policy and record cash/check receipts and credit card transactions daily in KFS.

Comments/Corrective Action:

Our H-Zone management team will promptly record and reconcile daily H-Zone sales every day to comply with Department and University financial policies.