

Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting

PUBLIC RELEASE

**OFFICE OF
INSPECTOR GENERAL
LIBRARY**
LIBRARY OF CONGRESS

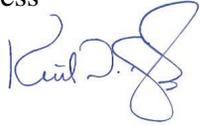
2017-PA-102
APRIL 2019



This page left blank intentionally

**OFFICE OF
INSPECTOR GENERAL
LIBRARY**
LIBRARY OF CONGRESS

MEMO

Date April 17, 2019
To Dr. Carla Hayden
Librarian of Congress
From Kurt W. Hyde 
Inspector General
Subject Final Audit Report – *Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting*, Report No. 2017-PA-102

This transmits our report for the Office of the Inspector General's performance audit of the Library of Congress' Gift Shop. The executive summary begins on page *i* and the full text of the report begins on page 1.

Based on management's written response to the draft report, we consider twenty recommendations resolved and two implemented. Management provided a corrective action plan addressing implementation of the recommendations, including implementation date, in accordance with LCR 9-160, *Rights and Responsibilities of Library Employees to the Inspector General*, §6.A. Management's response and corrective action plan to the recommendations appear in Appendix C.

We appreciate the cooperation and courtesies extended by the Office of Business Enterprises.

cc Principal Deputy Librarian of Congress
Chief Operating Officer
General Counsel

This page left blank intentionally

Summary

The Office of the Inspector General (OIG) as part of its fiscal years (FYs) 2017–2019 audit plan conducted an audit of the Library of Congress' (Library) Gift Shop. OIG conducted the audit in accordance with the Governmental Accountability Office's, *Generally Accepted Government Auditing Standards*. The audit's objectives included (1) determining whether the design and documentation of the systems of internal control were adequate to ensure the accuracy and reliability of accounting data and to protect Gift Shop assets, and (2) assessing whether compliance with the systems of internal control was adequate to rely on those controls

OIG conducted the audit from February 2018 through December 2018.

What the Audit Found

With the advent of the Library's new Visitor Experience, the Gift Shop stands on the edge of a remodel in anticipation of expanded customer traffic and sales. Increased traffic and sales will require shop management to handle greater inventory levels and increased point-of-sale¹ activity, while demanding more valid and reliable merchandising data to support merchandising investment decisions. With Congress establishing the Gift Shop as a revolving fund, its ability to sustain and grow operations relies solely on the Gift Shop's management to run it as a profitable business. Normally revolving funds do not receive appropriations, therefore the Gift Shop's destiny depends on the business expertise of its management team.

The emphasis of this audit focused on what the Gift Shop's operational needs are to accommodate the expected increases in traffic and sales due to the Library's impending "Visitor Experience."² A consultant's analysis of Gift Shop operations found that it has a highly educated customer and the potential to benefit even more with the introduction of the Visitor Experience. However, we found that to realize the benefits of the Visitor Experience,

management must address certain financial management issues in an expeditious manner.

Although we have several findings and recommendations that we believe will prepare the Gift Shop to handle increased customer traffic and sales expected in the future, there is one area of operations that deserves recognition. We found the stockrooms in good order. Common retail wisdom dictates that sloppy, dirty, and unorganized stockrooms and warehouses breed merchandise shortage. In the Gift Shop's case we found a clean and organized environment which supports good merchandise control. We commend Gift Shop management for this important operating condition in a key operating area.

Gift Shop Must Implement an Improved Subsidiary Accounting System for its Financial Management and Reporting

We found the financial management and reporting was not in compliance with generally accepted accounting principles (GAAP) and not adequate for managing the Gift Shop business. Further, there was not a sufficient internal control program and comprehensive documentation of operating and financial procedures. However, there were some areas where the Gift Shop management has instituted appropriate processes.

The Gift Shop operates without a financial reporting suite that integrates point-of-sale (including online sales), merchandise planning, purchase order management, inventory control, and financial reporting functionality. The Gift Shop currently relies on two disparate systems to capture sales, control deposits (including credit card payments), track inventory, and provide financial reporting. This increases the Gift Shop's exposure to fraud and financial reporting errors. Finally, accounts payable reporting for the subsidiary system was not in harmony with Momentum, the Library's central financial management system's accounts payable balances.

¹ A point-of-sale (POS) is the place where a customer executes the payment for goods or services.

² *Visitor Experience Plan*, Library of Congress, Thomas Jefferson Building, p 7

Annual Merchandise Plans and Inventory Planning Require Enhanced Documentation

The Gift Shop needs to produce a documented annual, written merchandizing plan, which is a standard practice in retail sales. Gift Shop management did not have written plans and supporting descriptions of (a) promotional themes planned or accompanying analysis regarding why the planned purchases were made and (b) the relationship of pricing and gross margin targets by merchandise category to planned gross margin and net profit annual targets. Also absent was documentation of planned inventory levels to sales, turnover, or other goals or targets. Such planning and documentation are central to merchandising and a retailer's profits.

Integrating Online Sales into the Point-of-Sale System will Reduce Exposure to Input Errors

We observed an opportunity to improve efficiency in the processing of online sales, which accounts for over \$119,000 of its sales. Currently, a Gift Shop customer service representative manually inputs, on a daily basis, all online sales orders into its retail management system. This can present workload and internal control issues during busy online shopping periods (for example, during the holiday season when Gift Shop management advised us over 500 orders may occur in one day). With the emphasis on more online ordering by consumers, management advised OIG the website is seeing increased traffic. To be more efficient and cost effective, management should consider an automated interface between its online and financial management systems.

Management Should Address other Internal Control Issues Found Including Point-of-Sale Transactions and Segregation of Duties

The audit found opportunities to improve point-of-sale accountability and reporting for refunds and transaction accountability. Additionally, material-handling procedures required operating and reporting changes to improve segregation of duties and the integrity of inventory information in the stock ledger.

Recommendations

OIG recommended that Library management comprehensively review and redesign the financial and accounting processes and systems to ensure Gift Shop financial management and reporting complies with accounting standards. This review and redesign will also improve operating and merchandising data for decision-making. Finally, Gift Shop management should improve internal control documentation in key areas to assure the reliability of accounting data and to provide it the ability to monitor internal control compliance. In all, we made 22 recommendations.

Management Comments

The Library concurred with the report's findings and recommendations. The Library recognizes the Gift Shop as an important outreach function of the Library and its accurate financial accounting as a critical factor in its success.

Gift Shop management is working with the Financial Reporting Division to ensure financial systems' internal controls are appropriate and both divisions intend to conduct monthly status meetings to discuss critical activities, information, and system requirements. Further, the Gift Shop's automated retail financial management system, DAX, is currently in the process of an upgrade that will strengthen internal controls and lay the groundwork for an integrated, GAAP-compliant financial reporting system.

Table of Contents

- Background 1
 - Plans for Near-term Expansion 1
 - Areas of Importance for Retail Management and Internal Control 2
- Findings 5
- Gift Shop Must Implement an Improved Accounting System for Its Financial Management and Reporting 5
 - The Reporting Process is Not Integrated between Subsidiary Records and Momentum 6
 - Financial Management and Reporting Processes Need to Be Redesigned and Documented 8
 - Financial Services Directorate and F&A Have Disparate Financial Reports and Results 8
 - Critical Financial Data Does Not Reconcile among the Three Methods Used by Management to Track Financial Results 9
 - Greater Controls and System Changes Are Needed Over the Updates to the Stock Ledger 10
 - Accurate Accounts Payable Aging Report Needed 10
- Annual Merchandise Plans and Inventory Planning Require Enhanced Documentation 14
 - Stockrooms Are Well Organized and Clearly Labeled 14
 - Operations Handbook for Inventory Adjustments Is Generally Complete 14
 - Documented Annual Merchandising Plans Need to Be a Standard Operating Procedure 15
 - Greater Documentation and Standardized Processes for Physical Inventories Needed 16
 - Procedures for Obtaining Credits and Return of Goods Needs to Be Documented 17
- Integrating Online Sales into DAX will Reduce Exposure to Errors 18
 - Shopify Sales Were Properly Entered into DAX 18
 - Efficiencies Gained through Integration of Shopify with DAX 18
 - Physical Access Controls for Online Order Inventory Appears Adequate 19
- Management Should Address Other Internal Control Issues Found Including Point-of-Sale Transactions and Segregation of Duties 20
 - More Efficient Process Needed for Point-of-Sale Recording of Refund Activity 20
 - Receiving and Material Handling of Merchandise Needs Further Controls and Oversight 20
- Appendix A: Objectives, Scope, and Methodology 24
- Appendix B: Office of Business Enterprises' Organization Chart 25
- Appendix C: Management Response 26

This page left blank intentionally

Background

Many renowned institutions including universities, museums, and libraries operate gift shops on their premises to enhance their brands, provide memorabilia to visitors, and to strengthen their identity with potential donors. In many cases, these institutions position the gift shops in areas near to or adjacent to first floor entrances and exits providing high visibility to visitors upon entering or as a lasting memory upon exiting the premises. Institutional management should not take lightly the location and objectives of the gift shop. When management strategically locates its gift shop to make first and lasting patron impressions, it demonstrates its understanding of the contribution of the gift shop to the larger scheme of institutional branding. Online sales are also contributing significantly to such bricks and mortar gift shops.

Plans for Near-term Expansion

The Library of Congress' (Library) Gift Shop occupies 2,423 square feet of selling space, and has five stock rooms to support the Gift Shop and its online sales operations.³ The Gift Shop carries approximately 2,200 to 2,500 separate, unique items for sale (also called SKUs, or stock keeping units). Sales for fiscal years (FYs) 2018 and 2017 were \$2.258 million and \$2.288 million, respectively. Net profit dollars and percent for the same years were stated to be \$164,000 (7.3%) and \$278,000 (12.2%), respectively. During FYs 2017 and 2018, inventory balances ranged from approximately \$262,590 to \$406,800.

Congress approved \$20 million in FY 2018 towards an improved customer experience via a public/private partnership to bring the Library's collections out of the vaults and into public spaces. The exhibits to accomplish this initiative will reside in the Jefferson building, and the Library's Gift Shop will sit adjacent to the planned improvements. With a potential \$60 million enhancement to the spaces adjacent to and in the area of the Gift Shop and an expected large increase in patron traffic to the exhibits, Library management expects Gift Shop sales to substantially increase. To reap the full benefits of this expected increase in business, the Gift Shop must have a well-designed financial management and reporting system that includes an up-to-date point-of-sale system supported with a well-designed system of internal controls.

A recent consultant's review of the Gift Shop highlighted demographics that demonstrate both the potential for the Gift Shop and the basis for an aggressive business plan. The review found that the Library has a visitor base that is well educated with 63% having post-graduate degrees and nearly two-thirds working in the education, training, or library fields. The consultant noted that "customers are responding positively to the merchandising selection and the pricing is in-line with customer purchasing thresholds." Alternatively, the Gift

³ The website is <https://library-of-congress-shop.myshopify.com>

Shop's capture rate (percentage of visitors making a purchase) ranks last against the five other comparable operations benchmarked.

As a congressionally designated revolving fund,⁴ the Gift Shop accounts for its operations much the same as a business. The Government Accountability Office's (GAO), *Principles of Appropriations Law*, 3rd edition (Red Book)⁵ states the following in describing a revolving fund, "A revolving fund authorizes an agency to retain receipts and deposit them into the fund to finance the fund's operations. The concept of a revolving fund is to permit the financing of some entity or activity on what is regarded as a more "business-like" basis. Laws that establish revolving funds may authorize agencies to perform reimbursable work for either the public or other federal agencies, or both."⁶

The revolving fund business provides a good or service and is self-sustaining—it is authorized to reach into its net surplus and expend funds to cover a shortfall. As any business, it must fund its own cyclical replacement of assets and shortfalls when period costs exceed revenue. Its earned revenue has the same feature as no-year appropriated funds in that the funds are available for use without an expiration date. The generated or collected receipts are available for expenditure for the authorized purposes of the fund without the need for further congressional action and without fiscal year limitation.⁷

There are three broad categories of revolving funds—public enterprise, trust, and intragovernmental.⁸ The Gift Shop is a public enterprise revolving fund. A public enterprise revolving fund is a revolving fund that derives most of its receipts from sources outside of the federal government. It usually involves a business-type operation, which generates receipts that are in turn, used to finance a continuing cycle of operations. Although not a legal requirement, the fund should be self-sustaining or nearly so,⁹ like a self-sustaining business operation. To comply with generally accepted accounting principles (GAAP), the fund must match revenue with all related costs in the same accounting period as the basis for recognizing revolving fund net earnings.

Areas of Importance for Retail Management and Internal Control

Every business sector has its areas of special emphasis that differentiates what management must concentrate on to steer the business, execute sales and operations, and provide systems of internal control. Internal controls must support capturing and preserving financial and operating data for short-

⁴ Title 2 United States Code (USC) 182b (a) (2) *Revolving fund for sales shop and other services*

⁵ GAO's objective in the Red Book is to present a basic reference work covering those areas of law in which the Comptroller General issues decisions, using text discussion with specific legal authorities to illustrate the principles discussed, their application, and exceptions.

⁶ *Principles of Appropriations Law*, Red Book, 3rd edition, 2016 GAO, p 12–85

⁷ *Ibid*, p 12–88

⁸ *Ibid*, p 12–97

⁹ *Ibid*, p 12–97

intermediate-, and long-term analysis; protecting assets; and delivering earnings. Areas of special interest pertaining to general merchandise retail sales operations include a technology driven merchandise stock ledger, automated purchase order management system, automated accounts payable processing system, and a merchandising analytical regimen. Following is a brief description of each of these areas of special emphasis for a merchandise retailer (including a gift shop).

- ***Merchandise Stock Ledger***—Merchandise stock ledgers (stock ledger) are key to merchandise planning, analysis, and corrective merchandizing strategies. The stock ledger is the full record of all merchandise activity from the beginning of the accounting period (season or year) to the end of the period. In essence, today's computer driven stock ledgers allow merchandizing managers to more quickly recognize SKU and category winners and losers, nimbly implement corrective actions, and reliably employ precision recording of cost of goods sold and gross margin. Finally, barcoding improves the identification of items during the physical inventory and the conversion of the physical inventory data into the stock ledger.
- ***Purchase Order Management***—Purchase order management systems are automated systems that support merchandise processing activities from the writing of a purchase order through receipt and processing of the merchandise. The automated tracking of purchase orders provides the ability to control authorization, issuance, and acceptance of merchandise deliveries thereby controlling the timing, flow, and acceptance of goods. Such systems allow retailers to maintain tracking of back orders from partial and unfilled purchase orders. Occurrences of partial deliveries and back orders in merchandise retailing is frequent and often disrupts planned sales promotions and provides confusion and errors in the record keeping for goods received. Also, merchandise vendors are notorious for shipping orders that have not been authorized or placed, especially in slow economic times to generate unplanned deliveries and acceptance of goods, to enhance sales. Automated Purchase Order Management systems provide the on-hand and accessible record-keeping for preventing acceptance of such “non-orders.”
- ***Integrated Accounts Payable System with Purchase Order Management***—To continue the benefits received from purchase order management, the integration of such data with accounts payable provides improved control over paying only invoices for merchandise deliveries actually received, taking discounts seamlessly and quickly, and maintaining control of vendor disputes for billing errors and unpaid invoices. A key internal control report from the system is an aging of outstanding accounts payable with references to the original purchase order and receiving data. Such a system becomes a major operational

asset when working with vendors to cure and resolve disputed deliveries and unposted payments.

- **Key Ratios and Performance Indicators**—Key ratios and performance indicators assist merchandise management in assessing performance and appropriately setting the bar for the next period’s merchandising plan’s performance.
- **Gross Margin Return on Inventory Investment**—This indicator may be the most important in that it measures and provides a basis to compare the rate of return on investment into each inventory category. No other indicator demonstrates such results in pure investment terms—the return on the investment that the item’s gross margin brings. The rate of return combines the effect of profit margin and inventory turnover in one performance measurement indicator facilitating equitable comparisons of the profit contributions from different merchandise investments.¹⁰ It is imperative that the merchandising management group agree on those key ratios and performance indicators that will be used to evaluate the retailer’s performance, and management must develop a historical track record of those ratios and performance indicators to measure performance progress.

¹⁰*Retail Accounting and Financial Control*, 5th edition, John Wiley & Sons, Inc. 1990, Zimmerman, Kaufman, et al, p 53

Findings

Gift Shop Must Implement an Improved Accounting System for Its Financial Management and Reporting

We found the method used by Gift Shop management to account for the shop's operations not in compliance with GAAP and not adequate for managing Gift Shop business. Further, there was an insufficient internal control program and comprehensive documentation of operating and financial procedures. However, there were some areas where the Gift Shop management has instituted appropriate processes.

The Gift Shop operates without an integrated financial reporting suite that provides, for example, point-of-sale (including online sales), merchandise planning, purchase order management, inventory control, and financial reporting functionality. The Gift Shop currently relies on two disparate systems to capture sales, control deposits including credit card payments, track inventory, and provide financial reporting. Both Business Enterprises' systems—DAX¹¹ and a manually prepared profit and loss statement (manual P&L) as currently configured—do not provide adequate financial reporting internal controls, which results in exposing Gift Shop management to the risks of fraud and financial reporting errors.

A trial balance is the most basic internal control in a financial management system (manual or electronic). The Gift Shop manually prepares a monthly profit and loss statement to manage the business, but this statement lacks critical information and is not supported by a proper accounting system. The manual P&L is not derived from a trial balance. The absence of a trial balance leaves the Gift Shop without the basic control for identifying posting errors and omissions as well as the inability to properly manage the financial status of its operations.

Without a trial balance, we believe Business Enterprises' Finance and Accounting (F&A) does not have the accounting data to prepare a comprehensive balance sheet, which further erodes Gift Shop management's ability to analyze the business and detect operating and accounting errors. As a result, basic analytical processes are difficult to conduct accurately, such as reconciling perpetual inventory records to balance sheet control account(s) or compiling basic ratio analysis (e.g., inventory turnover and return on total assets). This inhibits management from assessing the state of the business and implementing corrective actions.

¹¹ Microsoft Dynamic AX 2012 R2, also known as DAX, which is an automated retail financial management system. However, the Gift Shop uses only limited functionality of the system.

Based on the testing OIG performed, we noted several weaknesses throughout the “end-to-end” financial management process for the Gift Shop.

The Reporting Process is Not Integrated between Subsidiary Records and Momentum

Business Enterprises maintains a Standard Operating Procedure (SOP) that provides a high-level description of its internal controls. We took this into account for all audit testing of financial management and reporting when evaluating internal controls.

Through the testing performed, we found that the reporting process is not integrated between F&A’s accounting records and Momentum. Therefore, in the absence of an end-to-end fully integrated financial reporting and associated closing process, gaps existed that prohibited OIG from conducting some of our planned testing. We found the following financial reporting issues:

- The manual P&L does not present required standard retail line items for cost of goods sold and gross margin. It improperly includes the full cost of inventory purchased during the month as an expense without removing from the monthly P&L the unsold portion of those purchases that remain in inventory. Therefore, the P&L is not compliant with GAAP¹² and cannot be relied upon to depict a true financial picture of the Gift Shop operations. However, Business Enterprises’ management relies on this manual P&L to assess and monitor Gift Shop performance throughout the year.
- The Gift Shop does not use an integrated system as required by Library of Congress Regulation (LCR) 6-110, *Financial Management*, Section 4. Although the Gift Shop has an automated system, DAX, it does not use all the basic functionality of this retail financial system. Rather, it has disparate financial transaction processes that are not integrated, and F&A relies on manual processes¹³ to interface several

¹² It violates the “matching principle,” which requires that financial reporting match in the appropriate accounting period all revenue and related costs. Financial statements may not report revenues in an accounting period that is different from the period its related costs are reported. Non-compliance with the matching principle allows the manipulation of net profit by creating a false picture of the financial results of the affected accounting period. Under the current F&A reporting practices, net profit can be subject to inaccurate and large fluctuations based on the level of merchandise purchase activity.

¹³ Manual accounting systems are acceptable accounting processes for GAAP compliant financial reporting. However, electronic financial systems have major advantages over manual systems. Also when considering the cost of purchasing and maintaining an electronic accounting system, you must compare the costs of procuring and maintaining the electronic system to the long-term costs of full-time equivalents (FTEs) to operate a manual system. Manual system deficiencies include: the time it takes to compile financial statements compared to electronic systems; the limitations manual systems have for providing easily obtained actionable operating data for planning, budgeting, and analysis; the inability to seamlessly integrate subsidiary accounting systems such as POS, stock ledger, and purchase order management; and, the number of employees required to operate and maintain a manual system compared to an electronic system.

systems. Specifically, F&A is not using the automated financial statement capabilities of DAX. This is not an efficient or effective method to manage the financials of the Gift Shop.

- Library of Congress Directive (LCD) 6-810.3, *Financial Systems Reconciliations*, requires that the F&A accounting records balance to Momentum, the Library's central financial management system. A full reconciliation of the manual P&L to Momentum was not evident. Both systems should be in balance. We did see evidence of verification of Momentum obligations, spending lines, and cash deposits, but this activity did not comprise a full reconciliation between the manual P&L and Momentum's cumulative net surplus.¹⁴ The Business Enterprises' manager should ensure that these reconciliations occur.
- A full reconciliation would assure that the manual P&L agreed with the current ending balance in the cumulative net surplus account and would provide evidence that the manual P&L included all of the transactions affecting the cumulative net surplus account. If it did not agree, management would need to investigate significant differences because the differences are indicative of transactions occurring in one system but not the other.

In the absence of a reconciliation of the manual P&L to the Momentum Cumulative Results Account for the Gift Shop, OIG made an effort to conduct a reconciliation as of fiscal year end (FYE) 2017 using Business Enterprises' monthly, manual P&L statements. Our reconciliation resulted in an unreconciled difference between the manual P&L and Momentum of \$162,772 for the Cumulative Results Account. While conducting this reconciliation, we requested that F&A try to resolve the differences we were encountering. F&A was not able to reconcile the difference.

Due to the weaknesses noted above, we conclude that the monthly financial reporting and system of internal controls for the Gift Shop requires a comprehensive overhaul. Further, while we found that the Gift Shop's financial reporting and closing process occurs in Momentum, as required by LCR 6-110, *Financial Management*, Section 4, the financial reporting in Momentum is at a high level and does not provide sufficient data for managing the retail business on a regular basis. It is critical that the Gift Shop has a fully operational financial management and reporting system that collects and stores comprehensive operating data, provides analytical tools for managing the business, and generates GAAP compliant financial statements. The existing financial systems at the operating level are not sufficient for

¹⁴ In an earlier report, the OIG found that a Gift Shop buyer was not properly managing funding obligations, where purchase card transactions were not properly reconciled. Interim Report No. 2015-PA-102, *Library Management Needs to Exercise Stronger Oversight of the Library's Gift Shop's Participation in the Purchase Card Program*.

financial reporting and regular management of the business. We discuss some of the issues further in this report.

Financial Management and Reporting Processes Need to Be Redesigned and Documented

OIG requested from Gift Shop management documentation to support the financial reporting process including transaction flows and related internal controls along with the monthly and year-end financial reporting processes in F&A. Gift Shop management provided OIG with some documentation for the financial management and reporting processes. We received a ten-page description of how the manual P&L should be prepared (note that the P&L is not GAAP compliant). Through inquiry, observation, and inspection, OIG found that the documentation had gaps, especially in describing transaction flows and related controls. During preliminary discussion of our findings on documentation, the Business Enterprises' manager agreed that the office would immediately start improving documentation for all operating processes and related internal controls. However, OIG believes that rather than further documenting the current processes, Business Enterprises' management should first do a comprehensive restructuring of the processes and ensure the processes include sufficient internal control steps.

Financial Services Directorate and F&A Have Disparate Financial Reports and Results

OIG assessed the frequency in which financial reports were produced, who prepared them, and who reviewed and approved them. Our audit analysis involved comparing Financial Services Directorate's (FSD) and F&A's roles in the financial Gift Shop Revolving Fund financial reporting process. OIG found that FSD and F&A conduct separate yet concurrent processes for financial reporting for the Gift Shop that offer differing results. At the time, we found that the then National and International Outreach (NIO)¹⁵ chief operating officer and Business Enterprises' management were the only functions reviewing Gift Shop monthly financial reports. Those reviews used the F&A monthly manual P&Ls and not the financial reports coming from Momentum. The NIO and Business Enterprises' reviews were not formally documented.

Through interviews with the Financial Reporting Office,¹⁶ we found that there was no interaction between the Financial Reporting Office, Business Enterprises' management, and F&A concerning monthly and year-end financial reporting. Although the Financial Reporting Office made quarterly and year-end data calls, it had very little familiarity with Gift Shop financial reporting content or systems. We believe there needs to be an understanding

¹⁵ NIO was dissolved in conjunction with the Library's, *2018 Realignment - Enriching the User Experience*.

¹⁶ The Financial Reporting Office is part of the Office of Chief Operating Officer's Financial Reporting Directorate.

on the part of both staffs about each other's financial reporting form and content, system capabilities, and assurance that the subsidiary system's financial reporting complies with the Financial Reporting Office's expectations and Library policy.

In reviewing and testing the monthly Gift Shop's manual P&Ls to evaluate posting accuracy, we were not able to trace all of the Momentum Budget Object Classifications (BOCs) to the manual P&L. In addition, our tracing test found errors in nine accounts where the amounts included in the manual P&L differed from the source report, with one having a difference of \$200,000.

These posting differences produced variances in results between Momentum and the manual P&L that require research time to determine what caused them. The high error rate found in our tracing test diminishes the manual P&L's credibility, supports the case for improving controls for financial reporting, and demonstrates the benefits of integrated electronic financial reporting systems that seamlessly pass closing entries from original books of entry as part of the period ending closing process.

Critical Financial Data Does Not Reconcile among the Three Methods Used by Management to Track Financial Results

There is no integration between the Gift Shop systems—DAX, the manual P&L, and Momentum. Our comparison of selected account balances between the three systems for FYE 2017 found differences, as depicted in Table 1. The N/A in the table below indicates that the ledger account is not present in the system noted.

| Comparative Results of the Library Retail Reporting Systems – FY 2017 | | | | |
|---|--------------------------------|--------------------|------------------|--------------------|
| Ledger Account # | Name | DAX Report Balance | Momentum Balance | Manual P&L Balance |
| 211000 | Accounts Payable | \$66,850.37 | \$59,905.83 | N/A |
| 510000 | Revenue from Goods Sold | \$2,307,836.13 | \$2,304,302.79 | \$2,293,671.00 |
| 520000 | Revenue from Services Provided | \$14,000.00 | \$5,370.00 | \$14,000.00 |
| 650000 | Cost of Goods Sold | \$994,007.81 | \$989,651.42 | N/A |
| -- | Sales Shop Merchandise | N/A | N/A | \$932,900.00 |
| -- | Net Profit (Loss) | N/A | \$178,385.16 | \$366,401.00 |

Table 1: Comparative Results of the Library Retail Reporting Systems, FY 2017

Source: Library of Congress, Office of Business Enterprises and Financial Services Directorate

Gift Shop management stated that their financial system, DAX, has system constraints. DAX has supported the point-of-sale system since 2013. Although efforts are underway to upgrade the point-of-sale system, DAX continues to function as a standalone system that only captures and reports

sales information, without interfacing or integrating with Momentum.¹⁷ It also does not integrate with the Shopify system¹⁸ for online orders or the credit card terminals at the point-of-sale.

Business Enterprises and the Gift Shop are only receiving a fraction of the functionality that the system should provide. Inadequate financial systems and reporting inhibits the ability of Gift Shop management to analyze operations effectively, address noted deficiencies, and implement corrective actions. Retailing is a bellwether that reacts quickly to economic and cultural changes. Delays on the part of retail management to recognize early warning signs of those changes may result in long lasting or fatal impediments to its business.

Greater Controls and System Changes Are Needed Over the Updates to the Stock Ledger

If properly operating, DAX inventory tracking and accounting processes have the current state-of-the-art functionality for the Gift Shop to use in its merchandise management and financial accounting activities. As part of OIG's review of the merchandise inventory, we randomly selected 25 items from pre- and post-inventory reports and recalculated the system item cost based on the weighted moving average. We also examined the inventory results from the interim inventory taken in February 2018 to evaluate the inventory update's integrity including the item number's weighted moving average cost.

Our testing of the system's calculation for weighted moving average found no exceptions for recalculating the costs when the Gift Shop recorded new receipts. However, our testing of inventory updates to the stock ledger found 19 occurrences where item number costs changed immediately after the unit count update. We determined this is a system error. Malfunctions in the valuation of physical inventory updates jeopardize the integrity of financial reporting for assets and operating results—specifically, it effects the net profit results recorded in Momentum.

Accurate Accounts Payable Aging Report Needed

We evaluated the accounts payable balances as of FYE 2017 from various sources and found discrepancies in the reported balance totals. The objective of this analysis was to determine whether the accounts payable balances were

¹⁷ The current point-of-sale does not capture credit card data and process the credit card payments. The Gift Shop relies on a separate systems to transmit that data to the credit card processing agent for collection and payment to the U.S. Department of the Treasury. Sales data including amount, tender, stock keeping number(s) and time data for the transaction are captured separately. The dual recording and processing requirements are not state of the art retail processing which involves point-of-sales transactions combining in a single activity sales data recording and credit card processing.

¹⁸ Shopify is a proprietary e-commerce platform for online stores and retail point-of-sale. The Shopify e-commerce platform enables businesses of all sizes to conduct online sales and obtain supporting analysis from a single source.

in agreement between systems F&A uses. Our examination of the noted sources in the table found differences in each case and raises concerns as to whether any of the sources have credibility (see Table 2).

We evaluated the accounts payable aging report. The Office of the Chief Information Officer (OCIO) systems specialist provided us with a DAX-generated aging report as of FYE 2017. The aging report contained the proper aging categories (i.e., 0–30 days, 31–60 days, etc.) However, the balances shown by aging category on the report did not sum to the total for accounts payable in the report.

| Reporting Comparison of Accounts Payable | |
|---|---------------------------------|
| Source of Accounts Payable as of FY 2017 | Accounts Payable Reported Value |
| FRS Trial Balance Report (Accounts Payable and Accrued Accounts) *Estimate | (\$59,905.83)* |
| DAX Trial Balance Report | \$66,850.37 |
| DAX Vendor Aging Report (Total Accounts Payable Balance) | (\$321,363.42) |
| DAX Vendor Aging Report (Total Accounts Payable Balances by Aging Category) | (\$52,868.11) |
| BE Business Office (Financial Data Required for Year-end Closing) | \$0 |

Table 2: FY 2017–Reporting Comparison of Accounts Payable
Source: Library of Congress, Office of Business Enterprises

Gift Shop management does not routinely monitor the accounts payable aging report to evaluate the status of accounts payable. Gift Shop management noted it assesses outstanding accounts payable balances through an informal and undocumented process. However, management should be using balances that come from its accounting system and not an informal process.

Further, there are no procedures for how management should review and analyze its accounts payable. The following information was missing from, or incomplete in, the Retail Accounts Payable SOPs:

- Responsible parties for performing accounts payable activities and their respective roles;
- Approval process for invoicing and segregation of duties between purchasing from vendors and vendor payment activities;
- Description of processes and procedures to keep accounts payable current; and
- Description of retrieval and review of an accurate accounts payable aging report.

Gift Shop management needs to document, update, and retain current end-to-end accounts payable processing procedures. Also, the absence of an accurate accounts payable aging report exposes the Gift Shop to inefficiencies in

monitoring balances due vendors, inhibits compliance with prompt payment procedures, and may affect vendor relations.

Recommendations

Based on our evaluation of Gift Shop financial management and reporting, we recommend that Library management take the following action:

- 1) Comprehensively review and redesign the financial and accounting processes and systems. Implement a financial reporting system for Gift Shop operations that includes an automated trial balance based on double entry accounting, and one that produces a full complement of GAAP-compliant financial statements (balance sheet, P&L statement, and cash flow statement) on a monthly, quarterly, and annual basis.
- 2) Develop and implement GAAP compliant and accurate perpetual inventory information, including cost of goods sold and gross margin reporting on the manual P&L.
- 3) Reconcile monthly financial results and selected accounts between the Business Enterprises' F&A and Momentum financial systems.
- 4) Conduct reconciliations between key general ledger control accounts and related subsidiary accounts (e.g., inventory, accounts payable) on the F&A system when implemented.
- 5) Establish Business Enterprises' F&A compliance with all Library policies and directives for financial reporting and internal control compliance.
- 6) In conjunction with recommendation one, design proper and comprehensive internal control processes, and completely document internal business processes, transaction workflows, and the system of internal controls for the Gift Shop.
- 7) Establish a continuing dialog between Financial Reporting Office and Business Enterprises' F&A to bolster knowledge of each other's financial reporting and operations, and to improve Business Enterprises' GAAP and internal control compliance.
- 8) Establish, document, and track agreed upon financial reporting ratios to enhance management analysis of the Gift Shop operating results and performance goals.
- 9) Investigate and correct the condition causing the DAX system to malfunction where it changes SKU cost in the stock ledger as part of inventory count update.

- 10) Determine an accurate source of accounts payable information, from either Momentum or DAX.
- 11) Develop an accurate and reliable accounts payable aging report and monitoring process.
- 12) Enhance SOP documentation to cover internal accounts payable business processes and the related system of internal controls.

Annual Merchandise Plans and Inventory Planning Require Enhanced Documentation

We evaluated the Library's Gift Shop inventory process. Our objective was to evaluate the overall inventory process including inventory planning, conducting physical inventory counts, observing inventory in the stockrooms and on the shop floor, updating the physical inventory results in the perpetual inventory system, and accounting financially for the inventory on hand. We took into consideration the use of Momentum and the Gift Shop's point-of-sale system, DAX, for the inventory tracking and accounting processes. Based on the testing we performed, we identified some strengths but also internal control weaknesses that require improvement by Gift Shop management.

Stockrooms Are Well Organized and Clearly Labeled

Retailers often organize stockrooms and warehouses in a manner that attempts to reduce the level of effort and time it takes to perform processes such as filling orders, stocking new receipts, or traveling from staging areas to bin locations. This is done in an effort to minimize staff motion, reduce fatigue, and complete material handling processes in less time. The desired outcome for the retailer is reducing labor costs to fulfill sales either in the store or through on-line delivery. Retail dogma states that sloppy, dirty, and unorganized warehouses and stockrooms foster inventory shortage.

OIG inspected the receiving stockroom to verify that merchandise storage bins and products were clearly and properly labeled (SKUs, product number and description). Also, OIG assessed whether operations management arranged bin locations in accordance with operating guidelines. OIG determined that the stockroom manager clearly labels bins and products. Bin locations were arranged according to various product categories in both the main stockroom and the online stockroom. We also noted that good housekeeping existed in the stockrooms.

Operations Handbook for Inventory Adjustments Is Generally Complete

OIG reviewed the procedure for inventory adjustments for completeness and timeliness of system entry. Our goal was to determine whether Gift Shop personnel use a correction log and if so, use it correctly. OIG also inquired about what controls exist to assure inventory quantity adjustments have integrity and accuracy.

The auditors reviewed the inventory adjustment process in the Inventory Management section of the Library's Shop Operating and Policy Handbook (Handbook). This section of the Handbook includes screenshots of specific inventory adjustment screens. We evaluated the screens and found that they

do provide step-by-step processes. However, the Handbook documentation is incomplete. It does not identify who is responsible for inputting the inventory adjustments into DAX, when adjustments are permitted to be made, and who authorizes and approves the adjustments.

We confirmed that cycle count sheets are used to collect and record interim ongoing counts of items in inventory to compare those counts to inventory records and make adjustments where necessary. This process is a quality control practice for keeping the stock ledger's on-hand counts accurate and to assure adequate quantities of items are on hand. We examined a sample cycle count sheet as of FYE 2017. We noted that it included the proper identification information for individual items along with the description and quantity required by the Handbook.

Documented Annual Merchandising Plans Need to Be a Standard Operating Procedure

OIG requested the Gift Shop merchandise plan for FY 2018 to evaluate its content and completeness. Documented annual merchandizing plans provide the foundation for sales and profit goals along with detailed purchasing and inventory plans for accomplishing those goals. Such plans are a standard operating procedure in retail sales businesses. Most of the critical decisions for merchandise are made in the planning and procurement stages.¹⁹ From that foundation, continual adjustments should occur based upon the economic climate, sales trends, and customer traffic.

Current Gift Shop practice does not require a documented annual merchandizing plan. The Gift Shop buyer and Business Enterprises' manager did not prepare one for FY 2018. OIG analyzed the purchase process for the Library's Gift Shop using interviews with Gift Shop management and purchase information OIG received during the survey and fieldwork phases. Gift Shop management did not have documented plans and supporting descriptions of (a) promotional themes planned or accompanying analysis regarding why the planned purchases were made and (b) the relationship of pricing and gross margin targets by merchandise category to planned gross margin and net profit annual targets. Also absent was documentation of planned inventory levels to sales, turnover, or other goals or targets. Such planning and documentation are central to merchandising, recognizing that inventory reflects the retailer's investment from which business returns are realized.

¹⁹ *Retail Accounting and Financial Control*, 5th edition, John Wiley & Sons, Inc. 1990, Zimmerman, Kaufman, et al, p 40

Greater Documentation and Standardized Processes for Physical Inventories Needed

The execution of a physical inventory is a difficult and important process. It requires orchestrating activities that occur in multiple operational areas with many employees and requires strict adherence to guidelines. OIG reviewed the documentation for the FYE 2017 physical inventory. We also obtained the written inventory instructions for the January 2018 to determine whether the following items were included: inventory cutoffs, use of floor plans, method of recording inventory counts, accounting for inventory sheets, verification counts conducted, compilation and input of inventory counts, review of unusual inventory variances (over/under), and final updating of inventory records.

OIG's analysis found that the major operational weakness in the process was the absence of available documentation in the Handbook describing the year-end inventory process and procedures. Certain inventory instructions were conveyed in advance of the physical inventory via email. However, those instructions were incomplete. For example, the instructions omitted:

- directions for release of areas for counting after reviewing for readiness,
- instructions and cutoffs for the movement of new receipts and vendor returns before and after inventory,
- authorizations to release areas after inventory occurs,
- verification count procedures for quality control, and
- tolerances by merchandise class or category for requiring variance recounts.

Written inventory instructions for the mid-year inventory during February 2018 were not available. Therefore, we were not able to test inventory cutoffs, floor plans, executive counts/reviews, inventory count inputs, and management review of inventory variances.

Analytical reviews, where management evaluates inventory results by comparing balances and shortages to prior periods and establishing variance tolerances for investigation, is a commonly accepted practice to validate physical inventory results. We also reviewed a document titled, *2018 Mid-Year Inventory Final* that listed final inventory counts and extended values by SKU. We noted a steep increase in inventory on-hand at mid-year compared to the FYE inventory balances. The inventory total for mid-FY 2018 was \$406,813, compared to the inventory of \$323,429 for FYE 2016 and \$299,069 for FYE 2017. We saw no documentation of management discussing that comparison and confirming its validity.

Procedures for Obtaining Credits and Return of Goods Needs to Be Documented

We reviewed and assessed procedures for obtaining credits from vendors for items such as old age, damaged, and returned goods. We reviewed the Inventory Management section of the Handbook and found a section on the damaged goods process. However, the Handbook does not address specific procedures for obtaining credits from vendors for items such as damaged and returned goods. The Handbook section also does not address who is responsible for inspecting and approving damages for disposal and filling out the damage sheet.

Recommendations

Based on our evaluation of Gift Shop merchandise planning and inventory procedures, we recommend that management implement the following:

- 13) Prepare and communicate to senior management and Gift Shop management an annual merchandise plan documenting goals, inventory levels, themes, major events, primary vendors, and how funds will be allocated between merchandise categories and vendors. Also, ensure that yearly or more frequent proper analysis is done comparing actual to plan.
- 14) Prepare clearly written and disseminated inventory plans that include inventory cutoffs, use of floor plans, method of recording inventory counts, procedures for conducting verification counts, compilation and input of inventory counts, review of unusual inventory variances (over/under), test checking item number valuations, and final updating of inventory records.
- 15) Document in Handbook detailed instructions for approving the disposal of old age and damaged goods.
- 16) Document in the Handbook the (a) authorized individuals who can make inventory adjustments; (b) authorized periods for making adjustments; (c) officials responsible for verifying validity and accuracy of adjustments; and (d) required documentation retained to support the adjustments.

Integrating Online Sales into DAX will Reduce Exposure to Errors

In addition to the Gift Shop store operations in the Jefferson Building, the Gift Shop also conducts sales through a website. In our review of the Gift Shop's online sales process, our objective was to assess the processing of those sales, understand how online sales are processed, and determine the Gift Shop's use of Shopify (the e-commerce platform for online stores and retail point-of-sale systems). Online orders are placed and captured through Shopify.²⁰ We selected October 1, 2017, through March 31, 2018, as our testing timeframe.

Based on our review, we found the Handbook documentation adequate for processing online sales and the related accounting process. However, we did observe an opportunity to improve efficiency in the processing of online sales. Specifically, there is not an automated interface between Shopify and DAX. Rather, a customer service representative manually inputs on a daily basis all online sales orders received from the Shopify system into DAX. This can present workload and internal control issues during heavy online shopping periods (i.e., during the holiday season when Gift Shop management advised us over 500 orders may be received in one day). With the emphasis on more online ordering by consumers, management advised OIG the Gift Shop is seeing increased website traffic.

Shopify Sales Were Properly Entered into DAX

OIG selected six days within two of the busiest months in which online orders were received. OIG documented the number of sales, number of units, dollar amount of each, and compared the sales transactions input into DAX to the Shopify Trust Commerce daily reports. For the six days selected, OIG examined one online sale per day to verify that the information entered agreed to the online order (e.g., price, quantity, ship date, etc.). We found no exceptions.

OIG also evaluated the review process conducted by F&A. The review process was appropriate.

Efficiencies Gained through Integration of Shopify with DAX

OIG reviewed the process where the online sales entries posted to DAX were checked by F&A. We found the manual entry into DAX sufficient. However, the amount of time and the labor required to manually enter hundreds of sales orders into DAX creates efficiency issues in addition to exposure to data entry errors.

²⁰ Shopify is a proprietary e-commerce platform for online stores and retail point-of-sale. The Shopify e-commerce platform enables businesses of all sizes to conduct online sales and obtain supporting analysis from a single source.

Shopify does not integrate with DAX. Therefore, Gift Shop staff must manually post online sales into DAX. Business Enterprises performs a daily review of all online transaction inputs into DAX and retains all supporting documentation. However, the lack of automated integration between Shopify and DAX and the manual input of online sales into DAX present operational weaknesses. Although an internal control is in place, Business Enterprises is faced with having to perform daily manual checks on the inputs, which is time consuming. Relying on a manual system to input orders can also result in keystroke and other input errors causing inaccurate capture of online sales. Although we were initially told that there were plans to implement an automated interface between Shopify and DAX for transferring online orders into DAX, OIG later learned the Gift Shop would not implement this feature with the current DAX upgrade.

Physical Access Controls for Online Order Inventory Appears Adequate

OIG conducted reviews of the online sales process and observed that Gift Shop management stores inventory for online sales in a room separate from the bricks and mortar shop's merchandise inventory. OIG conducted an inspection of the online stockroom to assess physical controls over merchandise available for online sales. Our procedures included inspecting the space, noting whether access was limited to Library personnel, and determining whether conditions existed that may allow employees to remove items from the stockroom without detection.

The Library's Gift Shop maintains a separate stockroom with dedicated personnel to fulfill online orders. OIG inspected the space during a walkthrough conducted on March 1, 2018. We noted that access was limited through a card reader system and provided limited access to authorized Library personnel. We found no indications of areas where merchandise could be hidden for subsequent removal.

Recommendation

- 17) Library and Gift Shop management should assess whether it needs to invest in a fully functioning point-of-sale financial reporting system, particularly considering the expansion of the new visitor experience that could drive greater traffic to the Gift Shop.

Management Should Address Other Internal Control Issues Found Including Point-of-Sale Transactions and Segregation of Duties

In this finding, we report on two additional operational findings that we believe management should address and correct in an effort to obtain maximum business intelligence and operating performance.

More Efficient Process Needed for Point-of-Sale Recording of Refund Activity

Management needs an efficient process to track and research refund and return activity through its point-of-sale system. The current system's configuration does not permit such transactions to be researched easily. We found that transaction numbers were over-written by more recent transactions. Further, research determined that the system's point-of-sale transaction numbers turnover after every 10,000 transactions. In a normal year, that provides an average of 33 transactions a day or about 198 transactions per week. The Shop supervisor shared that once the system hits 10,000 transactions, it duplicates the numbers previously used in the back office file and restarts new sales transactions at "1." For example, the original December 15, 2017, identification number for the refund was recycled and the original transaction assigned a new number. This automatic numerical override breaks the audit trail for researching prior sales-related activities. Currently, a 10,000-transaction cycle appears to be too small for the level of activity occurring at the Gift Shop annually.

We also learned that the system incorrectly labels uneven exchanges and price checks. Price checks remain as open transactions and when closed the system records them as voids instead of price checks. The labeling of transactions may mask point-of-sale errors and attempts to use those transactions as methods for removing merchandise without purchase due to the interruption of the audit trail by those incorrect labels. Correctly labeling the nature of transactions, such as refunds, exchanges, voids, and price checks, is a key element for control against pilferage and shortage schemes at the point-of-sale. OIG reviewed the process where the sales entries posted to DAX for online sales were checked by F&A. We found the manual entry of online sales into DAX working.

Receiving and Material Handling of Merchandise Needs Further Controls and Oversight

We evaluated the Gift Shop process for receiving merchandise for the Library's Gift Shop and for online sales. Our objective was to evaluate the process for new deliveries, delivery examinations for damaged goods, purchase order discrepancies, and concealed shortages. We performed walkthroughs of two stockrooms on the ground floor of the Jefferson Building

with one stockroom dedicated to the store and one stockroom dedicated to online orders. We identified internal control weaknesses that require improvement by Gift Shop management. We note, however, that management resolved one of the weaknesses identified during the early stages of the audit. We commend Gift Shop management for their quick action.

- **Unattended Delivery Cages were Quickly Secured**—Our testing and analysis of the merchandise receiving process found an issue. During an initial walkthrough of the main stockroom, we observed that unlocked cages with new merchandise were left unattended in a public area. A passerby could remove merchandise from the cages. We brought this to Gift Shop management’s attention while accompanying us on the walkthrough. Integrated Support Services Directorate (ISS) now locks the cages to prohibit pilfering. OIG observed these changes during the audit and commends Gift Shop management for its quick resolution of this exposure. These standard procedures need to be documented and its implementation periodically observed by management during walkthroughs.
- **Greater Segregation of Duties Controls Needed**—Our testing of material handling procedures revealed two segregation of duties issues:
 - *Buyer should not confirm amount of merchandise received*—The buyer is one of two backups when the stockroom manager is absent or on leave. However, the buyer is verifying merchandise that he previously ordered. This is a segregation of duties issue.
 - *Stockroom manager should not perform spot-check*—Business Enterprises recently implemented an interim inventory count spot-check process that improves control. The stockroom manager performs a check once or twice per week on selected categories of merchandise. This serves as a check to determine that the inventory counts are accurate between the internal inventory counting process that occurs in the second quarter of each fiscal year and the formal inventory counting process that occurs at the FYE by an outside firm. The stockroom manager corrects any count discrepancies in DAX and keeps the supporting documentation. This process presents a new detective internal control. However, to ensure proper segregation of duties the stockroom manager, who is responsible for accepting all merchandise into the stockroom, should not perform this spot-check process. Ideally, other personnel aside from this manager should perform inventory spot-checks including posting the results.

- **Operating Handbook Needs More Comprehensive Documentation**—
We reviewed the Handbook and a separate set of Business Enterprises’ SOPs to determine the adequacy of material handling documentation. Similar to other areas, we noted that the Handbook documents some of the receiving activities performed; however, no written procedure contains all the activities in the receiving process. Therefore, we relied on interviews to gain an understanding of those processes, and created and vetted a flowchart for management’s confirmation. The following information was missing from or incomplete in the Handbook:
 - Stockroom manager and Integrated Support Services team material handling processes;
 - Stockroom manager’s handling of damaged merchandise;
 - Operating procedures for the physical transfer of merchandise;
 - Stockroom entry and exit procedures along with personnel authorized to enter the stockrooms and their roles (e.g., Architect of the Capitol to check gauges, OCIO to check computers/DAX, Gift Shop personnel to obtain merchandise);
 - Description of the receiving shortage control process including how the Gift Shop identifies, addresses, and conveys to vendors concealed shortages;
 - Known shortage account information; also, accounting for inventory shortages by reason/category does not exist in the manually prepared monthly P&L statement or the Momentum General Ledger;²¹
 - Newly implemented internal controls procedures for delivery of cages; and
 - Newly implemented procedures for interim cycle counts by category.

Recommendations

- 18) Re-evaluate the sales return process to ensure it contains sufficient management controls and audit trails, and permits easy and efficient research methods.
- 19) Determine whether DAX can be reprogrammed to provide separate reporting and identification of voids, price checks, even and uneven exchanges, and refunds.

²¹ Classification of inventory shortage categories enables management to apply shortage control solutions appropriately.

- 20) Determine whether DAX can be reprogrammed to sufficiently increase the transaction numbers available before reusing them at the point-of-sale, to allow for a proper audit trail.
- 21) Eliminate segregation of duties issues regarding Gift Shop buyer involvement in the merchandise checking in process and the stockroom manager's involvement in performing the inventory interim spot-check process.
- 22) Document internal business processes, transaction workflows, and the related system of internal controls.

This page left blank intentionally

Appendix A: Objectives, Scope, and Methodology

In conducting the audit of the Library of Congress' (Library) Gift Shop our audit objectives included evaluating the design of the systems of internal control over Gift Shop operations to ensure that assets are protected and financial data reflecting operations is accurate and reliable. Based on the results of OIG's evaluation of internal control design, we then determined where appropriate, to conduct tests of compliance with those internal controls.

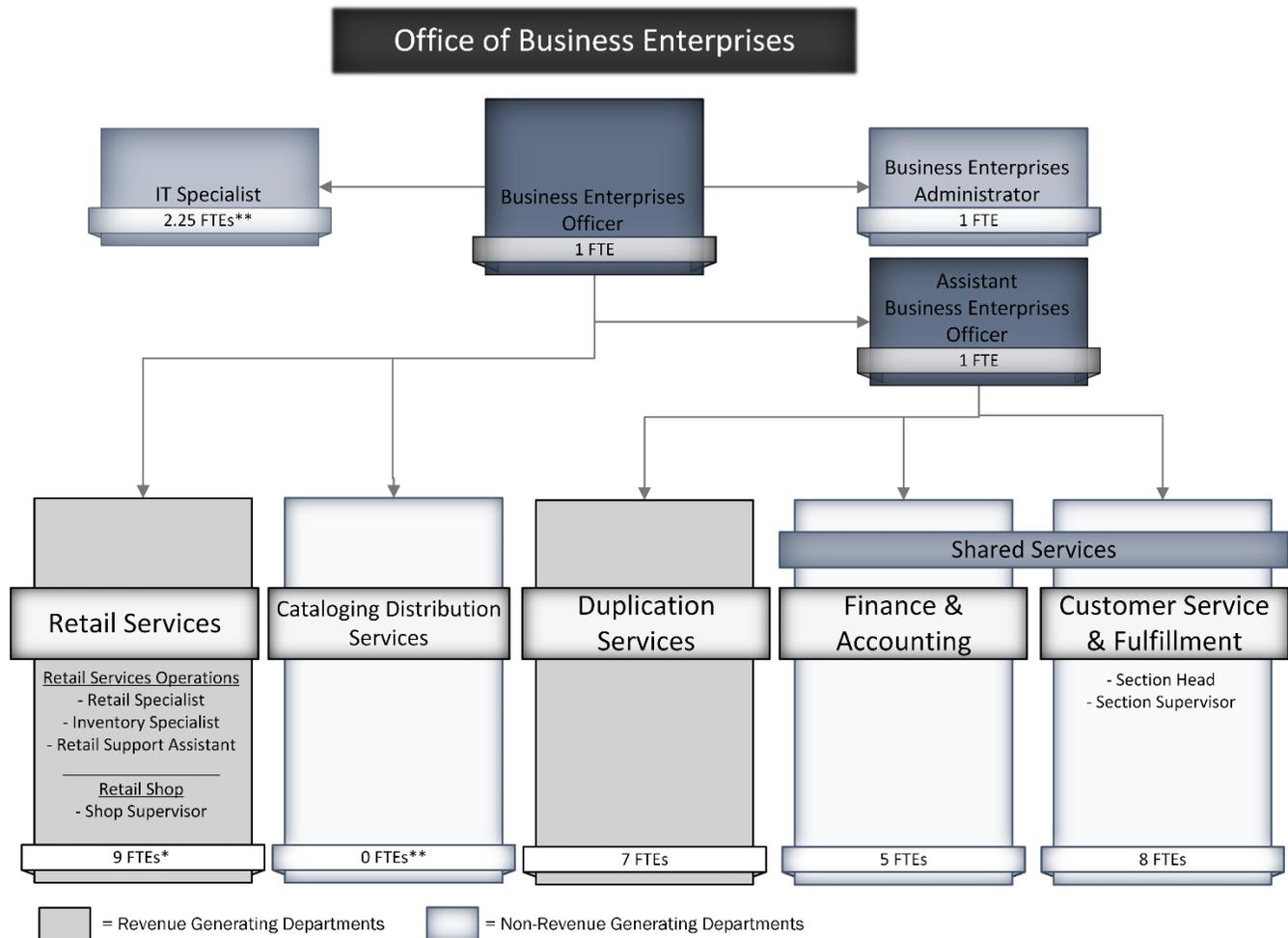
The scope of our audit pertained to the Gift Shop operations during the periods FYs 2017 and 2018. The methodologies we employed included inquiry, observation, inspection, and analytical reviews of transactions, workflows, and financial reports. During our fieldwork we conducted two sampling tests of merchandise data to evaluate the accuracy and reliability of the inventory valuation method employed by the Gift Shop, the weighted moving average cost method.²² We also reviewed the contract for migrating DAX and its system data to version R3 from version R2 and interviewed the contractor's project manager regarding the transition to the new version. Our fieldwork commenced February 2018 and we completed it in December 2018.

We conducted this performance audit in accordance with the Government Accountability Office's, *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

²² The first test was a sampling test of attributes of the weighted moving average cost for inventory on hand as of October 1, 2018. OIG judgmentally evaluated the test. OIG had F&A run a full inventory listing from the DAX stock ledger by SKU with cost as of that date. The report was ran as a query from the system by the F&A accountant with OIG not conducting tests to determine the validity and reliability of the report's data. The universe of inventory items at that time was 1868. OIG randomly selected 25 items with 6 replacement items using systematic selection and using the first item on the report as the sample selection starting point. OIG obtained from F&A for each item in the sample, the prior inventory beginning count and system cost along with delivery data for all interim deliveries with cost up to October 1, 2018. The expected error rate of the test was zero. OIG calculated the weighted moving average of the selected sample items. OIG's calculations agreed with the system costs resulting in zero exceptions found.

In the second test, OIG tested the weighted moving average cost of inventory items before and after the February 2018 interim inventory. OIG judgmentally evaluated the test. This also was a sampling test of attributes for the pre and post inventory costs. OIG obtained a report prior to the inventory by item with on hand counts and cost and the same report immediately after the inventory was updated for the counts. OIG did not conduct tests to determine the validity and reliability of the reports' data. The universe was 2262 items on 58 pages. OIG judgmentally block selected two pages (pages 1 and 41). From those pages, starting with a blind stab OIG randomly selected 25 items on a judgmental basis. We compared the pre and post item costs for each sample item selected. The expected error rate was zero. The actual error rate was 19. OIG concluded that the DAX system has a significant programming error related to carrying forward the inventory costs. This is a reportable condition in the report requiring management investigation.

Appendix B: Office of Business Enterprises' Organization Chart



*FTE count does not include 5 intermittent staff used in a flexible staffing model.

**Office of the Chief Information Officer's IT Specialist (2.25 FTEs) is funded by Business Enterprises for systems support and Cataloging Distribution Services programming.

Figure 1: Organization Chart for the Office of Business Enterprises as of October 2018.

Source: Office of Business Enterprises

Appendix C: Management Response



Office of the Librarian

MEMORANDUM

DATE April 3, 2019
TO Kurt Hyde, Inspector General
FROM J. Mark Sweeney, Principal Deputy Librarian of Congress 
SUBJECT Management Response to OIG report 2017-PA-102

Thank you for the opportunity to comment on your report regarding the Office of the Inspector General's (OIG) gift shop audit.

The gift shop provides an important outreach function that enables the Library to provide commemorative items for significant historical events and allows visitors to take home a physical reminder of their experiences and the resources available to them through the Library. The gift shop also serves to expand the Library's reach and brand, increasingly through on-line retail operations and activities.

We acknowledge that critical to the success of such enterprises is accurate financial accounting and inventory that aligns with established plans for the future. As the Library undertakes to expand its gift shop operations as part of the new visitor enhancements, the Business Enterprises (BE) division is taking steps to address weaknesses identified in your report.

The Library's financial management system, Momentum, is and will remain the account of record. However, BE has met with the Financial Reporting Division and has established a list of monthly reports that will be submitted to ensure appropriate internal controls and reconciliation between Momentum and the BE financial systems is conducted. In addition, the Financial Reporting Division and BE will hold monthly meetings to share information, updates on the status of outstanding issues, and plans for resolution and to discuss future coordination of system requirements.

With respect to the existing enterprise resource planning (ERP) system, BE is already in the process of upgrading the ERP system from Microsoft Dynamics AX R2 to version R3. This upgrade will eliminate security vulnerabilities and will enable BE to engage with the system support contractor to explore interim improvements to the system's financial and inventory modules. BE plans to upgrade its ERP system to one that has GAAP-compliant financial reporting capabilities and ideally can interface with Momentum.

Page 1 of 2

The attached chart provides additional details regarding the Library's plans to address the findings and recommendations in your report.

Please contact me if you have questions.

Attachment

cc: Edward Jablonski, Chief Operating Officer
Elizabeth Pugh, General Counsel

**Management Comments on Draft OIG Report No. 2017-PA-102,
Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting**

| Recommendation | Comments | Target completion |
|---|---|---|
| <p>1 Comprehensively review and redesign the financial and accounting processes and systems. Implement a financial reporting system for Gift Shop operations that includes an automated trial balance based on double entry accounting, and one that produces a full complement of GAAP-compliant financial statements (balance sheet, P&L statement, and cash flow statement) on a monthly, quarterly, and annual basis.</p> | <p>Agree.</p> <p>Short-term: BE has revised the Chart of Accounts and some accounting processes, as discussed below, to improve its ability to capture and report the information required for GAAP compliant financial statements and support of decision making.</p> <p>Mid-term: BE will acquire contractor support to gain additional functionality within the limits of the existing Microsoft Dynamics AX (DAX) system, now undergoing an upgrade from R2 to R3.</p> <p>Long-term: BE will work to assess and implement Microsoft 365 (or another system) with integrated functions capable of producing GAAP-compliant statements and the analytics addressed in other sections of the report needed for its operations.</p> | <p>Short-term: 6/30/2019</p> <p>Mid-term: 09/30/2019</p> <p>Long-term: 09/30/2021</p> |
| <p>2 Develop and implement GAAP compliant and accurate perpetual inventory information, including cost of goods sold and gross margin reporting on the manual P&L.</p> | <p>Agree.</p> <p>Short-term: BE will engage a contractor to determine if the updated system (R3) can support the First-In-First-Out (FIFO) inventory valuation methodology. BE will use the FIFO method to prepare monthly manual estimates of inventory value to calculate Cost-of-Goods Sold. The manual calculations will track inventory until such time as a reliable system for calculating weighted averages for a perpetual inventory is in place.</p> <p>Long-term: This will be a requirement of the planned Microsoft 365 (or alternate system) implementation.</p> | <p>Short-term: 09/30/2019</p> <p>Long-term: 09/30/2021</p> |
| <p>3 Reconcile monthly financial results and selected accounts between the Business Enterprises' F&A and Momentum financial systems.</p> | <p>Agree.</p> <p>Short-term: BE Finance and Accounting (F&A) will provide monthly reconciliations to Momentum for cash, revenues, purchases and accounts payable. We have set the fifth Business Day of each month as the target for completing this work.</p> <p>Long-term: BE F&A will provide monthly reconciliations of all accounts to Momentum.</p> | <p>Short-term: 05/05/2019</p> <p>Long-term: 09/30/2021</p> |
| <p>4 Conduct reconciliations between key general ledger control accounts and related subsidiary accounts (e.g., inventory, accounts payable) on the F&A system when implemented.</p> | <p>Agree.</p> <p>There is currently no basis of comparison for inventory against Momentum, as Momentum does not track inventory. BE will provide monthly reports based on the proposed chart of accounts.</p> <p>Short-term: BE Finance and Accounting (F&A) will provide monthly reconciliations to Momentum for cash, revenues, purchases and accounts payable. We have set the fifth Business Day of each month as the target for completing this work.</p> <p>Long-term: BE F&A will provide monthly reconciliations of all accounts to Momentum.</p> | <p>Short-term: 05/05/2019</p> <p>Long-term: 09/30/2021</p> |
| <p>5 Establish Business Enterprises' F&A compliance with all Library policies and directives for financial reporting and internal control compliance.</p> | <p>Agree.</p> <p>In response to recommendations 5, 6, and 22, BE has undertaken an exhaustive review of all business processes to design proper and comprehensive internal control processes, and completely document internal business processes, transaction workflows, and the system of internal controls. In the course of this review, if any item is found noncompliant, it will immediately be changed to achieve compliance.</p> | <p>April 30, 2019</p> |

**Management Comments on Draft OIG Report No. 2017-PA-102,
Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting**

| | | | |
|----|--|--|--|
| 6 | In conjunction with recommendation one, design proper and comprehensive internal control processes, and completely document internal business processes, transaction workflows, and the system of internal controls for the Gift Shop. | <p>Agree.</p> <p>In response to recommendations 5, 6, and 22, BE has undertaken an exhaustive review of all business processes to design proper and comprehensive internal control processes, and completely document internal business processes, transaction workflows, and the system of internal controls. In the course of this review, if any item is found noncompliant, it will immediately be changed to achieve compliance.</p> <p>Long-term: In connection with the plan for adoption of a Microsoft Dynamics 365 (or alternate system), BE will continue examinations of its control environment and revise its processes to maximize the opportunities available in the new system.</p> | <p>Short-Term: 4/30/2019</p> <p>Long-term: 09/30/2021</p> |
| 7 | Establish a continuing dialog between Financial Reporting Office and Business Enterprises' F&A to bolster knowledge of each other's financial reporting and operations, and to improve Business Enterprises' GAAP and internal control compliance. | <p>Agree.</p> <p>BE F&A will hold regular meetings with FSD's Financial Reporting Division.</p> | April 30, 2019 |
| 8 | Establish, document, and track agreed upon financial reporting ratios to enhance management analysis of the Gift Shop operating results and performance goals. | <p>Agree.</p> <p>In response to recommendations 4 and 6, BE will define ratios it can produce with available resources, document the procedures for preparing them, and report them to Library management with trend analysis. We have set the fifth Business Day of each month as the target for completing this work.</p> <p>Long-term: BE F&A will expand the number and type of ratios produced each month based on its information needs and the assessment and implementation of capabilities within Microsoft Dynamics 365 (or alternate system).</p> | <p>Short-term: 05/05/2019</p> <p>Long-term: 09/30/2021</p> |
| 9 | Investigate and correct the condition causing the DAX system to malfunction where it changes SKU cost in the stock ledger as part of inventory count update. | <p>Agree.</p> <p>Short-term: BE will engage a contractor find the root cause of the problem and, if possible, correct it.</p> <p>Long-term: This will be a functional requirement of the Dynamics 365 (or alternate system).</p> | <p>Short-term: 09/30/2019</p> <p>Long-term: 09/30/2021</p> |
| 10 | Determine an accurate source of accounts payable information, from either Momentum or DAX. | <p>Agree.</p> <p>Momentum is the system of record. BE will reconcile information in DAX based on results in Momentum. Differences will be researched and resolved with appropriate adjustments made in Momentum or BE information.</p> | 5/5/2019 |
| 11 | Develop an accurate and reliable accounts payable aging report and monitoring process. | <p>Agree.</p> <p>In conjunction with the response to recommendation 10, BE will use the aging report available from Momentum. <i>NOTE:</i> this has a Financial Reporting Division dependency.</p> | 5/5/2019 |
| 12 | Enhance SOP documentation to cover internal accounts payable business processes and the related system of internal controls. | <p>Agree.</p> <p>In conjunction with responses to recommendations 1 and 6, BE will fully document its accounts payable business process and related system of internal controls.</p> | April 30, 2019 |

**Management Comments on Draft OIG Report No. 2017-PA-102,
Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting**

| | | | |
|----|---|--|--|
| 13 | Prepare and communicate to senior management and Gift Shop management an annual merchandise plan documenting goals, inventory levels, themes, major events, primary vendors, and how funds will be allocated between merchandise categories and vendors. Also, ensure that yearly or more frequent proper analysis is done comparing actual to plan. | Agree. BE annually will prepare the types of purchasing and merchandising plans that were developed for FY19 and present them to the Chief Operating Officer. | Complete |
| 14 | Prepare clearly written and disseminated inventory plans that include inventory cutoffs, use of floor plans, method of recording inventory counts, procedures for conducting verification counts, compilation and input of inventory counts, review of unusual inventory variances (over/under), test checking item number valuations, and final updating of inventory records. | Agree. BE will prepare formal documentation of its inventory plans. In accordance with retail industry standards, the SOP for these activities has added a step to provide advance notice to FSD and the Library's external auditors, so that year-end audit activities may be observed as part of preparing GAAP-compliant financial statements. | April 30, 2019 |
| 15 | Document in Handbook detailed instructions for approving the disposal of old age and damaged goods. | Agree. BE will revise the instructions in its Handbook to provide additional details on approving the disposal of old age and damaged goods. | April 30, 2019 |
| 16 | Document in the Handbook the (a) authorized individuals who can make inventory adjustments; (b) authorized periods for making adjustments; (c) officials responsible for verifying validity and accuracy of adjustments; and (d) required documentation retained to support the adjustments. | Agree. In connection with addressing recommendation 15, BE will revise the instructions in its Handbook to clarify roles and responsibilities in making and documenting inventory adjustments. | April 30, 2019 |
| 17 | Library and Gift Shop management should assess whether it needs to invest in a fully functioning point-of-sale financial reporting system, particularly considering the expansion of the new visitor experience that could drive greater traffic to the Gift Shop. | Agree. BE has determined that a robust POS system is required to integrate in store and online inventory and transactional data. The planned Microsoft Dynamics 365 upgrade includes this functionality. BE will conduct additional market research investigating alternate POS systems/financial reporting systems to validate its planned upgrade optimizes investment and operational outcomes. | Short term: Market research to be completed by 12/31/2019 Long-term: 09/30/2021 |
| 18 | Re-evaluate the sales return process to ensure it contains sufficient management controls and audit trails, and permits easy and efficient research methods. | Agree. This process has been reevaluated and processes have been documented in the SOPs, including the authorization process, dollar thresholds and physical documentation. Short term: As part of its response to recommendations 18, 19, and 20, BE will engage a contractor to determine if the required improvements can be made in the existing DAX system. Long term: This will be a requirement of the Microsoft Dynamics 365 (or alternate system) upgrade. | Short-term: 9/30/2019 Long-term: 09/30/2021 |

**Management Comments on Draft OIG Report No. 2017-PA-102,
Comprehensive Redesign Needed of Gift Shop Financial Management and Accounting**

| | | | |
|----|---|---|---|
| 19 | Determine whether DAX can be reprogrammed to provide separate reporting and identification of voids, price checks, even and uneven exchanges, and refunds. | <p>Agree.</p> <p>Short-term: The present DAX system does not distinguish between sales returns, price checks, exchanges or refunds. This is controlled via logs, which require the Shop Supervisor's authorization and which are available for inspection. As part of its response to recommendations 18, 19, and 20, BE will engage a contractor to determine if the required improvements can be made in the existing DAX system.</p> <p>Long-term: This will be a requirement of the Microsoft Dynamics 365 (or alternate system) upgrade.</p> | <p>Short term: 9/30/2019</p> <p>Long-term: 9/30/2021</p> |
| 20 | Determine whether DAX can be reprogrammed to sufficiently increase the transaction numbers available before reusing them at the point-of-sale, to allow for a proper audit trail. | <p>Agree.</p> <p>Short-term: The present DAX system does not distinguish between sales returns, price checks, exchanges or refunds. As part of its response to recommendations 18, 19, and 20, BE will engage a contractor to determine if the required improvements can be made in the existing DAX system.</p> <p>Long-term: This will be a requirement of the Microsoft Dynamics 365 (or alternate system) upgrade.</p> | <p>Short-term: 6/30/2019</p> <p>Long-term: 09/30/2021</p> |
| 21 | Eliminate segregation of duties issues regarding Gift Shop buyer involvement in the merchandise checking in process and the stockroom supply technician's involvement in performing the inventory interim spot-check process. | <p>Agree.</p> <p>BE addressed non-compliance of buying staff with this policy and strengthened inventory receiving procedures. The Shop Supervisor conducts weekly spot-checks of receipts, which is documented in the revised Handbook.</p> | Completed |
| 22 | Document internal business processes, transaction workflows, and the related system of internal controls. | <p>Agree.</p> <p>In response to recommendations 5, 6, and 22, BE has undertaken an exhaustive review of all business processes to design proper and comprehensive internal control processes, and completely document internal business processes, transaction workflows, and the system of internal controls.</p> | April 30, 2019 |