

Department of Rehabilitation

Audit Report of the

Business Enterprise Program Turlock Road Side Rest Stop (Location 3-756)

Date: March 7, 2012

Control Number: 2011A- 104

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Introduction

The Department of Rehabilitation (DOR) Audit Services has completed our audit of the February 2011 through July 2011 Monthly Operating Reports (MORs) submitted by Mr. Nnabuaku Green, Business Enterprises Program Vendor (BEP Vendor) for the Turlock Road Side Rest Stop (South and North Bound) in Turlock, CA.

The BEP provides Department consumers, who are legally blind, opportunities to be trained in the operation of cafeterias, vending stands, and snack bars, with the ultimate goal of becoming independent food service professionals in California. The program was created through federal legislation, the Randolph-Sheppard Act of 1936, which was enacted to provide blind persons with remunerative employment, enlarge the economic opportunities of the blind, and stimulate the blind to greater efforts in striving to become self-supporting.

BEP Vendors operate their own facility and retain the profits from the facility they manage, excluding a percentage (set-aside fee) prescribed by law. This fee is placed in the Vending Facility Trust Fund, is matched with federal funds, and is used to establish new facilities, refurbish/maintain established facilities, and pay health and dental insurance for active vendors.

State regulations require each BEP Vendor to submit a MOR to DOR by the 25th day of the following month. The MOR is a report of operations as well as the basis of calculating set-aside fees, workers' compensation and liability insurance. BEP Vendors are required to remit these fees each month with their MORs. As set-aside fees are the primary source of income for the Vending Facility Trust Fund, inaccurate and unsupported MORs could result in an underpayment of fees.

DOR also uses information reported on the MOR to assist BEP Vendors in making decisions on improving their locations, as a source for required Federal and State reports, and for the establishment of fees.

Background

BEP Vendor Nnabuaku Green began operating the Turlock Road Side rest stop in October 2010. This location consists of approximately 18 vending machines with nine located at the north bound side and nine at the south bound side of Highway 99.

Audit Scope/Procedures

We conducted our audit in accordance with Government Auditing Standards for fiscal compliance as defined by the Government Accountability Office, except Standard 3.52 requiring an external peer review. Our audit included examining evidence in support of expenses reported on the May and July 2011 MORs to obtain reasonable assurance that the expenses reported were compliant with the Vendor's Monthly Operating Report Instructions (MOR Instructions), applicable Federal and State regulations, and were supported by appropriate records. Our audit also included a limited review of the

internal controls through use of questionnaires and interviews with the BEP Vendor. Audit fieldwork was conducted during November and December 2011.

Our audit is subject to the inherent risk that all significant errors and irregularities, fraud, or non-compliance will not be identified.

Summary of Findings

We identified several areas of non-compliance with regulations and the MOR instructions, and weaknesses in internal controls and recordkeeping. These deficiencies resulted in inaccurate or unsupported reporting of expenses on the MOR in the following areas:

- Gross Receipts/Sales Tax
- Cost of Goods Sold (Inventory & Merchandise Purchases)
- Operating Expenses

The MOR Instructions state that the BEP Vendor is responsible for the completeness and accuracy of the MOR report. The BEP Vendor's signature on the report signifies the report and attachments are a correct statement of the operation of the vendor's facility and contain valid financial information for the location. The BEP Vendor is responsible for the completeness, accuracy, and submission of the report along with required fees.

Details on the specific findings identified and recommendations are included in **Appendix A**.

BEP VENDOR RESPONSE TO THE AUDIT

Please provide a detailed schedule for me of sales taxes consistent with Board of Equalization guidelines as it applies to the month of July 2011 of my operation.

Finally I understand the audit report advising me to use plan-o-grams in my business operation. My consultants have been helping me launch that area in my operation and I expect to be able to be an active participant gaining better controls.

I am making a more concerted effort to strengthen my internal controls over the operation, improving recordkeeping practices, and doubling our efforts to insure accuracy of the MORs and fees submitted to DOR.

Upon receipt of your final audit report and in the process of preparing my corrective Action Plan (CAP) I will address more specifically some conclusions drawn in your findings that I question or disagree with.

Required Action and Follow-up

The California Code of Regulations (CCR), Title 9, §7220 require the BEP Vendor to take all appropriate action to correct any deficiencies identified by a BEP facility review or an audit conducted by the Department within the period of time established by the Department. To ensure appropriate actions are taken to correct the deficiencies identified in this report, a Corrective Action Plan (CAP) is required.

1. A CAP shall be prepared by the BEP Vendor to address each finding. It shall indicate the actions to correct the findings and implement the recommendations identified in this report. The BEP Vendor shall consult with BEP staff when developing the CAP to assure that the planned actions will be sufficient to correct the deficiencies noted.

The CAP is to be submitted by the BEP Vendor to Audit Services by Friday March 31, 2012.

2. Additionally, due to the significance of the discrepancies identified in the areas of Net Sales, Cost of Goods Sold and Operating Expenses, DOR will require the BEP vendor to submit a copy of the MOR for April 2012, along with documentation supporting accurately reported Net Sales, Cost of Goods Sold and Operating Expenses (due May 25th). Audit Services and BEP will review the MOR and supporting documentation to verify corrective actions taken and accuracy of the reported amounts.

Nnabuaku Green, BEP VENDOR
Location #3-756, Turlock Road Side Rest Stop

Details to Findings

Audit Services has conducted an audit of the MORs submitted by the BEP Vendor for the Turlock Road Side Rest Stop in Turlock, CA for the period of February 2011 through July 2011. Specifically, the MOR for the month of July 2011 was selected for detailed review and we noted the following:

Net Sales - Findings

1. The BEP Vendor's supporting documentation for sales contained inaccuracies resulting in a slight underreporting of Gross Receipts (Line 1) on the July 2011 MOR. Specifically, the BEP vendor documented gross receipts on his weekly cash collection reports. The bookkeeper captured gross receipts in a report entitled "Daily Cash Transactions Month End Report". The bookkeeper inaccurately recorded amounts, posted duplicate entries, and missed posting amounts from the weekly cash collection report to the month end report resulting in the amounts not matching. As a result, the BEP Vendor's documented gross receipts totaled \$17,967 but the bookkeeper's accounting records reflect \$17,893 as reported on Line 1 of the MOR.

The MOR instructions state that a copy of the instructions should be given to the vendor's accountant or any other person preparing the report. Further, when a vendor chooses an individual to prepare the MORs, that person must be able to prepare detailed and accurate reports.

2. The amount of money deposited into the vending machine for products vended pursuant to the meter readings did not agree with the gross receipts indicated on the vendor's cash collection reports. While the vendor consistently documented the meter readings, he did not reconcile the meter readings to the actual cash collected. As such, he was unaware that there were numerous discrepancies.

Good internal controls require that information obtained on business operations be evaluated. Discrepancies identified, including cash overages and shortages, should be acknowledged and monitored.

3. State Sales Tax of \$726 reported on Line 2 of the July 2011 MOR was incorrectly calculated and could not be fully supported by the accounting records. We recalculated sales tax utilizing percentages required by BOE regulations and yielded a sales tax amount of \$838. As such, Line 2 was underreported by \$112.

The methodology used by the bookkeeper is not consistent with the Board of Equalization (BOE) regulations which require that 32.2160% of the gross receipts for cold food items (chips, candy, fruit juices, etc) sold from vending machines be taxable. The bookkeeper contends that none of these items are taxable and therefore did not tax these items in the calculation of sales tax. In addition, regulations require that 32.2160% of gross receipts for hot beverages sold from vending machines be taxable. The bookkeeper calculated sales tax of these items based on 66.67% of gross receipts.

According to BOE, the tax rate factor for items taxable at 100% would be 93.1315% for San Joaquin County. The bookkeeper did not apply the tax rate factor for items taxable at 100%.

Lastly, the BOE Sales Tax Report, BOE 401EZ, was not provided. We were provided a copy of a cashier's check payable to BOE in the amount of \$1,611.00 dated July 26, 2011; however, it was unclear what the payment represented or if the correct tax payment was being made.

BOE Sales and Use Tax Regulations - Regulation 1574 Vending Machine Operators specify requirements for application of tax.

Over or understatements of gross receipts and sales tax impact accuracy of the MOR including calculations for liability insurance, Profit from Operations, and payment to the Vending Facility Trust Fund. Further, incorrect calculation of sales tax may result in inaccurate reporting/payments which could result in penalties or administrative action by BOE.

Net Sales - Recommendation

The BEP Vendor shall report Gross Receipts and State Sales Tax correctly and the accounting records shall accurately account for sales. Further, the BEP Vendor and bookkeeper must ensure that sales tax is calculated and reported in compliance with State BOE requirements.

The BEP Vendor should develop and implement a process for reconciling meter readings to the actual cash collected and assessing noted discrepancies.

Costs of Goods Sold - Findings

4. The BEP Vendor incorrectly reported Merchandise Purchases and could not support Inventory reported on the July 2011 MOR, resulting in inaccurate Cost of Goods Sold.
 - a. The amounts listed for Opening Merchandise Inventory (Line 4) and Closing Merchandise Inventory (Line 7) could not be supported. The BEP

vendor did not submit documentation to support that a physical inventory was conducted in December 2010 and June 2011 as required. The BEP vendor advised that inventory is estimated using order sheets; however, an adequate and clearly defined inventory process is not in place.

CCR Title 9 Section 7220 (o) requires the vendor to take and report the physical inventory of the vending facility merchandise and supplies twice annually for the periods ending June 30th and December 31st and submit the inventory reports to BEC and at other times as required by the BEP for which previous instruction has been given. The MOR Instructions for Closing Merchandise Inventory (Line 7) require that the vendor enter the total amount of the closing merchandise inventory for the report month. Inventory amounts must be supported.

- b. Merchandise Purchases (Line 5) in the amount of \$6,901 could not be fully supported by the BEP Vendor's records and in a few instances, expenses reviewed were unallowable.

The total merchandise purchases for July 2011, per account codes 41000 and 41300 on page one of the bookkeeper's Accounts Payable Month End Summary is \$6,900.88. This amount agrees with Line 5 of the July MOR; however, the same account codes on the final page reflect total purchases of \$6,614.88, causing a discrepancy of \$286.

The amount of \$6,614.88 noted on the last page is supported by merchandise receipts; however, a couple of receipts for Wal-Mart purchases were recorded incorrectly and in one instance, the receipt reflected purchases made in a prior month. We also identified items that did not appear related to items vended. As such, we determined the allowable and supportable amount to be \$6442.

The CCR Title 9, Section 7220 (l) requires the vendor to maintain required records on the operation of the facility for the current year plus the three preceding years. Further, MOR Instructions state that the vendor's signature on the MOR signifies the report is a correct statement of the operation of the vendor's facility and contains only valid financial information for the location.

Cost of Goods Sold - Recommendation

The BEP Vendor shall accurately calculate and report the Cost of Goods Sold on the MOR. The BEP Vendor shall ensure that merchandise purchases are allowable, supported by appropriate accounting records, and are reported in the month incurred.

The BEP Vendor shall implement and maintain a proper physical inventory control system to take and report inventory at least twice annually as required by regulations and as often as required by BEP.

Operating Expenses - Findings

5. Amounts reported on the July 2011 MORs for Operating Expenses could not be supported by source documentation, were incorrectly recorded in the accounting records, and in some instances were unallowable.
 - a. We identified multiple occurrences where source documentation such as invoices or receipts were missing, some of which included:
 - Utility expenses in the amount of \$275
 - Telephone expenses in the amount of \$280
 - Accounting Services in the amount of \$325
 - Mileage expenses in the amount of \$628 for July 2011
 - b. Operating expenses reported on the MOR did not reconcile with the amounts recorded on the bookkeeper's Accounts Payable (AP) invoice register and/or supporting documentation as follows:
 - The amount reported for rent/utilities is \$1,446 yet the AP register indicates \$275.00.
 - The amount reported for telephone expense is \$280 yet the AP register indicates \$145.00.
 - The amount reported for mileage is \$628.00 yet the AP register amount is \$425.00.
 - c. Certain amounts reported for Operating Expenses (Lines 16-26) were unallowable including:
 - Rent, Line 16, of \$900 and Utilities, line 16, of \$275 the claimed expenses include costs for the vendor's personal residence which are unallowable. Expenses for the storage of BEP property maintained at a vendor's personal residence is only allowable if the residence/warehouse is located in an area zoned as commercial or a business license to operate as such has been obtained from the local City government.
 - Other Expenses, Line 24, of \$30 for unallowable bank charges.
 - Other Expenses, Line 25, of \$184 for vehicle maintenance & repairs for which no prior approval was obtained and mileage was already being claimed.

CCR Title 9, Section 7220 (l) requires the vendor to maintain required records on the operation of the facility for the current year plus the three preceding years to include invoices and records for operation purchases.

The Vendor's MOR Instructions identify Non-Deductible Expenses including items such as commuting to and from work, including parking for self and/or employees, accounting expenses not pertaining to BEP vending facility operations, unauthorized vehicle mileage or repair, penalties for late fees, insurance and/or loan payments.

Operating Expenses - Recommendation

The BEP Vendor shall ensure the Operating Expenses reported on the MORs are accurate and allowable. Further, the expenses shall be properly supported by source documents and accounting records. The BEP Vendor requires all persons and companies with which he purchases goods and/or services to provide him with appropriate invoices / receipts. Such documentation should identify (as appropriate): persons or company; the goods purchased; the services rendered; dates; times; duration; cost; quantity; invoice number.

Vendor's Overall Operation - Findings

6. A statement identifying operator information and permit number was not affixed to any of the vending machines as required by the BOE.

BOE Regulation 1574 requires persons operating vending machines dispensing tangible personal property of a kind the gross receipts from the retail sale of which are subject to tax or dispensing food products at retail for more than 15 cents must obtain permits to engage in the business of selling tangible personal property. A statement containing the operators name, address and permit number must be affixed upon each vending machine in a conspicuous place.

Recommendation

The BEP Vendor shall post the required statement information on each vending machine as required by the BOE.

7. The BEP Vendor lacks a plan-o-gram or any documented analysis of product selection, price setting, customer satisfaction, product demand; and marketing strategy.

The BEP Vendor was previously instructed by BEP in a March 2011 location review to develop and submit a written business plan within ten days.

Recommendation

The BEP Vendor shall develop and submit to BEP a detailed plan-o-gram to encompass all aspects of his operation.