

Department of Rehabilitation

Audit Report of the

Business Enterprise Program

Valley Wells Roadside Rest (Location 3-1025)

Date: March 09, 2012

Control Number: 2011A- 105

DOR Audit Services Team:

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Introduction

The Department of Rehabilitation (DOR) Audit Services has completed our audit of the January 2011 through July 2011 Monthly Operating Reports (MORs) submitted by Mr. Fernando Lopez, Business Enterprises Program Vendor (BEP Vendor), for the Valley Wells Roadside Rest Stops (north and southbound) in San Bernardino County.

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 Fernando Lopez began operating the Valley Wells Roadside Rest located on Interstate 15 in San Bernardino County in August 2011. The Valley Wells Roadside Rest Stops consist of 11 vending machines containing the following items:

- cold beverages including soda, juices, energy drinks and water
- hot and cold coffee drinks
- confections and snacks such as candy bars, chips, nuts and trail mix.

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 July 2011 MORs (with additional payroll testing for the January 2011 MOR) 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 noted some 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)
- Payroll
- 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

The Vendor gave his response via telephone and stated that he agrees with the findings and is currently working on his corrective action plan. The Vendor has already begun using appropriate payroll documents for his employee and travel logs to support mileage expenses reported on the MOR. The Vendor has also asked for an extension to submit his CAP and MOR with supporting documents due to his accountant resigning. And extension has been granted.

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 Wednesday April 21, 2012.

2. Additionally, due to the significance of the discrepancies identified in the areas of Gross Receipts, 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 Gross Receipts, Cost of Goods Sold and Operating Expenses. Audit Services and BEP will review the MOR and supporting documentation to verify corrective actions taken and accuracy of the reported amounts.

We would like to thank Mr. Lopez and his accountant for their assistance with our audit.

Fernando Lopez, BEP VENDOR
Location #3-1025, Valley Wells Road Side Rest Stop

Details to Findings

Audit Services has conducted an audit of the MORs submitted by the BEP Vendor for the Valley Wells Road Side Rest Stop in San Bernardino County for the period of January 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. Gross receipts totaling \$16,428 reported on the July 2011 MOR was inadequately supported. Specifically:
 - The BEP Vendor recorded sales information in a notebook. The Vendor did not identify sales attributed to each vending machine rather he recorded sales as a grand total for all vending machines located at both the north and southbound rest stops.
 - The BEP Vendor did not routinely conduct meter readings and when he did record the meter readings, he inaccurately included a combination of historical and resettable figures.
 - The sales information was verbally provided to the BEP Vendor's accountant who prepared a schedule of sales including the meter readings for snack, can, bottle and coffee vending. The accountant's schedule contained some numbers that were different than the figures included in the BEP Vendor's source document (notebook) and it contained a couple of figures that were not found in the notebook.

Over or understatement of gross receipts impact accuracy of the MOR including calculations for liability insurance, Profit from Operations, and payment to the Vending Facility Trust Fund.

CCR, Title 9, Section 7220 requires the BEP Vendor to maintain a sales register or monthly summary of sales and other income.

The MOR Instructions state that the BEP Vendor is responsible for the completeness and accuracy of the report. The MOR Instructions state that a copy of the instructions should be given to the vendor's accountant and when a

vendor chooses an individual to prepare MORs, that person must be able to prepare detailed and accurate reports.

2. While the BEP Vendor documented intermittent meter readings, he did not reconcile the meter readings to the actual cash collected from each machine. As such, he was unaware of any discrepancies and the cause of the 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. Due to the unsubstantiated gross receipts for the month of July 2011, the state sales tax calculated and reported to BOE for the 3rd quarter ending September 2011 may not be accurate. The reported gross sales figure of \$38,075 includes the \$16,428 in gross receipts reported on the July 2011 MOR. If sales tax is collected on sales transactions and not properly reported and remitted to BOE, it may result in penalties or administrative action by BOE.

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

Net Sales - Recommendation

The BEP Vendor shall report gross receipts and state sales tax correctly and the accounting records shall adequately account for the vending machine sales. Further, the BEP Vendor must ensure that sales tax is calculated and reported in compliance with State BOE requirements.

The BEP Vendor shall:

- record cash collected from each vending machine rather than recording a summarized sales total that can't be tied back to the source of revenue.
- ensure that sales figures are carried forward to a monthly summary report to be provided to the accountant for accurate preparation of the MOR.
- consult with BEP about best practices for accurate meter readings.
- develop and implement a process for reconciling meter readings to the actual cash collected.

Costs of Goods Sold - Findings

4. Although the BEP Vendor indicated that he conducted a biannual inventory as required by regulations, the closing merchandise inventory reported on Line 7 of the MOR was not fully supported. Specifically:

- The inventory sheets for the months December 2010 and June 2011 do not specifically identify the inventoried item but indicates general product categories such as candy, snacks and chips.
- Due to the lack of specific product identification, some inventory items could not be traced back to the supporting merchandise receipts.
- One unit price is listed on the inventory sheets for each product category; however, not all products within the category are priced the same per the purchase invoices/receipts.
- The closing inventory reported on the MORs between December and June are based on estimates but there is no process or documentation to support estimated inventory.
- The June 2011 physical inventory sheet contained calculation errors for the line items candy, coke, energy drinks, and Dasani.

CCR, Title 9, Section 7220 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 program for which previous instruction has been given.

The MOR Instructions state for Line 7 Closing Merchandise Inventory, enter the total amount of the closing merchandise inventory for the report month in the "Itemized Amount" Column. Inventory amounts must be supported.

5. The accounting records (calculator tape) that supports the amount reported for merchandise purchases on Line 5 of the July 2011 MOR contained some minor inaccuracies. Specifically:

- A receipt for \$156.58 from Costco was not included in the total calculation.
- There was a double entry on the register tape in the amount of \$213.67.
- An invoice for \$111.62 from Smart & Final was not included in the total calculation. While the receipt was provided, the register tape did not include this amount in the total for purchases from Smart & Final.

The Vendor Monthly Operating Report Instructions for Line 5 - Merchandise Purchases, indicate to enter total merchandise purchases for the reporting period, including disposable goods, paper and plastic which are made available to the customer. The instructions also state that the BEP Vendor is responsible for the completeness and accuracy of the report and when a vendor

chooses an individual to prepare MORs (DR478 reports), that person must be able to prepare legible, detailed and accurate reports.

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 maintain a proper physical inventory control system to take and report inventory as required by regulations and shall prepare and maintain accurate and adequate inventory records.

The accounting records shall be accurate and shall support the merchandise purchase amount report on Line 5 of the MOR.

Payroll Expense - Finding

6. While the BEP Vendor had supporting payroll journals and paystubs to support the payroll expenses reported on the January and July MORs, the vendor did not require his employee to complete timecards to support hours worked. Without such records there is no documentation to support that the employee indeed worked the number of hours stated or that the hourly wage paid is supported.

CCR, Title 9, Section 7220 states that the BEP Vendor must maintain compensation records to support payroll expenses.

Payroll Expense - Recommendation

The BEP Vendor shall ensure that employee timesheets/timecards are prepared and maintained. The vendor should consider that time reporting documents account for dates/hours worked, time in and out, overtime, etc.

Operating Expenses - Findings

7. Amounts reported on the July 2011 MOR for some Operating Expenses could not be supported by source documentation as follows:

Mileage

The BEP Vendor did not prepare a mileage log or any documentation to support the amount reported on the MOR. He stated that mileage reported was from home office to various sites for merchandise purchases and not from his home to the roadside rest.

Supplies

An invoice to support the \$60 supplies expense was not provided.

Telephone

An invoice to support the \$75 telephone expense was not provided. Auditors received a copy of a cell phone bill for December 2010 but no invoice was provided to support the amount reported on the July 2011 MOR.

CCR Title 9, Section 7220 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 shall require all persons and companies with which he purchases goods and/or services to provide him with appropriate invoices/receipts.

The BEP Vendor shall utilize a mileage log that denotes purpose of trip, starting and ending location, and mileage incurred.