STATE OF CONNECTICUT

PERFORMANCE AUDIT REPORT
CONNECTICUT STATE UNIVERSITY SYSTEM
BOOKSTORE CONTRACT REVENUES

AUDITORS OF PUBLIC ACCOUNTS
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EXECUTIVE SUMMARY

In accordance with the provisions of Section 2-90 of the Connecticut General Statutes, we conducted a performance audit of the revenue-related provisions of the Connecticut State University bookstore contracts. Our findings, conclusions and recommendation for improving the contract negotiation process are summarized below.

Each of the four Connecticut State University (CSU) campuses contracts, separately, with a vendor to operate a campus bookstore. The institutions are paid a percentage of gross sales and receive certain ancillary payments as well. Though all four campuses contracted with the same vendor, Barnes & Noble, Inc., the time periods covered and commission payments varied significantly from contract to contract.

To establish a common ground for comparison of the relative benefit afforded CSU by the different contracts, we calculated the commissions that would have been generated under each during a hypothetical five-year period, given a reasonable estimate of the contracting campuses' sales volumes. We projected sales volumes for our hypothetical period by using actual 1998-1999 fiscal year sales at each campus for the first year and applying an inflation factor to that amount to derive the sales for the remainder of the period. We then calculated the present value of the commission revenue stream from each contract per thousand dollars of sales.

We expected our calculations to yield roughly similar ratios for each contract. Though the campuses are geographically separate, they are all located within Connecticut and are quite similar from a functional standpoint. Instead, we found a wide variation among campuses. Our model showed commission revenues per thousand dollars of sales of $68.42 and $79.67, respectively, for Central and Southern, the two larger campuses. Commission revenues per thousand dollars of sales were $109.47 and $111.66, respectively, for Eastern and Western, the two smaller campuses.

We discussed the procedures followed in the contract award process with representatives at each campus. Though some of the details were obscured by the passage of time, and staff attrition, it was evident that each campus had solicited proposals and awarded a contract independently of the others.

Our review indicated that CSU would benefit economically if the negotiation of campus bookstore contracts were to be coordinated centrally. It seems likely that those campuses with lower revenue to sales ratios could have obtained better terms – had they known that better terms were afforded others in similar circumstances.

For example, Central was negotiating a new bookstore contract when we started our review. We made the data we had accumulated at that point available to Central, hoping that it would aid in the negotiation process. It is our understanding that Central's new contract will provide for commission revenues of $109.27 per thousand dollars of sales, a considerable improvement over the former rate of $68.42.

The System Office should compile comparative data regarding financial arrangements entered into by the Connecticut State University campuses and make the compilation available for use as a negotiating tool.

INTRODUCTION

The Connecticut State University is a comprehensive university system incorporating four institutions and a central office. The four institutions are Central Connecticut State University in New Britain, Southern Connecticut State University in New Haven, Eastern Connecticut State University in Willimantic and Western Connecticut State University in Danbury. It operates primarily under the provisions contained in Sections 10a-87 through 10a-101 of the General Statutes and is governed by the Board of Trustees for the Connecticut State University.

Central and Southern are considerably larger than the other two CSU campuses, Eastern and Western. Spring 1999 enrollment totaled 11,285, 10,868, 4,454 and 5,171 for Central, Southern, Eastern and Western, respectively.

The Connecticut State University, as such, was created when Public Act 82-218, which reorganized the State's higher education system, renamed the four State colleges as the Connecticut State University and added provisions concerning trustees' duties regarding Statewide policy and guidelines and budget requests. This legislation continued a trend towards consolidation of the four institutions into a system that started when Public Act 330 of 1965 established the Board of Trustees for the Connecticut State Colleges as an independent governing board (previously, they were governed by the State Board of Education).

Currently, CSU maintains a System Office that centralizes some administrative tasks, most notably collective bargaining and certain aspects of information technology and telecommunication. However, each campus maintains an autonomous management group and carries out most functions independently. Though there has been a gradual movement towards partial integration, CSU has a "corporate culture" that values autonomy and self-determination.

Each of the four CSU campuses contracts with a vendor to operate a campus bookstore. The institutions are paid a percentage of gross sales and receive certain ancillary payments as well. These payments, the percentage paid on gross sales and any ancillary payments, are referred to, collectively, as "commission revenues" in this report. Though all four campuses contracted with the same vendor, Barnes & Noble, Inc., the amounts to be paid varied significantly from contract to contract.

Central's contract was effective January 1971. It was extended for set periods several times and, finally, extended on a continuing basis in May 1998. The institution's commission remained basically the same during the life of the contract. Southern's contract covered the period from May 1996 through April 2001, Eastern's from July 1999 through June 2004 and Western's from July 1999 through June 2004.

We discussed the procedures followed in the contract award process with representatives at each campus. Though some of the details were obscured by the passage of time, and staff attrition, it was evident that that each campus had solicited proposals and awarded a contract independently of the others.

Though the four campuses are geographically separate, they are all located within Connecticut and are quite similar from a functional standpoint. Other provisions of the contract (student buyback policies, etc.) could have an effect on the commission structure. However, absent such factors, a significant difference in commissions paid might well indicate an opportunity to enhance campus revenues. Therefore, we decided to compare the amounts afforded the CSU campuses by the four contracts to determine if such an opportunity existed.

AUDIT OBJECTIVE, SCOPE AND METHODOLGY

The Auditors of Public Accounts, in accordance with Section 2-90 of the Connecticut General Statutes, are responsible for examining the performance of State entities to determine their effectiveness in achieving expressed legislative purposes. We conducted a performance audit of the revenue-related provisions of the CSU contracts for the operation of the four campus bookstores. This audit was conducted in accordance with Generally Accepted Government Auditing Standards, and covered economy, efficiency and effectiveness issues, all of which are types of performance audits.

Each of the four CSU campuses solicited proposals and awarded a contract independently of the others. Given the many similarities among the campuses, we felt that a significant disparity in contract terms not readily attributable to economic forces might well indicate an opportunity to enhance revenues. Our objective was to determine if such an opportunity existed. Our review was narrow in focus and limited to this one aspect of CSU operations.

Bookstore sales volume differs significantly between the larger and smaller CSU campuses. The contracts cover different time periods and vary significantly in terms of commission structure. Gross sales during the 1998-1999 fiscal year were $3,294,188, $4,101,689, $1,885,378 and $1,848,961 for Central, Southern, Eastern and Western, respectively. Accordingly, a simple comparison of commission revenues actually received would have little meaning.

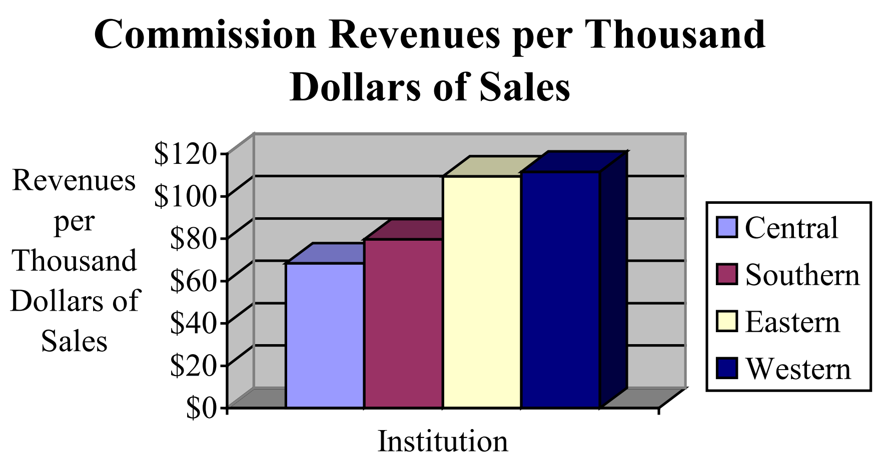
To establish a common ground for comparison of the relative values afforded by the different contracts, we calculated the commissions that would have been generated under each, given a reasonable estimate of the contracting campuses' sales volumes. We projected sales volumes for our hypothetical period by using actual 1998-1999 fiscal year sales at each campus for the first year and applying an inflation factor to that amount to derive the sales for the remainder of the period. We then calculated the present value of the commission revenue stream from each contract per thousand dollars of sales.

We used an inflation factor of 2.4 percent, the compound annual rate for the three months ended August 1999 (seasonally adjusted) from the Consumer Price Index for All Urban Consumers (CPI-U). We discounted projected future revenues at 5.36 percent, the August 1999 monthly effective yield of the State's Short Term Investment Fund (STIF).

Though we used actual 1998-1999 sales as a starting point, our analysis does not provide an estimate of commission revenues collected during a five-year period beginning with the 1998-1999 year. We were forced to base our comparison on a hypothetical, rather than actual five-year period, as the four contracts did not cover the same time period. We used actual sales data of a recent, arbitrarily selected year (1998-1999) for the base year of our hypothetical period so that our test data would accurately reflect the relative and absolute sales volume for the four institutions.

RESULTS OF REVIEW

We found that the revenues generated under the four CSU bookstore contracts varied significantly. The smaller campuses earned significantly higher commissions. Our model showed commission revenues per thousand dollars of sales of $68.42 and $79.67, respectively, for Central and Southern, the two larger campuses. Commission revenues per thousand dollars of sales were $109.47 and $111.66, respectively, for Eastern and Western, the two smaller campuses.

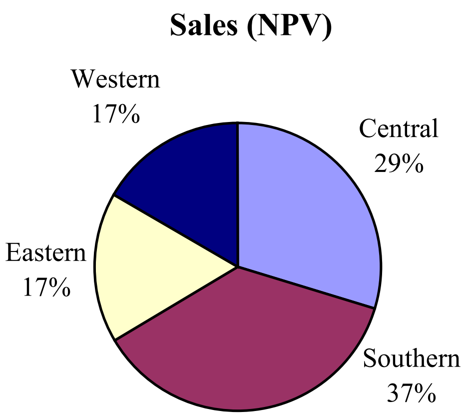


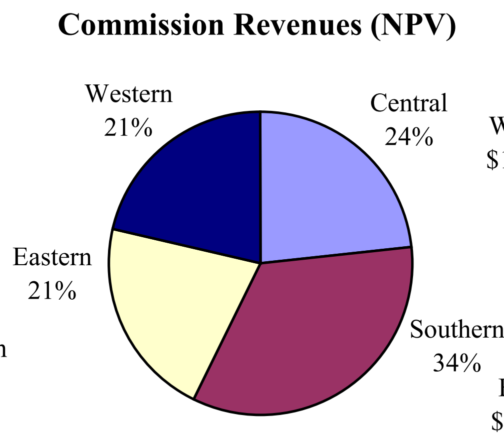
As discussed in more detail in the Audit Objective, Scope and Methodology section of this report, we calculated the commissions that would have been generated under each contract during a hypothetical five-year period, given a reasonable estimate of the contracting campuses' sales volumes. We used actual sales data of a recent, arbitrarily selected year (1998-1999) for the base year of our hypothetical period so that our test data would accurately reflect the relative and absolute sales volume for the four institutions.

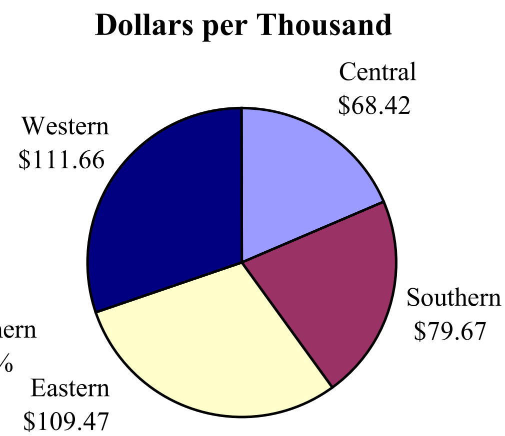
Gross sales during the 1998-1999 fiscal year were $3,294,188, $4,101,689, $1,885,378 and $1,848,961 for Central, Southern, Eastern and Western, respectively. We assumed that sales would increase by 2.4 percent (the August 1999 CPI-U) annually during the next four years and that sales and commission revenues should both be discounted at 5.36 percent (the August 1999 STIF rate). The following table shows the net present value of sales and commission revenues by institution under these assumptions and the resulting amount of commission revenues per thousand dollars of sales.

Institution	Sales (NPV)	Commission Revenues(NPV)	Dollars per Thousand
Central	$15,180,642	$1,038,629	$68.42
Southern	18,878,044	1,503,999	79.67
Eastern	8,677,810	949,989	109.47
Western	8,528,984	952,376	111.66

Though Western accounted for only 17 percent of sales it received 21 percent of total commission revenues, earning $111.66 per thousand dollars of sales. Eastern with approximately the same level of sales as Western, received slightly less in commission revenues. Southern, with the highest level of sales and a better commission structure than Central, received 34 percent of total commission revenues. Central accounted for 29 percent of sales but received only 24 percent of total commission revenues, earning $68.42 per thousand dollars of sales.







These disparities did not seem to be a result of economic forces. Considering the benefits of economies of scale, which should allow vendors to provide more favorable terms for larger operations, we would not have been surprised to see slightly better ratios at the larger campuses. However, as noted above, we found much higher ratios at the smaller campuses.

Significant differences in other provisions of the contract (student buyback policies, etc.) could certainly have an effect on the commission structure. For example, when Southern's bookstore operation was privatized, the vendor agreed to retain the existing bookstore employees – allowing them to remain State employees and reimbursing the State for the personal service costs incurred. We were informed that there are currently (May 2001) three such employees working at the bookstore. It is our understanding that, while their salaries are comparable to those of similar employees paid directly by the vendor, related State fringe benefit assessments are higher than the equivalent private sector costs. The vendor would undoubtedly have taken this cost into consideration when negotiating commission rates. However, while they undoubtedly had some effect, the disparities we noted did not appear attributable to such differences.

A rational vendor would not enter into an unprofitable contract; the more generous terms must be viable from a business standpoint. It seems likely that those campuses with lower revenue to sales ratios could have obtained better terms – had they known that better terms were afforded others in similar circumstances.

For example, Central was negotiating a new bookstore contract when we started our review. We made the data we had accumulated at that point available to Central, hoping that it would aid in the negotiation process. It is our understanding that Central's new contract will provide for revenues per thousand dollars of sales of $109.27, a considerable improvement over the former rate of $68.42. Under the assumptions we used in our comparison, Central would receive commission revenues of $1,658,782 on sales of $15,180,642, an increase of $620,153 over the five-year period.

Southern's contract period ended April 2001. The institution extended the contract on an interim basis pending the completion of its new student center. It intends to solicit proposals for a new bookstore contract next year, when construction has been completed. Southern has reviewed the contract terms afforded the other CSU campuses and will take them into consideration when the new contract is negotiated.

Though our audit was limited to a comparison of bookstore contracts, parallel disparities may well exist with respect to other financial arrangements, such as contracts for cafeteria operations, vending machines, bank teller machines, duplication services, soft drink arrangements, laundry operations, etc., entered into by the CSU Campuses. They should be reviewed to determine if similar opportunities to enhance revenues or reduce costs can be identified.

The System Office should compile comparative data regarding financial arrangements entered into by the CSU campuses and make the compilation available for use as a negotiating tool. (See Recommendation 1.)

Connecticut State University's Response:

"We agree with this recommendation. The universities and the System Office are primarily responsible for individually negotiating contracts with respect to their own activities. However, when similar financial arrangements are undertaken separately by two or more of the universities, it would be appropriate for the System Office to compile comparative data regarding these arrangements and provide them to the universities, for use as a negotiating tool. It is important to point out, however, that the value of contracts for financial arrangements, such as Bookstore contracts, is not necessarily measured purely on the basis of commission revenue alone. There are other, less tangible elements that need to be considered when negotiating such a contract, such as service, responsiveness, and willingness to provide moderate-to-larger-scale site renovations at the vendor's own cost. All of these types of elements, which are difficult to measure as monetary revenue, can add significant value to a contract."

Auditors' Concluding Comments:

We acknowledge that other contractual elements can add significant value to an agreement of this nature. Accepting lower commission revenues in instances where a vendor agrees to provide other services of equal or greater value could certainly be to an institution's overall advantage. However, as we noted in the Results of Review section of this report, while they undoubtedly had some effect, the disparities between contract commission revenues did not appear attributable to such differences.

RECOMMENDATION

1. **The System Office should compile comparative data regarding financial arrangements entered into by the Connecticut State University campuses and make the compilation available for use as a negotiating tool.**

Comment:

We found significant disparities between the commissions provided under the four campus bookstore contracts, disparities that could not be readily attributed to economic forces. It seems likely that those campuses with lower revenue to sales ratios could have obtained better terms – had they known that better terms were afforded others in similar circumstances. Though our audit was limited to a comparison of bookstore contracts, parallel disparities may well exist with respect to other financial arrangements entered into by the CSU Campuses. They should be reviewed to determine if similar opportunities to enhance revenues or reduce costs can be identified.

CONCLUSION

We wish to express our appreciation to the staff of the Connecticut State University for the cooperation and courtesies extended to our representatives during this examination.

James K. Carroll
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