

Rowan/Kannapolis ABC Board

Performance Audit Report



Alcoholic Beverage Control Commission
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ABC
COMMISSION
NORTH CAROLINA



ABC

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NORTH CAROLINA

Alcoholic Beverage Control

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May 30, 2012

Rowan/Kannapolis ABC Board
Ms. Linda Lowman, Chair
PO Box 114
Salisbury, NC 28144

Dear Chair Lowman,

We are pleased to submit this performance audit report of the Rowan County ABC Board. The objective of this audit was to examine existing policies, practices, and controls and to provide recommendations on methods to improve operating efficiency at the ABC Board in accordance with new legislative mandates.

The report consists of an executive summary, background information and operational findings and recommendations along with your General Manager's response to our recommendations. This report will be posted on the Commission's public web site.

We would like to thank you, the ABC Board and your staff for the assistance and cooperation provided to us during the audit. Additionally, we appreciate the efforts your Board has made to comply with the new performance standards and your continuing commitment to improving operating efficiencies within your ABC system.

If we can be of assistance in the future, please advise.

Respectfully,

Michael C. Herring
Administrator

Cc: North Carolina Association of ABC Boards

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EXECUTIVE SUMMARY

By state law, the ABC Commission shall ensure that all local ABC Boards comply with established performance standards by conducting regular audits or performance evaluations. Performance standards shall include, but are not limited to, standards that address enforcement of ABC laws, store appearance, operating efficiency, solvency, and customer service. Performance audits are examinations of existing operating policies, practices, controls, and activities to determine those areas in which there may be a need for improvements. This audit was conducted in accordance with Government Auditing Standards. This report details findings and recommendations with regard to organizational operational issues.

To achieve the objectives of the audit, ABC Commission staff

- Reviewed applicable General Statutes, ABC Commission Rules, and administrative polices;
- Reviewed applicable reports and studies of ABC boards with similar size and geography;
- Verified compliance with Commission and Board policies;
- Reviewed organizational chart and job descriptions;
- Reviewed ABC store annual audit for the fiscal year 2011;
- Visited all stores; and
- Interviewed key ABC board personnel.

The Rowan/Kannapolis ABC Board has responded to the performance audit recommendations. Since the 2005 merger, the board has shown a significant increase in profits but has acquired new debt to capture potential sales in different areas of operation. While it is clear the focus of the operation is on educational opportunities dealing with alcohol, the board is also striving to maintain compliance with statutes and Commission rules. Internal controls have been established and maintained to improve segregation of duties and checks and balances.

BACKGROUND INFORMATION

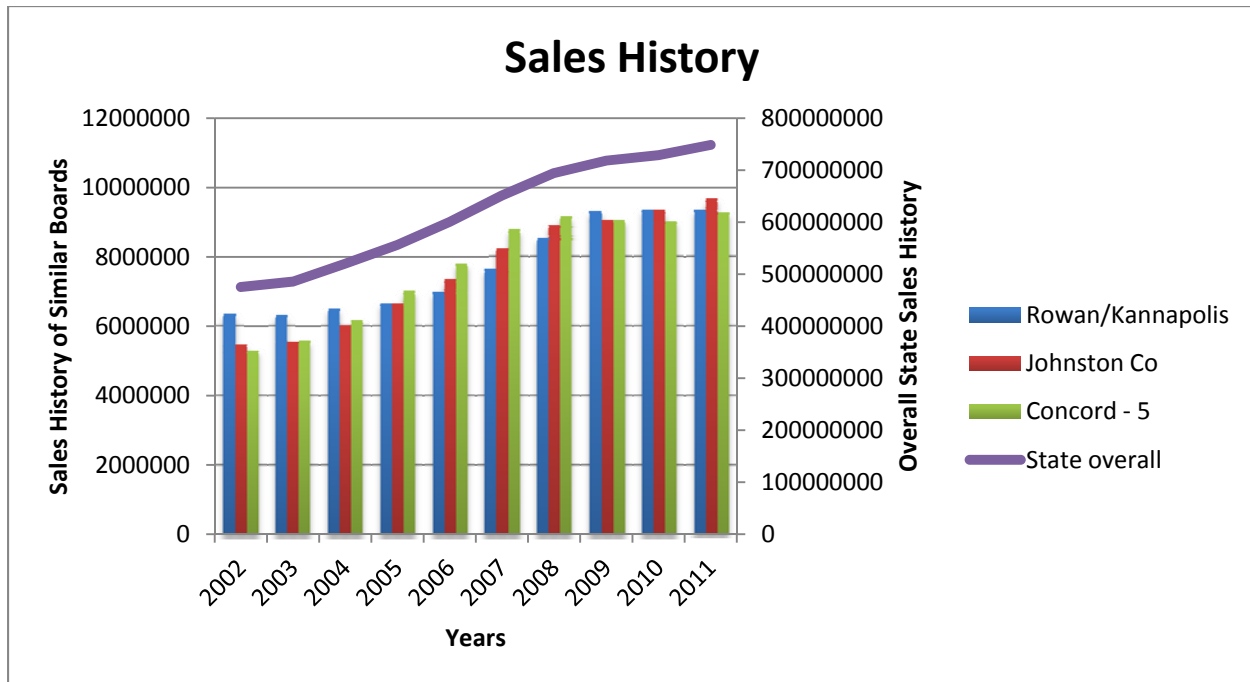
Rowan County held an ABC referendum on July 30, 1949 under the authority of the 1937 Act. The vote for an ABC store passed 7,856 to 6,709 and the first retail sale was made on October 24th of that year. The city of Kannapolis, which straddles the line between Cabarrus and Rowan counties, was authorized by S.L. 2004-92 to hold a referendum on opening an ABC store as part of the Rowan County ABC System. Following a successful vote on February 15, 2005, the system's name was changed to the Rowan/Kannapolis ABC Board and the board was tasked with the construction and operation of ABC stores in Kannapolis as part of the merged system. The board currently operates seven retail stores.

A county-wide mixed beverage referendum failed in 1986, but subsequent municipal elections were successful – Salisbury (1986), East Spencer (1986), Kannapolis (2002), Spencer (2002), China Grove (2007), and Landis (2008).

The board is currently made up of three members: Linda Lowman, chair, David McCoy and Kenneth Argo. The board employs thirty-seven employees, consisting of nineteen full-time and eighteen part-time employees. The general manager is responsible for creating programs as assigned dealing with alcohol education throughout the county. The finance officer is responsible for all financial activities as well as overseeing store and office operations. The warehouse manager controls warehouse and store inventories as well as managing mixed beverage (MXB) accounts. The store managers are primarily responsible for the upkeep of the stores, store personnel, and customer service duties. The clerks' duties involve various retail functions including selling products and stock maintenance.

Profitability

For fiscal year 2011, the board showed a profit; gross sales were \$9,343,992, income from operations was \$155,620, resulting in a profit percentage to sales of 1.67%. In comparing Rowan/Kannapolis ABC with other similar size boards over the past ten years, sales grew through 2009 and then leveled off, while for the same period, the state and some other boards slightly increased. *See chart below.*



Note: Concord ABC has 5 stores, the other boards have 7 stores.

Distribution

G.S. 18B-805 (c) (2) (3) requires the board to expend quarterly at least five percent of profits for law enforcement and at least seven percent of profits for alcohol education. The remaining profits are to be expended as follows:

- 40% to Rowan County
- 22 ½% to Salisbury General Fund
- 22 ½% to Kannapolis General Fund
- 15% to other municipalities in Rowan County

In 2011, the Rowan/Kannapolis ABC Board made distributions to law enforcement of \$27,072, to alcohol education of \$11,602; to county/city distributions totaled \$114,243. The Rowan/Kannapolis ABC Board sends all distributions to Rowan County which makes allocations to the appropriate funds.

FINDINGS AND RECOMMENDATIONS

On January 10, 2012, ABC Commission Board Auditor, Moniqua S. McLean, visited the Rowan/Kannapolis ABC Board and stores and interviewed Terry Osborne, general manager; Julie Eller, finance officer; Tommy Goodman, warehouse manager; Linda Lowman, board chairperson; David McCoy and Kenneth Argo, board members. The following are the findings and recommendations relating to the performance audit.

Inventory Turnover

The inventory turnover rate is calculated by dividing the cost of liquor by the average inventory in the system (Cost of Liquor/Average Inventory). The Commission has set goals for determining an effective rate based on the frequency of deliveries. Below are the turnover rates based on the delivery schedule:

- Once a week deliveries target at 6 times or more per year
- Twice a month deliveries target at 5 times or more per year
- Monthly deliveries target at 4.5 times or more per year

The Rowan/Kannapolis ABC Board has a weekly delivery schedule. The inventory turnover rate for the Rowan/Kannapolis ABC Board is 6.5 and has exceeded the target set by the Commission.

Recommendations:

- Continue analyzing sales history reports carefully to avoid overstocking.
- Continue to explore alternative marketing strategies for eliminating slow-moving products and encouraging sales.
- Transfer slow movers between stores that may have a greater demand.
- Provide sales staff with product knowledge training opportunities.

Operating Cost

Operating costs are calculated by dividing total operating expenses less depreciation by the gross profit on sales (Total operating expenses less depreciation/Gross Profit). Below are the average cost ratios for boards with and without mixed beverage sales:

- Boards with 3 or more stores with MXB – cost ratio .67 or less
- Boards with 3 or more stores without MXB – cost ratio .94 or less
- Boards with 2 stores (with and without MXB)– cost ratio .83 or less
- Single store boards with MXB – cost ratio .77 or less
- Single store boards without MXB – cost ratio .93 or less

The Rowan/Kannapolis ABC Board operates seven stores and has an operating cost ratio of .89; it does not meet the goal set by the Commission. Total operating expenses continue to increase at a faster rate in Rowan/Kannapolis than other boards. Overhead expenses are higher compared to other boards due to rent and building expenses. The board leases four locations and owns three stores. Annual rental payments are approximately \$178,015. To meet the cost ratio goal and

remain at current expense levels of \$2,005,875, revenues must be approximately \$12,500,000. To meet the goal and remain at current revenue levels of \$9,343,992, expenses must be reduced to approximately \$1,475,000. *Refer to Charts for breakdown of operation expenses and common expense comparisons.*

Recommendations:

- Because salaries and rents are the largest segments of operating expenses, analyze personnel hours to assess efficient personnel usage; re-negotiate rental agreements wherever possible to get a better rate.
- Request bids annually from various vendors to get the best rates possible on professional fees, utilities, maintenance contracts, and credit card processing fees.

Profit percentage to sales

The profit percentage to sales is calculated by dividing the total profit before distributions by the total liquor sales. The Commission has set efficiency goals based on the following breakdown:

- Gross sales greater than \$10M – target rate at 9%
- Gross sales between \$2M to \$10M – target rate at 6.5%
- Gross sales less than \$2M – target rate at 5%

The Rowan/Kannapolis ABC Board has a profit percentage of 1.67% and does not meet the goal set by the Commission. Two of the seven stores did not show a profit for FY2011 and have not shown a profit in the past five years.

<u>Location</u>	<u>Change in Net Assets</u>
Ketner Center	35,742
Jake Alexander Blvd	58,428
Cannon Blvd, Kannapolis, NC	11,117
Renaissance Square	(6,444)
Rockwell	13,030
Oak Avenue Mall	5,801
Gateway Center	(3,431)
<hr/>	
Total	114,243

Recommendations:

- Improve sales strategies by developing new marketing techniques. Refer to recommendations under inventory turnover and operating costs.
- Analyze and reduce operating expenses to increase profits by monitoring budget closely and continue taking advantage of Special Purchase Allowance (SPA's) and quarterly price reductions whenever possible.

- Explore economic aspects of purchasing property vs. leasing properties.

Working Capital

Working capital is total cash, investments, and inventory less all unsecured liabilities. Gross sales means gross receipts from the sale of alcoholic beverages less distributions as defined in G.S. 18B-805 (b), (2), (3), and (4). The Commission has set efficiency goals based on the following breakdown:

- Four months for boards with gross sales less than \$1.5M
- Three months for boards with gross sales less than \$50M and greater than or equal to \$1.5M
- Two months for boards with gross sales equal to or greater than \$50M

For FY2011, Rowan/Kannapolis ABC was allowed to retain up to a maximum of three months but had a working capital of \$717,266 which is equivalent to less than two months. The working capital retained is within the limits allowed by NCAC 02R .0902.

Store Appearance and Customer Service

The Rowan/Kannapolis ABC stores have linear footage ranging from 1500 to 3000 feet of shelf space. All stores hold an average of 1000 product codes.

- All stores were clean, smoke-free, well-lit, and free of clutter in the counter areas. The exterior areas were free of trash and well maintained.
- All stores have a definitive shelf management system that displays higher priced products on the top shelf and lower priced products on the lower shelves. Products were fronted and shelves were full.
- The required Fetal Alcohol Syndrome poster was displayed in all stores.
- In each store, a price book and monthly sale listings were made available to all customers.
- All employees exhibited good customer service skills by greeting every customer upon entering. When not waiting on customers, employees were stocking shelves and performing general store upkeep duties.
- The board does not have a written policy for handling price discrepancies between the shelf price and the register.

Recommendations:

- Adopt a written price discrepancy policy and include in the employee handbook so that all employees will know what to do if this happens. If a shelf tag is incorrect and shows a lower price than the register, it is good customer service to honor the lower price. The Commission will provide a sample policy upon request. *Refer to Appendix C (1) for rule.*

Policy Compliance and Procedures

- Deposits are made daily by whomever is working with the exception of four stores that have a courier service to pick up deposits.
- All employees maintain their own cash drawer. The cash drawers are counted before and after each shift.
- Warehouse inventory control is handled by the warehouse manager. Inventory counts are performed by the warehouse manager and assistant on a weekly basis. Store inventory counts are performed by all scheduled personnel monthly. Spot checks are performed occasionally more frequently during the busiest seasons.
- Each store manager creates a schedule for their employees. For payroll purposes, timesheets are filled out by the employees and verified by the store manager and the finance officer.
- The board has contracted with the Alcohol Law Enforcement Division to provide law enforcement services. A copy of the contract was submitted to the auditor.
- The board does not have in writing either a credit card or vehicle use policy.

Recommendations:

- Adopt a written credit card usage policy. Include a maximum limit allowed on purchases before a board member is notified for approval. A board member is to be notified of all purchases over the limit. Once adopted, submit a copy to the Commission. Document procedures for the usage of the credit card including:
 - Who has the authority to use the card,
 - What types of items the card may be used for,
 - Personal usage is not allowed,
 - A detailed receipt for every transaction is required,
 - A purchase order must accompany each receipt.
- Adopt a written vehicle usage policy indicating for what purposes board-owned vehicles can and cannot be used for.

Personnel and Training Compliance

- Training is provided by store managers to new and existing employees as new information is available. The general manager holds monthly meetings for store managers to keep them abreast of new issues.
- All board members, the finance officer, and the general manager have attended the mandatory ethics class.

Recommendations:

- Continue cross-training employees on key functions that include ordering liquor, closing out the end of the month, paying bills, and filing taxes in the event the finance officer were suddenly unavailable.

- Extend to employees training opportunities offered by the Commission and other approved venues. Document training completed and place in employee's personnel file.

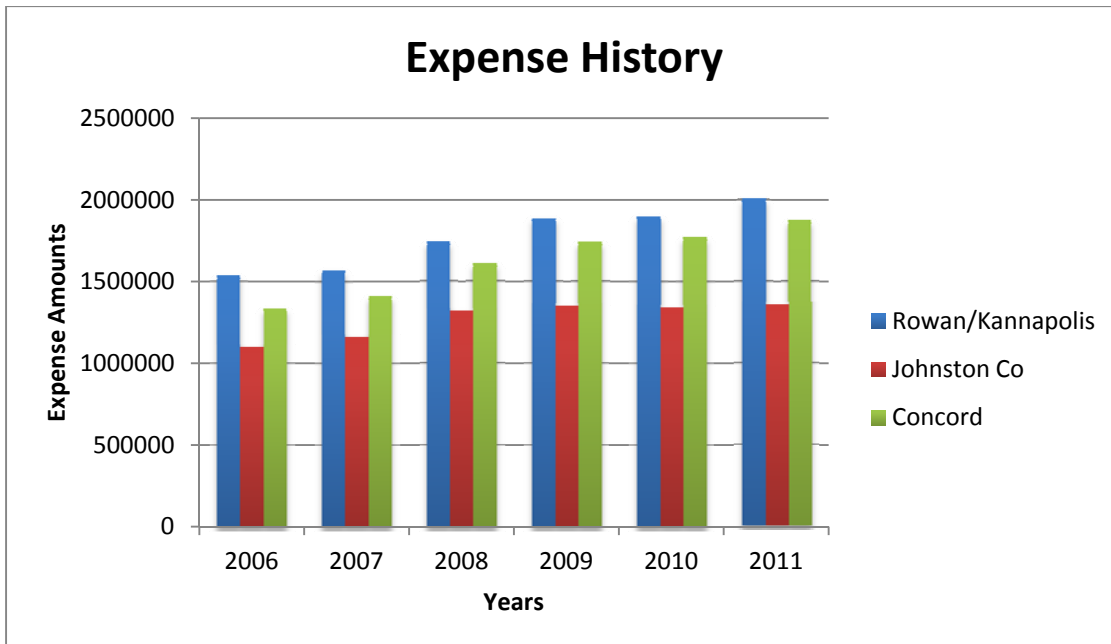
Administrative Compliance and Internal Controls

- Board meeting minutes were available to view referencing the conflict of interest statement and followed the order of proceedings for conducting a business meeting.
- Board information on the Commission website did not reflect the board members' latest appointment dates and compensation amounts. The Commission auditor updated this information once provided.
- Nepotism – The board is in compliance with G.S. 18B-700(k).
- The administrative assistant orders supplies online and the finance officer affixes the pre-audit certificate to the vendors' confirmation sheet.
- All orders to LB&B bear the pre-audit certificate as required by G.S. 18B-702 (m).
- All checks have the approved certificate embedded as required by G.S. 18B-702 (q). Invoices made with other forms of payment are stamped with the approved certificate and signed by the finance officer.
- All checks are signed by the finance officer and the general manager.
- A deputy finance officer has not been appointed to fill in if the finance officer is unable to work.
- Out of an average of 1,000 product codes in seven stores, a sample of approximately 200 product codes were tested, and three products did not reflect the prices set by the Commission. Grande Amber .375L 49-716 (Rockwell location) showed August 2011 prices, Hendrick's .75L 42-977 (Ketner location) showed August 2011 sale prices, and P.I.N.K. .75L (Gateway location) did not reflect the last listed price. *Refer to Appendix B for photos.*

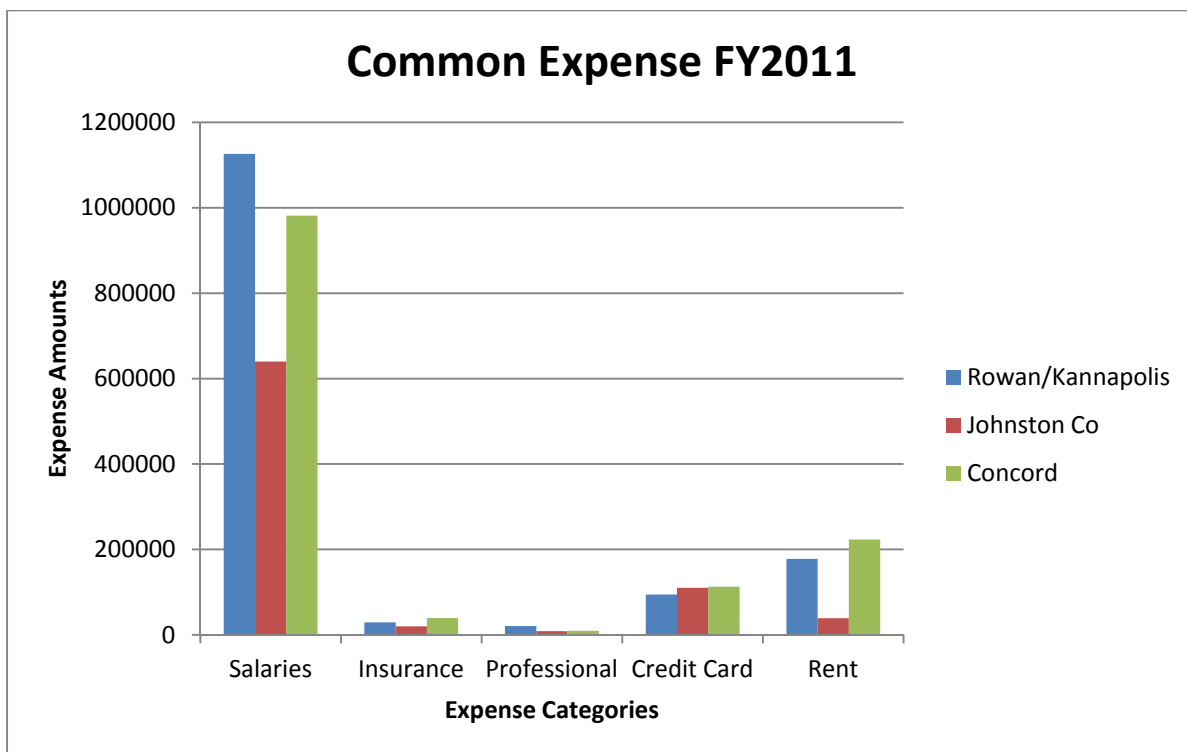
Recommendations:

- Appoint a deputy finance officer to aid in the duties of the finance officer when he/she is absent.
- North Carolina statutes require uniform pricing in all ABC stores. Immediately audit all shelf tags in the store and the cash register system for correct pricing. To ensure accurate pricing in the future, incorporate a shelf tag audit (by section) into the inventory counts.

APPENDIX A

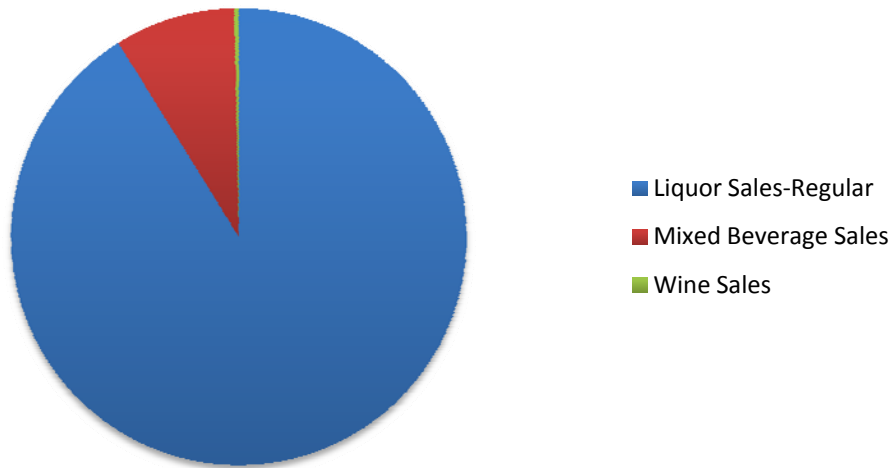


The expense history comparisons of similar size boards reveals that the Rowan/Kannapolis ABC expenses are higher than other similar size boards.



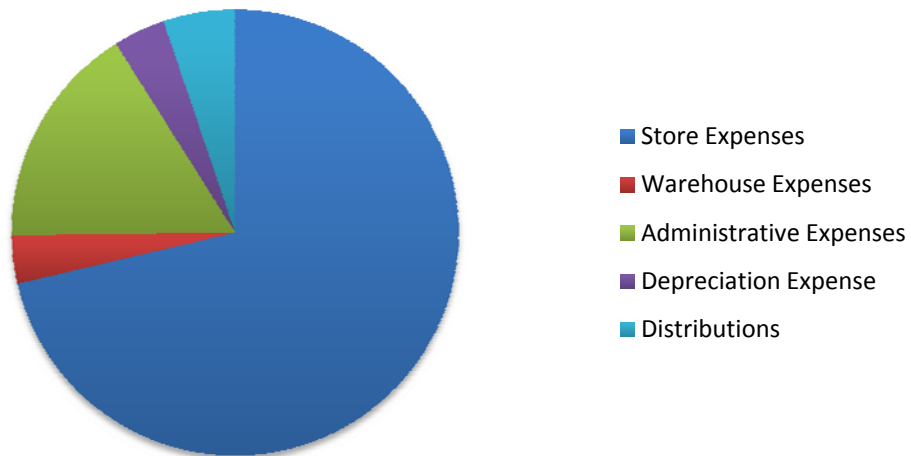
Other than salaries, common expense comparisons of other boards indicate Rowan/Kannapolis ABC's expenses are relatively lower. Note: In the rent category, Johnston County leases two stores, Concord leases five stores, and Rowan/Kannapolis leases four stores.

Operating Revenue - Sales FY 2011



An analysis of the breakdown of retail, mixed beverage, and wine sales of the Rowan/Kannapolis ABC Board

Expense Allocations FY 2011



An analysis of the breakdown of expense allocations of the Rowan/Kannapolis ABC Board. Note: Distributions include local government, law enforcement, and alcohol education.

APPENDIX B



Counter view of the Oak Avenue store.



Incorrect shelf price on 49-716. (Rockwell location)



Incorrect shelf price on 42-977. (Ketner location.)



Incorrect shelf price on 46-622(Gateway location)

APPENDIX C

(1) NCAC 02R.1706 (b) states "If a local board has a price discrepancy between the price on the shelf or bottle and the cash register, and the price on the shelf or bottle is lower, the local board shall sell the item at the shelf or bottle price and correct the shelf or bottle price to match the Commission's published uniform price."



ROWAN/KANNAPOLIS ALCOHOLIC BEVERAGE CONTROL BOARD

510 NORTH LEE STREET

POST OFFICE BOX 114

SALISBURY, N.C. 28146-0114

Audit Performance Review Committee:

Having received our corrected Performance Audit draft, as General Manager, I would like to provide the State ABC Commission with our response. It is our desire that we can utilize this assessment in the most pro-active manner in carrying out the intent of the Commission to make each of our Boards as efficient as possible, for the good of the system.

During the past decade, Rowan/Kannapolis ABC has been both receptive as well as responsive to any suggestions for change or improvement for our system, brought to our attention by the N.C. ABC Commission; that being said, in retrospect, as a part of our response, I feel it would be of importance to evaluate our performance over the prior ten (10) year history of our organization. In addition, I will emphasize some of the pro-active measures taken by our system.

In 2004-2005 as we evaluated both our short-term goals for internal improvements, to establishing long-term goals of fulfilling our obligations to serve new designated business areas.

Our Board met the challenge of expansion, and after many hours of study and guidance from the Commission, it was suggested that we approach Kannapolis with the "merger" concept. At that point in time, there was great emphasis on limiting the number of systems in the state and our system would become one of the early pilot programs in the state to help accomplish those objectives suggested from the state.

The city of Kannapolis welcomed the merger concept after evaluating their only two (2) options; forming their own system was not an option so the city looked at a second option. Although approximately 80% of the population of Kannapolis was in Cabarrus County they were forced to become a part of the closet county-wide system with Rowan County. This was an obvious opportunity with Rowan adhering to the county-wide requirement and a portion of the population of the Kannapolis population within Rowan. The latter option would meet the desire of the Kannapolis area to be served with ABC stores after the very positive vote to achieve this. Passage of Legislation in 2005 brought Kannapolis officially into the Rowan system and the merged system would be referred to as the Rowan/Kannapolis A.B.C.

Our Board immediately began evaluating potential store locations. Preparation for expansion would bring on the necessity for us to set as our initial action to expand the area of our warehouse. This would include a remodeling concept for the administrative offices which would also add a much needed Board room. An enclosed loading area of 450 square feet was filled and the loading area moved to the outside of the building. This would enable us to have our required space for warehouse and storage as well as

designated law enforcement offices without expanding the outer perimeters of our existing building.

The final phase of the project would bring three (3) new stores into the system. The service area would extend from center city Kannapolis to the Highway 73 border with Mecklenburg County. The Board obtained a \$400 thousand line of credit of a special preferred interest rate which has enabled this system to reach a debt-free status while paying off an existing loan on the N. Cannon Blvd. location in addition to the cost incurred with the opening of three (3) new store locations.

There have also been various operational adjustments internally complementing the goal of improving profitability and operating efficiency. As these changes were being considered, the Commission played an integral part in directing us, as well as assistance from the Employers Association. Many adjustments dealt directly with our personnel such as the adoption of our classification pay plan for all system positions. A revision of the ABC Personnel policy was enacted. There was a revision of employee vacation policy and elimination of accrued vacation.

As we are currently evaluating our lease agreements and operation plans long-term, it is our desire to carry out a calculated study on the performance of existing stores where change may be warranted, just as was done in 2009 with the closing of our Spencer store location due to low profitability.

Current negotiations and dialogue involving the future of our Gateway store location are being evaluated at this time with the expiration of the current lease agreement in December 2012. As of this date, proposals from the current landlord have reduced current payments by approximately 18.5%. Co-operative efforts from both the Landlord as well as the city of Kannapolis have had a positive impact on our business at this location with increased traffic flow from a new entrance to the facility.

Rowan/Kannapolis ABC has maintained due diligence with the primary objective of exercising control aspects of our system which continue to enhance our program with positive feedback. Our system was the lead entity in support of House Bill 1492 which was introduced to suspend the driver's license of adults who are caught unlawfully purchasing or supplying alcohol to underage persons. Written documentation from DISCUS (Distilled Spirits Council of the United States) credits the Rowan/Kannapolis system with the eventual passage of this Bill stating that without our persistence in obtaining support from other systems that this Bill would not have passed.

Our "Control" and educational programs have succeeded due to the co-operative efforts of our system and ALE (Alcohol Law Enforcement) during the transition from in-house law enforcement. Public Service Announcements serve to educate our youth about the dangers of alcohol and promote our programs stemming from our involvement with the Century Council which is an organization committed to fighting drunk driving and underage drinking. Many programs have been presented with the co-operation of school officials in the Rowan/Salisbury system as well as the Kannapolis City School system.

officials in the Rowan/Salisbury system as well as the Kannapolis City School system. Dialogue and planning are currently taking place as we look at new avenues to further our initiatives for our youth.

The "Sold Out" program initiated by Rowan Gabriel III is currently being evaluated as a resource for our middle-school and high-school programs for 2012-2013. Potential financial resources above and beyond the educational requirements mandated by the Commission from ABC profits are being discussed with local business entities, law enforcement and private individuals, to support this endeavor.

Endorsements from our Dist. Attorney's, praise our current ALE enforcement with initiatives such as the "Last Chance" program, BARS, and Key's to Life.

The internal operations have continually demanded communication with Board Members, Managers, store personnel, and administration. Monthly meetings with Managers have served to assist in critical areas such as exploring marketing strategies and product knowledge. All these studies have been invaluable as we have succeeded in reducing our inventory, while balancing the current demands for new product lines.

Employee benefits have been discussed recently and evaluations exist with health insurance, salaries, retirement etc. Salaries of our employees often seem exaggerated due to 60% of our employees who are at least 55 years of age which makes the salary scale "top-heavy"; however, this may be evaluated in a positive manner as it reflects veteran employees who have been loyal to and are of great value to our system. Evidence of this statement is indicative with the fact that we have maintained virtually the same number of full-time employees over a decade of service to the area while increasing the number of stores by two (2).

Board discussion with performance audit personnel emphasize the necessity of appointing a Deputy Finance Officer to assist our Finance Officer with complexities of the requirements established by the state Commission.

In closing, the recent performance audit serves as a positive model in evaluating the infrastructure of our system. We have areas that we certainly can improve on with a co-operative effort from all. The commitment is certainly evident. These findings complement positive evaluation from the Efficiency Committee with the ABC Association as well as the high praise exhibited on our system from the Audit appraisal done in Sept/Oct of 2011. These findings highlighted many of the areas which have been successful due to the vision of the system. Those successes served to lay the foundation for the passage of the first balanced budget in June of 2011.

Our Board Members currently have information gathered in regard to other systems' who have created credit card usage policies as well as vehicle operation policies and shelf price discrepancy policies. These issues will be agenda items for the general Board meeting in May (2012).

The obligation exhibited by the Commission in regard to a Deputy Finance Officer has already been dealt with; the name of the designee has been sent to the financial institution we work with and a formal vote to make this official is pending.

We will commit ourselves to evaluating our areas of success to transmit those concepts into areas that we need to improve which hopefully will reduce operating cost and lend themselves to the potential of greater contributions to our local municipalities.

We accept our challenge from the ABC Commission as we seek to better serve our area while maintaining the priority of the original intent of the state system, as a control operative.

RECEIVED

MAY 04 2012

NC ABC COMMISSION

ROWAN/KANNAPOLIS ALCOHOL BEVERAGE CONTROL BOARD

Recommendation Follow-Up

RECOMMENDATION	REQUIRED BY STATUTE	IMPLEMENTATION STATUS
<p>Store Appearance and Customer Service: **Adopt a written price discrepancy policy.</p>	<p><input type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p> <p>**Note: Required by rule.</p>	<p>(Please provide documentation supporting implementation status.)</p> <p><input type="checkbox"/> Fully Implemented</p> <p><input checked="" type="checkbox"/> Partially implemented 50% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>The board is planning to implement the requested policy. Once adopted, a copy of the policy will be submitted to the Commission.</p>
<p>Policy Compliance and Procedures: Adopt written policies for credit card usage and vehicle usage.</p>	<p><input type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p>	<p>(Please provide documentation supporting implementation status.)</p> <p><input type="checkbox"/> Fully Implemented</p> <p><input checked="" type="checkbox"/> Partially implemented 50% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>The board is planning to implement the requested policies. Once adopted, a copy of the policy will be submitted to the Commission.</p>

ROWAN/KANNAPOLIS ALCOHOL BEVERAGE CONTROL BOARD

Recommendation Follow-Up

RECOMMENDATION	REQUIRED BY STATUTE	IMPLEMENTATION STATUS
<p>Administrative Compliance and Internal Controls: Appoint a deputy finance officer.</p> <p>Audit all shelf tags with registers to ensure accurate pricing.</p>	<p><input checked="" type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p>	<p>(Please provide documentation supporting implementation status.)</p> <p><input checked="" type="checkbox"/> Fully Implemented</p> <p><input type="checkbox"/> Partially implemented __% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>The board has appointed a deputy finance officer and has implemented procedures to ensure accurate pricing between shelf and registers.</p>