UNIVERSITY OF HAWAI‘I AT MĀNOA
OFFICE OF INTERCOLLEGIATE ATHLETICS

H-ZONE

Comments and Observations

Year Ended December 31, 2015

University of Hawai‘i
Office of Internal Audit
To the Management of
University of Hawai‘i at Mānoa Office of Intercollegiate Athletics

In connection with planning and performing our examination of the Schedule of Gross Sales of the H-Zone at Ward Center for the year ended December 31, 2015, we observed improvement opportunities with respect to certain operational matters and internal control processes. Accordingly, we are submitting the accompanying comments, observations and recommendations as well as our evaluation of the status of prior year improvement opportunities 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,
Background
The University of Hawai‘i at Mānoa Office of Intercollegiate Athletics (Athletics Department) 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 H-Zone’s Schedule of Gross Sales (as defined in the lease). The Office of Internal Audit (Internal Audit) performed the initial examination for the period May 1, 2014 through December 31, 2014 and the current year examination for the year ended December 31, 2015. In connection with these examinations, we observed improvement opportunities with respect to certain operational matters and internal control processes. Improvement opportunities in connection with the initial examination were documented in an Internal Audit report dated February 12, 2015. Improvement opportunities identified during the calendar year 2015 examination and the status of our prior year comments are documented in this report.

Current Year Comments/Observations and Recommendations
During August 2015, Internal Audit met with H-Zone management to discuss the scope, timing, information request listing prepared by Internal Audit and the status of prior year comments and observations. Similar to the prior year, H-Zone management were challenged and encountered difficulties in the preparation and gathering of the requested information by the agreed upon due dates. Accordingly, the following comment results from these continued challenges as well as H-Zone’s inability to implement a majority of recommendations documented in Internal Audit’s February 12, 2015 report.

Operational Oversight and Management
During the performance of Internal Audit’s current year examination, Internal Audit noted various issues indicating opportunities for improvement in inventory management and analyzing periodic financial results. Analyzing and taking advantage of these opportunities in H-Zone’s operations should improve financial performance.

Internal Audit noted that on-hand inventory increased by approximately $54,000 during calendar year 2015 (approximately $288,000). For the six month period ended December 31, 2015 compared to the same period during 2014 (see table below), sales (net of discounts and returns) and gross profit decreased by $9,000 and $48,000, respectively. Gross profit percent decreased by 11% from 51% to 40% over this same period. H-Zone’s inventory turnover ratio (cost of sales/average inventory) for calendar year 2015 was approximately 1.5 (inventory is sold in approximately 240 days). Retail industry averages for calendar year 2015 with respect to gross profit percent and inventory turnover ratio was 46% - 49%1 and 2.8 – 3.71 (inventory sold within 130 – 99 days), respectively. Internal Audit believes these financial results reflect continued improvement is needed regarding inventory management.

---

1 Information from The Retail Owner’s Institute (ROI), a web-based resource that provides guidance on retail financial management and provides a variety of annual performance benchmarks for 55 separate retail segments. Internal Audit reported the gross profit percent and inventory turnover ranges for clothing retailers and gift, novelty, and souvenir retailers.
H-Zone at Ward Center:

<table>
<thead>
<tr>
<th></th>
<th>Six month period ended December 31,</th>
<th>Year ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
<td>2014</td>
</tr>
<tr>
<td>Sales, net of discounts &amp; returns</td>
<td>$424,000</td>
<td>$433,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>$171,000</td>
<td>$219,000</td>
</tr>
<tr>
<td>Gross profit percent</td>
<td>40%</td>
<td>51%</td>
</tr>
</tbody>
</table>

H-Zone prepares monthly Budget to Actual financial reports and reconciles sales and purchases recorded in Retail Pro (H-Zone’s retail management system) to KFS (the University’s general ledger). During November 2015, Internal Audit noted the commencement of sales promotions and the implementation of additional management approvals to purchase inventory. However, Internal Audit’s review of these schedules, inquiries of H-Zone management and the above noted financial results suggest that H-Zone management did not commence timely operational changes to improve financial results.

Other issues noted include the absence of management review and approval of sales discounts and damaged and unsaleable merchandise not written down to net realizable value. In addition, inventory adjustment (e.g., adjust price, cost, quantity of merchandise) documentation is not maintained to support operational and financial analyses. Finally, H-Zone did not monitor the expiration dates of certain agreements resulting in the H-Zone selling consigned merchandise without a written agreement thereby increasing the risk of dispute in regards to each party’s rights and obligations.

Recommendations:

H-Zone management should analyze their current practices and procedures to determine modifications needed to improve their oversight and management of H-Zone operations and thus improve financial results. Revised practices and procedures should then be formalized/documented to clarify responsibilities of H-Zone and Athletics Department personnel.

Prior Year Comments/Observations and Recommendations

As noted previously, the H-Zone did not implement a significant number of recommendations documented in Internal Audit’s February 12, 2015 report. The H-Zone’s corrective action letter in response to this report noted that all recommendations would be implemented by August 15, 2015. H-Zone management did not provide an explanation with respect to not implementing a majority of Internal Audit’s recommendations. The following provides additional information with respect to the status of Internal Audit’s prior year comments/observations and recommendations.

Retail Management System

Prior Year Comments/Observations/Recommendations:

Internal Audit recommended that H-Zone personnel enhance their knowledge and understanding of Retail Pro as a result of recordation errors and their unfamiliarity in utilizing Retail Pro’s baseline and elective computer controls and security settings.
**Current Year Status:**
Resolved.

**Contract Compliance**

*Prior Year Comments/Observations/Recommendations:*
Internal Audit recommended that H-Zone personnel monitor and enforce the provisions of contracts and agreements to mitigate the risk of financial loss.

*Current Year Status:*
Unresolved. See current year comment.

**Inventory Management**

*Prior Year Comments/Observations/Recommendations:*
In connection with the 2014 examination, Internal Audit noted that the majority of on-hand inventory at the Ward Center location was not displayed on the sales floor and that H-Zone had no policy, practice or methodology to purchase and manage inventory. It was also noted that inventory was purchased with unapproved purchase orders. Internal Audit recommended that H-Zone management develop and document policies to manage and control inventory purchases.

*Current Year Status:*
Inventory purchased during 2015 were ordered pursuant to approved purchase orders. However, improvement opportunities with respect to inventory management remain. See current year comment.

**Financial Reporting and Analysis**

*Prior Year Comments/Observations/Recommendations:*
Internal Audit noted that there were 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. In addition, damaged and unsalable merchandise not returned to the vendor was not written down to net realizable value. Internal Audit recommended that the H-Zone Director prepare a written analysis of monthly financial results compared to expectations and submit this analysis to Athletics Department senior management.

*Current Year Status:*
Unresolved. See current year comment regarding Budget to Actual financial reports.

**Untimely Recordation of Sales in KFS**

*Prior Year Comments/Observations/Recommendations:*
The H-Zone did not comply with University policy requiring the daily recordation in KFS of cash/check receipts and credit card transactions. Accordingly, Internal Audit recommended that H-Zone comply with University policy.
Current Year Status:
Unresolved. Internal Audit noted continued non-compliance with University policy as August, September and November 2015 online sales were recorded approximately 30 days after the sale date. H-Zone management could not explain the reason for the delay.
February 5, 2016

TO: Stanford Yuen
Chair, Board of Regents Audit Committee

VIA: David Lassner
President

VIA: Kalbert Young
Vice President for Budget and Finance, CFO

VIA: Robert Bley-Vroman
Chancellor

FROM: David Matlin
Director of Athletics

SUBJECT: Response to December 31, 2015 Internal Audit of H-Zone

The following are responses to the Internal Auditor’s December 31, 2015 H-Zone Comments and Observations.

Operational Oversight and Management:

From Internal Audit Report: H-Zone management should analyze their current practices/procedures to determine modifications needed to improve their oversight and management of H-Zone operations and thus improve financial results. Revised practices/procedures should then be formalized/document to clarify responsibilities of H-Zone management/personnel and Athletics Department management/personnel.

Comments/Corrective Action:

Since the internal audit, H-Zone management has been moving to address the various findings raised in the audit. For example, while the internal audit identified that H-Zone has implemented a formal approval process for purchase orders, H-Zone has also broadened that process to include promotions and discounts also. Through better
understanding and use of the data available from the H-Zone POS system, combined with stricter controls and approvals required for purchases, H-Zone’s total inventory level has decreased significantly from $432,000 as of 9/30/15 to $368,000 as of 12/31/15.

Practices have been adopted that will allow UHAD senior management to better track H-Zone performance with actual/budget comparisons and written variance analysis. Within H-Zone, staff responsibilities were reviewed and re-distributed to spread the workload over a wider base, thus improving effectiveness and efficiency - such as the timely daily recordation in KFS of cash/check receipts and credit card transactions.

Responsible Person: Felix Calvo, Megan Brown and Shawn Tobar

Corrective Action Completion Date: April 2016

Contract Compliance:

From Internal Audit Report: Prior Year Comments/Observations/Recommendations: Internal Audit recommended that H-Zone personnel monitor and enforce the provisions of contracts and agreements to mitigate the risk of financial loss.

Comments/Corrective Action:

During the internal audit, two contracts were identified as not being finalized on a timely basis. Both of those contracts were finalized and executed prior to the issuance of the Internal Audit report. On a going forward basis, effectively immediately, H-Zone personnel will monitor all contracts and agreements related to H-Zone and work with the other UH Athletics departments with responsibility for contracts to ensure that appropriate action is taken on a timely basis for any contracts related to H-Zone.

Responsible Person: Felix Calvo, Megan Brown

Corrective Action Completion Date: Effective immediately.

Inventory Management:

From Internal Audit Report: Prior Year Comments/Observations/Recommendations: In connection with the 2014 examination, Internal Audit noted that the majority of on-hand inventory at the Ward Center location was not displayed on the sales floor and that H-Zone had no policy, practice or methodology to purchase and manage inventory. It was also noted that inventory was purchased with unapproved purchase orders. Internal Audit recommended that H-Zone management develop and document policies to manage and control inventory purchases.
Current Year Status: Inventory purchased during 2015 were ordered pursuant to approved purchase orders. However, improvement opportunities with respect to inventory management remain.

Comments/Corrective Action:

In addition to implementing a formal approval process for all purchase orders, discounts, etc., H-Zone has recently moved to more efficiently manage its inventory. For example, the internal audit identified an inventory level of $432,000 as of 9/30/15, which has been reduced significantly to $368,000 as of 12/31/15. The reduction in inventory is attributable to a number of factors such as better understanding and use of inventory management data within the H-Zone POS system, discounting and promotions to clear slow moving inventory, and the purchase order approval process. H-Zone will be continuing to look at other ideas for efficiently managing inventory levels.

Responsible Person: Felix Calvo, Megan Brown
Corrective Action Completion Date: Effective immediately.

Financial Reporting and Analysis:

From Internal Audit Report: Internal Audit noted that there were 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. In addition, damaged and unsalable merchandise not returned to the vendor was not written down to net realizable value. Internal Audit recommended that the H-Zone Director prepare a written analysis of monthly financial results compared to expectations and submit this analysis to Athletics Department senior management.

Comments/Corrective Action:

With the guidance of the UHAD Business Office, H-Zone does prepare monthly budgets and tracks actual results as compared to budgeted. Going forward, as recommended by Internal Audit, H-Zone will prepare a written assessment of any significant variances that will be routed to UHAD senior management for review and action as may be appropriate. H-Zone will analyze the budget and determine if additional promotions or other actions are needed to meet projections.

Responsible Person: Felix Calvo, Megan Brown and Shawn Tobara
Corrective Action Completion Date: April 2016
Untimely Recordation of Sales in KFS:

From Internal Audit Report: Prior Year Comments/Observations/Recommendations:
The H-Zone did not comply with University policy requiring the daily recordation in KFS of cash/check receipts and credit card transactions. Accordingly, Internal Audit recommended that H-Zone comply with University policy.

Comments/Corrective Action:

The responsibilities of H-Zone staff were recently re-distributed to facilitate KFS transactions for all locations and are processed on a daily basis - - except for weekend transaction which will be processed the next business day (Monday).

Responsible Person: Felix Calvo, Shawn Tobara for Ward Center/Online, Megan Brown for Stan Sheriff Center.

Corrective Action Completion Date: March 2016