

Department of Rehabilitation

Audit Report of the

**Business Enterprise Program
East End Food Court Complex (Location 3-896)**

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Control Number: 2011A- 101

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Introduction

The Department of Rehabilitation (DOR) Audit Services has completed our audit of the October 2010 through March 2011 Monthly Operating Reports (MORs) submitted by Ronald G. Long, Business Enterprises Program Vendor (BEP Vendor) to the DOR for the East End Food Court Complex (East End Complex) in Sacramento.

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 then 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 by the 25th day of the following month. The MOR is a report of operations as well as the basis of calculating fees such as set-aside fees, workers' compensation and liability insurance. BEP Vendors are required to remit these fees to the BEP program 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 underpayment of fees which limits the amount of program funds eligible for matching federal funding and for use for the program.

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 Ron Long began operating the East End complex in November 2006 as a primary BEP vendor. Currently, he is operating the facility as an interim vendor until a permanent BEP vendor is selected. The East End complex is a very complicated location, consisting of the following operations:

- A full-service restaurant, the East End Sports Grill, which includes a sit down dining area, a working bar serving beer and wine, and a deli that offers hot and cold breakfast and lunch items for take-out. Catering is also provided.
- Three coffee kiosks that serve espresso drinks, pre-packaged food and snack items.

- Over forty vending machines located throughout the East End complex

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. These standards require that we plan and perform the audit to obtain reasonable assurance that the expenses reported on the MORs were compliant with the Vendor's Monthly Operating Report Instructions (MOR Instructions) applicable Federal and State regulations, and were supported by appropriate records. Audit fieldwork was conducted during June & July 2011.

Our audit included a limited review of the accounting systems and internal controls as they relate directly to the MORs through use of accounting system and internal control questionnaires and interviews with the BEP Vendor. We conducted additional testing, on a sample basis, of the March 2011 MOR expenses reported for sales, sales tax, purchases, inventory, and operating expenses.

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/Recommendations

During our review, we identified areas of non-compliance with regulations and the MOR instructions, and weaknesses in internal controls and recordkeeping requirements. These deficiencies resulted in inaccurate or unsupported reporting of expenses on the MORs in the following areas:

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

We recommend the BEP vendor must comply with applicable regulations and MOR instructions. Further, the BEP vendor shall strengthen controls over the operation, improve recordkeeping practices, and ensure accuracy of the MORs and fees submitted to DOR. Details on the findings and recommendations are included in **Appendix A**.

BEP VENDOR RESPONSE TO THE AUDIT

I have engaged the services of an accountant, who will set up an accounting system for my facility. She will be in contact with the Department staff to provide the MOR revisions. Upon discussion with the accountant the project to build the accounting records in accordance to GAAP will take a minimum of 90 days; as the program is requesting a complete year of history. My bookkeeping services with Cardinal Pointe will continue as is; until such time the accountant has the

opportunity to completely build the system and bring the accounting records up to date. We will provide the program with an update as to our progress every 30 days.

I will express my disappointment with the services of Cardinal Pointe as a BEP vendor. I feel the services they have provided are far below standard as this audit has pointed out. I will continue to cooperate with the program.

The accountant and I will submit a Corrective Action Plan (CAP) for approval within the next two weeks addressing each item in the findings with how this facility will correct each action. We will also include an estimated timeline for goal achievements.

Required Action and Follow-up

DOR is responsible for the proper administration and oversight of the BEP; thus, we are required to properly monitor BEP vendors to ensure their material compliance with federal, state, and DOR requirements.

1. Due to the significance of the differences identified and BEP program needs, the BEP vendor must submit amended MORs from July 2010 to current, as follows:
 - The BEP vendor will first prepare and submit an amended MOR for March 2011, to calculate the actual amounts to the affected line-items (Gross Receipts, Purchases, and Operating). The BEP vendor will also include a summary to explain the methodology used to prepare the amended MOR within 30 days of the date of this report.
 - Audit Services and BEP will review the March 2011 amended MOR submitted by the BEP vendor along with the summary provided to verify the methodology used whereupon DOR will provide feedback or approval to proceed with amending the remaining MORs.
 - The BEP vendor will submit the amended MORs for July 2010 to current to BEP for review, approval, and processing, within 60 days of the date of the DOR approval of the methodology used for the March 2011 amended MOR.
2. To ensure appropriate actions are taken to correct the findings deficiencies included in this report, a corrective action plan is required from the BEP vendor.

- A Corrective Action Plan (CAP) will be prepared by the BEP Vendor in consultation with BEP to correct the findings identified in this report.
- The CAP is to be submitted by the BEP Vendor to Audit Services by October 12, 2011. Audit Services will review the CAP with BEP. The BEP vendor will be notified of the approval, or will be contacted to discuss any necessary changes as needed to ensure that taken or planned actions will satisfactorily resolve the deficiencies noted in this report.
- Once the CAP has been approved, the DOR BEP will provide continued guidance and will monitor the BEP Vendor's efforts towards completing the CAP to ensure the issues identified in the report are being corrected appropriately and timely.

RON LONG, BEP VENDOR
Business Enterprises Program – Location #3-896
East End Food Court Complex

Details to Findings

Audit Services has conducted an audit of the MORs submitted by the BEP Vendor for the East End complex in Sacramento, CA for the period of October 2010 through March 2011. Specifically, the MOR for the month of March 2011 was selected for detailed review. We noted the following:

Net Sales

1. The BEP Vendor incorrectly reported Gross Receipts and Sales tax, resulting in a significant under-reporting of Net Sales. Specifically,
 - We found the Gross Receipts (MOR Line 1) amount of \$73,054, reported for March 2011 to be inaccurate, since the vendor is reporting gross receipts based on amounts transferred to and calculated on an Excel ledger rather actual figures from the Point-Of-Sale (POS cash register) reports (also identified as the Daily Consolidated System Sales Detail (DCSSD)) reports for the Vendor's dining facility (which includes the Restaurant, To Go, Bar, and Catering). The Excel ledger figures reported net sales exclusive of sales tax. Further, we noted data entry errors also impacted the reliability of the spreadsheet amounts.

As a result, there is a \$6,280.30 discrepancy between the Vendor's reporting of receipts (\$34,321.50) and the DCSSD report (\$40,601.80).

- We found the Sales Tax (MOR Line 2) amount of \$3,252, reported for March 2011, to be inaccurate, since the vendor is reporting sales tax based on a "test based" allocation method rather than the actual sales tax collected, as follows:
 - Sales tax was reported for Coffee Kiosks sales based on recognizing that only 20% of gross sales would be taxable.
 - Sales tax was reported for Catering sales based on recognizing that only 80% of gross sales would be taxable. The actual sales tax amounts collected are reported on the DCSSD and available for accurate reporting.

- Sales tax was reported for Take Out sales based on recognizing that only 68% of gross sales would be taxable. The actual sales tax amounts collected are reported on the DCSSD and available for accurate reporting.
- Sales tax reported on the MOR and BOE for Vending Machine sales did not match the amounts reported on the Vending Machine reports. The bookkeeper stated that the amounts do not agree because the vending machine reports do not calculate the correct tax on certain vending machine items.

Because the Gross Sales for the Vendor's vending facility were based on inaccurate figures contained in the Excel ledgers which had data transfer errors and omitted the sales tax, rather than the DCSSD reports, the inaccurate reporting of Gross Sales also affected the amount reported for Liability Insurance (MOR Line 18), Profit from Operations (MOR Line 29), and to the Vending Facility Trust Fund (MOR Line 39).

Over or understatements impact the overall BEP Vendor's profit from operations and the calculation of the set aside fee. Further, sales tax may have also been underreported to BOE. If sales tax is collected on sales transactions and not reported and remitted to BOE, it may result in penalties or administrative action by BOE.

The MOR Instructions state that the BEP Vendor is responsible for the completeness and accuracy of the report. Further, they require that the Vendor must sign and date the report. The 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 only valid financial information for the location. Willful falsification of the report is legal cause for revocation of the vendor's license. The BEP Vendor is responsible for the completeness, accuracy, and submission of the report with an acceptable check or money order. In addition, they state that a copy of the instructions should be given to the vendor's accountant or any other person preparing the report. When a vendor chooses an individual to prepare MORs (DR478 reports), that person must be able to prepare legible, detailed and accurate reports.

Recommendation

To ensure accurate reporting, the BEP Vendor must report Gross Sales and sales tax directly from the DCSSD reports rather than the Excel spreadsheets. Also, the Coffee Kiosks cash registers must be programmed to calculate the actual tax to be collected and reported, and the Vending Machine source reports must be updated to properly calculate tax on vending machine item sales.

2. In our review, we found the Vendor has not adequately supported the cash count and reconciled sales as required by regulations for March 2011 since cash overages/shortages from the cash register are not consistently documented or fully completed on a daily cash report or similar summary report, as follows:

- We were unable to always support the daily cash report figures back to the DCSSD reports. Further, the cashiers often count their own drawer, complete the Daily Cash Count form after each shift, and place the net cash balance and register tape in an envelope without direct supervision. Thus, there is limited assurance that the daily cash counts are accurately reported and reconciled to daily sales.
- Cash overages/shortages were not always reported on the daily cash reports we reviewed since we found at times the lines for these entries were not filled out and we were unable to trace the paid-outs for March 2011 to the paid-out receipts. Further, no summary report is generated to account for the total cash overages or shortages for the month to properly report these amounts on the MOR each month.

The BEP Vendor stated that he reconciles the cash registers on a daily basis; however, he does not specifically document the reconciliations or the cash overages/shortages. He explained that the cash registers usually reconcile and any differences are minimal and typically balance out at the end of the month. However, if the cash count is inadequately conducted and cash overages/shortages are not accurately documented, the BEP Vendor may not be able to readily identify unexplained cash overages or shortages. In addition, gross receipts and operating expenses may be inaccurately reported on the MOR if cash overages and shortages are not identified and documented.

CCR, Title 9, Section 7220(l)(4) requires the BEP Vendor to maintain records on the operation of the facility for the current year plus three preceding years including daily cash reports (cash count forms). Further, good business practices require documentation such as a daily cash report to ensure cash is controlled and reconciled to the amount of sales transactions ("Z" report tapes); and to ensure cash overages/shortages are identified and monitored.

Recommendation

The BEP Vendor shall prepare and retain daily cash reports as required by regulations to ensure cash is appropriately controlled, and sales are accurately reconciled and reported. Further, daily cash counts should be properly supervised to ensure accuracy of the reconciliation and reporting process.

Costs of Goods Sold

3. The BEP Vendor incorrectly reported Purchases and Inventory, resulting in unsupported Cost of Goods Sold. Specifically,
- The amounts listed on line 4, Opening Merchandise Inventory, and Line 7, Closing Merchandise Inventory, of the March 2011 MOR could not be supported. Specifically:
 - A final semi annual inventory document was not provided. The document provided referenced as 'December 2010 inventory' was undated, at times unspecific and failed to contain costs of inventoried items;
 - The amounts that were listed on lines 4 & 7 of the MOR could not be substantiated based on the documents provided. Any correlation between the opening inventory numbers, closing inventory numbers and the December 2010 document referenced as 'inventory' could not be determined. There appears to be no reconciliation process between the twice annual inventory and the numbers reported on the MORs;
 - While there is some form of an inventory process in place, it is not adequate or clearly defined. No documented written physical inventory presently occurs. The process for calculating the Closing Merchandise Inventory could not be determined. Nor could it be determined whether the amount claimed on Lines 4 or 7 is reasonable based on the information provided.
 - The amount listed on line 5, Merchandise Purchases of the March MOR could not be supported. While some documentation reviewed could be substantiated, others could not. In a few instances, expenses reviewed were unallowable and/ or unsupported or could not be reconciled to the supporting documentation. Specifically, the number listed on the March MOR line 5 could not be supported by the Accounts Payable Invoice Register (AP). When additional information was requested to support and explain why the Line 5 amount differed from the AP, we were advised that there was an adjustment however there were no notes on that entry and no recollection as to why the amounts differed. Upon further reviewing the AP several discrepancies were found:
 - Numbers were transposed on the AP when compared to the original receipt from Crystal Cream for a purchase dated 3/8/11 resulting in an unallowable amount on Line 5 of the March MOR of \$90;

- There were eight duplicate invoices listed on the AP as compared to the original receipts from Crystal Cream resulting in an unallowable amount of \$1,411.64, on Line 5 of the March MOR;
- There were unallowable expenses from Costco in the amount of \$131.52 for the purchase of personal items on Line 5 of the March MOR;
- The original source documents reviewed for purchases from Donut Happy and Grocery outlet do not sum to the totals indicated on the AP resulting in an additional allowable amount of \$4.90 on Line 5 of the March MOR.

Taking into account these discrepancies, the amount claimed on Line 5 of the March MOR still could not be supported. However, based on the auditor's review of the AP and original source documents, it appears that the purchases for March MOR 2011 are under reported by approximately \$318.25.

The California Code of Regulations (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, 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 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. Amounts shown as inventories must be actual at least twice annually, June 30 and December 31. Additionally, MOR Instructions requires a signature certifying that the report has been reviewed and is true and correct.

Recommendation

The BEP vendor must accurately calculate and report on the Cost of Goods Sold on the MORs and document this process in order to support these figures with appropriate accounting records.

The BEP Vendor must develop a purchase tracking system and an inventory management process by:

- Recording and reporting purchases in the month they are incurred by using an accrual based accounting system; and
- Maintain appropriate records to support the figures claimed on the Monthly Operating Reports; and

- Implement and maintain a proper physical inventory control system to be taken and reported at least twice annually as required by regulations and as often as required by BEP program as has been previously advised.

Operating Expenses

4. The BEP Vendor reported Other Operating Expenses, Entertainment that were not supported by appropriate documentation. The expenses incurred for DJ costs of \$600 appear to be allowable under the MOR instructions and appear reasonable for a sports bar. However, the documentation for these expenses is insufficient to support the expense, as they were all handwritten on a blank cash register tape, and in three instances were undated, resulting in an unallowable amount of \$600.

The California Code of Regulations (CCR), Title 9, Section 7220 (I) 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 all operation purchases.

Recommendation

The BEP Vendor must maintain adequate documentation to ensure the Operating Expenses reported on the MORs are properly supported.

We further recommend that the BEP Vendor require all persons and companies with which he purchases goods and services from to submit appropriate invoices / receipts. Such documentation should at a minimum include (as appropriate): identify persons or company involved; the goods purchased; the services rendered; dates; times; duration; cost; quantity; invoice number and be on acceptable letterhead.