Department of Rehabilitation:
Business Enterprise Program for the Blind
Financial Report
Year Ended June 30, 1994
Table of Contents

Summary S-1

Introduction 1

Independent Auditors’ Report 3

Financial Statements
Balance Sheet 5
Statement of Revenues, Expenses, and Changes in Retained Earnings 7
Statement of Cash Flows 9
Notes to the Financial Statements 11

Report on the Internal Control Structure 15

Report on Compliance With Laws and Regulations 17

Appendix: Findings and Recommendations 19

Other Comments 25

Response to the Audit 27
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
Blank page inserted for reproduction purposes only.
## 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.
Blank page inserted for reproduction purposes only.
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

<table>
<thead>
<tr>
<th>Operating Revenues</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Vending stand fees</td>
<td>$1,602,209</td>
</tr>
<tr>
<td>Vending machine commissions</td>
<td>432,822</td>
</tr>
<tr>
<td>Vendor contributions</td>
<td>1,141,019</td>
</tr>
<tr>
<td><strong>Total Operating Revenue</strong></td>
<td><strong>3,176,050</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative expense</td>
<td>2,187,289</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,859,665</td>
</tr>
<tr>
<td>Retirement and insurance expense</td>
<td>1,622,144</td>
</tr>
<tr>
<td>Repair and maintenance</td>
<td>193,839</td>
</tr>
<tr>
<td>Vending machine commissions</td>
<td>143,439</td>
</tr>
<tr>
<td>Other program expense</td>
<td>611,934</td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td><strong>6,618,310</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating Loss</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating Loss</strong></td>
<td><strong>(3,442,260)</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nonoperating Revenues (Expenses)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal grants</td>
<td>4,074,778</td>
</tr>
<tr>
<td>State grants</td>
<td>448,656</td>
</tr>
<tr>
<td>Interest revenue</td>
<td>92,505</td>
</tr>
<tr>
<td>Loss on disposal of fixed assets</td>
<td>(218,060)</td>
</tr>
<tr>
<td><strong>Net Nonoperating Revenues (Expenses)</strong></td>
<td><strong>4,397,879</strong></td>
</tr>
</tbody>
</table>

| Net Income                     | 955,619 |
| Retained Earnings, Beginning   | 12,612,496 |
| **Retained Earnings, Ending**  | **$13,568,115** |

See the notes accompanying the financial statements.
Blank page inserted for reproduction purposes only.
Department of Rehabilitation  
Business Enterprise Program for the Blind  
Statement of Cash Flows  
For the Fiscal Year Ended June 30, 1994

<table>
<thead>
<tr>
<th>Cash Flows From Operating Activities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Loss</td>
<td>(3,442,260)</td>
</tr>
<tr>
<td>Adjustments to reconcile operating loss with net cash provided by (used in) operating activities</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,859,665</td>
</tr>
<tr>
<td>Change in assets and liabilities</td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>(68,009)</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>138,268</td>
</tr>
<tr>
<td>Other assets</td>
<td>53,409</td>
</tr>
<tr>
<td>Loans receivable</td>
<td>43,768</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(809,484)</td>
</tr>
<tr>
<td>Due to General Fund</td>
<td>(239,621)</td>
</tr>
<tr>
<td>Compensated absences payable</td>
<td>43,778</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>(27,761)</td>
</tr>
<tr>
<td>Total Adjustments</td>
<td>994,013</td>
</tr>
</tbody>
</table>

| 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.
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:

<table>
<thead>
<tr>
<th>Equipment</th>
<th>$22,557,039</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less accumulated depreciation</td>
<td>(11,983,686)</td>
</tr>
</tbody>
</table>

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.