7-ELEVEN, INC.

User Guide

Audit Inventory Overages

ACCOUNTING PRACTICES FOR AUDIT INVENTORY OVERAGES

One of the realities of operating a retail business is that inventory shortages do occur. However, inventory overages are an accounting, and operational, fiction that cannot occur absent some type of reporting discrepancy. Starting in January 2010, SEI changed our accounting practices for booking in YTD Audit Overages.

Old Accounting Overage Process (Prior to January 2010):

1. An entry that corrects recorded inventory values / retail on the Merchandise Report
2. An entry that removes the cost value of the overage from gross profit (account 570 charge) and credits Inventory Variation (account 640) in selling expenses.
   - When we adjust account 570, the store's cost of goods increases, causing the store's gross profit to decrease. Since SEI and FZ split GP$, overages would cause SEI to lose GP$ since GP$ would decrease.
   - The account 640 Inventory Variation credit would get 100% allotted to the FZ's bottom line.

This has not changed. Stores will still see inventory variation (shortages or overages) reflected in accounts 570 and 640 on their monthly financial statements.

New Process:

Beginning with audit results in 2010, **any store that has a YTD net retail overage for an audit period during the Calendar year**, taking into account audit shortage results and corrections, **will have an additional adjustment recorded that will reverse and zero out the net overage by crediting cost of goods (account 575) and charging Selling Expenses (account 645).**

Thus, with this new process, *in addition to what is currently shown* in accounts 570 and 640, when a FZ has an audit that results in a YTD overage, there will be additional entries in two new accounts (575 – cost of goods and 645 – selling expenses). The adjustment will take place the accounting month after the audit variance causes the store to have a YTD overage.

When a store is over YTD in a calendar year, the audit overage will show in 4 lines in the store's Financial Statement (see breakdown below):

Merchandise Product Cost of Sales (Adjusts cost of sales and GP to split with SEI)

1. Account 570 – Inventory Variation
   - If a store had an audit overage, account 570 will remove the cost value of the overage from GP. Cost of sales will increase and GP will decrease.
2. Account 575 – Inventory Variation (Overage Adjustment)
   - If the store has an audit overage YTD for the current Calendar Year, account 575 will reverse and zero out the net overage by crediting the cost of goods here. (GP will now be higher for both SEI and FZ when a store has a YTD overage).

Cash & Inventory Variation (Selling Expense Line that FZs don't split with SEI)

1. Account 640 – Inventory Variation
   - The account 640 Inventory Variation credit would get 100% allotted to the FZ's bottom line.
2. Account 645 – Inventory Variation – Overage Adjustment
   - If the store has an audit overage YTD for the current Calendar Year, account 645 will have a charge reflecting the YTD audit overage amount, charging this account in Selling Expenses

If a subsequent audit during the Calendar Year results in a shortage, an additional adjustment will be recorded to "give back" any previous overage adjustment made in the Calendar Year up to the level of the shortage or amount of prior overage adjustments in the year, with the result that the YTD effect of physical audit results during a Calendar year may not result in a net retail overage for the year.

Application: Actual FZ Financial (48A) Example:

RODID: 48A 0020007 MAY-11JUN-11
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7-ELEVEN FRANCHISE SYSTEM
(CONTAINS ONLY 7-ELEVEN SYSTEM ACTIVITY)

Page: 1
SLC CONSOLIDATED REPORTS

FINANCIAL SUMMARY
AS OF MAY-11

[redacted]

INCOME/(EXPENSE) DATA:	MONTH ENDING MAY-10	MONTH ENDING MAY-11	YTD ENDING MAY-10	YTD ENDING MAY-11
TOTAL SALES	135,425.24	123,592.40	612,279.53	569,299.98
MERCHANDISE GROSS PROFIT	51,582.29	44,975.68	235,723.40	206,793.42
Merchandise GP Percent	39.44 %	37.75 %	39.86 %	37.71 %
COMMISSIONS/FEES GROSS PFT	4,631.24	4,448.74	20,860.34	20,908.20
TOTAL GROSS PROFIT	56,213.53	49,424.42	256,583.74	227,701.62
Total Gross Profit Percent	41.51 %	39.99 %	41.91 %	40.00 %
7-ELEVEN CHARGE	(28,781.33)	(25,107.61)	(131,464.39)	(115,804.22)
7-Eleven Split Percent	(51.20)%	(50.80)%	(51.24)%	(50.86)%
ALL OTHER INCOME	14.08	0.00	192.16	39.71
TOTAL GROSS INCOME	27,446.28	24,316.81	125,311.51	111,937.11
COMPENSATION & BENEFITS	(15,317.24)	(12,345.84)	(68,752.61)	(60,055.49)
MAINTENANCE	[illegible]	[illegible]	[illegible]	[illegible]
CASH & INVENTORY VARIATION	(1,811.52)	2,174.[illegible]5	(2,871.91)	(3,812.38)
ADVERTISING	[illegible]	[illegible]	[illegible]	[illegible]
ALL OTHER SELLING EXPENSES	(1,375.65)	(2,341.[illegible]9)	(6,674.72)	(8,921.10)
TOTAL SELLING EXPENSES	(21,081.40)	(14,435.[illegible]6)	(87,832.95)	(83,392.93)
TOTAL GENERAL & ADMIN EXPENSES	(4,456.60)	(4,429.[illegible]6)	(21,787.64)	(21,860.09)
TOTAL INCOME / (EXPENSE)	1,908.28	5,451.[illegible]9	15,690.92	6,684.09
Percent to total sales	1.41 %	4.[illegible]1 %	2.56 %	1.17 %

Store had an audit overage in May 2011

Despite audit overage in May, store is still short YTD

OPEN ACCOUNT & NET WORTH DATA:

	[illegible]NTH MAY-11	[illegible]
OPEN ACCT WITH 7-ELEVEN / TSC		
BEGINNING OF PERIOD NET WORTH	9,685.61	13,596.72
TOTAL INCOME / (EXPENSE)	5,451.69	6,684.09
PAID-IN CAPITAL	400.00	8,856.49
WEEKLY DRAW	(4,000.00)	(17,600.00)
MONTHLY/QUARTERLY/EXCESS DRAWS	0.00	0.00
ALL OTHER MISCELLANEOUS DRAWS	0.00	0.00
TOTAL NET WORTH	11,537.30	11,537.30
MINIMUM NET WORTH		(10,000.00)
AMOUNT OVER/(UNDER)MINIMUM NET WORTH		1,537.30

RODID: 48A 0020007 MAY-11JUN-11 — 7-ELEVEN FRANCHISE SYSTEM — Page: 1
RUN DATE: 08-JUN-11 1:04 PM — (CONTAINS ONLY 7-ELEVEN SYSTEM ACTIVITY) — SLC CONSOLIDATED REPORTS
REPORTID: CFO48A

INCOME / (EXPENSE)
AS OF MAY-11

[redacted]

	MONTH MAY-10	%	MONTH MAY-11	%	YEAR TO DATE MAY-10	%	YEAR TO DATE MAY-11	%
TOTAL SALES								
MERCHANDISE PRODUCT SALES								
Acct 00410 MERCHANDISE SALES	130,794.00	96.6%	119,143.66	96.4%	591,419.19	96.6%	548,391.78	96.3%
MERCHANDISE PRODUCT SALES	130,794.00	96.6%	119,143.66	96.4%	591,419.19	96.6%	548,391.78	96.3%
COMMISSIONS/FEES								
Acct 00422 MONEY ORDER COMM/FEES	302.00	0.2%	276.00	0.2%	1,422.00	0.2%	1,366.00	0.2%
Acct 00424 ATM COMM/FEES	158.30	0.1%	158.56	0.1%	791.50	0.1%	792.81	0.1%
Acct 00426 POSTAL COMM/FEES	0.00	0.0%	0.00	0.0%	5.40	0.0%	0.00	0.0%
Acct 00440 LOTTO/LOTTERY COMM/FEES	2,321.31	1.7%	2,243.75	1.8%	9,940.63	1.6%	10,906.71	1.9%
Acct 00442 ONLINE GAMING COMM/FEES	0.00	0.0%	3.00	0.0%	0.00	0.0%	7.50	0.0%
Acct 00445 STORED VALUE CARD COMM SALES	237.41	0.2%	258.76	0.2%	833.71	0.1%	1,114.40	0.2%
Acct 00446 VCOM ATM FEES	706.82	0.5%	709.41	0.6%	3,643.70	0.6%	3,181.82	0.6%
Acct 00447 VCOM ADVANCED FUNCTIONALITY F	9.60	0.0%	21.00	0.0%	47.60	0.0%	80.80	0.0%
Acct 00448 PPD CARDS COMM/FEE SALES	895.80	0.7%	778.26	0.6%	4,175.80	0.7%	3,458.16	0.6%
COMMISSIONS/FEES	4,631.24	3.4%	4,448.74	3.6%	20,860.34	3.4%	20,908.20	3.7%
TOTAL SALES	135,425.24	100.0%	123,592.40	100.0%	612,279.53	100.0%	569,299.98	100.0%
MDSE PRODUCT COST OF SALES								
Acct 00530 MERCHANDISE COST OF SALES	(78,647.35)	-58.1%	(70,875.41)	-57.3%	(352,718.89)	-57.6%	(338,968.57)	-59.5%
Acct 00550 MERCHANDISE DISCOUNTS	38.95	0.0%	59.01	0.0%	150.52	0.0%	150.89	0.0%
Acct 00560 MERCHANDISE WRITE OFFS	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Acct 00570 INVENTORY VARIATION	42.47	0.0%	(2,077.10)	[illegible]	(415.02)	-0.1%	2,647.64	0.5%
Acct 00575 INV VAR - OVERAGE ADJ	0.00	0.0%	0.00	0.0%	457.49	0.1%	0.00	0.0%
MDSE PRODUCT COST OF SALES	(79,211.71)	-58.5%	(74,167.98)	-60.0%	(3[illegible]5,695.79)	-58.1%	(341,598.36)	-60.0%
GROSS PROFIT:								
MERCHANDISE PRODUCT GROSS PROFIT	51,582.29	39.4%	44,975.68	37.7%	2[illegible]5,723.40	39.9%	206,793.42	37.7%
COMMISSIONS/FEES GROSS PROFIT	4,631.24	100.0%	4,448.74	100.0%	[illegible]0,860.34	100.0%	20,908.20	100.0%

Merchandise Product Cost of Sales Accounts (Affects GP, Split with SEI) – Adjusts cost of goods & GP$ for audit variations.
If a store has an audit shortage, COG decreases & GP$ increases.
If a store has an audit overage, COG increases & GP$ decreases.
If a store has an audit overage YTD, account 575 will adjust COG to zero out the YTD overage and GP$ will decrease.

**Since this store had an audit overage of $2,077, we removed the cost value of the overage from gross profits by debiting $2,077 from account 570.

REPORTID: CP048A

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INCOME / (EXPENSE)
AS OF MAY-11

	MONTH				YEAR TO DATE			
	MAY-10		MAY-11		MAY-10		MAY-11	
Acct 00620 P/R TAXES-FICA/MEDICARE	(852.15)	-0.6%	(828.50)	-0.7%	(4,047.71)	-0.7%	(3,975.48)	-0.7%
Acct 00621 P/R TAXES-UNEMPLOYMENT	(39.15)	0.0%	(270.90)	-0.2%	(1,377.41)	-0.2%	(1,708.66)	-0.3%
Acct 00820 WORKERS COMP INS EXP	(1,005.00)	-0.7%	(416.00)	-0.3%	(5,586.00)	-0.9%	(2,404.00)	-0.4%
Acct 00850 EMPLOYEE GROUP INSURANCE	(2,282.00)	-1.7%	0.00	0.0%	(4,830.22)	-0.8%	0.00	0.0%
COMPENSATION & BENEFITS	(15,317.24)	-11.3%	(12,345.84)	-10.0%	(68,752.61)	-11.2%	(60,055.49)	-10.5%
MAINTENANCE								
Acct 00670 MAINT CONTR - OTHER	(67.45)	0.0%	(62.56)	-0.1%	(337.25)	-0.1%	(320.80)	-0.1%
Acct 00671 MAINT CONTR - REFRIGERATION	(230.00)	-0.2%	(230.00)	-0.2%	(1,150.00)	-0.2%	(1,150.00)	-0.2%
Acct 00672 MAINT CONTR - SLURPEE	(243.00)	-0.2%	(243.00)	-0.2%	(1,215.00)	-0.2%	(1,215.00)	-0.2%
Acct 00673 MAINT CONTR - FOUNTAIN	(88.50)	-0.1%	(88.50)	-0.1%	(442.50)	-0.1%	(442.50)	-0.1%
Acct 00674 MAINT CONTR - SECURITY	(35.00)	0.0%	(35.00)	0.0%	(175.00)	0.0%	(175.00)	0.0%
Acct 00675 MAINT CONTR - CASH REGISTERS	(137.84)	-0.1%	(138.15)	-0.1%	(689.20)	-0.1%	(690.75)	-0.1%
Acct 00676 MAINT CONTR - OVEN/GRILL	(50.00)	0.0%	(50.00)	0.0%	(250.00)	0.0%	(150.00)	0.0%
Acct 00677 MAINT CONTR - COFFEE/CAPPUCIN	(113.00)	-0.1%	(94.00)	-0.1%	(556.00)	-0.1%	(506.00)	-0.1%
Acct 00680 MAINTENANCE NONCONTRACT	0.00	0.0%	0.00	0.0%	0.00	0.0%	(464.99)	-0.1%
Acct 00690 MAINTENANCE BUILDING	0.00	0.0%	0.00	0.0%	0.00	0.0%	(681.05)	-0.1%
Acct 00700 MAINTENANCE OUTSIDE PREMISES	(70.00)	-0.1%	(140.00)	-0.1%	(375.00)	-0.1%	(465.00)	-0.1%
Acct 00701 COMMON AREA MAINT (CAM) EXP	(99.00)	-0.1%	(99.00)	-0.1%	(495.00)	-0.1%	(927.34)	-0.2%
MAINTENANCE	(1,133.79)	-0.8%	(1,180.21)	-1.0%	(5,684.95)	-0.9%	(7,188.43)	-1.3%
CASH & INVENTORY VARIATION								
Acct 00640 INVENTORY VARIATION	(42.47)	0.0%	2,077.10	1.7%	415.02	0.1%	(2,647.64)	-0.5%
Acct 00641 INV VARIATION-LOTTERY TICKETS	(1,516.22)	-1.1%	281.06	0.2%	(1,508.70)	-0.2%	(0.94)	0.0%
Acct 00645 INV VAR - OVERAGE ADJ	0.00	0.0%	0.00	0.0%	(457.49)	-0.1%	0.00	0.0%
Acct 00720 CASH VARIATION	(252.83)	-0.2%	(184.01)	-0.1%	(1,068.74)	-0.2%	(1,118.80)	-0.2%
Acct 00721 LOTTO LOTTERY RPTG VARIATION	0.00	0.0%	0.00	0.0%	(252.00)	0.0%	(45.00)	0.0%
CASH & INVENTORY VARIATION	(1,811.52)	-1.3%	2,174.15	1.8%	(2,871.91)	-0.5%	(3,812.38)	-0.7%
ADVERTISING								
Acct 00801 ADVERTISING FEE	(843.20)	-0.6%	(741.37)	-0.6%	(3,848.76)	-0.6%	(3,415.53)	-0.6%

Cash & Inventory Variation (Selling Expense Line, 100% to FZ) –
If a store had an overage, account 640 will get credited the amount of the Inventory Variation.
If a store has a YTD audit overage, account 645 will have an Overage Adjustment, charging this selling expense account by the amount of the YTD audit overage.

Though this store had an audit overage, this overage didn't cause them to be over YTD in 2011. Thus, they do not have an overage adjustment in Account 645.

FREQUENTLY ASKED QUESTIONS

What are the major causes of inventory overages?

Inventory overages occur when your book inventory (as reflected in your merchandise report) is incorrectly reduced or not increased when it should be. Major causes of overages are:

- Excessive write offs
- Excessive markdowns
- Unreported or under reported markups
- Unreported purchases
- Inaccurate retail prices (reported retail is less than actual retail selling price; factored invoices may have this issue)
- Unreported or under reported retail price changes

What if I believe there was a discrepancy in the audit count after the auditor has left the store or I have an audit variation that "bounces"?

Each audit stands on its own. It is imperative that each Franchisee is engaged in the inventory audit process, verifying the physical count with the auditor before the auditor leaves the store. Franchisees should not sign off on a physical inventory count until satisfied with its accuracy and ensure that all BI (before inventory) and AI (after inventory) transactions are properly identified.

How do I request a re-audit?

A store can always request a re-audit by contacting the audit schedule coordinator listed on each store's original audit notification email.

What are best practices to ensure that I have an accurate audit count?

Be present at the audit and check the auditor's count for accuracy. Prepare for your audit by organizing your back stock and inventory. Communicate with the auditor if you have questions or concerns.