Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature

MIKE CULLEN
CHAIRMAN

July 18, 1977

Letter Report 306.1

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's letter report of his examination of the Business Enterprise (unsighted operators) Program.

Senate Bill 468 by Senator Holden, and AB 1803 by Assemblyman Fazio address the issues described in the letter report.

The auditors are Robert M. Neves, John P. Sontra, Dan Perez and Bob O'Neill.

Respectfully submitted,

MIKE CULLEN, Chairman
Joint Legislative Audit Committee

July 12, 1977 | Letter Report 306.1

Honorable Mike Cullen
Chairman, and Members of the
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Chairman and Members:

In response to a resolution of the Joint Legislative Audit Committee, we are examining the Department of Rehabilitation's Business Enterprise Program (BEP). This examination is being conducted under the authority vested in the Auditor General by Section 10527 of the Government Code.

During our review of the collection and disbursement of BEP set-aside funds we obtained historical information on set-aside fees relevant to BEP policy considerations now before the Legislature. The purpose of this report is to demonstrate the cost and impact of alternatives currently being considered regarding fee collection.

Background of the Business Enterprise Program

The BEP resulted from the federal enactment of the Randolph-Sheppard Act in 1936. Comprehensive amendments to this act, which expanded and clarified its original provisions, were made in 1974. In California the Department of Education administered the BEP until 1963 when it was transferred to the Department of Rehabilitation.

Purpose and Objective of BEP

The California Welfare and Institutions Code states that the BEP was established "For the purpose of providing blind persons with remunerative employment, enlarging the economic opportunities of the blind, and stimulating the blind to greater efforts in striving to make themselves self-supporting . . ." To accomplish these ends, the BEP constructs and supervises vending stand and food service facilities and acts as the licensing agency which authorizes the legally blind to operate on government locations and in private industry.

Set-Aside Funds

The BEP collects fees to support vending stand operations based on monthly gross sales from blind operators. These fees, which are referred to as set-aside funds, are deposited in the Special Deposit Fund which consists of two accounts. The State Vending Stand Trust Account is maintained for operators on state and local government locations, and the Federal Vending Stand Trust Account is for operators on federal and private industry locations. Expenditures from these accounts are eligible for federal matching money.

Schedule of Fees

In 1939 California began charging operators a fee based on a fixed percentage of gross sales to establish a fund to help new operators get started in business. In 1943 the State had made funds available for vending stand construction and by 1946 had assumed the responsibility for vending stand maintenance and repairs. A graduated fee schedule based on gross sales was adopted in 1948 and has been revised several times. The current fee schedule was adopted in 1968 (Appendix 1).

1974 Randolph-Sheppard Act Amendments

One of the purposes of the 1974 Randolph-Sheppard Act Amendments was to bring about a "uniformity of treatment of blind vendors" by state licensing agencies administering business enterprise programs. The need for uniformity was revealed in a study issued by the U.S. General Accounting Office in 1973 which found a nationwide variation in the fees paid to set-aside funds. Federal regulations implementing the 1974 amendments mandate that vending stands operating on federal property be charged fees on the basis of net proceeds, rather than gross sales. These federal regulations do not require that vending stands on state and local government locations be charged on the same basis; however, legislation is currently pending to bring California law into agreement with federal law so that all operators in California will pay fees based on net proceeds.

Fees Based on Gross Sales

Present fees are based on gross sales and do not allow for variations in vending stand operating costs. As a result, operators with approximately the same net income may be charged significantly different fees, as shown in Appendix 2. A fee based on net proceeds which takes into consideration the disparity between net income and fees paid has been proposed in the Legislature.

Fees Based on Net Proceeds

Net proceeds are defined as gross sales minus operating expenses (excluding fee charges). Fees calculated on the basis of net proceeds take into account an operator's ability to pay fees. An analysis of current fees expressed as percentages of net proceeds based on 1975-76 income data is presented in Appendix 3. A fee schedule based on such percentages could provide the same total fee revenue as the present fee schedule.

Fee Structuring Alternatives

A number of alternatives are available to more directly relate a new fee schedule based on net proceeds to an operator's ability to pay. The fee data developed in Appendix 3 can be used to calculate the relative impact of these alternatives.

Some suggested alternatives would limit fees charged as a percentage of net proceeds. Appendix 4 illustrates graphically that only the highest income groups would realize savings from fee limitations of either 20 or 25 percent of net proceeds. Limiting fees to no more than 20 percent of net proceeds would reduce fees for those operators whose net proceeds average more than $1400 per month. Limiting fees to 25 percent of net proceeds would reduce fees for operators whose net proceeds average more than $2500 per month.

Another alternative that is being considered is the exclusion of operators with net proceeds below a specified level from the fee requirement. Appendix 5 shows the estimated loss of fee revenue resulting from excluding monthly net proceeds below the $400, $500 and $600 levels. Excluding operators earning low net proceeds from fee payment would increase the burden of other operators if the total fee revenue was to remain the same. The amount of fees lost and the percentage of total fees that would have to be collected from other operators as a result of excluding from payment operators with low net proceeds is shown in Appendix 5.

An annual cost-of-living adjustment to the level of the exclusion has been proposed to provide additional fee relief for operators with low net proceeds. The effects of an annual cost-of-living adjustment on the size of the net proceed exclusion are shown in Appendix 6.

Audit Considerations

The Department of Rehabilitation has stated that any new fee schedule that is adopted must generate approximately the same amount of total revenue as the present fee schedule if the BEP is to continue its planned growth and development.

A fee schedule based on net proceeds will not generate the expected fee revenue if net proceeds are inaccurately determined. The BEP seldom audits its operators and does not employ an auditor, although there are more than 300 operators. Changing to a fee schedule based on net proceeds would necessitate more audits to ensure proper reporting of net proceeds.

Respectfully submitted,

Wesley E. Voss for

JOHN H. WILLIAMS
Auditor General

Staff: Robert M. Neves
John P. Sontra
Dan Perez
Bob O'Neill

Attachments: Response to the Auditor General's Report

Appendix 1--	Schedule of Fees
Appendix 2--	Illustration of Disparities Resulting from Current Fee Schedule
Appendix 3--	Current Fees as a Percentage of 1975-76 Average Monthly Net Proceeds
Appendix 4--	Impact of Fee Limitations on Net Proceed Groups
Appendix 5--	Estimated Loss in Fee Revenue From a Net Proceed Exclusion
Appendix 6--	Size of Annual Adjustment to Low Income Exclusion Based on Average Increase in CPI of 7.12%

State of California **Health and Welfare Agency**

Memorandum

To : John H. Williams
Auditor General

Date: July 8, 1977

From : **Department of Rehabilitation**
OFFICE OF THE DIRECTOR

Subject: Letter Report 306

We have reviewed the draft of Letter Report 306 concerning your review of the collection and distribution of Business Enterprise Program (BEP) set-aside funds. We are in agreement with your findings and particularly appreciate the information regarding fee structuring alternatives.

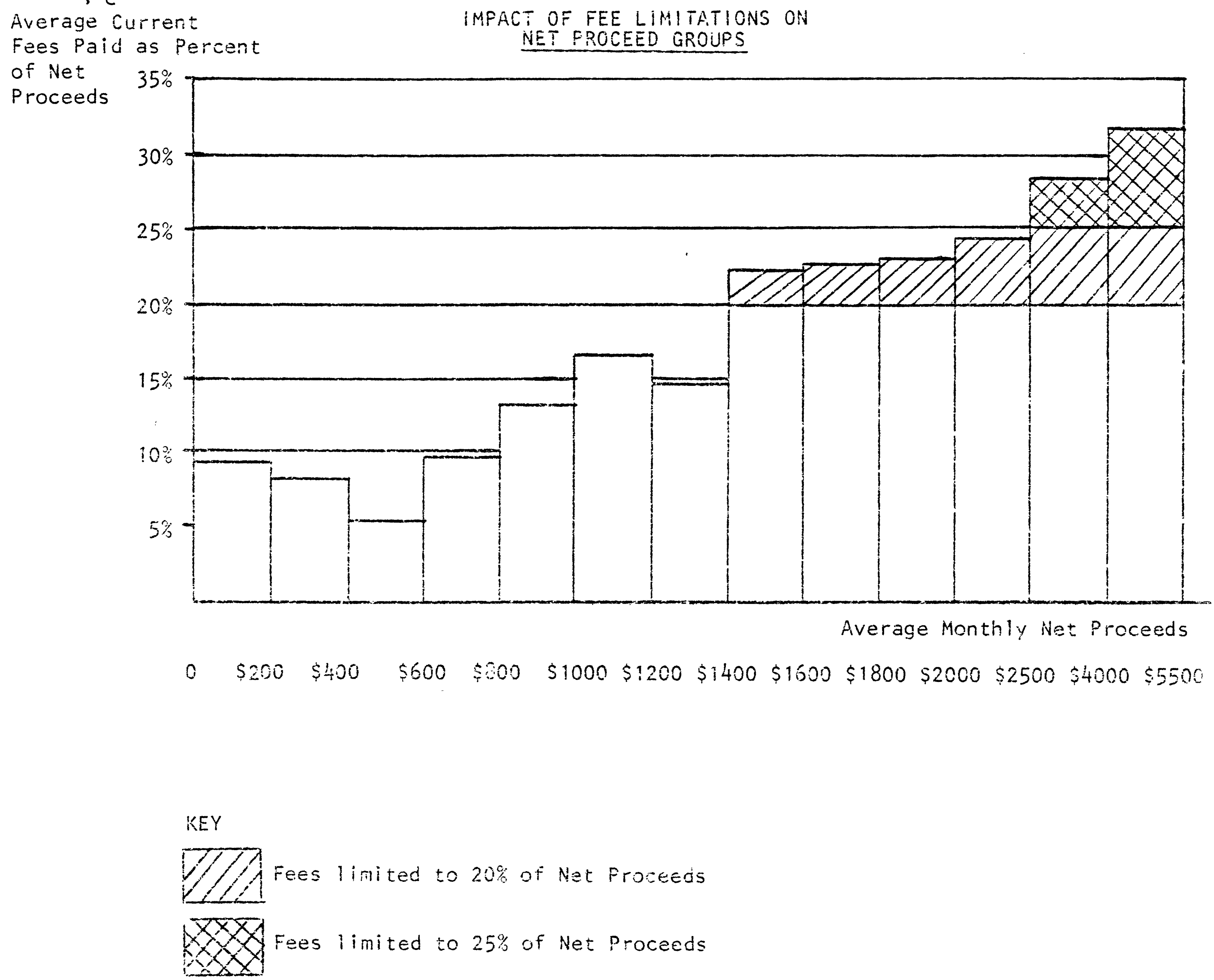
It is our belief that the language regarding set-aside funds included in both SB 468 (Holden) and AB 1803 (Fazio) which converts the basis of set-aside fees to net proceeds rather than gross sales while maintaining the same maximum fee provision that currently exists in the law, allows us to develop a fair and equitable fee schedule.

The BEP staff, with the assistance of others in the Department, are working with the California Vendors Policy Committee to develop a new fee schedule based on net proceeds. As indicated in the report, a change to fees based on net proceeds will require increased auditing of individual vendors. BEP staff currently review each vendor's income report. The Department's Auditing Section has assigned a full-time auditor to meet the needs of the Business Enterprise Program. As the new fee schedule is implemented, a comprehensive auditing system will also be established.

R T Soderberg

R. T. SODERBERG
Chief Deputy Director

Office of the Auditor General



ESTIMATED LOSS IN FEE REVENUE FROM A NET PROCEED EXCLUSION

Net Proceed Exclusion	Estimated Loss In Fee Revenue 1976-77	1977-78	Percent of Total Fee Revenue Lost
$400	$ 7,700	$ 8,500	.77%
500	12,700	14,000	1.27
600	20,200	22,300	2.02

These calculations were based upon average monthly gross sales and average monthly net income for 303 vending stands in 1975-76. Those vending stands which have subsequently closed and those which opened late in the year were not included in generating the estimates.

APPENDIX 6

SIZE OF ANNUAL ADJUSTMENT TO LOW INCOME EXCLUSION BASED ON AVERAGE INCREASE IN CPI OF 7.12%

	1978	1979	1980	1981	1982	1983
Exclusion per year	400	428.48	458.99	491.67	526.67	564.17
Exclusion per year	500	535.60	573.73	614.58	658.34	705.21
Exclusion per year	600	642.72	688.48	737.50	790.01	846.26

This chart projects the amount of the annual low income exclusion from fee payment if it were adjusted at an average rate of 7.12 percent per year beginning in 1979.

The 7.12 percent increase per year was used because this is the amount that the Consumer Price Index increased on the average for the cities of Los Angeles and San Francisco over the past five years. A proposal for an annual adjustment to the level of the exclusion has been based on such an index.

State Department of Rehabilitation
Business Enterprise Program

APPENDIX 1

SCHEDULE OF FEES

Monthly Gross Sales	Fee	Percent of Sales
$ 00.00 - $ 499.99	$ 1	-
500.00 - 599.99	1	.2%
600.00 - 699.99	1	.17
700.00 - 799.99	1	.14
800.00 - 899.99	1	.12
900.00 - 999.99	1	.11
1,000.00 - 1,099.99	2	.2
1,100.00 - 1,199.99	3	.27
1,200.00 - 1,299.99	4	.33
1,300.00 - 1,399.99	5	.38
1,400.00 - 1,499.99	6	.43
1,500.00 - 1,599.99	8	.53
1,600.00 - 1,699.99	10	.62
1,700.00 - 1,799.99	12	.70
1,800.00 - 1,899.99	14	.78
1,900.00 - 1,999.99	16	.84
2,000.00 - 2,099.99	19	.95
2,100.00 - 2,199.99	22	1.05
2,200.00 - 2,299.99	25	1.14
2,300.00 - 2,399.99	28	1.22
2,400.00 - 2,499.99	31	1.29
2,500.00 - 2,599.99	35	1.4
2,600.00 - 2,699.99	39	1.5
2,700.00 - 2,799.99	44	1.63
2,800.00 - 2,899.99	49	1.75
2,900.00 - 2,999.99	55	1.9
3,000.00 - 3,099.99	61	2.03
3,100.00 - 3,199.99	68	2.19
3,200.00 - 3,299.99	75	2.34
3,300.00 - 3,399.99	83	2.52
3,400.00 - 3,499.99	90	2.65
3,500.00 - 3,599.99	96	2.74
3,600.00 - 3,699.99	104	2.89
3,700.00 - 3,799.99	111	3.0
3,800.00 - 3,899.99	119	3.13
3,900.00 - 3,999.99	128	3.28
4,000.00 - 4,099.99	137	3.42
4,100.00 - 4,199.99	148	3.61
4,200.00 - 4,299.99	158	3.76
4,300.00 - 4,399.99	168	3.91
4,400.00 - 4,499.99	178	4.05

Monthly Gross Sales	Fee	Percent of Sales
$4,500.00 - 4,599.99	$190	4.22%
4,600.00 - 4,699.99	203	4.41
4,700.00 - 4,799.99	215	4.57
4,800.00 - 4,899.99	227	4.73
4,900.00 - 4,999.99	240	4.90
5,000.00 - 5,099.99	250	5.0
5,100.00 - 5,199.99	255	5.0
5,200.00 - 5,299.99	260	5.0
5,300.00 - 5,399.99	270	5.1
5,400.00 - 5,499.99	275	5.1
5,500.00 - 5,599.99	281	5.1
5,600.00 - 5,699.99	291	5.2
5,700.00 - 5,799.99	296	5.2
5,800.00 - 5,899.99	302	5.2
5,900.00 - 5,999.99	307	5.2
6,000.00 - 6,099.99	318	5.3
6,100.00 - 6,199.99	323	5.3
6,200.00 - 6,299.99	329	5.3
6,300.00 - 6,399.99	334	5.3
6,400.00 - 6,499.99	339	5.3
6,500.00 - 6,599.99	351	5.4
6,600.00 - 6,699.99	356	5.4
6,700.00 - 6,799.99	362	5.4
6,800.00 - 6,899.99	367	5.4
6,900.00 - 6,999.99	373	5.4
7,000.00 - 7,099.99	385	5.5
7,100.00 - 7,199.99	391	5.5
7,200.00 - 7,299.99	396	5.5
7,300.00 - 7,399.99	402	5.5
7,400.00 - 7,499.99	407	5.5
7,500.00 - 7,599.99	420	5.6
7,600.00 - 7,699.99	426	5.6
7,700.00 - 7,799.99	431	5.6
7,800.00 - 7,899.99	437	5.6
7,900.00 - 7,999.99	442	5.6
8,000.00 - 8,099.99	456	5.7
8,100.00 - 8,199.99	462	5.7
8,200.00 - 8,299.99	467	5.7
8,300.00 - 8,399.99	473	5.7
8,400.00 - 8,499.99	479	5.7
8,500.00 and over *		5.8

* Use percentage shown. Adjust to nearest whole dollar

DR Form 475 (Rev. 7/68)

ILLUSTRATION OF DISPARITIES RESULTING FROM CURRENT FEE SCHEDULE 1975-76 AVERAGE MONTHLY FIGURES

The following table indicates the disparity between net income and fees paid. This results because fees paid are currently based on gross sales which do not take into account factors that affect vending stand profitability, such as size and type of stand.

Each of these stands averaged monthly net incomes between $312 and $396 in 1975-76; however, since fees are based on monthly gross sales, fees paid range from $1 per month to $291 per month.

Net Income	Fee Paid	Gross Sales
$ 312	$ 1	$ 840
321	291	5,623
323	25	2,218
332	31	2,430
334	44	2,711
341	1	602
343	3	1,145
348	4	1,255
350	25	2,208
358	5	1,310
365	75	3,250
382	1	902
384	28	2,322
384	49	2,800
395	8	1,523
396	31	2,407

CURRENT FEES AS A PERCENTAGE OF 1975-76 AVERAGE MONTHLY NET PROCEEDS

Net Proceeds Category	Number of Stands	Average Fees Paid	Average Net Proceeds	Current Fees as a % of Average Net Proceeds
$ 0 - 199	5	$ 6	$ 70	9.03
200 - 399	22	25	311	8.08
400 - 599	35	27	502	5.40
600 - 799	50	66	701	9.46
800 - 999	42	116	899	13.01
1,000 - 1,199	32	177	1,087	16.29
1,200 - 1,399	24	186	1,287	14.47
1,400 - 1,599	22	327	1,480	22.09
1,600 - 1,799	18	387	1,703	22.73
1,800 - 1,999	11	430	1,877	22.93
2,000 - 2,499	16	538	2,215	24.29
2,500 - 3,999	16	857	3,053	28.07
4,000 - 5,500	10	1,480	4,662	31.75

The percentages in the last column represent the rate at which operators within each specific net proceeds category would have to be assessed to generate the amount of revenue derived from the current fee schedule.