California State Auditor

BUREAU OF STATE AUDITS

Department of Rehabilitation:

The Business Enterprises Program for the Blind Is Financially Sound, but It Has Not Reached Its Potential

June 2001

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CALIFORNIA STATE AUDITOR

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June 19, 2001 99020

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

This report concludes that the financial condition of the program is sound, however, the program has not reached its potential. Specifically, the department could improve its fiscal management of the program by developing a comprehensive business plan that shows whether its proposed uses for its fund surplus are appropriate and feasible. Additionally, the department can do more to pursue the vending machine commissions that it is mandated to collect. For example, it could establish vending machines at additional state and federal locations and could more actively pursue commissions from vending machine operators or agencies that have failed to remit these commissions.

Respectfully submitted,

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SUMMARY

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The Business Enterprises Program for the Blind (program) is financially sound. However, the Department of Rehabilitation could improve its fiscal administration of the program by taking the following steps:

- ☑ ***Preparing a comprehensive business plan to better monitor and prioritize the use of its program resources.***
- ☑ ***Better identifying, pursuing, and collecting vending machine commissions.***

RESULTS IN BRIEF

In giving qualified blind people the opportunity to be self-supporting, the Business Enterprises Program for the Blind (program) maintains two funds that are both financially sound and that adequately provide for program needs and for the blind participants' pension plan. Nevertheless, the Department of Rehabilitation (department), which administers the program and its funds, could improve its fiscal management of this program by developing a comprehensive plan outlining the program's growth and by pursuing more actively the vending machine commissions that support the participants' pension plan.

Under the department's direction, the program trains blind people to operate their own vending businesses located on state or federal property. By furnishing these individuals with ongoing consulting services, assistance with equipment maintenance, and a pension plan, the department complies with the terms of the federal Randolph-Sheppard Act and the California Welfare and Institutions Code. Federal grant money, the State's General Fund, vendor fees, and vending machine commissions fund the program. The department accounts for the receipt and use of vendor fees in the Vending Stand Fund (vending stand fund) and the receipt and use of vending machine commissions in the Vending Machine Account (vending machine fund).

Although the vending stand and vending machine funds are financially stable, the program would benefit from a comprehensive plan outlining the program's growth and its plans for the vending stand fund's reserve. The vending stand fund's assets exceed liabilities by approximately $3.8 million, of which $2.1 million—called a surplus—is available for future program purposes. However, the department has not prepared a comprehensive business plan demonstrating that its proposed uses for this surplus are appropriate and feasible. By developing such a plan, the department could better monitor and prioritize its use of this surplus.

In addition, the department could increase income in the vending machine fund by installing vending machines at additional state and federal locations and by pursuing commissions from vending machine operators or agencies that have failed to remit these payments. Although the department asserts that it lacks the resources needed to pursue and collect commissions adequately, we found that other states have composed their statutes to allow the use of certain vending machine commissions for hiring staff to help administer the program. The department's failure to collect all available vending machine commissions has a direct impact on the blind vendors' pension plan, to which the majority of these funds are allocated. The department is working on a strategic plan for the program that will address the main concerns in our report.

RECOMMENDATIONS

To improve its financial management of the program, the department should take the following actions:

- Complete its strategic plan, including a component that outlines its proposed use of the vending stand fund surplus and that will help the department determine whether the surplus is appropriate for future program needs.

- Finish its survey of state and federal properties to identify possible sites for additional vending machines, thus increasing the potential for vending machine commission income.

- Identify and pursue the collection of vending machine income from agencies and vending machine operators that refuse or fail to remit commissions.

- Verify the status of organizations that claim they are exempt from remitting vending machine commissions. Collect vending machine commissions from those that are not.

To ensure that it has the staff needed to identify and collect vending machine commissions, the department should evaluate whether it should redirect staff from other units, contract for professional services, or possibly seek legislation to amend state law so that the department can use vending machine commissions for the hiring of staff.

AGENCY COMMENTS

The department generally agrees with our conclusions and recommendations. It states that the results of our review are consistent with its current actions and plans and that it will consider our comments and recommendations as it continues the reengineering of the program. However, it continues to disagree that it should do more to pursue vending machine income from the California State University system. ■

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INTRODUCTION

BACKGROUND

The Department of Rehabilitation (department) administers the Business Enterprises Program for the Blind (program) in accordance with the federal Randolph-Sheppard Act and the California Welfare and Institutions Code. The program's purpose is to provide blind people with gainful employment, enlarge their economic opportunities, and stimulate their becoming self-supporting. To accomplish this purpose, the department furnishes training that enables qualified blind people to operate their own vending businesses and then provides vending facilities located on state or federal property to these individuals. From July 2000 to March 2001, the department supplied rehabilitative services, such as counseling and training services, to approximately 5,700 blind individuals, of which 183 participate in the program.

Participation in the Program

A blind individual interested in receiving vocational services may submit an application to the department. By reviewing the application and conducting an interview, a department counselor will assess the applicant's interest and suitability for the program. For those individuals who enter the program, the department provides a comprehensive six-month food service training course, licensing those who successfully complete the course. A licensee can then apply to operate one of the department's established vending facilities, which include cafeterias, snack bars, vending stands, and vending machine businesses. A program-appointed selection committee selects the licensee for assignment to a vending facility. After furnishing the licensee with a vending facility location, the department provides continued support through consulting services and through the procurement and repair of necessary vending equipment. The licensed vendors receive income from the successful operation of their assigned vending facilities and are eligible to participate in a retirement plan. As of March 2001, 166 of the 183 active licensees were operating vending facilities, while the remaining 17 continue to be notified of opportunities to operate a vending facility.

Funding for the Program

The program receives funds from the federal government, the State's General Fund, vendor fees, and vending machine commissions. Federal funds and vendor fees pay for vending facility equipment, installation costs, and management services provided by the department. For these costs, the federal share is approximately 80 percent and vendor fees cover the remaining 20 percent. Vendor fees are money that the department requires licensed vendors to set aside from the net income of their operations and remit to the program. The department also uses these fees, which it accounts for in the Vending Stand Fund (vending stand fund), for maintaining and replacing equipment, purchasing new equipment, constructing new vending facilities, and other miscellaneous costs. The department also receives income from vending machines located on state and federal properties within California. It disburses this money, which the department accounts for in the Vending Machine Account (vending machine fund), either to the vendors' pension plan or to the vendors who compete with the vending machines for business.

Before January 1999 vendors participating in the pension plan were required to contribute monthly to their pension fund, and they could choose to contribute additional amounts. Because the Internal Revenue Service determined that the pension plan was not a qualified plan of deferred compensation, contributions to the plan were no longer allowed as of January 1999. As a result, the department implemented a new deferred compensation plan that is funded only by the vending machine fund. The amounts previously contributed remain in the original plan and belong to the vendors that participated in this plan.

Results of Previous Audit Reports

Over the last six years, the Bureau of State Audits (bureau) has reviewed the program three times. The bureau issued a fiscal audit report in August 1995 and one in January 1999, and it published a performance audit in August 1997. The 1995 fiscal audit concluded that the program was sound financially, but the report noted some weaknesses in the department's internal control structure and in its compliance with certain laws and regulations. The 1997 performance audit concluded that poor management practices limited the program's effectiveness and found continuing internal control weaknesses. The 1999 fiscal audit concluded that the fund balance of the vending stand fund appeared excessive and that the department could increase income by establishing more contracts to collect commissions from all vending machines on state and federal property.

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 to perform a programmatic review and audit every five years until January 2003. This is our third and final fiscal audit of the program and covers the fiscal year ending June 30, 2000. Our first two fiscal audits covered the fiscal years ending June 30, 1994, and June 30, 1997, respectively. At a later date, we will conduct our final performance audit of the program.

To determine whether the vending stand and the vending machine funds were financially sound as of June 30, 2000, we examined selected account balances of these funds. Appendix A and Appendix B summarize the funds' accounts and their respective balances; the accounts we reviewed appear in bold type. Further, we assessed the department's efforts to address the issues reported in our second fiscal audit of the program.

For both the vending stand fund and the vending machine fund, we reviewed the cash, fund balance, revenue, and expenditure accounts. We selected the cash and fund balance accounts because they provide useful information relative to the program's financial condition. The fund balance, for instance, shows the difference between total assets and liabilities—in other words, the amount of resources available that the program may set aside for a specific purpose or use for future operations. We selected revenue and expenditure accounts because they provide the financial results from program operations. These accounts show how much the program received in fees and commissions and how much of this money it spent on program operations.

For each of these accounts, we reviewed various accounting records to determine the accuracy, appropriateness, and completeness of the reported amounts. These accounting records include documents such as invoices, deposit slips, vendors' profit and loss statements, and vending machine operators' commission statements as well as the journals and ledgers in which the department records the various accounting transactions. For the cash accounts, we reviewed the department's cash reconciliation as of June 30, 2000. For the revenue accounts, we selected a sample of fees and commissions and reviewed the supporting records to verify that the department received and correctly recorded these receipts. In addition, we analyzed the department's records for fees and commissions due but not yet received. For a sample of expenditures, we reviewed the supporting accounting records and verified that the payments were duly authorized, correctly recorded, and represented appropriate uses of program money. In addition, for each of the accounts, we examined various department reconciliations of its accounting records with the balances maintained by the State Controller's Office. Finally, we analyzed the year-to-year changes in the selected account balances, including the vending stand fund's repair and maintenance expenditure account and this fund's equipment account, for fiscal years 1997-98 through 1999-2000.

We also reviewed the department's process to account for its program property. Although the department has adequate procedures to account for program property, it has fallen behind schedule in its physical inspections of this property but asserts it will be current by December 2001. ■

AUDIT RESULTS

THE VENDING STAND FUND BALANCE REMAINS POSITIVE BUT HAS DECLINED IN RECENT YEARS

The Business Enterprises Program for the Blind (program) has continued to maintain a positive fund balance in its Vending Stand Fund (vending stand fund), meaning that the fund's assets, which are primarily cash, exceed its liabilities, or the amounts it owes. Although a positive fund balance indicates that the program is financially sound, which is important, it is not a measure of the program's efficiency or effectiveness. In fact, an overly large fund balance could indicate that the Department of Rehabilitation (department) is not spending enough on the program or that program fees are too high. Conversely, a small fund balance could mean that the department is spending too much or that program fees are not sufficient. We did not review the program's efficiency or effectiveness during this audit.[1]

Vendor fees are the primary source of income for the vending stand fund, which the department uses to pay the program's share of certain costs, including the purchase of new vending equipment, the construction of vending facilities, and the maintenance of older vending equipment. Income to the fund and the costs charged against it affect the fund balance. If total income exceeds total costs, the fund balance increases. Conversely, if total costs exceed total income, the fund balance declines. Because the department spent more on program costs than it received in income, the vending stand fund balance began to decline in fiscal year 1997-98. Although the fund balance fluctuated between June 30, 1998, and June 30, 2000, it eventually decreased from $3,890,000 to $3,751,000.

A portion of this fund balance, which is the amount available for program needs, may be reserved or set aside for specific purposes. For example, blind vendors participate in a self-insured workers' compensation program that allows the department to pay the vendors' employees for work-related injuries. To participate, the vendors remit money to the

[1] Our next performance audit will cover the program's efficiency and effectiveness.

Although the vending stand fund surplus has declined over the last two years, it is sufficient to pay for 1.1 years' worth of expenses.

department and the department then accumulates these payments in the vending stand fund. As of June 30, 2000, the department had reserved $1,537,000 of the fund balance for the workers' compensation program and $140,000 for other purposes, for a total of $1,677,000. The remaining $2,074,000 unreserved fund balance—sometimes called a surplus—is the amount available for future program needs. Figure 1 shows the total fund balance and depicts the surplus declining over the last two years. Because the fund's annual program expenditures over the last three years have averaged about $1,836,000 after subtracting insurance costs that are reimbursed by vendors, this $2,074,000 surplus is sufficient to pay for 1.1 years' worth of expenses. This surplus is an improvement over the excessively large surplus—2.8 years' worth of expenses—that we reported in our previous fiscal audit.

FIGURE 1

The Vending Stand's Unreserved Fund Balance Has Declined Over the Last Two Years

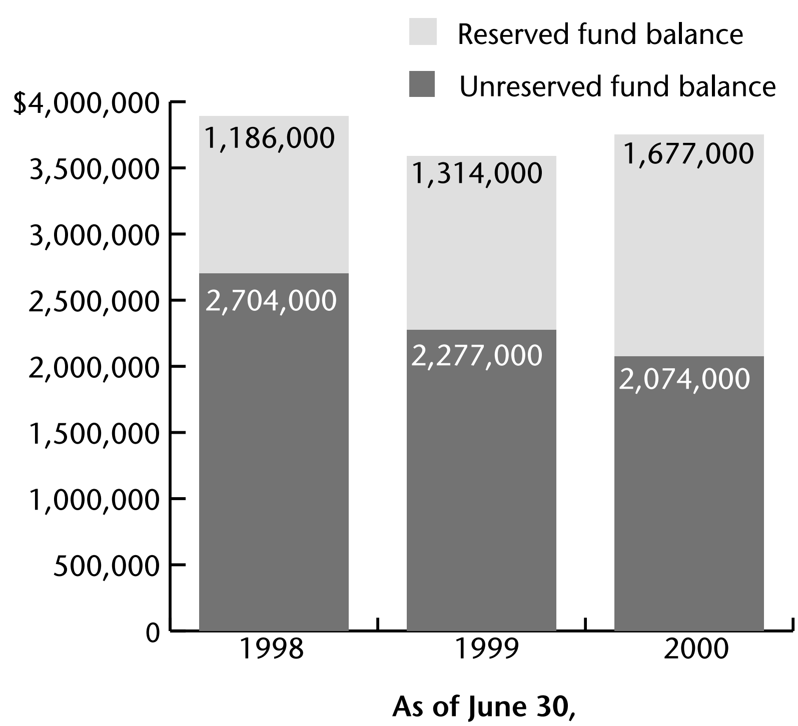
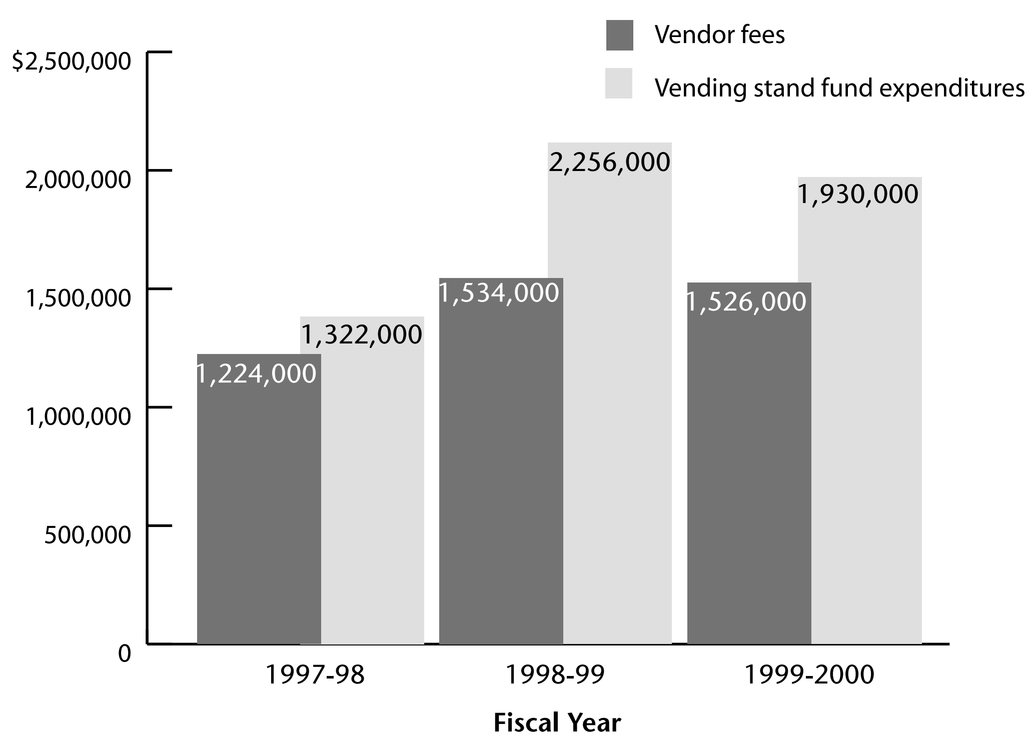


Figure 2 shows that the department's program expenditures were greater than its vendor fee revenues for the last three fiscal years. During this period, the department used the fund to develop and open 28 vendor stand facilities in eight correctional institutions, three roadside rest areas, six post offices, and eleven other locations. Additionally, it has developed 4 facilities in the current fiscal year and plans to develop 38 new vendor stand facilities within the next three years.

A closer look at the fund's revenue also disclosed that the fees that the vending stand fund received from vendors remained steady over the last two years. These revenues decreased to $1,224,000 in fiscal year 1997-98, continuing the downward trend from fiscal years 1995-96 through 1996-97 that we had reported in our previous fiscal audit. However, the increase in revenues to more than $1.5 million per year for each of the last two fiscal years indicates that the fund had a slight recovery. According to the department, the increase is due to the start-up of new locations for vendors as well as the combining of smaller locations into larger ones. If vendors do not generate enough income from their vending facilities, the vendors are not required to remit fees to the department. The combining of smaller locations into larger ones allows vendors to generate more income and thus remit fees to the department.

FIGURE 2

Expenditures From the Vending Stand Fund Exceeded Vendor Fee Revenues



THE DEPARTMENT COULD BENEFIT FROM A COMPREHENSIVE PLAN OUTLINING FUTURE FUND USE

Although the department currently maintains some information about its development projects, it could benefit from a more comprehensive plan that details its proposals for using its surplus. In our 1999 fiscal audit, we reported that the vending stand fund appeared to have an excessive surplus and recommended that the department analyze this situation to determine whether these funds were sufficient for its future program needs. In its monitoring of the surplus, the department has maintained a worksheet that shows the surplus remaining in the fund as well as a list of development projects and their estimated costs. This information is useful for keeping track of the amount of the fund surplus. However, the department has not consolidated this information in a comprehensive business plan that it could use to communicate to stakeholders about its planned use of the fund. Stakeholders, such as the vendors, the committee of blind vendors, and other interested parties, would be able to know not only whether the surplus is sufficient but also whether the program is meeting its objectives.

A business plan would help guide the department's fiscal administration of the program and contribute to the program's success.

In addition to improving the department's communication with its stakeholders, a comprehensive business plan would help guide the fiscal administration of the program. A business plan would contribute to the success of the program and could include, but would not be limited to, a discussion of the program's objectives and goals, its estimated costs, and the funding sources available to the program. Such a plan would also include a capital budget component and allow the department to outline the planned use of the surplus by identifying the number of new vending stand facilities that the program could open, prioritizing these new facilities, and ensuring that the department does not commit to spending more than it receives. A capital budget component would provide the development costs of each project and the projected revenues that the fund will receive once the facilities are completed over the next several years. Without such plans, the department cannot readily assess whether its fund surplus and future revenues are sufficient to finance future planned developments, nor can it effectively develop the program to its fullest potential.

According to the department, it started a strategic planning process in fiscal year 1999-2000, but a departmental reorganization delayed the process until April 2001. The department is continuing its development of a strategic plan for the comprehensive review and reengineering of its program to improve employment opportunities for individuals who are blind, to modernize all components of the program, and to improve the program's accountability. The department expects that a draft plan will be completed by October 2001.

A DECREASE IN VENDING MACHINE COMMISSIONS HAS RESULTED IN REDUCED CONTRIBUTIONS TO THE VENDORS' PENSION PLAN

The Vending Machine Account (vending machine fund) receives commissions from those vending machines located on state or federal property that blind vendors do not operate. Most of these commissions go to the vendors' pension plan, while some go to blind vendors. Vendors operating a vending facility in buildings with vending machines receive the commissions from these machines because they compete directly with the vendors' operations.

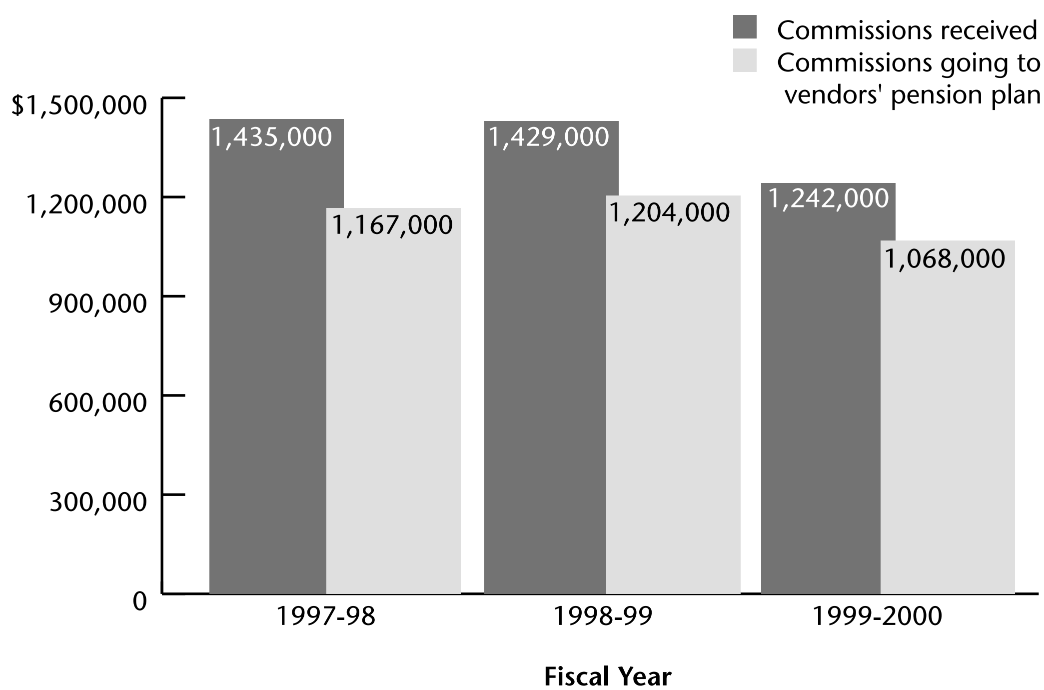
Commissions have decreased, in part, because the department has converted some vending machine locations into facilities run by blind vendors.

The financial condition of the vending machine fund is sound. Its fund balance has fluctuated from a low of $35,000 as of June 30, 1998, to a high of $146,000 as of June 30, 2000, while its cash balance was approximately $265,000 for each of the same years. These amounts are significantly lower than amounts for the same accounts in the vending stand fund because the vending machine fund functions as a "pass-through" fund: Almost all of the cash coming into the fund is paid to vendors and the pension plan within a few months of receipt. The department retains only a small amount of cash for unforeseen expenses.

In the last couple of years the vending machine fund's income from commissions has decreased, and its contributions to the vendors' pension plan mirror this decline. Figure 3 displays both the income that the program received from commissions and the portion of the commissions that went to the pension plan over the last three years. As the figure shows, vending machine commissions decreased by $193,000 between fiscal year 1997-98 and 1999-2000, from $1,435,000 to $1,242,000. For the same period, annual contributions to the blind vendors' pension plan from these commissions have fluctuated between $1,167,000 to $1,068,000. The department attributes these decreases to its efforts toward converting vending machine locations to facilities operated by blind vendors. Before the conversion, money from these locations went to the vending machine fund. Currently, the money goes to the blind vendors that operate the facilities. For instance, in fiscal year 1998-99, the vending machine fund received $285,000 from 12 locations. In fiscal year 1999-2000, when these locations had been converted to facilities run by blind vendors, the vending machine fund received $134,000, a decrease of $151,000. As of June 2000, because the program had assigned all 12 locations to blind vendors, the pension plan would no longer receive the resulting commissions.

FIGURE 3

Vending Machine Commissions and Related Contributions to the Pension Plan Decreased in Fiscal Year 1999-2000

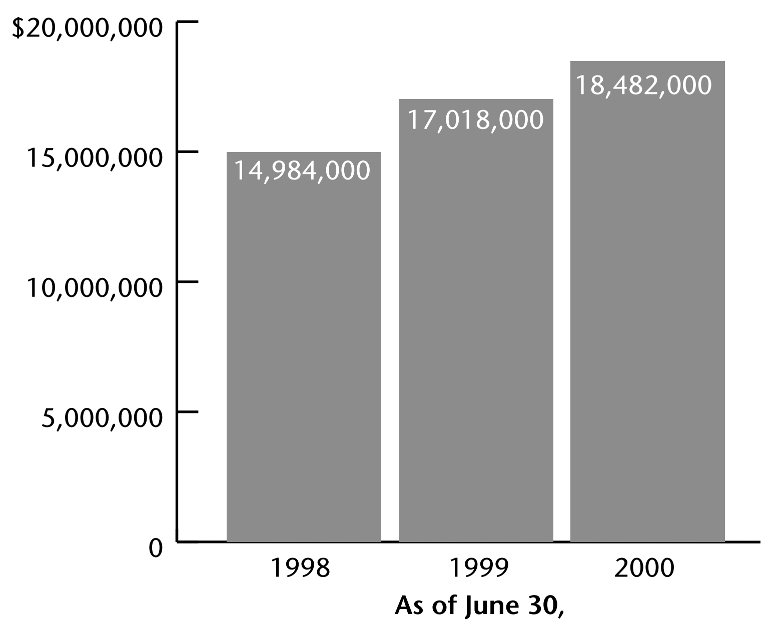


Although the conversion of vending machine businesses to vendor-operated facilities was responsible for most of the decline in commissions, additional factors, such as the department's failure to ensure that vending machine operators report and remit commissions, may also have contributed to the situation. We discuss these other factors in detail in the following section.

Nevertheless, the reduction in commission contributions to the vendors' pension plan, which is managed by an outside custodian, resulted in the plan's growing more slowly than in the past. Figure 4 shows that at the end of fiscal year 1997-98, the pension plan balance was $14,984,000. By June 30, 2000, the pension plan balance had grown by $3,498,000 to $18,482,000. However, the year-to-year growth had slowed from $2,034,000 between fiscal years 1997-98 and 1998-99 to $1,464,000 between fiscal years 1998-99 and 1999-2000. Approximately $136,000 of this drop in growth resulted from declining vending machine commission contributions, while approximately $151,000 arose from the fact that vendors could no longer contribute to the pension plan as of January 1999 because the Internal Revenue Service determined that the pension plan was not a qualified plan of deferred compensation. Together, these two amounts account for half of the overall drop in the pension plan growth. According to the department, it believes this decline will continue over the next four years as vending machines at locations such as correctional institutions are converted to facilities run by the program's vendors. However, the department anticipates that the amount of commissions it receives will level off at $570,000 per year after the conversions of facilities are complete. As of December 31, 2000, 283 vendors or their beneficiaries participated in the vendors' pension plan.

FIGURE 4

Balance of the Vendors' Pension Plan 1998 through 2000



THE DEPARTMENT COULD DO MORE TO COLLECT ADDITIONAL VENDING MACHINE COMMISSIONS

Although the department has continued to make progress in collecting vending machine commissions, it is still not receiving all the vending machine commissions available to the program. State law requires the department to actively pursue all commissions from vending machine facilities on state and federal property that blind vendors do not operate. Further, an August 1995 interim order issued by the Sacramento County Superior Court required the department to actively pursue and collect all income from vending machines on state property and from state agencies previously exempt from paying vending machine commissions. To fulfill these requirements, the department must identify vending machines located on state and federal properties that blind vendors do not operate and pursue commissions from the vending machine operators. However, the department has not pursued all the commissions that it is mandated to collect, has not promptly identified additional state and federal properties from which to pursue vending machine commissions, and has not followed up with vending machine operators that fail to remit commissions.

Although the department has made progress in identifying vending machines that are subject to commissions and increasing the number of machines under contract, it has not consistently pursued commissions from the vending machines located on state-owned or state-leased properties of other state agencies, such as those used by the California Highway Patrol (highway patrol) and the California State University (university) system. According to the department, it has not collected commissions from more than 100 highway patrol field offices because the highway patrol asserts that the nonprofit employee organizations that receive the vending machine income are exempt from remitting commissions to the department. By law, vending machines operated in state facilities by existing, employee-operated, nonprofit organizations that were incorporated before January 1, 1977, are exempt from remitting vending machine commissions. However, the department has not confirmed the exempt status of these employee organizations.

Although it has made progress in identifying vending machines on state and federal property, the department has not pursued all commissions that it is mandated to collect.

Additionally, the department has not collected commissions from the university because the university has argued that it has statutory authority to keep the revenue generated by its campuses' vending machines. The validity of this claim is unclear because the department has not sought a legal opinion or arbitration, which is available to it, to resolve this difference of opinion. According to the department, it has not sought a legal opinion from the State's Office of the Attorney General because it believes that an opinion stating that the university is subject to state laws that guide the program is not binding and that the university would not accept the opinion. Finally, the department believes that the arbitration option has some limitations and that the university would not agree to participate in arbitration as specified in the law because the university has argued that it is not subject to the program's jurisdiction. For these reasons, the department states that it has met its obligation to actively pursue vending machine income from the university and has taken all reasonable steps to ensure compliance with the law. Although this issue is difficult to resolve, the department should take steps to settle this outstanding issue formally.

The department has been slow in identifying additional state and federal properties in which to establish vending facilities.

The department has also been slow in updating its list of state and federal properties that might be suitable for vending machines. By law, the department is required to conduct a survey in every odd year and to identify all state and federal property that could accommodate a vending facility. The department is then required to report to the blind vendor committee and the Legislature the results of the survey on or before January 1 of every even-numbered year. With this report, the department can develop greater opportunities for its program's vendors and can target new locations for vending machine services. We requested the most recent report, which was due January 2000, to determine whether the department had adequately identified possible vending machine locations. However, the department could not provide the document because it had just recently started the process of preparing its first report. Without such a report, the department cannot demonstrate that it adequately identified additional vending machine opportunities for program vendors.

The department obtained a list of state properties to survey and determine whether vending machine services would be appropriate. However, the department did not obtain this list until four years after it received the previous list in fiscal year 1995-96. Additionally, the department selected 25 out of the 164 location types to identify locations that might be suitable for vending machines. According to the department, it has a limited number of staff to devote to this process, so it selected these 25 location types, which included sites such as office buildings and hospitals, because it believes they are the best prospects for vending machine services. Although we agree that some of the remaining 139 location types would not be suitable for vending machines and that others may not be the best prospects, other locations could prove to have potential. Without a complete survey of other possible location types, the department cannot determine the amount of potential commissions it is forgoing nor explain why it chose not to investigate these other locations.

Similarly, the department has just begun working to identify and pursue commissions from operators of vending machines located on federal property. Currently, the department receives information from the General Services Administration (GSA), a federal agency, regarding new federal sites that are interested in vending machine services. The department stated that in 1999 it requested a list from GSA identifying existing federal agencies and locations that the department could consider for vending machine services, but GSA could not provide one at that time because it was in the process of changing its database system. Because of staff shortages and other priorities, the department did not follow up with GSA to obtain this list until April 2001. The department plans to use this list to identify federal properties suitable for vending machine services.

In addition, since August 1998, the department has not sought commissions that vending machine operators have failed to remit. According to the department, in fiscal year 1997-98, it used a new database system to track the commissions it received. However, because of problems in getting reliable information from the new system and staff shortages, the department could not follow up on missing commissions. The department stated that its use of an alternative method for pursuing missing commissions would require additional staff to review manually all cash receipts from 1998 to the present and to ensure that the vending machine operators did not remit commissions in subsequent months or that the missing commissions were not posted elsewhere in the system.

When it does not pursue all the commissions it is mandated to collect, the department misses opportunities to increase contributions to the vendors' pension plan.

When the department does not actively identify and pursue all the vending machine commissions it is mandated to collect, it misses opportunities to increase income to the vending machine fund. Consequently, the vending machine fund's contributions to the vendors' pension plan are lower than they could be.

The department told us that it lacked the resources to properly identify and pursue vending machine commissions. It stated that in 1996, it temporarily redirected several staff from other units to execute more contracts with vending machine operators. However, it could not continue to redirect staff because it had limited resources and needed to commit those resources to other departmental priorities. By September 1998 the vending machine unit decreased by 40 percent, losing one full-time and one part-time employee. According to the department, it will determine, as part of its strategic planning process, whether the vending machine unit still requires additional staff.

Current state law does not allow the use of vending machine income for administrative purposes, such as paying for staff in the department's vending machine unit. It does, however, allow a committee of blind vendors to use the fund to procure professional services. The committee of blind vendors proposed that the department contract for the professional services needed to enter into vending machine contracts and to collect commissions for the program. The department is reviewing this proposal and considering its feasibility.

Two of the three states we contacted use the income from vending machines on state property to fund the administrative functions of their programs.

It is also important to note that other states we surveyed have structured their state laws to allow them to use vending machine commissions to provide for the administrative functions of their programs for the blind. Although one of the three states we surveyed restricts the use of commissions in a manner similar to that of California, two other states use commissions from vending machines located on state properties to fund their programs for the blind, including the programs' administrative functions. The department, however, claims that vending machine income cannot pay for administrative costs because federal law prohibits such use, and the department believes that state law must follow federal law. According to a federal representative we spoke with, although state rules generally follow federal rules, state law does not have to mirror the federal law's restrictions on the use of income from vending machines. Federal law only restricts the use of vending machine income from machines on federal properties; it does not restrict the use of income from machines located on state properties. Therefore, states could compose their laws to allow the use of a portion of the income from vending machines on state properties to fund the administrative functions of their programs.

RECOMMENDATIONS

To improve its financial management of the program, the 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.
- Finish its survey of state and federal properties to identify vending machine opportunities that could generate commissions for the program.
- Identify and pursue vending machine commissions from agencies and vending machine operators that refuse or fail to remit 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 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.
- Evaluate the feasibility of the blind vendors' proposal for contracting for professional services to identify and collect vending machine commissions.
- 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.

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

ELAINE M. HOWLE
State Auditor

Date: June 19, 2001

Staff: Nancy C. Woodward, CPA, Audit Principal
Robert C. Cabral, CPA, CIA
Brian S. Kishiyama

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APPENDIX A

Vending Stand Fund
Fiscal Year 1999-2000
*Account Balances**

Assets, Liabilities, and Fund Balance as of June 30, 2000	
Assets	
Cash	**$4,483,000**
Other assets	242,000
Total Assets	$4,725,000
Liabilities	$ 974,000
Fund balance	**3,751,000**
Total Liabilities and Fund Balance	$4,725,000

Revenues, Expenditures, and Net Income for the Fiscal Year Ended June 30, 2000	
Revenues	
Vendor fees	**$1,508,000**
Vendor penalties	18,000
Interest revenue	**265,000**
Insurance fees†	299,000
Total Revenues	2,090,000
Expenditures†	**(1,930,000)**
Net Income	$ 160,000

* We selected and reviewed the accounts in bold.

† We reduced insurance fees and expenditures by $520,000 to eliminate insurance expenditures that were reimbursed by vendors.

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APPENDIX B

*Vending Machine Account Fiscal Year 1999-2000 Account Balances**

Assets, Liabilities, and Fund Balance as of June 30, 2000		
Assets		
Cash	**$**	**264,000**
Total Assets	$	264,000
Liabilities	$	118,000
Fund balance		**146,000**
Total Liabilities and Fund Balance	$	264,000

Revenues, Expenditures, and Net Income for the Fiscal Year Ended June 30, 2000		
Revenues		
Vending machine commissions	**$**	**1,242,000**
Total Revenues		1,242,000
Expenditures		**(1,183,000)**
Net Income	$	59,000

* We selected and reviewed the accounts in bold.

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Agency's comments provided as text only.

Department of Rehabilitation
Director's Office
2000 Evergreen Street, 2nd Floor
Sacramento, CA 95815

Elaine M. Howle* June 4, 2001
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Re: Report 99020

Dear Ms. Howle:

Thank you for the opportunity to review and comment on the Bureau of State Audits' draft audit report entitled, "The Business Enterprises Program for the Blind Is Financially Sound, but It Has Not Reached Its Potential".

Our response addresses the four subject areas in the report and any associated recommendations. We have also enclosed the response disk as requested in your cover letter to the draft report dated May 29, 2001.

If you have any questions about the response, please contact Jean Johnson, Audit Chief, at (916) 263-8935.

Sincerely,

(Signed by: Catherine Campisi)

CATHERINE CAMPISI, Ph.D
Director

Enclosures

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* California State Auditor's comments begin on page 35.

Business Enterprises Program

Response to the Financial Audit conducted by the Bureau of State Audits

The Bureau of State Audits' (bureau) financial audit of the Business Enterprises Program (BEP) disclosed that the Vending Stand and Vending Machine Fund are financially sound and noted significant improvements in the program. Of the four subject areas identified by the bureau, only two were deemed to be issues that resulted in recommendations.

The Department of Rehabilitation's (department) response addresses the (4) four subject areas and any associated recommendations.

The Vending Stand Fund Balance Remains Positive but has Declined in Recent Years

The department is pleased that the bureau concluded the program is financially sound. This section of the report describes the condition and activity of the Vending Stand Fund and no issues were identified.

Recommendations:

None

The Department Could Benefit From a Comprehensive Plan Outlining Future Fund Use

The department agrees that the BEP would benefit from a comprehensive business plan, including a capital budget component. A primary goal of the current administration has been the "reengineering " of the BEP to:

- ensure stronger management;
- improve accountability;
- increase opportunities for blind individuals to achieve economic self support;
- strengthen the working relationship with the California Vendors Policy Committee (CVPC); and

- develop sound fiscal policies and controls to foster responsible program growth.

In recognition of the need for focused attention on services for persons with sensory disabilities (blindness and deafness), a new Specialized Services division which includes BEP was created as part of the Director's reorganization plan, and a new Deputy Director was appointed in November 2000.

One of the primary responsibilities of the Deputy Director is the reengineering of the BEP. The Deputy Director resumed a strategic planning process that had been initiated by the Acting Deputy Director responsible for the BEP by convening a statewide meeting of program staff and CVPC representatives. The need for program change is fundamental to this planning process.

The department has maintained active communication with CVPC, field office staff and other stakeholders throughout the planning process. The BEP management team expects to complete the strategic plan by October 2001.

Recommendation:

- **The department should complete its strategic plan, including a component that outlines future uses of the Vending Stand Fund to determine whether its surplus is capable of supporting its approved projects.**

  The department is continuing the strategic planning process, mentioned above, that will include the fiscal tracking system already in place to ensure an appropriate fund balance is maintained.

A Decrease in Vending Machine Commissions Has Resulted in Reduced Contributions to the Vendors' Pension Plan

The department is pleased that the bureau concluded the Vending Machine Fund is sound. This section of the report describes the condition and activity of the Vending Machine Fund and no issues were identified. However, the department is concerned

1 that the title of this section may lead the reader to erroneously conclude that the department's actions in this area are detrimental to the BEP and provides the following clarification.

The bureau is correct that commissions and deposits to the retirement fund decreased due to the conversion of vending machine locations to blind vendor facilities. However, the bureau failed to acknowledge the overall program benefit of these conversions that resulted in additional employment opportunities for individuals who are blind. The conversions made in the 1998-99 and 1999-2000 fiscal years account for approximately 95% of the decrease in vending machine commissions received during this period.

Consistent with the bureau's 1997 program audit of the BEP, the department has been more aggressively pursuing opportunities for blind vendors. An annual report of vending machine locations by city is submitted to BEP field staff for determining potentially profitable vending machine routes for blind vendors. The sites that appear profitable are converted to vendor facilities. The purpose of the BEP is to provide opportunities for blind vendors, and therefore, the department does not see this decrease as detrimental to the program and will continue the conversions.

Recommendations:

None

The Department Could Do More to Collect Additional Vending Machine Commissions

The department appreciates the bureau's recognition of the department's progress in collecting vending machine commissions and acknowledges the need for continuing improvement in this area.

The department is currently working on the surveys and reconciliation required by Welfare and Institutions Code Section 19640. From the results of those surveys the department will identify potential new locations for vending machine contracts. The reports to the Legislature and CVPC regarding the survey process will be issued in January 2002 as required.

For state properties, the Department of General Services (DGS) provided a listing and description of sites by location code. The department identified 25 of the 164 location codes to be included in the survey process. The department does not agree with the bureau's assertion that the selection was limited based solely on the lack of staff. The identification of the 25 codes was based on an analysis of the location codes that would generate the highest vending machine commission revenue. The 25 location codes generated a list in excess of 4,600 sites. Excluding locations already under contract, involved in contract development, or operated by BEP vendors, 200 potential locations remained and are currently being surveyed. Although the remaining DGS location codes are unlikely to generate sufficient vending machine commission revenue, the department will consider surveying these sites within these codes after contracts have been developed from the current survey process. 2

The department currently pursues new federal locations as they are identified by the General Services Administration (GSA). In addition, an analysis will be completed on the list recently obtained from GSA. A survey and reconciliation process will be conducted and the results used to identify locations with the potential for vending machines, and contracts developed for those sites.

The department agrees it needs to address workload issues related to contract processing and collection of delinquent commissions. Although the long-range strategic plan will address the resource needs, interim remedies include the use of temporary staff, such as retired annuitants, student assistants and contract consultants. The resources will be dedicated to contract processing and database design and development. The database, upon completion will assist the department in pursuing uncollected commissions.

Recommendations:

- **The department should complete its survey of state and federal properties to identify vending machine opportunities that will generate commissions for the program.**

  The department will continue its current survey process.

- **The department should identify and pursue vending machine commissions from agencies and vending machine operators that refuse to or fail to remit commissions.**

  This recommendation relates to the California State Universities (CSU) as well as vending machine operators who fail to remit commissions.

  The August 1997 BEP report, by the bureau, noted that in response to department demands, CSU responded that it had no income to report and that commissions generated in the CSU system were for the benefit of students. It cited Government Code sections 89300 and 89905 in support of its position that it was excluded from the ambit of Welfare and Institutions Code 19630(a) and the obligation to remit
  3 commissions. The bureau nonetheless recommended that department pursue commissions from CSU. The department disagreed noting that it had met its obligation to pursue vending machine income from CSU and taken all reasonable steps to ensure compliance. The department's position is unchanged. CSU would not agree to participate in arbitration pursuant to Welfare and Institutions Code section 19627, as suggested by the bureau, because it disputes that it is subject to the jurisdiction of the BEP. CSU has no reason to agree to arbitration and risk a decision that it is subject to BEP jurisdiction. Similarly an Attorney General opinion that CSU is subject to BEP jurisdiction is not binding and would not be accepted by CSU.

  The department anticipates that it will be able to pursue uncollected commissions from vending machine operators upon completion of the design and development of a new vending machine operator database.

- **The department should verify the exempt status of incorporated, non-profit employee organizations, then collect vending machine commissions from those that are not exempt.**

The department acknowledges the importance of verifying the exempt status of employee organizations in sites where vending machines are located. The department will seek to re-establish communication with the California Highway Patrol in an effort to negotiate agreements related to the collection of vending machine commissions consistent with the law.

- **The department should determine if it can allocate staff from other units of the department based on the results of its strategic plan.**

The strategic planning process will address resource needs in all department programs including strategies such as redirection of staff.

- **The department should determine whether the blind vendor's proposal of contracting for professional services to identify and collect vending machine commissions is feasible.**

The CVPC has proposed that the department contract for professional services to secure vending machine contracts and commissions. The department will examine the feasibility of this proposal from the legal, fiscal, and programmatic perspectives.

- **The department should consider seeking legislation to amend state law to allow it to use some of the vending machine income for hiring staff to perform the administrative functions of the program.**

Both the federal Randolph-Sheppard Act, 20 United States Code, section 107d3(c), and state law, Welfare and Institutions Code section 19630, limit the uses of vending machine commissions. They do not permit use of commissions for the hiring of department administrative staff. The bureau reports that it has spoken with a federal representative who advises that federal law does not restrict the use of commissions from machines on state, as distinguished from federal property. It would be improvident to consider changes to state law that may conflict 4 with federal law, without formal written agreement from the federal Rehabilitation

Services Administration (RSA). The department will further consider this possibility in consultation with RSA, Health and Human Services Agency and other control agencies.

Conclusion

The department is pleased that the results of the bureau's financial review of the BEP are consistent with the department's current actions and plans. The comments and recommendations will be considered as the department continues the reengineering of this program.

COMMENTS

California State Auditor's Comments on the Response From the Department of Rehabilitation

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

1 The title of the section merely describes the fact that commissions have decreased and this decline has resulted in smaller contributions to the vendors' pension plan. Although the department told us that most of this decline is due to its conversion of vending machine locations to vendor-operated facilities, the report does not conclude that these conversions harm the overall Business Enterprises Program for the Blind (program). Moreover, the report does not recommend that the department discontinue its practice of converting more vending machine locations to vendor-operated facilities. The report does, however, indicate that other reasons, such as the department failing to collect from vending machine operators who do not remit commissions, may have also contributed to this decline in commissions. As we explain on page 18 of the report, when the department does not pursue the commissions it is mandated to collect, it negatively impacts the contributions to and the growth of the vendors' pension plan.

2 When we asked the department about its procedures for selecting the 25 location types, it could not provide a clear description of its procedures or methodology but instead stated that its staff selected these 25 location types based on their knowledge and experience. Moreover, the department told us that because it did not have sufficient staff to investigate all location types, it selected those that it believes are the best prospects for vending machine services. The department's inability to provide us with clear plans or procedures demonstrated to us that it does not have a well-planned approach for identifying locations to survey for vending machine services. Furthermore, as its response to our report suggests, the department is ambiguous in its planned course of action and timetable for completing the surveys for the remaining location types.

3 As we state in our report, although it is a difficult issue to resolve, the department should seek to settle this matter formally. Similar to the issue of confirming the claims of nonprofit employee organizations that they are exempt from remitting commissions to the program, the department should seek legal advice or a legal opinion to confirm the validity of the position taken by the California State University (university) system. The Sacramento County Superior Court previously ruled that the University of California and the California Community Colleges are exempt from remitting commissions to the program; however, it specifically did not include the university in this ruling. Therefore, as we state in our report, since the validity of the university's position is unclear, the department should formally settle this outstanding issue.

4 Although we recommend that the department consider seeking legislation to allow the department to use some of the vending machine income to hire staff for the administrative functions of the program, we recognize that there are some preliminary steps that would be required. We would expect the department to diligently investigate this alternative with all interested stakeholders to understand fully its options and any limitations before seeking changes in the law.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press