California State Auditor

BUREAU OF STATE AUDITS

Department of Rehabilitation:

Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind

September 2002

2002-031

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CALIFORNIA STATE AUDITOR

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September 12, 2002 2002-031

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Section 19640.5 of the California Welfare and Institutions Code, the Bureau of State Audits presents its audit report concerning the Department of Rehabilitation's (department) Business Enterprise Program for the Blind (program).

This report concludes that the department's delays in addressing known problems have hampered its ability to provide blind persons with meaningful business opportunities that allow them to be independent. In recent years, the department has achieved only a limited level of success in terms of program participation and operator income. In fiscal year 2000–01, more than half the blind operators earned less than $2,500 per month, the program's minimum for opening a new vending location, and almost a third of the operators earned less than what a person could earn working full time at California's 2001 minimum wage. In a step forward, the department recently completed its first strategic plan for the program, but the plan lacks defined outcomes and important performance measures. In contrast, after more than seven years of work, the department has yet to update its regulations for administration of the program, which may lead to disparate service delivery. Lacking guidelines, the department has not ensured that partnerships between blind operators and private food-service companies are consistent with federal law and pay their fair share of program costs. Finally, the department has neither adequately addressed significant flaws in its process for collecting past-due commissions from private vending businesses nor consistently fulfilled its responsibilities to program participants by providing adequate consulting and monitoring services.

Respectfully submitted,

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SUMMARY

Audit Highlights . . .

Our review of the Department of Rehabilitation's (department) administration of the Business Enterprise Program for the Blind (program) reveals that:

- ☑ ***Program participants' (operators) average net income has increased, but 30 percent of them still earned less than minimum wage in fiscal year 2000–01.***
- ☑ ***In May 2002 the department completed its first strategic plan for the program; however, the plan lacks defined outcomes and important performance measures.***
- ☑ ***Although the department has been working for more than seven years to update its regulations, it has yet to do so.***
- ☑ ***The department has not ensured that partnerships between operators and private food-service businesses are consistent with federal law and pay their fair share of program costs.***
- ☑ ***Since August 1998 the department has not actively pursued the collection of past-due vending machine commissions from private companies.***

continued on next page

The Department of Rehabilitation (department) administers the Business Enterprise Program for the Blind (program) in accordance with the federal Randolph-Sheppard Act and the California Welfare and Institutions Code. The goals of the program are to provide blind persons with remunerative employment, enlarge the economic opportunities of the blind, and to stimulate the blind to greater efforts in striving to make themselves self-supporting. To accomplish these goals, the program provides food-service facilities and training to qualified blind persons throughout the State, enabling them to operate their own food-service businesses, including cafeterias, snack bars, wet and dry vending stands, and vending machines. However, we found that the department's delay in correcting known program weaknesses has hampered its ability to provide blind persons with meaningful business opportunities that allow them to be independent.

In recent years, the department has achieved only a limited level of success in terms of program participation and income for blind operators of food-service facilities (operators). Specifically, the number of new participants has declined recently, falling from 16 in federal fiscal year 1997–98 to 7 in federal fiscal year 2000–01. Of the 7 participants who completed training in federal fiscal year 2000–01, only 3 obtained food-service facilities. Further, in fiscal year 2000–01, more than 50 percent of operators earned less than $2,500 per month, the program's minimum for opening a new location, and nearly 30 percent earned less than $1,050, about what a person could earn working full time at California's 2001 minimum wage. Nonetheless, because a small number of operators have been quite successful, the average net income earned in federal fiscal year 1999–2000 by California's operators was slightly higher than the national average, totaling about $34,300 a year.

The problems the program has faced may in part arise from the department's delays in correcting weaknesses that previous audits identified. These weaknesses included the need for a strategic plan and the need to update the regulatory guidelines that govern the program. The department has only recently developed its first strategic plan, which represents a significant step forward. However, the plan lacks defined outcomes and

☑ *The program does not adequately monitor operators or provide them with all required consulting services.*

important performance measures that would enable the department to track whether it achieves its objectives. In addition, after more than seven years of work, the department has yet to update its regulations. Consequently, the program lacks clear guidelines for basic and critical tasks such as purchasing equipment, which may lead to a disparate delivery of its services. The department has no clear time frames or deadlines for completing the regulations, and the reasons it offers for not having done so lack substance.

One of the key areas in which the department requires immediate guidance concerns partnerships between program participants and private food-service businesses. To make its cafeterias more profitable, the department has pursued these private partnerships, which ideally would serve as transitional situations during which the operator would receive training from the private partner. However, in practice the partnerships have resulted in operators essentially contracting out some of their program benefits to private businesses for set monthly fees in what appears to be an action inconsistent with the content of the federal law. Moreover, the department has effectively relinquished the ability to monitor the financial information for these facilities. As a result, it cannot ensure it collects the full fees that it would normally collect from the facilities, which in effect means that other operators are paying an inequitable share of program costs.

Other weaknesses in the department's administration of the program have impeded its success and that of its participants. Since August 1998 the department has not actively pursued the collection of past-due commissions owed to the program by private vending machine businesses. Because of the department's delay, some of these funds may now be uncollectible, which effectively reduces the money available to fund the operators' retirement plan. Further, the department has not ensured that the program provides required consulting services and upward mobility training to its operators, nor has it adequately monitored the operators so it might intervene and assist in resolving financial or operational problems.

RECOMMENDATIONS

To improve the effectiveness of the program, the department should ensure that it dedicates the proper level of attention and resources to correcting the program's known weaknesses. Specifically, the department should take the following actions:

- Revise the program's strategic plan to include expected outcomes and performance measures so it can evaluate the program's success and measure its progress in achieving strategic goals and improving noted deficiencies.

- Ensure that the program promptly and aggressively pursues the development of program guidelines, including regulations, so the department staff equitably provide services to participants and better enable participants to succeed in the program.

- Establish and follow guidelines for operator partnerships to ensure that the partnerships are in agreement with federal and state law, regulations, and guidance. The guidelines should also require that the program properly administer and monitor the partnerships to ensure that they enhance, not drain, program resources.

- Aggressively pursue collection of commissions owed to the program by private businesses operating vending machines at federal or state facilities.

- Ensure that the program provides adequate consulting, monitoring, and upward mobility training services to the operators.

AGENCY COMMENTS

The department generally agrees with our recommendations and states that it will continue its efforts to improve the program. However, it strongly disagrees with some of the statements and conclusions contained in the report concerning management and the operation of the program. Our comments on the department's response immediately follow it. ■

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INTRODUCTION

BACKGROUND

In accordance with the federal Randolph-Sheppard Act and the California Welfare and Institutions Code, the Department of Rehabilitation (department) is responsible for administering the Business Enterprise Program for the Blind (program). The goals of the program are to provide blind persons with remunerative employment, enlarge their economic opportunities, and stimulate them to greater efforts in striving to make themselves self-supporting. To meet these goals, the program trains qualified blind persons to operate their own food-service businesses and provides them with food-service facilities located in government buildings throughout the State. Between October 2000 and September 2001, the program served 168 blind operators of food-service facilities (operators).

A blind person interested in receiving vocational services can submit an application to the department. By reviewing the application and conducting an interview, a department counselor assesses the applicant's interest and suitability for the program. The department provides a comprehensive six-month course in food service for individuals entering the program and licensing for those who successfully complete the training. A licensee can then apply to operate one of the department's established food-service facilities, which include cafeterias, snack bars, wet and dry vending stands, and vending machines. After a program-appointed committee selects the licensee for assignment to a facility, the department provides continued support through consulting services and by procuring and repairing necessary vending equipment. The operators earn income from the successful operation of their assigned facilities, and by participating in the program, they receive valuable health, life, dental, and retirement benefits.

Because program participants receive preference for providing food services in state and federal buildings in California, any state or federal department interested in obtaining food services must submit a request to the program. The program then evaluates the location's potential to support an operator, and if it finds the location suitable, the program determines the type

of food-service facility it will provide, organizes selection of the operator, and acts as the operator's advocate with the tenant of the building who requested food service.

To support its activities, the program receives funds from the federal government, the State's General Fund, operator fees, and commissions from private vending machine businesses. The federal government pays approximately 80 percent of costs allowed under its guidelines, which include the purchase of new and replacement equipment, the provision of initial stock and supplies for facilities, the salaries of the program's personnel, and certain other administrative expenditures. Depending on the nature of the expense, the remaining 20 percent is provided either by the General Fund or by set-aside fees, which are funds paid by the operators to the department from the net proceeds of facility operations. Even when locations are not operated by a blind operator, the program receives commissions from private businesses that operate vending machines on state and federal properties within California. The program disburses the commissions either to the operators' retirement plan or to the program participants who run the sites where the privately owned vending machines are located.

PROGRAM ADMINISTRATION

The department administers the program through the supervision of a deputy director and a program manager. For fiscal year 2000–01, the program had nearly 35 authorized staff positions. Staff are located in a central office and four regional, or field, offices. Seventeen of these positions are business enterprise consultants (consultants) who provide operators with consultation services and assistance to support the operation of their facilities. In addition, the program receives services from several departmental units outside the program, including accounting services, legal counsel, and the collection of commissions from private vending machine businesses operating in state and federal locations.

The operators have a voice in the program's administration. In accordance with federal regulations, the department established the California Vendors Policy Committee (committee) to represent the operators. The duties of the committee include actively working with the department to determine major policy and assist in program decisions, receiving and transmitting

operators' grievances to the department, and developing operator-training programs. Operators within the program elect the members of the committee biennially.

PAST AUDITS OF THE PROGRAM

During the past 11 years, the program has been the subject of five reviews by the Bureau of State Audits (bureau) and three reviews or evaluations by other entities. These other reviews include a 1991 study by the University of California at Davis, a 1993 study by a consultant, and a 2000 internal review. The program acknowledges that many of these evaluations noted the same weaknesses. Appendix A summarizes the department's reported progress on the recommendations from the bureau's most recent programmatic and fiscal reviews.

Bureau of State Audits' Reviews Reveal Continuing Program Weaknesses

1995 fiscal audit: The report concluded that the program was sound financially, but noted some weaknesses in the department's internal control structure and in its compliance with certain laws and regulations.

1997 programmatic review: The report concluded that poor management practices limited the program's effectiveness. It found continuing internal control weaknesses.

1999 fiscal audit: The report concluded that the fund balance in the vending stand fund, which contains operator fees, appeared excessive and that the department could increase its commission income by establishing more contracts to collect commissions from all vending machines located on state and federal property.

2001 fiscal audit: The report concluded that the financial condition of the program was sound but that the department could improve its fiscal management of the program by developing a comprehensive business plan that showed whether its proposed use for its vending fund surplus was appropriate and feasible.

SCOPE AND METHODOLOGY

The California Welfare and Institutions Code, Section 19640.5, requires the bureau to conduct a fiscal audit of the program every third fiscal year until January 2002 and a programmatic review every five years until January 2003. This is the last of the series of reviews required by the statute. In 1995, 1999, and 2001, we completed fiscal audits of the program. In 1997, we completed a programmatic review.

To determine the department's practices for administering the program, we interviewed key department and program personnel. To compare California's practices to other states, we interviewed administrators of three other states' business enterprise programs for the blind. We compared California's program results to these states' performance by reviewing annual reports to the U.S. Department of Education's Rehabilitation Services Administration. In addition, we reviewed California's program expenditures for fiscal years 1996–97 through 2000–01 and evaluated the financial success of the program's operators by analyzing program records of operator-reported monthly income. We also reviewed the program's recent strategic plan to help us understand the department's vision of program success.

To better understand the program's requirements and to determine whether the program's guidelines and standards encourage the effective use of program resources in the facility development and equipment replacement processes, we reviewed federal and state laws and regulations. We also reviewed key program policy and procedures, analyzed data from the department's equipment database, and interviewed department staff.

To evaluate the department's efforts to improve the program through the use of vending machine contracts and operator partnerships with private food-service businesses, we interviewed key program staff and staff at the Department of General Services. We reviewed correspondence from the U.S. Department of Education's Rehabilitation Services Administration and interviewed its designated contact person to obtain the federal perspective. To determine program expenditures and related business information for the facilities involved in private partnership agreements, we reviewed expenditure reports and operators' monthly operating reports. Finally, we examined the contracts between the private partners and the operators to better understand the distribution of duties between partners.

To evaluate the department's provision of services to operators, we reviewed its monitoring of required location reviews. We also evaluated the review form, interviewed program staff, and reviewed certain department documents. We also surveyed 35 operators to obtain their perspectives on the program.

To review the department's progress in addressing our past recommendations regarding collection of current and past-due commissions from private vending machine businesses, we interviewed staff and evaluated the system the department uses to track reported sales and commissions.

To assess the department's progress in addressing recommendations we made in prior reviews, we interviewed key department and program staff and reviewed various department records. We summarize the department's reported progress on recommendations made in the 1997 programmatic review and the 2001 fiscal audit in Appendix A. ■

AUDIT RESULTS

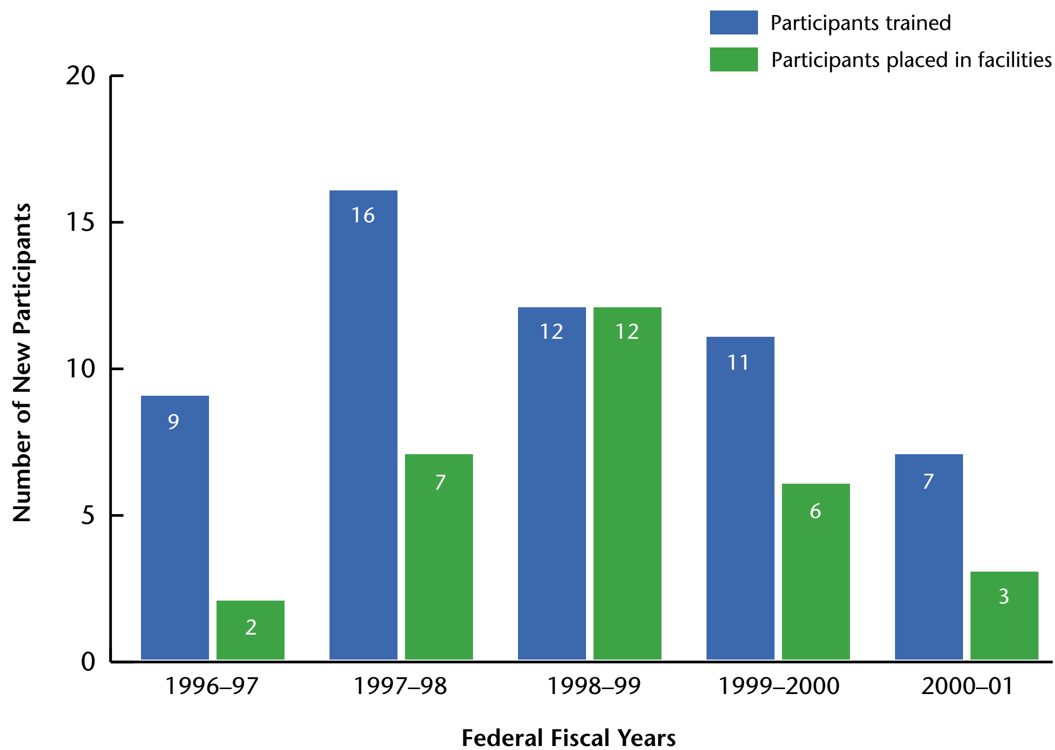
IN RECENT YEARS, THE PROGRAM HAS ACHIEVED ONLY LIMITED SUCCESS IN MEETING ITS GOALS

The intent of the federal Randolph-Sheppard Act (act) and of California's Business Enterprise Program for the Blind (program) is to provide blind persons with remunerative employment, enlarge their economic opportunities, and stimulate them to greater efforts to be self-supporting. However, the program has achieved only limited success in reaching these goals. Although California has the largest number of blind operators of food-service facilities (operators) of any business enterprise program for the blind in the nation, the number of new participants in the program has decreased by more than half over the past four years. Further, in terms of the ratio of new trainees to current operators, the program ranked only 29th out of 50 in federal fiscal year 1999–2000. Although some operators earned fairly lucrative incomes in fiscal year 2000–01, more than one in four earned less than minimum wage. The average net income earned by California's program operators was slightly higher than the national average, ranking 20th when compared to other states.

The Number of New Participants in California's Program Has Declined

According to the annual reports the Department of Rehabilitation (department) submitted to the U.S. Department of Education's Rehabilitation Services Administration, the number of new participants in the program has declined over the past four years. As shown in Figure 1 on the following page, the number of newly trained participants peaked in federal fiscal year 1997–98, with 16 individuals completing the training and 7 being placed. In federal fiscal year 2000–01, only 7 new participants completed the training, and only 3 were placed in facilities.

FIGURE 1



Source: California Department of Rehabilitation's annual Report of Vending Facility Program for federal fiscal years 1996–97 through 2000–01.

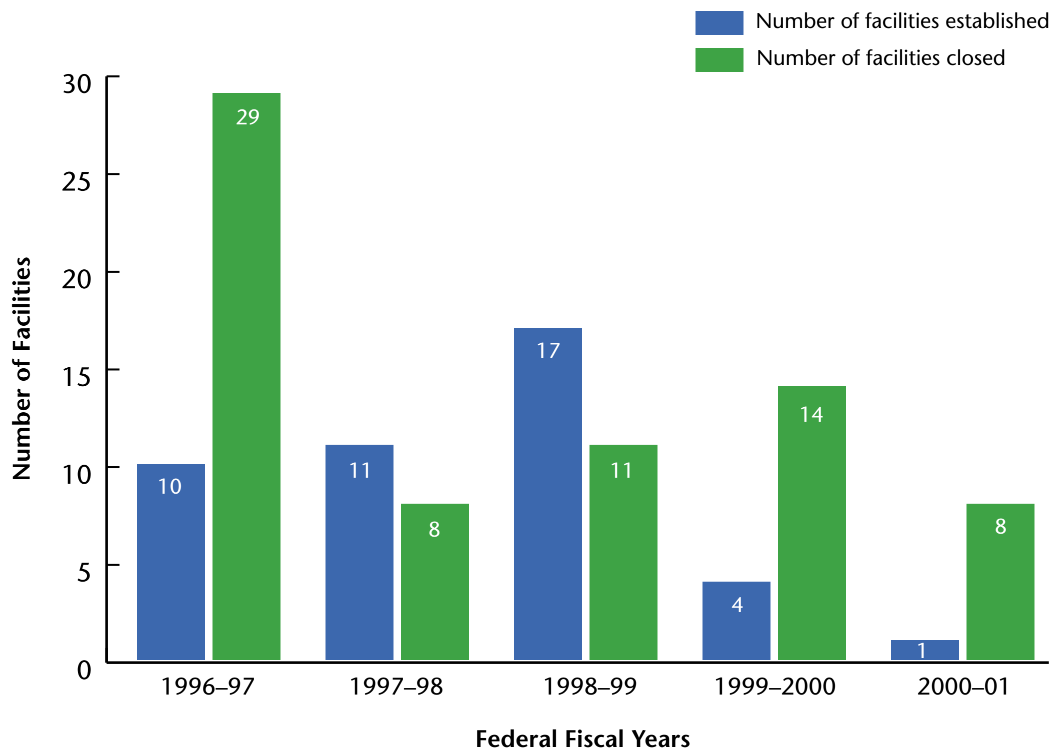
According to the most recent statistics from the U.S. Department of Education's Rehabilitation Services Administration, California ranked 4th overall in the nation in its number of new trainees for federal fiscal year 1999–2000. However, for the same year, California ranked 29th in percentage of new trainees to total operators. Because California's program had the largest number of operators, its efforts to train and place new program participants had a smaller proportional effect on its program than the same number of new trainees would have on states with smaller programs.

The decrease in new participants can probably be attributed to a number of causes. The program currently offers training only in Sacramento, which may represent a potential barrier to entering the program, as discussed later in the report. As shown in Figure 2, the number of food-service facilities has declined. Recently, the number of facilities closed has generally exceeded the number of facilities opened, which might also have contributed to the decline in program participation. Figures 1 and 2 suggest a

correlation between the number of new food-service facilities established and the number of participants placed. For example, federal fiscal year 1998–99, the year that the department established the highest number of food-service facilities, is also the year that it placed the highest number of new program participants. To attract and place new program participants, the department must continue to establish new facilities for the participants to operate. Finally, the decrease in participation may reflect a declining interest in the program.

FIGURE 2

The Number of Food-Service Facilities the Department Has Closed Each Year Has Generally Exceeded the Number of New Food-Service Facilities It Has Opened



Source: California Department of Rehabilitation's annual Report of Vending Facility Program for federal fiscal years 1996–97 through 2000–01.

Although the Average Income of Program Participants Has Increased, Many Are Not Self-Supporting

Despite the intent of the act, many of California's program participants have not earned sufficient income to be self-supporting. In fiscal year 2000–01, nearly 30 percent of the operators earned a monthly average net income—income

In fiscal year 2000–01, nearly 30 percent of the operators earned a monthly average net income of less than $1,050, or about what a person could earn working full time at minimum wage.

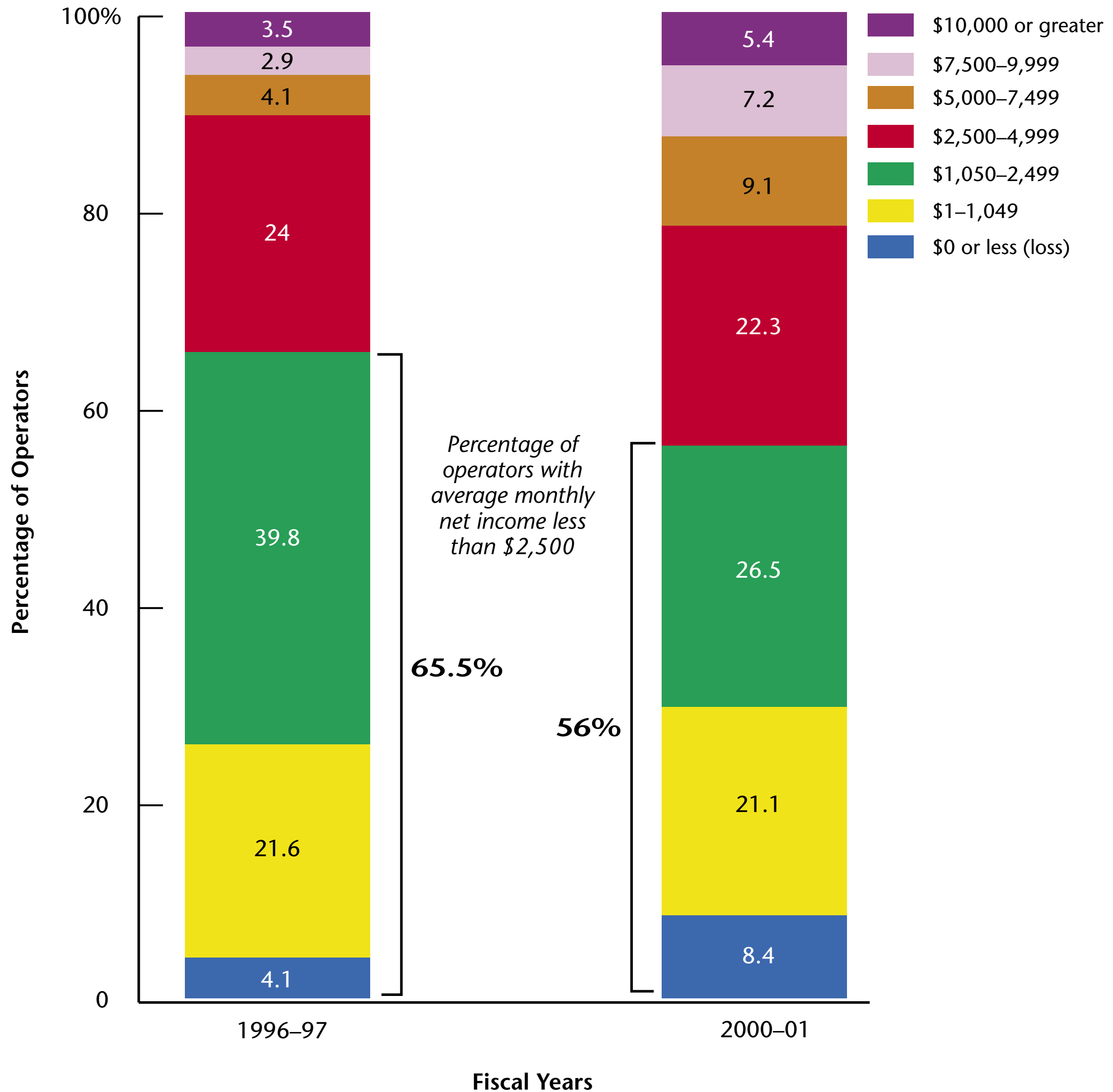
after program fees—of less than $1,050, or about what a person could earn working full time at California's 2001 minimum wage of $6.25 per hour. As shown in Figure 3, between fiscal years 1996–97 and 2000–01, the percentage of operators with average monthly net incomes of zero or less (that is, those who either broke even or lost money during the year) more than doubled, from 4.1 percent to 8.4 percent. Moreover, in fiscal year 2000–01, 56 percent of the operators earned less than $2,500 a month, the minimum the department must estimate a new site will earn before it will establish that site.

However, 25 of the 35 operators surveyed (71 percent) indicated that they believe the incomes they receive from the program allow them to be self-supporting. At the same time, 14 (40 percent) of the operators surveyed told us that they are actively seeking to change locations. Six of these 14 specifically said they want to relocate to increase their incomes. Additionally, 15 operators (43 percent) believed that their current locations should be closed or combined with other locations. These answers indicate to us that the operators might believe they are self-sufficient but still are not satisfied with their current incomes. The department told us it is difficult to base success in the program solely on the level of net income produced. The department believes the fact that some operators choose to remain in lower income locations indicates that some operators choose that particular location for other reasons, including geographic location and ease of operation.

It is important to point out that regardless of their monthly incomes, operators are eligible for health, dental, and life insurance benefits, as well as a retirement plan, by participating in the program. The number of operators electing to participate in the benefits varies. For some of the benefits, the operator pays a small portion of the monthly costs. For example, for a single operator electing to participate in all of the benefits offered in June 2002, the operator would pay $10 per month, and the program would pay $232 per month. Also, during 2001, the program contributed approximately $489 per month to the retirement plan of each eligible operator.

FIGURE 3

Although Average Operator Incomes Have Increased, Many Operators Still Make Less Than $2,500 Per Month



Source: California Department of Rehabilitation's Business Enterprise Financial System.

Some improvements have occurred. The average monthly net income for operators increased from $2,691 in fiscal year 1996–97 to $3,302 in fiscal year 2000–01, and although the percentage of total operators earning an average monthly net income of zero or less increased, so did the percentage of operators making an average monthly net income of $5,000 or more. In fact, nine

operators earned average net incomes of $10,000 or more a month in fiscal year 2000–01, a 50 percent increase from fiscal year 1996–97. Moreover, according to the U.S. Department of Education's Rehabilitation Services Administration, California's operators earned slightly more than the national average of $34,337 during federal fiscal year 1999–2000, making on average $35,239.[1]

According to the U.S. Department of Education, California's operators earned an average of $35,239 during federal fiscal year 1999–2000, slightly more than the national average of $34,337.

To determine why some operators are able to achieve considerably more income than other operators, we reviewed the facility types for the nine highest-earning operators in fiscal year 2000–01. We found that four of these nine operated multiple vending machine locations, which are generally the most profitable type of vending facilities. For example, one operator who ran a vending machine facility at a roadside rest stop, earning an average of nearly $7,800 per month during the year, was awarded a second, temporary or interim location for seven months of the year, which earned on average another $4,700 per month. Although we support the creation and reorganization of facilities to enable operators to increase their incomes, we question the program's decision to appoint multiple profitable facilities to certain operators while other operators are either not assigned locations or not earning enough to be self-sufficient. In a previous report, issued in August 1997, we reported that the department's policy for classifying and circulating locations was inequitable, because it had not developed a fair process for assigning interim locations. To date, the department still has not corrected this weakness.

THE DEPARTMENT ONLY RECENTLY PROVIDED STRATEGIC DIRECTION TO ITS STAFF AND PARTICIPANTS

In May 2002 the department, in consultation with the California Vendor's Policy Committee, issued its first strategic plan for the program. The department's previous lack of action to establish strategic priorities for the program, identify expected outcomes, or offer methods to measure improvement hampered the program's ability to fulfill its mission and to address deficiencies in its operations that various audits identified as early as 1991. The current plan states that the program's mission is to provide profitable, productive, and independent career opportunities for blind individuals. It identifies five major goals

[1] Federal fiscal year 1999–2000 was the most recent year for which national program data were available at the time of this audit.

for the program: quality, uniformity, efficiency, accountability, and profitability. However, the strategic plan does not reflect decisions regarding the prioritization of scarce resources, show which areas the department believes the program needs to improve the most, or provide any mechanism for the program to use to determine what level of resources to expend to attain planned objectives.

Moreover, although the strategic plan lists deadlines for the completion of its stated objectives, it does not identify expected outcomes or offer performance measures or benchmarks that might help the program track its progress. Consequently, the department might dedicate resources and efforts to an area but never be able to determine if the program has reached—or is even moving toward—a stated goal. Further, the program's management will not be able to monitor progress and effectively determine which areas need additional attention and resources. In some instances, establishing such benchmarks or performance measures would be fairly simple. For example, the strategic plan calls for maximizing the profitability of each location. However, it does not establish an expected outcome for location profitability, nor does it identify any index, ratio, income level, or other method to measure the program's progress toward the goal. One way the department could evaluate profitability would be to monitor operator and location income on a monthly or quarterly basis. However, the department currently does not regularly obtain this information for use in its management activities.

THE DEPARTMENT HAS NOT UPDATED ITS GUIDELINES FOR THE ADMINISTRATION OF THE PROGRAM

The lack of clear guidelines may lead to disparate service delivery and compromise the program's success.

The department lacks guidance the program needs for sound administration. The program has neither updated its regulations nor provided updated policies for program administration to its staff. The lack of clear guidance may lead to disparate service delivery and compromise the program's success. State law and regulations require that every three years the department review and consider updating its regulations for the administration of the program. However, the department has been working for at least seven years to update the regulations. Because of this delay and the program's reliance on a 1994 policy and procedures manual that is outdated in some areas and provides insufficient guidance in others, the program has lacked clear guidelines on how it should operate. The program has not provided sufficient guidelines in its purchase of equipment and establishment of

private partnerships. As a result, the department cannot ensure that the purchase of equipment is consistent among locations and that its private partnerships—which we discuss in greater detail later in the report—conform to federal law and its own mission statement.

The department attributes its delay in updating its regulations on staff vacancies and on the magnitude and importance of the task. According to the deputy director, the program is complex and subject to various kinds of complaints and grievances filed by the operators. The law allows any operator dissatisfied with an operational or administrative action to appeal that action. Further, federal and state law require that the operators be represented by a committee of operators representative of all licensees. Specifically, the law requires that the committee be involved in any major administrative decisions and policy and program development. Therefore, according to the deputy director, when it embarks on new ways of doing business, the program needs to develop guidelines and have the guidelines reviewed and placed in regulation so the department can ensure consistent statewide implementation of the guidelines and be able to defend its actions when operators challenge the program. Although we understand the department's emphasis on the importance of regulations, seven years seems an unreasonably long time for the program to function without updated operating guidelines. Moreover, by seeking to make its regulations overly comprehensive, the department might render the program inflexible.

The department is currently developing a new draft of the proposed regulations, but it has not established timetables or deadlines to manage the process.

The department is currently developing a new draft of the proposed regulations. However, it has not established timetables or deadlines for submitting the draft to the Office of Administrative Law or for holding the public hearings and receiving stakeholders' comments as required by the regulatory process. The department intends to revise its policy and procedures manual to coincide with the new regulations once they are adopted.

The Program Has Not Issued Sufficient Guidelines to Govern the Purchase of Equipment for Its Facilities

Federal law and state regulations require that the program determine the need for and provide equipment to facility locations. Within the four field offices, business enterprise consultants (consultants), who provide operators with consultation services and assistance to support the operation of their facilities, are responsible for making equipment-purchasing decisions, with

the approval of supervising consultants. However, the department has not ensured that the consultants and supervising consultants have sufficient guidelines to govern their decisions, nor has it provided a core program list of appropriate or inappropriate equipment. As a result, the department has no assurance that staff members are using the same standards or information to decide whether equipment purchases are warranted. Although the supervising consultants believe they make consistent decisions for the locations in their respective districts, operators in different parts of the State may not be receiving equitable services from the program. For example, one operator we surveyed stated that he noticed a difference among the responses to operators' requests for equipment: His request for equipment might be denied while another operator obtained the same equipment.

Lacking sufficient guidelines, the department has no assurance that staff members use the same standards or information to decide whether equipment purchases are warranted.

All four supervising consultants we interviewed indicated that they make equipment-purchasing decisions on a case-by-case basis. They indicated that they might ask a consultant or operator to provide a written business plan or justification for a questionable item. According to two supervising consultants, some operators will either appeal negative decisions until they receive the items they want or contact the department headquarters to attempt to have the field office's decisions overruled.

One supervising consultant was able to provide us with a worksheet that he stated was given to the field offices at one time to assist the consultants in their assessment of the return on investment for proposed pieces of equipment. The form was created to help consultants determine if purchasing specific equipment made good business sense. However, this worksheet only required a return on investment based on the amount paid from the vending stand trust fund; it discounted any federal funds spent, which are usually about 80 percent of a purchase price. The central office does not require that the field offices use this or any other form for assisting in equipment-purchasing decisions.

The Department's Reasons for Not Being Able to Establish Guidelines Are Unfounded

According to the department, it has been unable to update the program's regulations for the past seven years because of staff vacancies and the complexity of making the regulations sufficiently comprehensive. However, we found the department's reasoning regarding both these issues to be flawed. The department believes it is necessary to put program policies into

regulations because the program is subject to various complaints and grievances filed by the operators and to litigation filed by federal and state agencies. The department maintains that once policies are in regulation, it is in a better position to defend its actions if challenged. Moreover, the department believes that using the regulatory process to establish policies might reduce grievances. The department explained that the task of creating the new regulations has become more time-consuming as it identified additional issues to consider and as the new regulations become more comprehensive.

Although we understand the department's emphasis on the importance of regulations, we believe that its practice of requiring the program's governing policies to be in regulations could render the program inflexible and unable to promptly react to changing conditions. Policies that are susceptible to frequent or regular change might be better specified in departmental or program policies. This would enable the department to respond to changing conditions when necessary without going through the lengthy regulatory process.

The department claims that staff vacancies and its desire to ensure its regulations are comprehensive have limited its ability to establish program guidelines; however, during the seven years it has been working on the regulations, it had the time and staff it said it needed.

In addition to its desire to ensure that its regulations are comprehensive, the department claims that staff vacancies have limited its ability to establish program guidelines. However, it has been working to establish these guidelines in regulation for seven years, during which it had the staff and the time it said it needed. The department attributes its inability to move the process to the next step to vacancies in the program's assistant manager and legal counsel positions. However, these vacancies are recent. Although the previous legal counsel left the department in November 2001, the position has been established for over two and a half years and is paid for by the program. The position of assistant program manager has also been vacant since November 2001, but this position was established many years ago and has been consistently filled since May 1994 except for a brief four-month period in 2000. Vacancies in key positions can certainly cause delays, but seven years is an unreasonably long period to have not completed the task. We believe that the department's decision to operate the program without updated guidelines for an extended period puts the program at risk for criticism and legal action.

BY ALLOWING OPERATOR PARTNERSHIPS WITH PRIVATE BUSINESSES, THE PROGRAM HAS COLLECTED INEQUITABLE OPERATOR FEES AND MAY NOT HAVE COMPLIED WITH FEDERAL LAW

By encouraging private partnerships between blind operators and private food-service businesses, the department recently has allowed the private businesses to obtain program benefits that federal law intended for blind operators.[2] In a private partnership agreement, a program participant licensed to operate a food-service facility contracts with a private food-service business to allow that business to prepare and sell food at a program facility. The program generally maintains the location's equipment, provides consulting services, and supplies a preferential location in a state or federal building. As with other new program locations, the department may pay for the cost of the initial stock of goods to be sold. In return, the private food-service business typically agrees to pay the program participant either a set monthly amount or a portion of gross sales ranging from 6 percent to 15 percent.

Under a private partnership agreement, a contract between a program participant and a private food-service business, the private business pays the program participant a monthly amount and in exchange is allowed to prepare and sell food at a program site in a state or federal building and to receive other program benefits, such as consulting services and equipment maintenance.

The program manager explained that he has pursued these agreements because he felt that several of the program's cafeterias had a history of not making enough profit and that the agreements would provide a transitional period for the participants to make them profitable. Currently, cafeterias are the second-least profitable type of program facility, earning an average of about $1,900 per month in program participant net income in fiscal year 2001–02. To date, the department has six partnership locations in place or being developed and plans to spend approximately $807,000 in developing these locations. It had spent or encumbered $84,000 of program funds as of June 30, 2002, to assist in operating these locations since they became partnerships and plans to spend approximately $723,000 more by March 2003. Locations range from a dining facility on an air force base to a café and coffee cart in Southern California to a proposed sports restaurant and grill in Sacramento. The department's investment per site varies from approximately $9,000 to a proposed $723,000.

However, we found numerous problems with the program's administration of its private partnership agreements. Specifically, it has not adequately ensured that its actions conform to

[2] In private partnerships, operators generally assign the daily operational duties to their partners; therefore, in this section, we refer to the blind operators as program participants.

the intent of the act, under which the program was created. Moreover, because it has not developed guidelines on when or how to implement the partnerships, it cannot be sure that the partnerships are allowable, prudent, or consistent or that they protect the interests of the State or the program participants. Because of the terms of the partnerships, the department has lost its ability to monitor the investment of program funds in these locations in the same way that it can monitor the use of program funds at other locations, and it has not obtained enough information from the partnerships to determine if they are successful business ventures. Further, although the program generally provides the same services to private partnerships that it would to other program participants, it allows some partnerships to pay disproportionately lower fees than other program participants pay.

The Private Partnerships Seem Inconsistent With the Spirit of the Federal Randolph-Sheppard Act

Federal officials told us that the goal should be to have program participants take over the operations of the facilities; however, the partnership agreements do not always specify that program participants operate the facilities, obtain training, or take over the operation of the facilities.

Although the department has the responsibility to ensure that the private partnership agreements it honors conform to federal and state laws, it has not established any guidelines to this effect. Recently, the department has allowed program participants to enter partnerships with private food-service businesses through which the program participants essentially have exchanged some of their program benefits under the act to the private businesses for a guaranteed monthly amount or a percentage of sales. These partnership agreements do not always specify that program participants operate the facilities or that, once they are trained, program participants assume operational control over the facility. The act does not specifically prohibit private partnerships; however, both the act and state law that authorizes the expansion of the act's preference to state buildings assert that blind persons licensed under the provisions of these laws shall be authorized to operate vending facilities on federal and state property. Moreover, the act clearly states that its intent is to provide blind persons with meaningful business opportunities that encourage them to be self-sufficient.

Private partnerships should be limited to specific purposes. According to the Commissioner of the U.S. Department of Education's Rehabilitation Services Administration and follow-up conversations with the commissioner's specified contact person, generally program participants should manage and operate the facilities. Program participants may use partners, for

example, in military cafeterias to provide them with training, but the goal should be that the program participants eventually take over the operation of the facilities. The department should establish training requirements, objectives, goals, and time frames in conjunction with the program participants and the private business partners to enable the program participants to independently manage the food-service facilities as soon as possible.

Although six private partnerships exist or are being developed, of the four operating as of June 2002, only three have contracts between the program participant and the partner. The three existing partnership agreements we reviewed did not consistently require program participants to operate the sites, obtain training, or assume operation of the sites. In two partnership contracts, responsibility for operating the site was assigned to the private partner rather than the program participant. In the third agreement, the program participant was the onsite manager and reported to the private partner's representative. That agreement required the program participant to comply with the private partner's written recommendations concerning the operation of the site. Although two of the agreements we reviewed listed training as a contract requirement, they did not contain specific goals, subjects, or timetables. One contract specifically precluded the program participant from operating the site without the private partner.

Two of the three contracts we reviewed showed that although the private partners were responsible for maintaining monthly profit and loss statements, this information was not typically shared with the department. The third contract did not even require the preparation of such a statement.

The Department's Lack of Guidelines Governing Private Partnerships Has Resulted in Inconsistent Contract and Program Requirements

Because the department has not established guidelines on how to administer its private partnerships, contract and program requirements are inconsistent in critical areas, such as reporting and payment of fees, the degree of involvement required of the program participant, and the signing of the contract. These inconsistencies have resulted in significant variations in how partnerships comply with the spirit of the act and in how they assist program participants in learning how to operate food-service facilities. If the department does not treat all partnerships consistently and establish guidelines that require partnerships and other locations to be treated equally, the department may expose itself to future complaints and liability.

One of the areas in which the contracts have not been consistent involves the preparation of financial documents and the payment of set-aside fees, which are funds paid by the operators to the

department from the net proceeds of facility operations. Because the existing state regulations regarding set-aside fees and financial reporting are standard for all locations, we would expect partnered locations to be subject to the same requirements. However, two of three contracts we reviewed showed that although the private partners were responsible for maintaining monthly profit-and-loss statements, this information was not typically shared with the department, as required of program participants' locations that do not involve private partners. The third contract did not require the preparation of such a statement, requiring instead that financial information be kept confidential. Program participants in all three partnerships we reviewed have submitted their required monthly operating reports that were based on the income received from the private partners rather than based on the operations of the facilities. Finally, the contracts did not specify a standard amount of set-aside fees to be paid back to the program, as required of program locations not involving private partners.

In addition, little consensus appears to exist within the program regarding issues such as who must sign the contract and the degree to which program participants must take part in the management of facilities. The four supervising consultants who oversee the field offices disagree on the required involvement of program participants in the management of the partnership facility. One supervising consultant stated that the program does not require any program participant to be onsite. Another stated that the program participant is required to be onsite or use a designated manager, which could include the partner. Similar confusion seems to exist around the issue of signing the contract. Although two of the three contracts we reviewed were signed only by the private partner and the program participant, the third was also signed by the department's program manager, who in this instance also signed a separate contract between the program and the private partner.

The Department Has Not Adequately Protected the Interests of the State or Program Participants

The department has not consistently confirmed that program participants and partners have written contracts before beginning operations.

By allowing these private partnership agreements, the department has inadequately protected the interests of the State and program participants. It has not consistently confirmed that program participants and partners have written contracts before beginning operations, has not analyzed the investment and return on investment of the partnerships to the program and the program participant, and has not adequately reviewed the

partnership agreements. The department stated that it does not always perform these activities because the program participants are independent businesspeople authorized to contract for goods and services. However, we believe this stance is inappropriate because in most cases, program participants are essentially assigning some of their program benefits to private food-service partners and thereby are committing program resources for business expenses such as equipment and equipment repairs. Moreover, the partnership agreements allow private businesses the advantage of location preference in state and federal buildings that do not charge rent or utility fees.

In some instances, the department has either failed to ensure that contracts were in place or has agreed to contract terms that may prove problematic. For example, a partnership that had been operating since November 1, 2001, still did not have a contract in place as of June 2002. Under another partnership, the program committed $191,000 to design a sports restaurant and grill and requested redirection of another $532,000 from a previously approved project to pay for the facility's construction costs, even though as of July 2002, the partner and program participant had not signed a contract and the department had not performed an analysis of its return on investment. Further, in the one contract that the department signed, it agreed that if the program participant ever terminated the agreement, the State would guarantee that any future program participant would be required to accept the same terms as the original contract. In this case, the program guaranteed a private company the exclusive right to a location regardless of the program participant's wishes. In contrast, the two other partnerships that have contracts allow the program participant to dismiss the partner either with 90 days' notice or for causes specified in the contract.

The department is spending a significant proportion of the program's funds on partnerships without knowing if the partnerships are a worthwhile investment for the operator or the program.

The department has also inadequately analyzed its partnership investments. The department could not provide us with an analysis of the investment required from both parties and the return on investment for any partnership. However, it has spent or plans to spend at least $807,000 by March 2003 on its partnership agreements, an amount equal to 12 percent of the program's reported annual expenditures for federal fiscal year 2000–01. The department is spending a significant proportion of program funds without knowing if these partnerships will result in sufficient fees to the program and funds to the program participants to make the investment worthwhile.

Finally, the department's review of private partner contracts has not ensured that these contracts are adequate. The department's deputy director told us that the program has not approved the contracts for three of the six partnerships because the program's field offices, not the central office, put them into place, and the central office did not become aware of the program participants' agreements with their private business partners until after the fact. The department's chief legal counsel told us that partnerships are something new for the program and the role of the legal unit in relation to partnership agreements is still being worked out with the department. Currently, the legal unit told us it reviews these partnership arrangements to ensure the department's interests are protected. However, the legal unit does not evaluate the partnership agreements to ensure the program participant's interests are protected; instead, it has recommended that program participants considering partnerships obtain their own legal counsel. In addition, according to the department's chief legal counsel, the legal unit does not evaluate the amount of fees to be paid to program participants or to the program.

The Department Is Unable to Effectively Monitor Its Private Partnerships and Collect Appropriate Program Participant Fees

The department's inconsistent enforcement of its requirements for reporting on operations and collecting set-aside fees has rendered it unable to effectively monitor partnership agreements. Current state regulations require all locations to submit monthly operating reports, which show the business activities of the location including sales, expenses, and other information. However, the monthly reports submitted by private partnerships generally do not include the information the department needs to determine the degree of the location's success and the return on the program's investments. The deputy director in charge of the program stated that the department is currently considering developing guidelines and a new monthly operating report for partnerships, but as of June 2002 it had not established a specific timeline to complete this task.

The department does not require the private partnerships to submit monthly operating reports that show the business activities of the location, including sales, expenses, and other information the department needs to evaluate the location's success and the return on the program's investment.

None of the four locations whose monthly operating reports we reviewed included critical information such as gross sales and cost of goods sold. In each case, the program participant only reported the amount of money the private partner paid the program participant each month for the right to manage and operate the site. For example, in one instance, the private partner paid the program participant $7,500 a month. The

program participant thus reported his income, $7,500 per month, as net proceeds, and usually did not report any sales or expense information from the operation of the business.

Because the department has allowed partnerships to submit less information on monthly operating reports than other locations, the department has not ensured that it charges an equitable amount of fees to program participants involved in partnerships. The department charges all other locations set-aside fees from a fee schedule based on net profits. The maximum amount of set-aside fees a program participant pays is the lesser of 6 percent of gross sales or the amount specified on the fee schedule. However, as the previous example shows, the department has allowed program participants who have entered partnership agreements to report their guaranteed payments from the private partners as the net profits from the location. These partnership participants then pay a set-aside fee of 6 percent of the guaranteed payment figure rather than the potentially much higher fee amount the program charges other program participants based on net profits or gross sales. For instance, the program participant who received $7,500 a month in payment from the private partner should, according to the fee schedule, have paid the lesser of $3,675 per month or 6 percent of the facility's gross sales, which are unknown. However, the program charged the program participant $450 per month in fees—6 percent of his guaranteed payment. This treatment of partnership participants is inconsistent and inequitable to program participants of other locations, who must in turn pay a disproportionate share of program costs.

In computing set-aside fees, the department's treatment of partnership participants is inconsistent and inequitable to the program participants of other locations, who must in turn pay a disproportionate share of program costs.

THE DEPARTMENT HAS NOT CORRECTED FLAWS IN ITS PROCESS FOR PURSUING PAST-DUE COMMISSIONS, SOME OF WHICH MAY NOW BE UNCOLLECTIBLE

Since August 1998 the department has not actively collected past-due commissions owed to the program by private vending machine businesses (private businesses) operating on federal and state properties. Its delay may have rendered a significant portion of these commissions uncollectible, causing program participants to lose commission revenues earmarked to fund their retirement. Moreover, although it recently established a system to monitor the collection of commissions, the system has proved inadequate. This problem has been compounded because the department has not maintained all its contracts, conducted planned audits, and appropriately trained its collection staff.

The Department's Lack of Pursuit of Past-Due Commissions May Have Rendered These Commissions Uncollectible

When a vending machine facility located within a federal or state building is operated by a private business instead of a blind operator, the private business must pay a portion of its net income, called a commission, to the department. The department either provides the commission to a blind operator who runs a facility that competes with the private business or uses the commission to fund the retirement plan for all operators. The private business submits a monthly or quarterly sales report to the department, which calculates the commission due based on the report and the contractual commission rate. Although state law requires the department to actively pursue all commissions from private businesses, we found that it has not adequately pursued its past-due commissions. Because it has not promptly followed up on commissions that private businesses failed to remit since August 1998, it may not be able to collect these amounts. We were unable to accurately estimate the amount of these past-due commissions because of the quality of the data and because the program's current system for tracking contracts is not able to accurately identify the amount of past-due commissions. The department is also unable to estimate the amount of past-due commissions because it needs to use a manual process to do so.

The department's ability to collect these commissions has decreased as time has passed, particularly because it believes that the only power it has to demand collections is its ability to cancel ongoing contracts with delinquent private businesses. Since vending machine contracts generally expire after three years, the department's nearly four-year delay in ensuring that staff actively pursue past-due commissions has reduced its ability to collect the amounts. Staff told us that the department had not followed up on these past-due amounts because it had insufficient staff and an inadequate record-keeping system in the past. The department recently developed a new contract and commission-tracking system, but as of June 2002, it was still not pursuing the collection of overdue commissions.

The Department's Collection Process Is Inadequate, and Its New Database Cannot Track Past-Due Commissions

According to the department, in fiscal year 1997–98, it used a database system to track the commissions it received. However, in part because of the questionable accuracy of the information from that system, the department did not follow up on missing

Because the department tracks commissions by the month they were paid rather than the month for which they were owed, it is unable to determine quickly which private businesses owe additional commissions.

commissions. In June 2001, the department contracted with a consultant to develop a new database system to track commissions from private businesses and to provide reports of amounts owed. However, the program's new commission-tracking system does not adequately serve this purpose. By using the system to track commissions by the month they were paid rather than the month for which they were owed, the department is unable to determine quickly which private businesses owe additional commissions. For example, if a private business sent a payment in June for the amounts it owed for May and June, the system would only show a commission received for June. To determine which private businesses actually owed commission payments, the department staff would need to investigate each instance of nonpayment or potential underpayment.

An adequate accounts receivable system should contain a detailed history of payments by each private business and accurate and current information identifying amounts still owed. The challenge that the department faces is that it is unable to calculate the commissions owed until the private businesses report their monthly or quarterly sales. Other agencies such as the State Board of Equalization, which collects sales taxes from private businesses and relies on the reported sales amounts, have adopted methods of addressing similar problems. The department should consider incorporating attributes of the State Board of Equalization's model into its own procedures. In particular, it should track who should be paying and at what commission rate and then promptly follow up if private businesses do not report sales for the month or quarter.

In addition, the program does not always have current and accurate contract information. The department's contracts with private businesses identify the commission rate for vending machine sales at specified locations. However, when we asked to review the contracts, the department did not have copies of contracts for 30 locations operated by private businesses. For 25 locations, the department did not have contract numbers, either because no contracts existed for the location or the agency where the vending services were provided executed their own contracts and the department did not acquire a copy of the contracts. Without contracts, the department cannot verify that it is owed commissions or determine the rate it should use to calculate the commissions.

The department cannot ensure that reported commissions are accurate because it has not audited private businesses' reported sales and commission payments since 1999.

Further compounding the situation, the department has not audited private businesses' reported sales and commission payments since 1999. According to the department, it can only determine whether the commissions that private businesses pay are correct by checking to ensure that private businesses appropriately multiply the commission rate by the sales they report each month or quarter. Without auditing the private businesses, the department cannot ensure that the sales information is accurate. Although it has planned to audit private businesses every year since fiscal year 1996–97, the department has not conducted any of these planned audits since 1999 due to lack of staff resources and other assignments deemed higher priority.

Finally, the department staff currently assigned to track commissions from private businesses appear to lack a working knowledge of state collection procedures and effective accounts receivable management. When we discussed the long delays in collection of past-due commissions with the responsible staff person, she told us that she had drafted procedures and collection letters but before collecting past-due commissions, she needed to study the State's collection procedures and receive the approval of her supervisor. Since this person has been assigned since 1997 to the task of developing a collection system and procedures for collecting past-due commissions, we are concerned that the department has not ensured she receive training in receivables management and the State's collection procedures. It is also unclear why the department has not transferred these responsibilities to its accounting section, which is knowledgeable regarding collection procedures and already has an established accounts receivable system it uses to track and collect outstanding operator fees owed to the program.

THE DEPARTMENT HAS NOT CONSISTENTLY MET ALL OF ITS RESPONSIBILITIES TO PROGRAM PARTICIPANTS AS REQUIRED BY LAW AND ITS OWN REGULATIONS

By not fulfilling all its responsibilities to program participants in terms of training, feedback, and financial monitoring, the department may have hindered the ability of participants to succeed and engage in improved work opportunities. Specifically, the department has not complied with state law that requires it to provide the program's initial training in two locations, nor has it consistently provided upward mobility training as required by federal law. Further, the department

has not always offered operators documented feedback that might enable them to increase the success of their facilities even though its own policies require that it give such feedback every three months. Finally, the department has not ensured that operators submit financial reports and fees as required by regulations; consequently, the department cannot readily identify operators who may be having operating and financial difficulties and need the program's assistance.

The Program Has Not Complied With Certain State and Federal Requirements for Operator Training

The program has neither provided initial program participant training in two California locations as required by state law nor supplied training to allow current operators to become upwardly mobile as required by federal law. State law requires that the program offer training in two locations in the State, but since 1997, the program has offered training to new program participants only in the Sacramento area. More than five years ago, the program offered training in a second location, San Diego. According to the department, it limited training to one location because of declining enrollment and limited program resources.

By limiting operator training to Northern California, the program may create a barrier for visually impaired persons interested in participating in the program. Blind vocational clients wishing to participate in the training must relocate to the Sacramento area for several months, and they may have to relocate again to operate their first assigned food-service facilities. Moreover, although it may be more economical for the program to offer the training only in Sacramento, the costs of relocating multiple participants are still the State's financial responsibility, paid through the department's vocational rehabilitation program.

During the last three years, the department reported that it provided no upward mobility training for program operators.

As we reported in our 1997 review, the program still offers only limited opportunities for upward mobility training. Federal law requires ongoing upward mobility training that includes further education and additional training or retraining for improved work opportunities for all licensed operators. According to the department's annual reports to the U.S. Department of Education's Rehabilitation Services Administration, the department provided no upward mobility training during federal fiscal years 1998–99 through 2000–01. Further, except for mandatory sanitation certification training, during the same three years, it provided in-service classes to only 39 operators. The department's in-service

training is designed to provide operators with instruction and guidance to maintain their skill levels and improve current operations. The program's trainer also indicated that operators are able to receive retraining by sitting in on classes offered to the new participants when space is available and that operators might receive individual training in the field, when the consultants feel it is warranted. Although in-service training may be valuable for maintaining operator skill levels, it may not be sufficient to meet the federal requirements to provide training to prepare operators for more complex work assignments. More than 25 percent of operators we surveyed thought there were inadequate opportunities for upward mobility. Furthermore, 53 percent of the operators surveyed believed that barriers to upward mobility exist.

The department addressed training concerns in its recent strategic plan. It stated that it intends to provide continuing training to operators and to customize training to individuals' needs. It also indicated that its goal is to make training available in more locations. The department anticipates implementing these improvements to the program's training efforts by December 2002. However, as of June 2002, the department was still reviewing its training program and had not yet implemented any improvements or developed a tangible plan for doing so.

The Department Has Not Offered Operators Documented Feedback in a Timely Manner

The department recognizes the importance of periodic formal monitoring, and operators confirmed its importance and value. Both the deputy director and the program manager stated that location reviews are very important for monitoring a location's operating condition. Although the operators we surveyed reported that they received periodic feedback and it was helpful, we found that the department was not providing documented feedback as required by its own policies. These reviews document aspects of a location's condition that otherwise might not be noted.

Ten of the 16 locations we sampled had not received a quarterly review as required and 6 had not received a quarterly review within the last 12 months.

When we obtained the most recent reviews for 16 locations—4 from each of the program's 4 districts—we found 10 locations, or more than 60 percent, that had not received quarterly reviews as required. In fact, 6 locations, or nearly 40 percent, had not received quarterly reviews within the last 12 months, and the most recent reviews for 2 locations dated as far back as 1998. The program's administrative office currently monitors when it

receives a copy of these reviews, but it does not notify program consultants if reviews are past due. Therefore, operators may not receive timely feedback that would enable them to improve their locations. Although operators may receive informal feedback through conversations with their consultants, informal discussions do not necessarily address each area covered by reviews nor result in the proper documentation of locations' recurring problems. Lacking such documentation, the department may not be able to readily identify operators who need further assistance and resources to ensure that their locations operate at optimum levels.

Because the Department Has Not Promptly Followed Up on Missing Reports From Operators, It Has Not Been Able to Monitor These Operators' Financial Problems Properly

State regulations require each operator to submit a monthly operating report (which the program previously called a profit-and-loss statement) by the 25th day of the following month for each location he or she operates. The monthly operating report includes a summary of the facility's operations that the department uses as the basis for calculating certain fees owed to the program by the operator, including set-aside fees, workers' compensation insurance for employees, and liability insurance for the facility. Operators are required to remit the fees to the program each month with their monthly operating reports. The program also uses the information from the reports to assist operators in making decisions in improving their locations and as a source for required federal reports and the establishment of fees.

Although the department has enhanced its existing database to track missing monthly operating reports, it has not required staff to aggressively follow up on either missing reports or missing fees.

Although the department has enhanced its existing database to track missing monthly operating reports, it has not required staff to aggressively follow up on either missing reports or missing fees. This has allowed some operators to become delinquent in remitting their reports and fees. Our analysis indicated that 43 of the 166 operators who submitted monthly operating reports in fiscal year 2000–01 had at least one missing monthly operating report and related fees. Fifteen of the operators had three or more monthly operating reports missing. State regulations require the program to estimate fees and penalties for missing monthly operating reports after they are delinquent more than a month. The department estimated that missing fees for active operators as of June 30, 2002, totaled at least $28,982. However, a memo circulated in 2000 by the program's management requested that consultants not follow up on missing monthly operating reports until they were at least 60 days delinquent.

The program's manager stated that the department extended the period because some operators were needlessly contacted by their consultants for reports they had already submitted. According to the manager, monthly operating reports received late by the accounting section were often erroneously included as 30 days delinquent.

To verify that the program is contacting operators regarding delinquent monthly operating reports and estimating fees and penalties owed, we reviewed the correspondence between the consultants and the four operators with the greatest number of missing reports between January 2000 and January 2002. We found that none of the consultants for these four operators had sent notices for these missing monthly operating reports with estimates of owed fees and penalties in a timely manner. While the consultants may have sent reminders or had phone discussions about the missing reports, they did not send out initial notices with estimates until the reports were delinquent between 83 and 292 days.

The extensive delays hindered the program's ability to properly monitor and promptly intervene to help operators resolve financial problems they were experiencing. Because the program has decided to wait until a report is 60 days late before notifying the operator and providing estimates of amounts owed, nearly three months pass since the month the report covers. One of the four operators with the greatest number of missing reports between January 2000 and January 2002 resigned from her site because the State Board of Equalization revoked her seller's permit for delinquent sales taxes. According to the department, another operator recently filed for bankruptcy but is still operating the facility. The other two operators are both still operating their facilities. Each of the four operators owed the program between $4,000 and $18,900 in actual and estimated fees. If the department had ensured that program staff promptly addressed the missing monthly operating reports, perhaps it could have assisted the operators in correcting their business problems. Assistance could have been in the form of providing timely consulting services to help the operators become more profitable or even shutting down locations before the operators owed such debts.

RECOMMENDATIONS

To ensure that its application and selection process for locations is equitable, the department should establish procedures to circulate all permanent and interim food-service locations to eligible operators.

The department, in consultation with the California Vendors Policy Committee, should revise the program's strategic plan to include expected outcomes and performance measures so the department can evaluate the program's success and measure its progress in achieving strategic goals and improving noted deficiencies.

The department should aggressively and promptly pursue development of program regulations. If the current draft is too complex or lengthy, the program should consider breaking the draft regulations into segments, first identifying and addressing the highest priorities. The department should ensure that the guidelines include measures that will improve consistency in equipment purchase decisions, including a list of allowed and disallowed equipment and supplies, and statewide criteria for equipment purchase and replacement.

To improve its administration of private partnerships, the department should take the following steps:

- Establish and follow guidelines for partnerships, ensuring that they are in agreement with federal and state law, regulations, and guidance.
- Require program staff to further study the cost and benefit of each partnership to ensure that future agreements do not inequitably drain program resources.
- Establish a review process for proposed private partnerships that will allow the department to adequately protect the interests of the State and program participants.
- Monitor partnerships to enable the department to compare the costs and benefits of partnerships and determine if they achieve program objectives.
- Ensure that program staff are able to monitor the success of all locations, including private partnerships.

To make sure that that it promptly addresses known problems, the department should consider moving the commission-collecting function to its accounting section, which already collects operator fees for the program and possesses the necessary collection knowledge and accounts receivable tracking system.

To ensure that the program provides adequate consulting, upward mobility training, and monitoring services to operators, the department should take the following steps:

- Offer program participants a second training location. This will ensure that the program complies with existing state law intended to remove potential barriers to individuals entering the program.
- Ensure that the program identifies and offers upward mobility training classes for operators as stated in its strategic plan.
- Track location reviews to identify past-due reviews and to ensure that business enterprise consultants complete the required reviews at least quarterly.
- Discontinue its practice of waiting 60 days before identifying delinquent monthly operating reports. Also, the department should require the accounting section to enter the data into the database more promptly. These steps would provide program consultants with important financial information sooner.
- Ensure that consultants contact operators regarding missing monthly operating reports when the reports are a month or more delinquent, as required by current regulations.
- Make sure that the program monitors operators adequately to prevent the accumulation of significant past-due fees and lengthy delinquencies in reporting. When operators refuse to submit financial reports as required by regulations, the department should demonstrate it is willing to suspend and terminate operators' licenses to ensure compliance with program requirements.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

Date: September 12, 2002

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APPENDIX A

The Department's Progress in Implementing Prior Audit Findings

TABLE A.1

The Department's Reported Progress in Implementing Recommendations From the Bureau of State Audits' June 2001 Fiscal Audit

Recommendations	Department Actions
To improve its financial management of the program, the Department of Rehabilitation (department) should take the following steps:	
Complete its strategic plan, including a component that outlines future uses of the vending stand fund and that will help the department determine whether its surplus can support its approved projects.	The department recently completed its strategic plan for the program. The plan includes a three-year spending budget that outlines proposed uses of program funds.
Finish its survey of state and federal properties to identify vending machine opportunities that could generate commissions for the program.	The department completed its survey and in March 2002 submitted a report to the Legislature and the governor's office identifying five new locations feasible for program development.
Identify and pursue vending machine commissions from agencies and vending machine operators that refuse or fail to remit commissions.	Since August 1998 the department has not actively pursued collection of past-due commissions. See Audit Results for further discussion of past-due commissions.
Verify the exempt status of incorporated, nonprofit employee organizations, and then collect the vending machine commissions from those that are not exempt.	The department currently is not actively pursuing the collection of commissions from potentially exempt organizations. The department states that college and university organizations are not likely to cooperate and pay vending commissions. Consequently, the department has decided not to pursue collecting commissions from them.
The department should evaluate its need for resources to identify and collect income from operators of vending machines, and it should consider taking one or all of the following steps:	
Use the results of its strategic plan to determine whether it can allocate staff from other units of the department.	The department has recently completed its strategic plan and states that, because of budget reductions and the current hiring freeze, there are no additional staff resources to devote to the vending machine unit. The department believes it should be able to maintain its new commission database with current staff and the assistance of a consultant. See Audit Results for further discussion of uncollected commissions and weaknesses of the new database.
Evaluate the feasibility of the blind operators' proposal for contracting for professional services to identify and collect vending machine commissions.	The department is still reviewing the feasibility of the proposal and has missed its initial deadline to reach a decision by August 2002.
Consider seeking legislation to amend state law to allow the department to use some of the vending machine income for hiring staff to perform the program's administrative functions.	The department disagrees with this recommendation. It believes that such a change in state law would conflict with federal law governing the program.

TABLE A.2

The Department's Reported Progress in Implementing Recommendations From the Bureau of State Audits' August 1997 Programmatic Review

Recommendations	Department Actions
To ensure that it is adequately promoting the program, the department should take the following actions:	
Consistently inform all rehabilitation counselors for the blind and counselors about the program to ensure that all blind clients of the department are made aware of it.	The department states that it discusses the program at new employee orientations, during district visits, and at numerous meetings of blind organizations and counselor groups. The department also states that it annually mails promotional material to various blind organizations, community groups, and department counselors.
Initiate mailings to blind individuals and community organizations to ensure that blind individuals who are not currently clients of the department are made aware of the program.	
To ensure that all applicants meet criteria for the program, the department should take the following actions:	
Comply with existing state regulations, or if appropriate, propose revisions to state regulations to remove the requirements that medical and vocational evaluations document an applicant's physical and emotional qualifications to operate a vending facility.	The department plans to propose revisions to state regulations to remove requirements that medical and vocational evaluations document an applicant's physical and emotional qualifications to operate a vending facility.
Require medical evaluations that provide evidence of the applicant's TB status.	The department now requires prospective trainees to provide evidence of their TB status.
To fulfill its mission to provide blind persons with enlarged economic opportunities and assist the efforts of the blind to be self-supporting, the department should do the following:	
Aggressively identify and establish profitable vending locations on both public and private property, combine locations when beneficial, and document the analysis performed to determine a location's potential.	The department believes it fulfills its mission to establish profitable vending locations. State and federal agencies are required by law to notify the department when facilities with food service become available. Additionally, the department has received from the Department of General Services a list of all state agency locations. Program staff have evaluated the potential of these locations to house new program vending facilities. The department maintains documents to support its analysis of new locations.
Formulate criteria and procedures for supplementing less lucrative locations and apply them consistently.	The department plans to promulgate regulations to provide a process to allow operators to compete for a location that can be combined with his or her existing location. See Audit Results for further discussion of the department's efforts to update regulations governing the program.
Establish a process to identify and pursue priority for blind operators when a state or federal facility has a vending facility that is not operated by a licensed blind operator.	The department states that it has sent letters to appropriate state and federal agencies reiterating the program's priority for operating vending facilities located on state and federal property. The department requested that these agencies report to it any vending facilities operated by parties other than program operators. Also, department staff prepare an annual report of vending facilities operated by private businesses from its database of private businesses that pay commissions on sales of vending machines operated on state and federal property. Staff can then group and analyze these locations for potential development into a program vending machine location.
To ensure that it is taking adequate steps to expand business opportunities, the department should establish procedures to systematically study the successes of private enterprise and analyze potential lucrative business opportunities. In addition, it should consider innovative ways to implement new business opportunities in the program.	The department addresses innovative ways to implement new business opportunities in its recently completed strategic plan for the program. See Audit Results for discussion of the weaknesses of the program's strategic plan.

Recommendations	Department Actions
To ensure that its policy for classifying and circulating locations to operators is equitable, the department should establish procedures to circulate all vending locations to eligible operators.	The department has not corrected the inequities inherent in its selection process for assigning interim locations. It plans to establish regulations to provide for a competitive process that will permit the department to circulate notices for all locations. Currently, the supervising business enterprise consultant for the region where the interim facility is located assigns interim locations at his or her discretion. This assignment is made from a list of operators who have expressed an interest in operating interim locations. See Audit Results for further discussion of the department's assignment of interim locations.
To improve its ongoing training program, the department should take the following actions:	
Ensure that the curriculum provides opportunities for all operators to improve current operations or improve existing skill level to advance to more complex vending facilities.	The department has provided limited upward mobility training opportunities for its operators. Its recent strategic plan includes plans to provide continuing education for operators with a projected implementation date of December 2002. See Audit Results for further discussion of training.
Consult with operators to develop ongoing training classes that meet their needs.	The department mailed a needs assessment questionnaire to operators to receive their feedback on desired training classes.
To ensure that the program meets its responsibilities to promote and encourage operator success, the department should do the following:	
Enforce state regulations that require operators to submit monthly operating reports (which the program previously called profit-and-loss statements) and maintain adequate records to assist business enterprise consultants in performing operating report reviews.	The department is testing an enhancement to its business enterprise financial system that will identify and report on missing monthly operating reports. See Audit Results for further discussion of monthly operating reports.
Develop procedures to ensure that the business enterprise consultants consistently and accurately complete operator appraisals and location reviews.	The department, with the approval of operators' policy committee, has eliminated the program requirement to have business enterprise consultants perform annual operator appraisals due to the perceived subjectivity of the evaluations. The department still requires that its business enterprise consultants conduct operator location reviews at least once every three months. However, the department has not ensured that the business enterprise consultants complete the reviews as frequently as required. See Audit Results for further discussion of location reviews.
Re-evaluate the use of business enterprise consultants to provide equipment services, with the goal of optimizing the time available for consulting services.	The department has not revised the responsibilities of the business enterprise consultants to reduce the amount of time they spend on equipment duties. However, it reported that it has consolidated equipment-purchasing duties and assigned them to a staff person at the central office.
Provide guidance to the business enterprise consultants by developing a formal training program and scheduling routine meetings to discuss policies and procedures that will ensure consistency in the services provided to operators.	The department's recently completed strategic plan for the program calls for improved quality and availability of training for program staff and has a projected implementation date of December 2002.
Establish clear policies for the business enterprise consultants to follow when counseling operators who are not complying with the terms of their contracts.	The department believes that existing statutes, regulations, and procedures for the program provide sufficient guidance to its business enterprise consultants and has instructed the consultants to take action consistent with these statutes, regulations, and procedures.
Modify operator contracts to include ranges of acceptable performance, and uniformly enforce the terms of the contracts.	The department disagrees with this recommendation and has not included performance ranges in its operator contracts.
Suspend or terminate the licenses of those operators who fail to respond to the business enterprise consultants' counseling and continue to disregard contract terms.	The department has sent letters to all operators, putting them on notice of its intent to take action against operators in violation of their contract terms.

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Recommendations	Department Actions
To improve its management of monthly operating reports, the department should take the following actions:	
Improve the accuracy of its database and add missing records. Implement procedures to improve the accuracy of the summaries of missing monthly operating reports it distributes to business enterprise consultants. Reconstruct records prior to September 1995 and follow up on missing monthly operation reports from that period. Intervene when an operator falls behind in submitting monthly operating reports and assist the operator if help is needed in preparing them.	The department has completed an enhancement to its business enterprise financial system, which will allow better monitoring of monthly operating reports. The system generally does not include records before September 1995. The department believes that the time and resources required to reconstruct monthly operating reports before September 1995 is better spent pursuing and maintaining records on a prospective basis. The new system enhancements will allow prompt identification of missing monthly operating reports and allow staff to intervene when the operator falls behind in submitting reports. However, current department practice allows reports to be 60 days delinquent before they are identified as being late. See Audit Results for further discussion of monthly operating reports.
Take action against chronically delinquent operators in accordance with laws, regulations, and department policy.	As stated on page 39, the department has sent letters to all operators notifying them of its intent to take action against operators in violation of their contract terms, which includes not submitting required monthly operating reports. Additionally, the department has established payment schedules for many previously delinquent operators.
Ensure that monthly operating report information is provided in a timely manner to business enterprise consultants so they can promptly follow up with the operators.	See system enhancement previously described.
Estimate fees and penalties owed from operators for missing monthly operating reports and record the estimated amounts as receivables.	The department generally estimates the fees and penalties associated with missing monthly operating reports and includes these amounts as part of its reported contingent receivables on its year-end financial statements for the program.
To improve its monitoring of accounts receivable, the department should identify when a operator is falling behind in his or her payment of fees and establish a reasonable corrective action plan, and remove the operator from the location or take action against the operator's license if he or she fails to comply with the corrective action plan and pay all fees.	The department is currently testing an enhancement to its accounts receivable system that it hopes will enable consultants and management to better monitor operators that fall behind in payments to the department. See Audit Results for further discussion of the department's monitoring of operators' financial problems.

Recommendations	Department Actions
To ensure that it appropriately administers set-aside fees, the department needs to take the following actions:	
Ensure that it uses set-aside funds only as allowed by federal law and propose changes to state law to ensure it is consistent with federal law.	Consistent with the purposes identified in federal law for set-aside fees, the department no longer makes initial stock loans to operators as was allowed by state law and the department's procedures manual.
Vigorously attempt to collect all outstanding initial stock loans.	The department has contracted with a collection agency for collection of overdue stock loan accounts.
Reimburse the trust fund for moneys that were used as initial stock loans.	The department disagrees with this recommendation and has not reimbursed the trust fund for money used as initial stock loans.
Propose legislation to eliminate the $1,000 income minimum and require all operators to pay fees.	The department disagrees with this recommendation and has not proposed the suggested legislation.
Modify the existing fee schedule to ensure that all operators pay a fair amount of fees.	The department disagrees with this recommendation and believes that not all operators should be required to pay fees. However, the department has currently assigned work groups to review the fee schedule to ensure that all operators pay a fair amount of fees.
Ensure that the set-aside fee schedule is appropriately updated.	The department generally updates the fee schedule's minimum amount required for paying fees annually but has not yet updated the amounts of fees to be paid by operators. Further, the department plans to promulgate regulations to establish the process for updating the entire fee schedule. See Audit Results for further discussion of the department's efforts to update its program regulations.
To improve its collection of vending machine commissions, the department should do the following:	
Continue its efforts to enter into contracts with vending machine companies.	The department has continued its efforts to enter contracts with private vending machine businesses. However, it does not always get copies of contracts that other agencies entered with private vending machine businesses. This hampers the department's ability to effectively monitor the commissions these businesses pay to the department. See Audit Results for further discussion of past-due commissions.
Consider dedicating additional staff to assist in establishing contracts.	The department has not added any additional staffing resources to establish contracts.
Perform an analysis to determine the costs and benefits of using moneys in the trust fund to address staffing needs.	The department maintains that trust funds should not be used for additional staffing.
Establish procedures to monitor contract compliance.	The department performs a desk audit of reported commissions by multiplying reported sales by the contract commission rate. However, the department is unable to verify the accuracy of the reported sales amounts and, as previously discussed, does not always have the contract to identify the contracted commission rate. See Audit Results for further discussion of this issue. In the past, the department's internal audit unit performed site reviews of a few of these private vending machine businesses; however, due to other priorities and limited resources, no such audits have been performed since 1999.

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Recommendations	Department Actions
To ensure that vending machine commissions are appropriately used, the department, with the approval of the operators, should establish a plan that would use the unassigned vending commissions to benefit all operators.	The department currently uses unassigned vending machine commissions to fund the retirement of all operators assigned a vending location.
To improve its controls over program assets, the department should take the following actions:	
Discontinue the practice of allowing a private food-service company to use equipment purchased with federal funds.	For the case in question, the department corrected the situation by selling the equipment that previously was being used by a private food-service company. However, the department is currently allowing private food-service businesses to use program equipment through its encouragement of private partnerships. See Audit Results for further discussion of partnerships.
Collect the money that is owed to it by the Legislature.	The Legislature was billed for, and has paid, the amount it owed the program.
Ensure that all contracts entered into with other entities are for authorized purposes and are approved by staff with the appropriate authority.	The department maintains that all contracts are forwarded to its budget and contract section to be reviewed and signed by the appropriate department representatives. However, we have concerns with the contracts for private partnerships. See Audit Results for discussion of private partnerships.
Promptly reconcile the results of its physical inventories with the equipment records.	Currently, the department's business services unit does not reconcile the physical inventories of the operators' facilities with property records. The business services unit recently stopped performing physical inventories due to department-imposed travel restrictions as a result of the current budget crisis.
To minimize the potential financial risk to both operators and the State, the department should take the following actions:	
Work to resolve the retirement plan issues as quickly as possible.	With the establishment of its new retirement system and the system's favorable tax status approval acquired from the Internal Revenue Service, the department maintains that its retirement issues have been resolved.
Perform a thorough review of the status of the operators as state employees or independent contractors.	The department believes that no additional legal analysis is needed.
Implement those modifications that will ensure that workers are treated as intended.	The department maintains that program operators are not state employees but independent contractors who own their own business consistent with the statutes and regulations that govern the program. However, the department added a clarifying paragraph to its standard operator agreements to reinforce this.

APPENDIX B

Survey of Blind Operators of Food-Service Facilities

To obtain input from blind operators of food-service facilities (operators) regarding the administration of the Business Enterprise Program for the Blind (program), we surveyed 35 active operators by telephone. Below are summarized results of the key questions on the operator survey.

	Yes	No	Unsure		
Does the income you receive from participating in the program allow you to be self-supporting?	71.4%	28.6%	—		
	Increased	**Decreased**	**Gone Up and Down**	**Remained the Same**	
Since you have been in the program, has your income from participating in the program . . .	45.7%	17.1%	34.3%	2.9%	
	0 times	**1 Time**	**2 Times**	**3 Times**	**4 or More Times**
How many times did your business enterprise consultant (consultant) visit your facility in the last 12 months?	0.0%	2.9%	14.3%	17.1%	65.7%
	Location Review	**Provide Training or Guidance**	**Equipment**	**Other***	
What was the focus of the consultant's visits to your facility?†	65.7%	11.4%	34.3%	65.7%	
	Yes	**No**	**Unsure**		
Did you receive any feedback from your consultant, such as a location review report, as a result of a facility visit?	91.4%	8.6%	0.0%		
Was the feedback you received appropriate and helpful?	80.0	2.9	17.1		
Are equipment repairs and replacements done in a timely manner?	71.4	17.1	11.4		
When you applied for your current location, did the program accurately estimate the location's expenses and income?	60.0	34.3	5.7		
Are you actively seeking to change locations?	40.0	60.0	0.0		
Should your location be closed or combined with another location?	42.9	54.3	2.8		
Are you satisfied with the program's development of new locations?	42.9	51.4	5.7		
Do you believe the program offers adequate opportunities for upward mobility?	74.3	25.7	0.0		
Do you believe there are barriers to upward mobility?	52.9	47.0	0.0		
Do you believe there are barriers to entering the training program?	17.7	58.8	23.5		
Are you interested in working with a private partner—in general, not necessarily at your current location?	45.7	34.3	20.0		

* Other included such categories as reviewing inventory; remodeling; speaking with the health department or building management; and checking sales, sharing ideas, or touching base.

† Survey participants could choose more than one response, thus the total percentage of responses is greater than 100 percent.

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Agency's comments provided as text only.

California Health and Human Services Agency
1600 Ninth Street, Room 460
Sacramento, CA 95814

August 28, 2002

Elaine M. Howle*
State Auditor
Bureau of State Audits
555 Capitol Mall — Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Attached you will find the response of the Department of Rehabilitation to your recent draft audit report of the Business Enterprise Program for the Blind. I have also enclosed a diskette containing the department's response.

Sincerely,

(Signed by: Grantland Johnson)

GRANTLAND JOHNSON

Attachments

* California State Auditor's comments begin on page 61.

Department of Rehabilitation
2000 Evergreen Street, 2nd Floor
Sacramento, CA 95815

August 28, 2002

Elaine E. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Report #2002-031

Dear Ms. Howle:

Enclosed is the response to your report entitled **"Department of Rehabilitation: Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind"** performed in accordance with Section 19640.5 of the California Welfare and Institutions Code. Thank you for the additional time to respond to the report.

If you have any questions about the response, please contact Juney Lee, Assistant Director, Operations and Accountability Section at (916) 263-8826.

Sincerely,

(Signed by: Catherine Campisi)

CATHERINE CAMPISI, Ph.D
Director

Enclosure

DEPARTMENT OF REHABILITATION
Response to the Bureau of State Audits Report Entitled "Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind"

INTRODUCTION

Since January 2000 when the current executive level management team assumed responsibility of the Department of Rehabilitation (department), the department has been strongly committed to make the Business Enterprise Program (BEP) program a success and recognizes that improvements are needed to achieve that goal. Despite the many real barriers that the department has encountered during the past 2 years, the department has accomplished the following:

1. The development of a strategic plan and implementation of a financial planning process, which enables the program to project revenues and make sound decisions for program growth and improvement.
2. Completion of a master purchase agreement, which streamlines the purchasing process for vending machines.
3. Competed for and won the contract to provide food service at Edwards Air Force Base where the blind vendor recently won the Hennessey Award, the top honor awarded for food service by the Air Force.
4. Opened vending facilities in 7 prisons and 1 roadside rest, the top income producing types of BEP locations.
5. Automated the annual reporting process required by Rehabilitation Services Administration (RSA), reducing required staff time by 75% and improving accuracy.

In addition, beginning fiscal year 2002-03, the department plans to establish approximately 30 highly profitable vending machine locations over the next three years.

The department is pleased that the survey of program participants conducted by BSA (Appendix B) indicates strong satisfaction with the program. A large majority of the vendors surveyed felt that the income they earned allowed them to be self-supporting, the oversight and feedback provided by the program was helpful, the equipment repairs were provided in a timely manner, and that there was adequate upward mobility. California compares favorably with other BEP programs and, in fact, the average income California vendors receive is above the national average.

The department faces many challenges brought on by reductions made in the department's budget for Fiscal Year (FY) 2001-02 and further reductions being considered for budget year 2003-04. In addition, the department faces elimination of an unknown number of vacant positions, many of which may support the BEP. However, despite these challenges as well as other real barriers facing all departments responsible for program implementation, the department is committed to improving the overall performance of the BEP.

The department provided the BSA valid examples of external occurrences that have had a significant impact on the program, such as changes in the department's administration and program management, department reorganization, changes in the membership of the advisory committee representing the vendors and key staff vacancies. These occurrences, although heavily discounted in the report, are very real and have significantly impacted the department's ability to manage this program.

The department understands the nature and reason of a programmatic review and welcomes feedback for the betterment of a program. However, the department believes that this report lacks perspective and does not present a balanced and objective review of the program. The department strongly disagrees with some of the statements, conclusions and mischaracterizations of information concerning the management and operation of the BEP. However, the department will consider the suggestions and recommendations made in the report and continue to do its best to make a very successful program even better. The department offers the following in an attempt to provide clarity and perspective to some of the statements and conclusions made in the report.

IN RECENT YEARS, THE PROGRAM HAS ACHIEVED ONLY LIMITED SUCCESS IN MEETING ITS GOALS

Participation in the program has remained steady during the last five years with the exception of a peak of 16 in FY 1997-1998. The department conducts continuous outreach efforts seeking new vendors to enter into the program. Several factors may impact consumers' decision to choose the program as their vocational outcome. Consumers know that to be successful in the program they might be required to relocate several times. Also, other opportunities are available to consumers who are visually impaired through the department's vocational rehabilitation program. These other employment opportunities may be available in their own communities. Ultimately, it's up to each consumer to make the choice to enter the BEP or not.

According to the survey included in BSA's report, 71.4% of vendors surveyed indicated that the income they receive from the program allowed them to be self-supporting. This high percentage could be attributed in part to the generous benefits package provided by the program. For example, in FY 1999, 2000, and 2001, vendors received an annual contribution to their retirement fund of $6428, $6595, and $5868 respectively. Vendors also receive monthly benefits of health insurance premiums at $225, dental at $34, and life insurance on a sliding scale at $.58 per $1000 of coverage the cost of providing their own individual health benefits if the program did not provide them would be much higher. Therefore, in the year 2000, for example, for the 30% of vendors receiving an average net income of less than $1050 per month, their actual average monthly income including benefits would have been $1909. Additionally, many vendors employ spouses and adult children whose wages are reflected as expenditures on the Monthly Operating Report (MOR) but in fact, contribute to the family income.

The department established a standard of $2500 per month as a measure to determine whether to open a new facility and not as a measure to determine self-sufficiency. To the extent vendors continue to operate facilities earning less than $2500 per month, despite opportunities to move into more lucrative locations, they do so for a variety of reasons: they have sufficient income, they do not wish to relocate, and/or they do not choose to work in a more demanding location. The department intends to continue adding more profitable locations to the program; however, the program does not set minimum standards for ongoing operations. Vendors have had, and will continue to have, regular opportunities to move into more profitable locations.

The department has written procedures for finding vendors for interim locations. The field office supervisors send a letter-of-interest to all vendors in their regions approximately every two years to generate a list of potential interim vendors. Names of other interested vendors may be added to the list upon written request to the supervisor on an ongoing basis. The selection of an interim vendor is based on availability, qualifications, and proximity to the vendor's primary location.

The department does not circulate announcements for interim locations because, based on experience, it is not productive or practical. In emergency cases such as sudden abandonment through the death of the vendor, the staff must find an interim vendor as quickly as possible, which precludes following a more lengthy procedure. Following the selection of an interim vendor, however, staff circulates the location to all vendors, following the procedure for selection of a permanent vendor.

THE DEPARTMENT ONLY RECENTLY PROVIDED STRATEGIC DIRECTION TO ITS STAFF AND PARTICIPANTS

While the BSA accurately identifies a lag in time for the department to issue its first strategic plan, the department followed through with a previous BSA recommendation to develop and issue a strategic plan. The report discounts the significant factors that impeded the department's ability to complete the strategic planning process in a timelier manner. However, in year 2000, a change in administration occurred, resulting in a period of time before the department appointed its upper management team. It also took time for the department to complete a structural reorganization to better serve individuals who are blind and visually impaired, among others. Moreover, since year 2001, the department has faced significant vacant positions and resource constraints, which further slowed the planning process.

The BEP strategic plan identifies specific objectives, specific tasks and staff assignments. The department agrees that benchmarks and identified outcomes would be helpful and will consider such performance measures in future updates to its strategic plan.

THE DEPARTMENT HAS FAILED TO UPDATE ITS GUIDELINES FOR THE ADMINISTRATION OF THE PROGRAM

The existing state and federal regulations guiding the administration of the BEP are extensive and complete. The department acknowledges that some of the regulations may be outdated and can either be modified or eliminated. However, the department is not aware of any specific regulation that has impeded its ability to efficiently and effectively manage the BEP. In addition, the Welfare and Institution Code requires the department to only consider revisions to its regulations on a regular basis, which the department has done repeatedly over the years. So, while the BSA is correct in its statement that the department did not make changes to its regulations, the department is not required to change any regulation within a specified period and in fact, is not required to make any changes to the regulations at all. It is a matter of management discretion to assess the need for regulatory changes and the relative priority for such changes compared to other program needs. Furthermore, the department does not agree with the BSA's conclusion that a lack of revisions to the regulations equates to an absence of guidance. The existing regulations provide extensive guidance regarding the administration of the program.

In addition to the lengthy process needed to analyze, develop and obtain appropriate approvals for amendments to regulations, the department is required to consult with the California Vendors' Policy Committee (CVPC) that represents the operators concerning policy development, including regulations. A change in the committee membership occurred while the department was in the process of reviewing possible regulatory changes. Consultation with the committee, before and again after the change in membership, extended the required period for development of regulation changes.

In the report, the BSA faults the department for making its draft regulations "overly comprehensive" and in its judgment such level of detail "may" render the program "inflexible." However, the BSA provided no support for its judgment that the level of detail being considered in the revised regulations is inappropriate. In the department's experience, in many cases, greater detail has facilitated a superior administration of the program. The department acknowledges that it is difficult to satisfy the statutory requirement that certain types of rules be issued as regulations while at the same time preserving maximum flexibility in its ability to operate the program. The difficult challenge of drafting appropriate regulations requires that the department proceed deliberately. In addition, the department will initiate a review of the regulatory changes by the Office of Administrative Law only after the final version of the proposed regulatory changes have been reviewed by the department's legal staff.

The department does not believe that issuing policy in lieu of regulations is a sound management practice, as this would expose the department to legal action to have such policies considered as underground regulations hence unenforceable. The department is required to place certain types of rules into regulation, after appropriate notice and opportunity for public comment. The department is not free to issue policies, if the subject matter of the policy is regulatory in nature.

In the report, the BSA states the department has not provided guidelines to staff in making decisions regarding equipment purchases, including a list of appropriate and inappropriate equipment. As a result, the report concludes that operators "may not be receiving equitable services."

Department staff is guided by existing regulations regarding equipment, including the requirement that the program consult with the vendor concerning equipment purchases. The department believes that allowing program staff to evaluate and decide a vendor's equipment on a case-by-case basis is appropriate. Each location has unique needs, based upon factors such as customer preferences, potential food sales produced by the equipment, other equipment already in use at the location, space, local competition and operator needs. Overall consistency is also assured by approval of purchases by supervisors after consultation with the program manager. In its report, the BSA does not cite any instances in which a program operator was treated inequitably, instead apparently relying upon the speculation of one operator who stated that his request for equipment might be denied while another operator received the same equipment. Regulations allow program operators the right to appeal decisions if they disagree with a decision regarding equipment. As the program has received very few grievances from operators based on this issue, the department believes that the current flexible and collaborative approach to equipment purchases is working well.

BY ALLOWING OPERATOR PARTNERSHIPS WITH PRIVATE COMPANIES, THE PROGRAM HAS COLLECTED INEQUITABLE OPERATOR FEES AND MAY NOT HAVE COMPLIED WITH FEDERAL LAW

The department does not allow vendors to trade program benefits to private companies and the department has not provided program resources to such companies.

As noted in the report, the Randolph-Sheppard Act, under which the program is operated, does not prohibit contractual arrangements between operators and private companies. Such agreements are in use in other states. The department acknowledges that legitimate issues for discussion exist with respect to contractual arrangements between operators of vending facilities and private businesses. However, the BSA is incorrect in characterizing these agreements as "partnership agreements" and the department as a party to the agreements. Nonetheless, the department agrees with the BSA that such contractual relationships should not and will not relieve operators of their responsibility to operate or manage their facilities.

These agreements are limited in number and scope and are between the operator of the facility and a private business. Over the past few years, the program has explored the use of these innovative contractual arrangements between the operator and private companies in a few unique situations where the program believed that such an arrangement would permit a facility to be operated (and provide an opportunity for a blind individual) that otherwise could not be operated. The program has attempted to assure that the proposed arrangements are consistent with state and federal law. No program funds or other benefits are made available to the private entities and the

private entities pay fees similar to other program participants. In each case in which the department has approved contractual arrangements with a private company, the department has done so within the framework of existing regulations that specifically provide that the vendor is responsible for managing and operating the facility.

Further, it should be noted that while existing regulations provide that the operators are responsible for managing and operating the facility, the operators are permitted to purchase services, including the services of on-site manager, food suppliers, accounting services, etc. Within the parameters of the regulations and the operating agreement for their facility, the operators have the same freedom as any other small business operator to decide how the facility is operated and with whom they contract for services.

The contractual relationships with private entities have only been used for specific purposes and have only occurred to date in two limited circumstances: in connection with food service at federal military bases, and in connection with cafeteria operations on state property.

One of the six facilities referenced in BSA's report is a military base. A contractual agreement between the operator and an experienced food service company permitted the operator to obtain a facility that he otherwise could not have obtained and operated. The contract between the operator and private company required the operator to function as the manager of the operation, with management assistance, training and a line of credit provided by the private company. The federal government awarded the underlying food service contract for a limited period, and the parties contemplated that the services of the private company would likely be required throughout the term of the underlying contract given the size and complexity of the operation. Accordingly, the contract between the operator and vendor did not include a timetable for the private company to cease providing assistance at a particular point.

As noted in BSA's report, the program has also explored the use of contractual arrangements between vendors and private companies in the context of cafeteria operations in an effort to address the historically low profitability of such facilities. Cafeterias produce the second least net income of any type of facility in the program, are more difficult to operate, and are fraught with personnel, liability and quality issues. Many cafeteria locations have been unable to attract an operator for years with some even returning to the private sector. The program has to either implement new and innovative methods to make cafeteria operations more successful or cease cafeteria operations all together. Use of contractual agreements with private companies appears to be a potential option to assist vendors in operating this type of facility successfully.

Currently, certain vendors who are operating cafeterias have entered into arrangements with private companies. One such facility is a cafeteria in a state building operated by an interim vendor. Although the cafeteria is large and attractive and 2500 people work in the building, there are dozens of restaurants in the area that compete with the facility. A local restaurateur expressed interest in working with a blind vendor

to develop the business. An interim vendor was identified, and a proposed contract between the vendor and the private entity established a specific training program for her. As she is an interim vendor, and has her main location in another building, she is not at the cafeteria all the time (nor is she required to be by state regulation). She is, however, responsible for the operation of the facility and is learning the many facets of running a cafeteria. Since the cafeteria was built and equipped by Department of General Services (DGS), no funds were invested by the program in this arrangement. The program has been able to open and operate the facility while providing training and experience to a vendor.

A second cafeteria in which the vendor is working with a private company involves a state leased building. The existing cafeteria is poorly designed, it is extremely large and requires a minimum of thirteen employees to operate. The building population is relatively low. The previous occupant of the building subsidized the cafeteria operation. Only a very experienced operator could be expected to make the location profitable without such a subsidy. Because of its high visibility, several local restaurateurs approached the state agency when it first occupied the building to express interest in operating the cafeteria. After analyzing its potential, however, these companies all declined. The program believed that with the assistance of an experienced private entity, a vendor might be able to succeed. The original owner of the building had provided all of the equipment and furnishings, so very little expense was required to open the facility. The blind vendor selected to operate the facility is on-site every day, participating in the operation of the facility and acquiring training from the private company. No program benefits were exchanged with the private company by either the blind vendor or the program.

The department's expenditure of $800,000 noted in the report was mostly attributable to the establishment of one particular facility located in the newly built East End project and, contrary to BSA's statement, did not benefit private entities. The East End is being constructed through a joint powers project involving not only DGS and the state departments that will be occupying the space, but also the City of Sacramento and the Capital Area Development Authority (CADA). DGS notified the program over two years ago that it did not want a typical "sterile state cafeteria." Instead, DGS wanted a high-end restaurant in this facility to satisfy the concerns of the city in particular that this facility be open evenings and weekends to avoid a "black hole" effect in the heart of the city after working hours.

The department viewed this particular location as an excellent opportunity to be innovative and demonstrate that the BEP can provide top of the line customer service. The program recognized that this facility would be more expensive to establish than a typical cafeteria; however, due to the size of the complex, the potential exists for the location to produce significant revenue, provide above-average income to the operator and generate significant fees to the program. The program analyzed the selected vendor's concept for the location, as well as the level of investment needed and potential income for the vendor. A thorough analysis was made of the potential return from the restaurant at the East End project both for the vendor and for the program.

The funds allocated for the East End project are for the development of the restaurant for the program and its selected vendor, not for a private entity. At this time, although the vendor contemplates a contractual arrangement with a private company in connection with this facility, no such arrangement is required nor has any agreement been reached.

In all instances when vendors enter into an agreement with private vendors, the department takes the necessary steps to reasonably ensure that the interests of the State and of program participants are protected.

The department acknowledges that it has not yet developed specific guidelines with respect to the contractual arrangements between vendors and private companies. The department is currently evaluating the merits of these arrangements and considering how best to provide criteria and guidance for their use. The department will develop procedures to ensure compliance with current guidelines. However, program management has been mindful of the legal and regulatory framework applicable to the program in its exploration of the use of innovative contractual arrangements in a limited number of cases.

The department acknowledges that in two instances program field staff allowed arrangements to proceed without contacting program management to assure that any such arrangements were consistent with existing regulations and statutes. However, these arrangements were never approved. When program management learned of these proposed arrangements, field staff was advised that these arrangements were not approved and notified all field offices that these types of arrangements must be reviewed and approved by program management.

The department acknowledges that the preparation of the MORs and calculation of the set-aside payment can be complicated in situations in which the vendor and private party have a contractual agreement. The department continues to review this issue. Based upon the limited number and scope of these types of arrangements, however, the department believes that the BSA overstates the magnitude of this issue.

In one instance identified in the BSA report, a vendor was operating a facility with the assistance of a private entity without a contractual agreement in place. The program is working to correct this situation.

With respect to another contractual arrangement, the BSA criticizes the department for agreeing, “that any future program participant would be required to accept the same terms as the original contract” regardless of the program participant’s wishes. While this is a true statement, such an agreement was necessary in order to secure the services of the private company to assist in the operation of the facility on the military base. The program agreed that the private company could continue to participate in the operation of the facility for the term of the underlying military contract, in the event that the operator left the facility. This request was reasonable under the circumstances, because of the limited term of the underlying contract and the need for the company

to be assured a reasonable opportunity to recoup its cost of initial outlay. This agreement did not prevent any operator from managing this site alone, because no vendors had the requisite experience or credit line necessary to undertake performance of the underlying food service contract without assistance.

The obligation to report income generated from the facility rests with the operator. There is no evidence that the department has not enforced such reporting by the participants who have entered into arrangements with private entities. BSA's point is well taken, as noted above, that calculating the set-aside to be paid can become more complicated when the vendor's agreement with the private entity involves payment for services based upon a percentage of the facility's income. In determining the amount of set-aside, the department is considering how best to address this issue through the regulatory process. While the method used to determine the set-aside may be faulted in particular cases, these isolated instances do not support the conclusion that some operators who contract with private companies pay disproportionately lower fees than other operators. An operator's fees are based on the income of their own facility. They do not pay a "share" of program costs. The fees paid by a participant do not in any way affect the fees paid by others.

It is inaccurate to conclude that in all cases the department has "allowed the partnerships to submit less information on monthly operating reports than other locations." The department agrees that, in isolated cases, there is an issue with respect to the information being reported. The department is reviewing these cases and will address them.

THE DEPARTMENT HAS FAILED TO ADEQUATELY ADDRESS SIGNIFICANT FLAWS IN ITS PROCESS FOR PURSUING PAST-DUE COMMISSIONS, SOME OF WHICH MAY NOW BE UNCOLLECTIBLE

The department has collected $6,135,517 of vending machine commissions from July 1997 - May 2002. Out of this amount, $629,000 was paid directly to vendors and $5,162,868 was deposited into the retirement fund.

The department concurs that it has not aggressively pursued or collected past due commissions for most of the contracts not remitting commissions since 1998. However, the department began a process of pursuing past due commissions in late July 2002. The department will pursue past due commissions based on available staff resources starting with the most recent past due commissions. The department has notified delinquent vendors in situations where the vendor has submitted a bid for a contract at another location, or when special circumstances arose that made the department aware of the past due commissions.

The department has not been able to pursue past due commissions primarily because the information needed to determine past due commissions was lost and/or corrupted in late 1998 when the database storing the data crashed. Consequently, the department

began designing and building a new system in 1999, as several attempts to restore the database failed. A consultant was contracted to complete the database in 2001, and the department is continuing to refine the database system.

Although the new database system is not yet fully operational, the department is currently pursuing past due commission by improving the attributes in the database. These efforts will broaden its usefulness by allowing the database system to collect program and contract data and serve as an accounts receivable system. The department will evaluate the Board of Equalization's (BOE) process cited by the BSA. However, unlike BOE, the department has no statutory or regulatory authority to demand payment and establish an account receivable based on historical information.

The department concurs with the BSA's comment that it does not always have current and accurate contract information and cannot always verify commission payments. The department routinely requests a copy of the contract when the state or federal agency receiving the vending services implements its own contract. However, when the department is not a party to a contract, it has no authority to require a copy of a contract from private businesses or public agencies. The private business and state or federal agency are complying with the statute by submitting income derived from vending services. The department has no authority to require the vending company to enter into a contract.

The BSA stated in the report that staff responsible for collection are under trained, and suggested that the collection process should be transferred to the Accounting Section. The vending machine contracts and commissions collection system is more complex than a typical accounts receivable function. The commission collection is only one part of the contract and commission functions and information necessary for the department to administer the BEP and the retirement fund. The department will evaluate the resources available and the proper placement of the collection function. The results of that evaluation will determine whether additional training and/or movement of the function are warranted, and the department will take the appropriate action based on the evaluation and available resources.

THE DEPARTMENT HAS NOT CONSISTENTLY FULFILLED ITS RESPONSIBILITIES TO PROGRAM PARTICIPANTS AS REQUIRED BY LAW AND ITS OWN REGULATIONS

The department had provided training in Sacramento and San Diego until late 1996. Declining participation in the San Diego class made it impractical to continue the training in this location (only one of three applicants successfully completed the 1996 San Diego class). Additionally, the program found that it did not have the facilities and other resources in the San Diego area to support the on-the-job training needs, and other requirements, of the training class. Plans were formulated to move the class to Los Angeles, but a suitable classroom site could not be secured, and during this interval the Southern California trainer left the position. Since then, the training class has been conducted in Sacramento where all the training needs can be met. However, the train-

ing workgroup established for the strategic plan has been studying all issues regarding training, including training locations, and will be submitting its recommendations by December 31, 2002.

The department trains vendors to operate and manage all types of facilities offered in the BEP. Consequently, the department believes that BSA's criticism for not providing upward mobility training is unwarranted. Training a vendor to operate only a specific type of facility would make it necessary to provide upward mobility training to allow the vendor to advance to a more complex facility. However, the training that the department provides to all participants certifies and licenses them to operate all types of facilities, hence they do not need to obtain additional certification to advance to more complex facilities. In addition, the department offers training to all interested vendors in the areas of sanitation, vending machine operation, and selection committee presentation on an on-going basis. All certified BEP vendors are welcome to attend part or all of the training offered by the program as a refresher.

The department agrees it can do a better job in providing and tracking the quarterly location reviews. However, the department provides feedback in a number of other ways not referred to in the report. For example, the MORs are reviewed on a monthly basis by the field staff for discrepancies or problems, which are discussed with the vendor by telephone, written correspondence, and site visits. The field staff visits their locations on a regular basis. The lack of a location review is not an indication that the operator did not receive feedback. In fact, BSA's own survey of the operators indicates the vendors receive feedback on a regular basis that they find appropriate and helpful (See Appendix B).

Department staff does follow up on missing reports from operators. In fact, the program has taken action to terminate the licenses of several vendors based on delinquencies. The department is not aware of and the BSA did not link the failure of any individual vendor to a lack of timely review on the part of the department of the vendor's MOR. Further, the review of the MOR is unrelated to the issue of whether the vendor experiencing financial difficulties received other forms of assistance or intervention from the program. Moreover, vendors can experience business problems for a variety of reasons, not all of which can be resolved by the program.

RECOMMENDATIONS

To ensure that its application and selection process for locations is equitable, the department should establish procedures to circulate all permanent and interim vending locations to eligible operators.

Response

The department already has an established procedure for circulating all permanent vending locations to eligible operators. The department also has a procedure for selecting interim operators that the department believes is equitable and appropriate

The department, in consultation with the Vendors' Policy Committee, should revise the program's strategic plan to include expected outcomes and performance measures so that the department can evaluate the program's success and measure its progress toward achieving strategic goals and improving noted deficiencies.

Response

Although the department believes its current plan is sufficient, it will review the plan and consider BSA's recommendation.

The department should aggressively and promptly pursue development of program regulations. If the current draft is too complex or lengthy, the program should consider breaking the draft regulations into segments, first identifying and addressing the highest priorities. The department should ensure that the guideline include measures that will improve consistency in equipment purchase decisions, including a list of allowed and disallowed equipment and supplies, and statewide criteria for equipment purchase and replacement.

Response

The department will pursue appropriate regulatory changes consistent with the department's overall needs, priorities and resources. The department will consider the suggestion regarding addressing particular regulatory issues in separate regulation packages. The department believes its current system for equipment purchases is consistent, and does not unreasonably consider individual location needs. Statewide criteria for equipment replacement currently exist in state regulation.

To improve its administration of private partnerships, the department should take the following steps:

- **Establish and follow guidelines for partnerships, ensuring that they are in agreement with federal and state law, regulations, and guidance.**
- **Ensure that program staff further study the cost and benefit of each partnership to determine that future agreements do not inequitably drain program resources.**
- **Establish a review process for proposed partnerships that will allow the department to adequately protect state and program participant interests.**
- **Monitor partnerships to enable the department to compare the costs and benefits of partnerships and determine if they achieve the program's objectives.**
- **Ensure that program staff are able to monitor the success of all locations, including private partnerships.**

<u>Response</u>

The department is evaluating the use of contractual agreements between operators and private entities and considering regulations to address this issue. The department currently studies all potential locations for costs and benefits. No location would be approved for development if it drained program resources. The department will continue to monitor the success of all locations.

To ensure that it promptly addresses known problems, the department should consider moving the commissions' collections function to its accounting section, which already collects operator fees for the program and possesses the necessary collection knowledge and accounts receivable tracking system.

<u>Response</u>

The department will evaluate the recommendation and determine the proper placement for the vending machine commissions' collection function.

To ensure that the program provides adequate consulting and monitoring services to operators, the department should take the following actions:

- **Offer program participants a second training location. This will ensure that the program complies with existing state law intended to remove potential barriers to individuals entering the program.**
- **Ensure that the program identifies and holds upward mobility training classes for operators as stated in its strategic plan.**

Response

The department is in the process of evaluating the entire training program to ensure it meets the needs of the program participants, including offering program participants a second training location and the need for upward mobility training.

- **Track location reviews to identify past-due reviews and to ensure that business enterprise consultants complete the required reviews at least quarterly.**

Response

The department will strengthen its tracking system for the quarterly location reviews.

- **Discontinue its practice of waiting 60 days before identifying monthly operating reports delinquent. Also, the department should require the accounting section to enter the data into the database more promptly. These steps would provide program consultants with important financial information sooner.**

Response

The department will take this recommendation under consideration.

- **Ensure that program consultants contact operators regarding missing monthly operating reports when the reports are a month or more delinquent as required per current guidelines.**

Response

The department agrees with this recommendation. The department will develop procedures to ensure compliance with current guidelines.

- **Ensure that the program better monitors operators to prevent the accumulation of significant past-due fees and lengthy delinquencies in reporting. When operators refuse to submit financial reports as required by regulations, the department should demonstrate it is willing to suspend and terminate operators' licenses to ensure compliance with program requirements.**

Response

The department is pursuing delinquent vendors and will work to better monitor program operators. The department will continue to refer the suggestion to suspend or terminate operators' licenses to our legal department and, based on their counsel, consider the appropriate place and circumstances for such actions.

COMMENTS

California State Auditor's Comments on the Response From the Health and Human Services Agency

To provide clarity and perspective, we are commenting on the Department of Rehabilitation's (department) response to our audit report. The numbers below correspond to the numbers we placed in the margins of the department's response.

We disagree with the department that the report lacks perspective and does not present a balanced and objective review of the Business Enterprise Program for the Blind (program). Throughout the audit report we provide the department's perspective on the issues presented and impartially present the facts regarding the program as they exist.

The department is avoiding the issue presented and that issue is the adequacy of its written procedures. As we state on page 14, in 1997 we reported that the department's policy for classifying and circulating locations was inequitable because it had not developed a fair process for assigning interim locations. The written procedures to which the department refers predate our August 1997 report. Thus, as we state in our report at page 14, the department has not corrected this weakness.

The department has been responsible for administering the program since the 1960s. Recent challenges the department faced are not unique and should not have prevented it from providing its staff and program participants timely strategic direction. On the contrary, the circumstances the department describes are typical of the environment in which it works.

The department contradicts earlier statements it made to us in which it indicated that the lack of updated regulations hinders its ability to address recommendations made in prior audit reports. Additionally, the department explained to us that it had been working to update its regulations for many years. As early as its October 1997 response to our 1997 programmatic review, it reported that certain portions of its regulations were inappropriate, and that it intended to propose revisions to update them by December 1998. For example, it wanted to revise its regulation requiring medical and vocational evaluations. Again,

in its first meeting with us on March 13, 2002, the department stated that the lack of updated regulations was a barrier to it addressing certain recommendations from our past audits and that it was currently working to update its regulations.

We disagree with the department's statement. It was the department that concluded it needed to update its regulations to provide proper guidance to its staff and participants, as we discuss in note 4. However, as we state on page 15, in certain areas outdated regulations for administering the program have contributed to the lack of clear guidance in these areas.

The department misrepresents our statements. On pages 17 and 18 of our report, we do not fault the department for making its regulations overly comprehensive. However, we caution the department that doing so could render the program inflexible. We clarify our meaning by stating that program guidelines that are susceptible to frequent or regular change might be better specified in policies so that the department can respond to changing conditions without going through a lengthy regulatory process.

The department wrongly assumes that our conclusion is based on the speculation of one operator. Our conclusion is based on many hours of audit work—interviewing consultants and reviewing program records. The instance we cite in the report was intended to provide the reader with a practical example. It was not intended to be misconstrued as the sole basis for our finding.

We believe that the term "partnership" correctly characterizes these agreements. In fact, in documents we obtained from the department, including an actual contractual agreement between a program participant and a private business, an internal memorandum, and a location announcement that the program sent to program participants; the department, private businesses, and program participants refer to the private businesses as "partners" or "teaming partners" and the agreement as a "partnership contract."

Contrary to the department's assertion, it has in fact allowed the private partners to benefit from the program in a variety of ways. As we state on page 19 of the report, the program allows the private partner access to program locations, program equipment, and equipment maintenance. In addition, the department has spent or encumbered $84,000 and plans to spend another $723,000 to develop locations that program participants and

their private business partners will occupy and operate. Further, as we state on pages 24 to 25 of the report, none of the four operating partnerships pay fees similar to the other program participants. Program participants in these partnerships pay fees equal to 6 percent of the participant's reported net proceeds, rather than the lesser of the amount specified on the fee schedule or 6 percent of the location's gross sales.

The department is incorrect. As we state on page 21 of the report, three partnership agreements exist.

The signed copy of the contract between the program participant and the partner states that the "partner shall provide basic food-services training to further enhance the operator's overall knowledge of all elements of food services." It provides no specific training program for the program participant. Further, it specifically states that the program participant grants to the partner, "the right to establish, manage and operate a food service program in the facility." Thus, contrary to the department's claims, the program participant is not responsible for the operation of the facility.

Unfortunately, the department was unable to provide us such an analysis during our audit. In fact, the department's November 2001 announcement for this particular location stated that the department's earnings estimate only included vending machines and coffee carts and not a restaurant. Also, the department's deputy director confirmed for us in July 2002 that an analysis had not been completed, when she informed us that the department had only just begun to calculate the return on investment for this location. However, the department had already committed $191,000 for its design and requested redirection of another $532,000 from a previously approved project to pay for construction costs. Additionally, the department acknowledges on page 54 of its response that the East End project does not yet have a contractual agreement between the program participant and the partner. Thus, as we state on page 23, the department is spending a significant proportion of program funds without knowing if these partnerships will result in sufficient fees to the program and funds to the program participants to make the investment worthwhile.

The department contradicts itself. As it acknowledges just two paragraphs later, two of the three partnership agreements we discuss in the report were in place before it had seen or

approved them. Thus, we cannot agree that the department takes all necessary steps to ensure that the State's and program participants' interests are protected when participants enter into agreements with private businesses.

We disagree that we are overstating the magnitude of this issue. As we state on page 23, by March 2003, the department plans to spend the equivalent of 12 percent of its reported annual expenditures for federal fiscal year 2000–01 on these partnerships. Further, we believe this issue may be increasing in importance. As we state in Appendix B, on page 43 of the report, nearly 46 percent of operators we surveyed were interested in working with a private partner.

The department misrepresents the facts. The department requires monthly reports from program participants who use a private business partner. However, the information contained in these reports is not the same as that required of other program participants and is insufficient to determine the degree of the location's success and the return on the program's investments in the location. As stated on page 24, the department did not require program participants to submit sales and expense information from the operation of their partnership locations as is required on the monthly operating reports of program participants not using a private partner. Instead, the department only required those program participants to report the payments they receive from their private partners.

These are not isolated examples. As we state on page 24, we reviewed monthly operating reports from all four operating private partnerships. None of the program participants involved in these partnerships included critical information such as gross sales and cost of goods sold in their monthly operating reports.

The department is mistaken. As we report on page 6 of the report, the department funds a portion of the program's activities with the operators' set-aside fees. Consequently, to the extent that some operators pay less than their fair share of fees or the program pays disproportionately more for their locations, they are being subsidized by the other operators.

Our criticism is warranted. Although initial training may expose the operator to all types of facilities offered by the program, it may not sufficiently prepare them for more complex work assignments. Further, the department itself acknowledged in

its reports to the U.S. Department of Education that it had not provided upward mobility training during federal fiscal years 1998–99 through 2000–01.

Although department staff may follow up on missing reports from operators, as we state on pages 31 and 32, it does not do so promptly. The department's current processing system does not identify a monthly operating report as late until three months after the reporting month, hindering the program's ability to properly monitor and promptly intervene to help operators that may be experiencing problems.

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