Department of Rehabilitation:

Business Enterprise Program for the Blind Financial Report Year Ended June 30, 1994

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Summary

The financial condition of the Department of Rehabilitation's Business Enterprise Program for the Blind (program) is sound. Specifically, during fiscal year 1993-94, the program's revenues exceeded its expenses by approximately $1 million. In addition, at June 30, 1994, the program had approximately $4 million in cash and pooled investments, and its total assets exceeded its total liabilities by approximately $14 million. The principal source of funding for the program is state and federal grants, which accounted for approximately 58 percent of revenues during fiscal year 1993-94. The remaining revenue came principally from vending stand fees, vendor contributions, and vending machine commissions.

Although the financial condition of the program is sound, we noted certain weaknesses in its internal control structure. Specifically, we noted the following:

- The department does not ensure it receives all monthly operating reports, fees, and loan payments due from blind vendors.

- It does not ensure it receives all vending machine commissions available to the program.

- It improperly used federal funds to pay for parts and materials associated with equipment repair.

- It did not accurately report its liabilities at June 30, 1994.

- It has improved controls over fixed assets, but more improvement is needed.

- It has not adequately separated certain incompatible duties.

- It is not required to prepare financial statements summarizing all of the program's activities such as those presented in this report. However, to better assess the program's financial condition and to facilitate future audits, we recommend it prepare such financial statements.

These issues are described further in the Appendix. We will follow up on these issues during fiscal year 1995-96 when we conduct a programmatic review of the program in accordance with the California Welfare and Institutions Code, Section 19640.5.

Agency Comments

In its response, the department generally agrees with the findings and recommendations and discusses the actions it has taken or plans to take to address the deficiencies.

Introduction

Background

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 purpose of the program is to provide blind persons with paid employment, enlarge their economic opportunities, and stimulate them to greater efforts in making themselves self-supporting by allowing them to operate vending facilities within the State.

The department is responsible for training and licensing blind vendors (vendors) to operate vending facilities. Once vendors successfully apply to operate a vending facility, the program assists them by paying for equipment and certain start-up costs necessary to run the facility. The program provides continuing services to the vendors, including repair of equipment and replacement of equipment that has exceeded its useful life.

The program derives its revenues from a variety of sources including federal and state grants, vendors fees and contributions, and vending machine commissions. Federal grants provide for the purchase of new and replacement equipment, initial stock and supplies for a facility, management services, and other administrative costs of the department. For costs allowed under federal guidelines, the federal share is approximately 80 percent. Depending on the nature of the expense, the remaining 20 percent is provided either by the State's General Fund or by vending stand fees, which are funds set aside from the net proceeds of vending facility operations. These fees are used for maintenance and replacement of equipment, purchase of new equipment, construction of new vending facilities, payment of various vendor benefits, and other miscellaneous costs. The program also receives income from vending machines located on state and federal property within California. This income is either distributed to vendors or used to pay various vendor benefits. Finally, vendors are required to make monthly contributions to their pension plans and may contribute additional amounts voluntarily.

Previous Audit

On July 5, 1990, the Office of the Auditor General issued a report that detailed significant weaknesses in the department's internal controls over program equipment. The report concluded that the department had not adequately managed the purchase and use of program equipment and did not adequately control the equipment's transfer and disposal. In September 1990, Section 19640.5 was added to the California Welfare and Institutions Code to require the auditor general to conduct a fiscal audit of the program every third fiscal year and a programmatic review and audit every five years. However, the Office of the Auditor General closed in December 1992. The Bureau of State Audits, created in California Government Code Section 8543, is now responsible for conducting these audits that are mandated by statute. Our current report contains the results of our financial audit for the period ended June 30, 1994. In addition, we reviewed the department's efforts to correct the weaknesses noted in the earlier report.

Scope and Methodology

We conducted a financial audit of the program as of and for the year ended June 30, 1994. As part of our audit, we reviewed and evaluated the department's internal control structure to determine the audit procedures and the extent of testing necessary to express an opinion on the program's financial statements, and we performed tests of the department's compliance with certain laws and regulations. Our report on the financial statements is on page 3; our report on the internal control structure is on page 15; and our report on compliance with laws and regulations is on page 17.

Independent Auditors' Report

Department of Rehabilitation
State of California

We have audited the accompanying financial statements of the Department of Rehabilitation's Business Enterprise Program for the Blind as of and for the year ended June 30, 1994. These financial statements are the responsibility of management of the Department of Rehabilitation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Business Enterprise Program for the Blind and are not intended to present fairly the financial position of the Department of Rehabilitation and the results of its operations and cash flows in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Business Enterprise Program for the Blind as of June 30, 1994, and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles.

In accordance with government auditing standards, reports on the program's internal control structure and compliance with laws and regulations are presented on pages 15 and 17, respectively, of this report.

BUREAU OF STATE AUDITS

SALLY L. FILLIMAN, CPA
Deputy State Auditor

March 15, 1995

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Department of Rehabilitation
Business Enterprise Program for the Blind
Balance Sheet
As of June 30, 1994

ASSETS	
Current Assets	
Cash and pooled investments (Note 3)	$ 4,049,758
Interest receivable	57,438
Accounts receivable (net)	68,009
Due from General Fund	13,593
Due from federal government	82,583
Loans receivable (net)	204,788
Other assets	25,619
Total Current Assets	4,501,788
Long-Term Assets	
Fixed assets (Note 4)	10,573,353
Total Long-Term Assets	10,573,353
Total Assets	**$15,075,141**
LIABILITIES	
Current Liabilities	
Accounts payable	$ 787,602
Due to General Fund	547,422
Total Current Liabilities	1,335,024
Long-Term Liabilities	
Compensated absences payable (Note 5)	172,002
Total Long-Term Liabilities	172,002
Total Liabilities	1,507,026
EQUITY	
Retained earnings	13,568,115
Total Liabilities and Equity	**$15,075,141**

See the notes accompanying the financial statements.

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Department of Rehabilitation
Business Enterprise Program for the Blind
Statement of Revenues, Expenses and
Changes in Retained Earnings
For the Fiscal Year Ended June 30, 1994

Operating Revenues	
Vending stand fees	$ 1,602,209
Vending machine commissions	432,822
Vendor contributions	1,141,019
Total Operating Revenue	3,176,050
Operating Expenses	
Administrative expense	2,187,289
Depreciation	1,859,665
Retirement and insurance expense	1,622,144
Repair and maintenance	193,839
Vending machine commissions	143,439
Other program expense	611,934
Total Operating Expenses	6,618,310
Operating Loss	(3,442,260)
Nonoperating Revenues (Expenses)	
Federal grants	4,074,778
State grants	448,656
Interest revenue	92,505
Loss on disposal of fixed assets	(218,060)
Net Nonoperating Revenues (Expenses)	4,397,879
Net Income	955,619
Retained Earnings, Beginning	12,612,496
Retained Earnings, Ending	**$13,568,115**

See the notes accompanying the financial statements.

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Department of Rehabilitation
Business Enterprise Program for the Blind
Statement of Cash Flows
For the Fiscal Year Ended June 30, 1994

Cash Flows From Operating Activities	
Operating Loss	$ (3,442,260)
Adjustments to reconcile operating loss with net cash provided by (used in) operating activities	
Depreciation	1,859,665
Change in assets and liabilities	
Receivables	(68,009)
Prepaid expenses	138,268
Other assets	53,409
Loans receivable	43,768
Accounts payable	(809,484)
Due to General Fund	(239,621)
Compensated absences payable	43,778
Other liabilities	(27,761)
Total Adjustments	994,013
Net Cash Provided by (Used in) Operating Activities	(2,448,247)
Cash Flows From Noncapital Financing Activities	
Grants received	3,218,371
Net Cash Provided by (Used in) Noncapital Financing Activities	3,218,371
Cash Flows From Capital and Related Financing Activities	
Grants received	1,613,211
Acquisition of fixed assets	(2,049,824)
Proceeds from sale of fixed assets	115,102
Net Cash Provided by (Used in) Capital and Related Financing Activities	(321,511)
Cash Flows From Investing Activities	
Interest received	35,067
Net Cash Provided by (Used in) Investing Activities	35,067
Net Increase in Cash and Pooled Investments	483,680
Cash and Pooled Investments, Beginning	3,566,078
Cash and Pooled Investments, Ending	**$ 4,049,758**

See the notes accompanying the financial statements.

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Notes to the Financial Statements

Note 1.

Definition of the Reporting Entity

The accompanying financial statements present the financial position, results of operations, and cash flows of the Business Enterprise Program for the Blind (program) as of and for the fiscal year ended June 30, 1994. This report does not include the financial activities of any other funds or account groups administered by the Department of Rehabilitation (department).

Note 2.

Summary of Significant Accounting Policies

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles applicable to governmental entities. The following information is a summary of significant accounting policies that pertain to these financial statements.

Fund Accounting

The program is classified as an enterprise fund. An enterprise fund is a proprietary fund which accounts for operations that are financed and operated in a manner similar to private business enterprises. An enterprise fund is used to account for goods or services provided to the public on a continuing basis when all or most of the cost involved is financed by user charges or when the periodic determination of revenues, expenses, and net income is appropriate for capital maintenance, public policy, management control, and accountability.

Basis of Accounting

The program is accounted for on the accrual basis. Under the accrual basis, revenues are recognized when they are earned, and expenses are recognized when incurred. For purposes of the statement of cash flows, all cash and pooled investments, as discussed in Note 3, are considered to be cash equivalents.

Interest Receivable

Interest receivable reflects the interest earned but not received on amounts on deposit with the State's pooled money investment program.

Accounts Receivable

Accounts receivable reflects amounts due from vendors for fees, insurance, fines and penalties, or dishonored checks. This account also reflects amounts found owing as a result of internal audit exceptions. This balance is presented net of an allowance for doubtful accounts of $233,276.

Loans Receivable

Loans receivable consists of amounts due from vendors to repay the program for purchases of initial stock made on the vendor's behalf. The program provides these loans to continuing vendors to purchase supplies for a new location. This balance is presented net of an allowance for doubtful accounts of $80,902.

Fixed Assets

Fixed assets, consisting of vending facility equipment, are reported at cost less accumulated depreciation (Note 4). These assets are depreciated over their estimated useful lives, ranging from 4 to 25 years, using the straight-line method of depreciation.

Operating Revenues

- Vending stand fees: Funds set-aside from the net proceeds of vending facility operations.

- Vending machine commissions: Commissions received from vending machine operations on state and federal property.

- Vendor contributions: Contributions for liability and workers' compensation insurance and mandatory and voluntary contributions for retirement.

Operating Expenses

- Administrative expense: The department's personal service expenses of $1,591,582 and other administrative expenses of $595,707.

- Insurance and retirement expense: The program's payment of retirement and insurance benefits for vendors.

- Vending machine commissions: The redistribution to eligible vendors of vending machine commissions received by the department.

- Other program expense: The program's expenses for supplies; equipment installation, transportation and storage; and management services.

Note 3.

Cash and Pooled Investments

The cash account consists of $938,758 in general cash and cash in state treasury, and $3,111,000 in the State's pooled money investment program administered by the State Treasurer's Office. The necessary disclosures for the State's centralized treasury system and pooled investment program are included in the general purpose financial statements of the State of California.

Note 4.

Fixed Assets

The following schedule presents a summary of the fixed assets as of June 30, 1994:

Equipment	$22,557,039
Less accumulated depreciation	(11,983,686)
Net Fixed Assets	**$10,573,353**

Note 5.

Compensated Absences

As of June 30, 1994, the department's estimated liability for compensated absences related to accumulated vacation and personal leave amounted to approximately $172,000. The liability for compensated absences does not include amounts for accumulated sick leave because employees cannot receive cash for sick leave balances when they leave state service. However, unused sick leave balances may be exchanged upon retirement for service credits in an employee's retirement account.

Note 6.

Retirement Plan

Regular employees of the department are members of the Public Employees' Retirement Fund (PERF), a defined benefit contributory retirement plan. The PERF is an agent multiple-employer retirement plan for state and local governments in California. The department's contribution rates are determined actuarially on a statewide basis so that the contributions provide the necessary funding to pay for benefits when they come due. The contribution rate for the department as a whole was approximately 8.8 percent of covered payroll, and the amount of contribution was approximately $5.8 million for the year ended June 30, 1994.

Similar information related to the program was not available. However, payroll for the program represented approximately 2.3 percent of the department's payroll for the year ended June 30, 1994.

The California Public Employees' Retirement System issues a publicly available report that includes the financial statements and required supplementary information for the PERF. The financial report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

Note 7.

Post-Retirement Health Care Benefits

In addition to providing pension benefits, the department pays for certain health care and dental benefits for eligible retired employees for which the department contributes as an employer. The benefits are provided in accordance with the California Government Code to all employees who retire from the State on or after attaining certain age and length of service requirements. To be eligible for these benefits, first tier plan annuitants must retire from the State on or after attaining age 50 with at least five years of service, and second tier plan annuitants must retire from the State on or after attaining age 55 with at least ten years of service. In addition, annuitants must retire within 120 days of separation from state employment to be eligible for these benefits. In accordance with the Government Code, the department generally pays 100 percent of the health insurance cost for annuitants plus 90 percent of the additional premium required for the enrollment of family members of annuitants. Although the department generally pays 100 percent of the dental insurance premium for annuitants, the Government Code does not specify the department's contribution towards dental insurance costs.

The cost of retiree health care is recognized on a pay-as-you-go basis. Post-retirement health care data for the program's retirees was not available and could not be reasonably estimated.

Note 8.

Contingencies

The program receives funding from the federal government in the form of grants and is entitled to these resources only if it complies with the terms and conditions of the grants and with the applicable federal laws and regulations. Beginning in 1992, the department has charged the federal government approximately $673,000 for repair and maintenance of program equipment. Although federal funding is available to the program for the acquisition of equipment, it is not available for the cost of repairs and maintenance. Consequently, the program may be required to repay all or part of the $673,000 charged to the federal government.