

A Review of

Contract Monitoring of Purchased Services



Office of the State Auditor
Lawrence F. Alwin, CPA

October 1994

Report No. 95-007



OFFICE OF THE STATE AUDITOR

TWO COMMODORE PLAZA
206 EAST NINTH ST., SUITE 1900
AUSTIN, TEXAS 78701

MAILING: P.O. BOX 12067
AUSTIN, TEXAS 78711-2067

PHONE: (512) 479-4700 FAX 479-4884

LAWRENCE F. ALWIN, CPA
State Auditor

SHARON W. COBB, CPA
First Assistant

October 5, 1994

Members of the Legislative Audit Committee:

The contract monitoring functions at the agencies reviewed are unable to ensure that taxpayers' funds are allocated to contractors who consistently provide the best services. Health and human services programs reviewed at the Texas Commission on Alcohol and Drug Abuse, Texas Department of Health, Texas Department of Human Services, Texas Department of Mental Health and Mental Retardation, and the Texas Department of Protective and Regulatory Services spent over \$2.5 billion in fiscal year 1993 on contracts for services to protect and enhance the health, well-being, and productivity of Texas citizens.

Monitoring of contractors' performance is important to ensure that Texans receive the best value for the dollars spent on services. The elderly, children, and persons with mental illness or addiction to alcohol or drugs all receive services from the programs included in this review. Effective monitoring should ensure that these citizens consistently receive quality services.

We found that current contract monitoring functions primarily focus on determining compliance with state and federal regulations, not on evaluating the success or results (outcomes) of the services provided. As a result, there is limited assurance that contractors are providing quality services that meet intended program objectives.

Monitoring processes within agencies were often fragmented and inconsistent. Many of the programs have not established criteria which clearly define what is acceptable or unacceptable performance. Without standardized criteria, agencies do not have comparable data on which to base decisions about which contractors to use.

The health and human services agencies we reviewed should restructure their contract monitoring functions to include the appropriate combination of compliance monitoring and assessment of outcomes. This will provide agency management and state leaders with information that will allow them to identify:

- methods to improve service delivery
- methods to effectively allocate limited resources
- the relative success of individual contractors or programs

The purpose of this audit was to evaluate and report on the effectiveness of contract monitoring programs as required by Government Code, Chapter 321.015 (a) and (b)(1).

Sincerely,

A handwritten signature in cursive script, appearing to read "Lawrence F. Alwin".

Lawrence F. Alwin, CPA
State Auditor

LFA/rmn/enclosure

Key Points Of Report

A Review of Contract Monitoring of Purchased Services

October 1994

Key Points of Report

- Agency oversight of contractor performance does not provide sufficient information to determine if taxpayers' funds are allocated to contractors who consistently provide the best services. During fiscal year 1993, the health and human services programs included in our review paid over \$2.5 billion to contractors who are responsible for providing services to protect and enhance the health, well-being, and productivity of Texas citizens.
- Most contractors are held accountable by judging whether their activities follow the procedures laid out in regulations, rather than the outcomes or results they produce. None of the 225 contracts we reviewed contained specific outcome measures requiring the contractor to perform at a certain level of success.
- No standardized contract monitoring process exists within the State or even within individual agencies. Most agencies have not established standardized criteria to evaluate contractor performance. As a result, it was difficult to determine if the performance of the contractor had been adequately monitored or not.

Contact:

Kay Wright Kotowski, CPA, Audit Manager (479-4755)

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Executive Summary

Agency oversight of contractor performance does not provide sufficient information to determine if taxpayers' funds are allocated to contractors who consistently provide the best services. The health and human services programs included in our review spent over \$2.5 billion on contracts for purchased services during fiscal year 1993. The contractors who receive these funds are responsible for providing services to protect and enhance the health, well-being, and productivity of Texas citizens.

Monitoring of contractors' performance is important to ensure that Texans receive the best value for the dollars spent on services. The elderly, children, and those persons with mental illness and addiction to alcohol or drugs all receive services from the programs included in this review. Effective monitoring should ensure that these citizens consistently receive quality services.

All of the programs had a process in place to monitor contractor performance. However, the following factors limited agencies' abilities to ensure that the State is using the most effective contractors to provide services:

- Contract monitoring functions focused on determining compliance with state and federal regulations, not on evaluating the success or results (outcomes) of the services provided. As a result, there is limited assurance that contractors are providing quality services which meet intended program objectives.
- Some programs only performed limited reviews of contractors' accounting controls. Inadequate oversight of accounting controls increases the risk that taxpayers'

money will not be spent in a manner which provides the most benefits to citizens.

- A lack of standardized monitoring procedures prevents most agencies from obtaining sufficient information to assess the overall performance of the contractor. This also made it difficult to tell whether the performance of the contractor was adequately monitored or not.

AGENCIES INCLUDED IN OUR REVIEW

Health and Human Services Agencies:

- Texas Department of Human Services
- Texas Department of Health
- Texas Department of Protective and Regulatory Services
- Texas Department of Mental Health and Mental Retardation
- Texas Commission on Alcohol and Drug Abuse

Contract Monitoring Functions Do Not Focus On The Most Important Factors Of Contractor Performance

Evaluation of performance outcomes was not included in the contract monitoring functions we reviewed. Instead, the monitoring functions primarily focused on determining compliance with federal and state standards and regulations. Most contractors are held accountable by judging whether their activities follow the procedures laid out in regulations, rather than the outcomes, or

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results, they produce. While standards are important, agencies should also measure the success or results of the contractors in order to ensure that Texans receive quality services.

The health and human services agencies reviewed need to restructure their contract monitoring functions to include the appropriate combination of compliance monitoring and assessment of outcomes. Although compliance monitoring should not be eliminated, it should be done in conjunction with evaluation of outcomes. This will provide agency management and state leaders with information that will allow them to identify:

- methods to improve service delivery
- methods to effectively allocate limited resources
- the relative success of individual contractors or programs

Wide Variations Within Financial Monitoring Activities Indicate Improvements Are Needed In Some Programs

The extent of financial monitoring at the agencies reviewed varied significantly. The fiscal coverage ranged from limited desk reviews of independent audit reports to extensive financial monitoring of the majority of contractors. Without adequately monitoring the accounting controls of contractors, there is limited assurance that state and federal funds are spent appropriately.

Lack Of Standardized Monitoring Process Impacts Usefulness Of Results

No standardized contract monitoring process exists between the agencies reviewed, or even within individual agencies. Multiple divisions within each agency all play roles in monitoring contractors. We found limited coordination among these divisions. Without coordination of monitoring activities, management does not have sufficient information to form an overall assessment of the effectiveness of a contractor. This increases the risk that the contractors are providing services which do not meet the intended objectives of the program.

During the review of contractor files, it was often difficult to tell whether the performance of the contractor was adequately monitored or not. None of the contracts reviewed contained clear statements of how contractor performance would be evaluated. The majority of programs have standardized checklists for contract monitors to use during their audits. However, the programs have not established criteria which defines what is acceptable or unacceptable performance.

Summary of Management's Responses

Management responses from all five agencies are included in Appendix 5.

Summary Of Audit Objective And Audit Scope

The audit objective was to evaluate and report on the effectiveness of the audit (monitoring) programs performed by the executive branch,

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including audits of contractors and sub-grantees, as required by Government Code, Chapter 321.015 (a) and (b) (1).

The scope of this audit was limited to contracts for program-related purchased services. The six agencies included in this audit accounted for 96 percent of fiscal year 1993 statewide expenditures for program-related purchased services. The results from the review of the five health and human services agencies are included in this report.

The contract monitoring work at the Texas Department of Transportation was done in conjunction with a larger review of the Department's management controls. The issues and recommendations related to the Department's contract monitoring processes, along with the Department's responses, are contained in the management control audit report to be issued in the first quarter of fiscal year 1995.

We did not directly evaluate the performance of the contractors providing services. Instead, we focused on the effectiveness of the monitoring functions performed by the supervising agencies.

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Section 1:

Contract Monitoring Functions Do Not Focus On The Most Important Factors Of Contractor Performance

Evaluation of performance outcomes was not included in the contract monitoring functions reviewed. Instead, the monitoring functions primarily focused on determining compliance with federal and state standards and regulations. Most contractors are evaluated by judging whether their activities follow the procedures laid out in regulations, rather than the outcomes, or results, they produce. While standards are important, agencies should also measure the success or results of the contractors in order to ensure that Texans receive quality services.

Sections 1 through 3 of this report apply to the following health and human services agencies:

- Texas Department of Human Services
- Texas Department of Health
- Texas Department of Protective and Regulatory Services
- Texas Department of Mental Health and Mental Retardation
- Texas Commission on Alcohol and Drug Abuse

The majority of programs reviewed also did not have a formalized risk assessment process to determine which providers to review and the level of review needed at each provider. As a result, there is no assurance that limited monitoring resources are allocated to those providers or functions which have the highest risk.

Section 1-A:

Contract Provisions Do Not Contain Performance Outcome Measures

The health and human services programs included in our review spent over \$2.5 billion on contracts for purchased client services during fiscal year 1993. However, none of the 225 contracts we reviewed contained specific outcome measures requiring the contractor to perform at a certain level of success. Requiring contractors to perform at a specific level of success is important to ensure that citizens consistently receive the highest quality services.

Outcome measures indicate results achieved and, therefore, provide information for assessing the quality and effectiveness of services. Identifying and evaluating performance outcomes can provide agency management and state leaders with

Public entities can no longer just be held accountable for how much they spend and on what they spend their resources.

The public and government leaders want to know what the citizenry is getting for the use of public funds and how efficiently and effectively these funds are being used by state agencies.

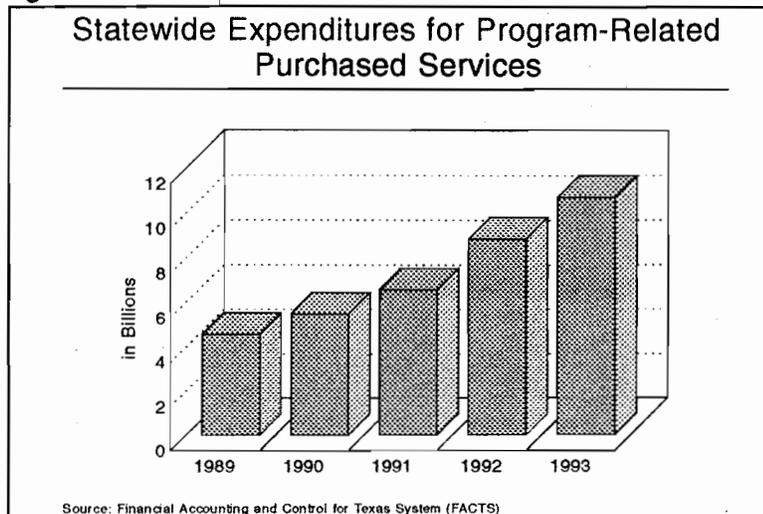
-Service Efforts and Accomplishments Reporting:
Its Time has Come, *Governmental Accounting Standards Board, 1990.*

information that will allow them to identify:

- methods to improve service delivery
- methods to effectively allocate limited resources
- the relative success of individual contractors or programs

If state leaders cannot assess the effectiveness of the services provided, they cannot determine if the State's money is paid to those contractors who are providing the best services. Statewide expenditures for program-related purchased services have increased 135 percent over the last five years. (See Figure 1.) As these expenditures continue to increase, it is essential that the State be able to determine that limited tax dollars are allocated to the most effective and efficient contractors.

Figure 1



The majority of the contracts we reviewed required contractors to meet state and federal standards by incorporating compliance with program policy and procedure manuals into the contract provisions. These standards then became the foundation for monitoring contractors.

COMPLIANCE STANDARDS

Compliance standards focus on how services are delivered, rather than the benefits the client receives from the services.

Examples of compliance standards used to monitor contractors include determining if:

- services are regularly publicized
- services are offered at a convenient location
- this service provider has appropriate workplace policies
- the service provider is in compliance with health and safety standards

Compliance monitoring emphasizes how services are delivered, but does not provide useful information regarding the effectiveness of services or the efficiency of service delivery. Determining compliance with state and federal standards and regulations can answer the question, "Is the provider doing what was promised?" However, it does not tell the agency what it needs to know in order to answer the question, "Should Texans be paying for this provider to offer these services?"

DIFFERENCE BETWEEN OUTPUT AND OUTCOME MEASURES

Output measures report the number of units produced or number of services provided by a program. Output measures should capture what a program does.

Outcome measures report the results or impact of a program. Outcome measures should capture why a program exists.

Some contracts included the contractor's estimate of the number of clients to be served. However, measuring and tracking the number of people who received a particular service does not provide information regarding how successful the contractor has been at achieving the intended objectives of the program.

For example, one of the objectives of the Family Planning Program at the Texas Department of Health (TDH) is "to promote quality medical, social and health services to the residents of Texas who are of reproductive age to prevent unplanned or mistimed pregnancies." Program

literature states that family planning services have been shown to save \$4.05 for every dollar spent.

The measure currently used by TDH to annually track contractor results is "the number of clients provided family planning services." This is an output measure and does not provide decision-makers with any information related to the success or

results of this program. Outcome measures which indicate the savings resulting from counseling or the reduction in unwanted pregnancies would provide more information regarding the result or benefit that the State receives by providing these services.

Section 1-B:

Recent Efforts To Develop Performance Outcomes Are Still Inadequate To Hold Contractors Accountable

Several of the programs we reviewed have taken steps to assess outcomes as part of their monitoring processes. (See Appendix 2 for details of these efforts.) Although these efforts are a step in the right direction, they still fall short of holding contractors accountable for achieving specific results. Holding contractors accountable for delivering services which meet specific levels of success is important to ensure that taxpayers receive the most for their money.

For example, the Texas Commission on Alcohol and Drug Abuse (TCADA) has included performance outcomes for treatment providers in their fiscal year 1994 contract provisions. However, the language in the contract states, ". . . . the Commission will consider contractor's progress in meeting the performance standards in decisions regarding contract renewal and increases and decreases in contract amounts" (underline added). Thus, there are still no specific consequences for failing to achieve the established results.

While we recognize the efforts taken by certain programs to incorporate assessment of outcomes into their contracting process, we still noted the following weaknesses:

- The contract monitors consider the measures as "goals," as opposed to requirements that must be met. The monitors report that they use the measures as indicators to provide technical assistance to the contractors.

For example, the Texas Department of Mental Health and Mental Retardation's (TXMHMR) contracts with the Community Centers include performance and workload measures which are negotiated by the contract manager and the contractor. However, when a contractor fails to meet the measures, the contract manager works with the contractor to develop contract amendments which reflect a more accurate projection of services to be provided. Contract requirements are amended to reflect what is actually occurring instead of requiring the contractor to improve performance to meet established performance and workload measures.

- Contractors are primarily responsible for developing and monitoring their own objectives. Each contractor is allowed to develop its own objectives and define how these objectives will be measured. As a result, contract monitors cannot compare results between service providers. This limits the monitors' abilities to assess, on a continuing basis, whether the impact of services is as intended.

- The majority of the contracts reviewed contained provisions which required the contractors to submit monthly or quarterly status reports on their progress towards achieving objectives. However, this information is self-reported and is not routinely verified during the course of the field audits. Without verifying the accuracy of the data, its usefulness is questionable.

Section 1-C:

There Is No Assurance That Monitoring Functions Focus On Areas With The Highest Risk

The majority of the monitoring functions reviewed did not use a formalized risk assessment methodology to determine what providers to review and the level of review needed at each provider. As a result, there is no assurance that the monitoring functions are focusing on the riskiest areas, or that limited monitoring resources are used in the most efficient manner.

For the most part, program monitors use the same process to audit each service provider, regardless of any risks associated with the provider. Covering the same areas at each provider every year may not be the most efficient use of monitoring resources. As the expenditures for purchased services have increased, most of the programs we reviewed indicated that the resources devoted to monitoring functions have not increased proportionately. For example, the workload of program monitors at TCADA has increased from 38.28 contracts per program monitor in 1991 to 64.83 contracts per monitor in 1994. As the workloads of the program monitors continue to increase, it will be essential that available resources are used in the most efficient manner.

The frequency with which contractor field visits are conducted varied considerably. Several programs attempt to provide coverage of each provider on an annual basis, but some programs scheduled reviews on more arbitrary aspects such as geographic location. Figure 2 illustrates some of the differences among agencies in terms of the frequency of review and the program monitoring costs of the reviews.

Only one of the programs we reviewed actually conducted unannounced, or "surprise," examinations of the contractors. All other programs scheduled the audits well in advance, sometimes as much as eight weeks prior to the actual audit date. This much advance warning gives the contractor plenty of time to correct areas that it knows the contract monitor will be reviewing. As a result, the monitor may not be able to truly assess the contractor's performance.

Figure 2**Frequency of Monitoring Reviews and Costs**

Agency and Program	No. of Contracts	Frequency of Review	Program Monitoring Costs*	Annual Cost Per Contract
Texas Commission on Alcohol and Drug Abuse	555	Annually	\$662,343	\$1,193
Texas Department of Health • Family Planning and Family Health Services	117	Family Planning - every two years Family Health Services - 3 (out of 11) regions are audited each year	\$165,499	\$1,414
Texas Department of Health • HIV	262	Annually	\$424,260	\$1,619
Texas Department of Health • Community Oriented Primary Care	34	Annually	\$24,496	\$720
Texas Department of Human Services • Child Care Management Services	27	Ongoing basis	\$1,342,631	\$49,727

* Data for monitoring costs was provided by agency management based on the same set of criteria for each agency. These figures have not been audited.

Some programs did report using an informal risk assessment process to determine which provider to audit first. However, this process is not documented. Often the assessment of risk was based on intuition or the monitor's level of experience, knowledge, or past experience with the particular provider.

Risk assessment allows resources to be used efficiently and provides some assurance that the most critical areas are being reviewed. The following are examples of factors that should be considered in identifying risk:

- amount of revenue and expenditures
- newness of the activity or changes in its conditions
- adequacy of internal control systems
- results of prior audits/history of prior problems
- level and extent of review or other form of independent oversight
- public perceptions and political sensitivity of the areas under audit

The example cited below demonstrates how monitoring functions can be enhanced by evaluating the process and refocusing resources on areas which are the most important.

The Internal Audit Division of the Texas Department of Human Services (DHS) recently reviewed the operations of the Utilization and Assessment Review (UAR) Section of the Nursing Home Vendor Payment Program to determine whether UAR was managing its resources in an economical and efficient manner. UAR staff are responsible for performing inpatient utilization reviews in hospitals and case mix assessment reviews in nursing homes. These reviews are essential for ensuring that Medicaid dollars are appropriately spent and program abuses are minimized.

Among other things, the audit report pointed out the following opportunities for the UAR division to increase the effectiveness and efficiency of its operations by refocusing their work:

- The audit found that the UAR devoted about 25 percent of its available resources to reviewing areas that posed relatively little or no financial risk to DHS. As a result, millions of dollars in provider overpayments were going unreported each year.

The Internal Audit Division recommended that UAR concentrate its efforts on reviewing the riskiest areas to maximize recoupment of provider overpayment. The estimated fiscal impact (cost savings) to the agency from implementing this recommendation was \$19 million over five years.

- The audit also found that UAR most often uses teams of two or three nurse reviewers to conduct nursing home on-site visits. The audit recommended that one nurse reviewer, working independently, was the most efficient method to conduct the case mix assessment reviews. The estimated fiscal impact to DHS from implementing this recommendation was a cost savings of \$5 million over five years.

Recommendation:

Agency management, in conjunction with program personnel, should evaluate and restructure their monitoring efforts to focus on assessing the results, or success, of the services provided by each contractor. As the monitoring procedures are evaluated, it is important to consider the cost-benefit of both current and potential monitoring procedures. This process will help agency management ensure that current monitoring resources are allocated to functions which provide the most useful information for decision making. The results of contract monitoring can provide valuable information which should be used in the planning and acquisition phases of contract administration. In order to accomplish this task, we recommend the following:

- Restructure contract monitoring functions to include the appropriate combination of compliance monitoring and assessment of outcomes.

Although compliance monitoring should not be eliminated, it should be done in conjunction with evaluation of outcomes.

- Develop clearly defined goals, outputs, and measurable outcomes which directly relate to the program objectives. The agency should be able to clearly define the desired outcomes of services before it contracts for them. The outcomes should establish a measure of success on which contractors would be paid.
- Include the objectives and outcome and output measures in each contract.
- Develop a formalized system to capture and monitor information related to the outcome measures from the contractors. Most agencies already have a system in place to collect monthly or quarterly reports from the contractors. This system could be adjusted to collect the data on outcome measures.
- Develop a system to track and evaluate the attainment of outcomes. The monitoring function should ensure that the contractors are progressing towards or meeting expected performance requirements and outcomes.
- Develop a risk assessment process to determine what contractors and which areas of contractor operations are the riskiest or would provide the best information to assess contractor performance. Allocate limited monitoring resources to those areas.

Section 2:

Wide Variations Within Financial Monitoring Activities Indicate Improvements Are Needed In Some Programs

The extent of financial monitoring by agencies reviewed varies significantly. Fiscal coverage ranged from limited desk reviews of independent audit reports to extensive financial monitoring of the majority of contractors. Monitoring accounting controls is important to ensure that state and federal funds are used for intended purposes. Without adequately monitoring the fiscal controls of contractors, there is no assurance that contractors spend taxpayers' money in a manner which provides the most benefits to the citizens.

The following examples highlight the differences in financial monitoring noted during our review:

- At the Texas Department of Health (TDH), the Grants Management Division performs extensive fiscal audits for contracts over \$25,000. During fiscal year 1993, the efforts of this division recovered a total of \$440,408 from contractors, at a monitoring cost of \$307,668.

In accordance with federal requirements, TDH also requires each contractor who receives in excess of \$25,000 to submit an audit performed by an independent certified public accountant. The Internal Audit Division is responsible for performing a desk review of the independent audit reports. During fiscal year 1993, the efforts of this division recovered a total of \$583,726 from contractors, at a cost of \$47,233.

Thus, during fiscal year 1993, the efforts of these two divisions recovered a total of \$1,024,134 from contractors. The monitoring costs for these functions for the same time period totaled \$354,901, resulting in a net recoupment of \$669,233.

- At the other end of the spectrum, the Texas Commission on Alcohol and Drug Abuse (TCADA) relies almost solely on independent audit reports to review the fiscal controls of its contractors. Prior to fiscal year 1994, audit reports were not required (either by agency or federal requirements) from contractors who accounted for 56 percent of the \$110 million spent on purchased services. The Audit Department is responsible for performing desk reviews of the independent audit reports. The fiscal year 1993 monitoring cost for this division was \$315,682.

TCADA does not routinely perform financial audits of its providers. In fiscal year 1994, only after receiving tips from an outside entity, they performed a limited scope audit of a provider who had received acceptable reviews from the Program Monitoring Division. This audit resulted in the discovery of approximately \$2 million in unreasonable and unallowable expenditures. In addition, TCADA auditors found that executives had received unauthorized bonuses and that rare books and jewelry had been purchased with program funds.

The examples above demonstrate some of the different approaches used to monitor accounting controls of contractors. While the financial monitoring costs for TCADA and TDH were approximately the same, the results of the monitoring processes were very different.

The example also highlights the necessity to review accounting controls in conjunction with program reviews in order to form an overall assessment of the contractor. Although the TCADA contractor was receiving acceptable performance reviews, the contractor had financial practices that were completely unacceptable.

Recommendation:

We recommend that each agency evaluate current financial monitoring procedures to determine if the procedures are adequate to ensure that state and federal funds are spent properly and accurately accounted for. The level of fiscal monitoring should provide each agency with some assurance that contractors' internal controls are effective and that financial data is accurately and properly reported. The necessity for field audits should be included in the risk assessment process.

Section 3:

Lack Of Standardized Monitoring Process Impacts Usefulness Of Results

No standardized contract monitoring process exists within the State or even within each agency reviewed. Multiple divisions within each agency play roles in monitoring contractors. Each division is responsible for reviewing different requirements of a contractor. The decentralized nature of these processes limits agencies' abilities to assess the overall performance of a contractor. Furthermore, the lack of established criteria to use in monitoring may lead to inconsistent coverage of contractors, even within the same program.

Section 3-A:

There Is Limited Coordination Of Monitoring Functions Within Agencies

In most of the programs we reviewed, we found limited coordination among the divisions responsible for contract monitoring. Responsibility for monitoring was divided among at least three divisions for each program reviewed. Lack of coordination prevents agencies from forming an overall assessment of contractor performance. Moreover, this type of structure may be inefficient and may ultimately hinder the timely resolution of audit findings. (Appendix 4 provides detailed information regarding the structure of the monitoring functions reviewed.)

The following examples illustrate how decentralized monitoring functions affect an agency's ability to form an overall assessment of contractor's performance:

- At the Texas Department of Mental Health and Mental Retardation (TXMHMR), three groups are responsible for the monitoring of contractors. The Mental Health and Mental Retardation sections of the Standards Quality and Assurance Division (SQA), Internal Audit, and the assigned contract managers may each visit a contractor at different points in time during the year. Each division issues a separate report, which addresses audit findings pertinent only to their area.

The SQA Division performs a program quality review once every three years. Thus, the responsibility for following up on corrective actions has been assigned to the contract manager. However, in our review of the contract manager files, it was difficult to determine if any follow-up had occurred, or whether corrective actions had been taken by the service provider.

- At the Department of Human Services (DHS), the Office of the Inspector General (OIG) performs desk reviews of all of the independent audit reports and sends notices of specific items needing attention to program personnel for resolution. However, program personnel, not the OIG, are responsible for following up on corrective actions, and program personnel do not always follow up.

During our review of the Child Care Management Services (CCMS) program, we found that the OIG had completed timely reviews of the single audit reports which were submitted by the contractors. However, we found that the CCMS program did not have a tracking system set up for either single audit reports or to track the status of related findings identified in the audit report. In four out of the five files we reviewed, either corrective actions had not been implemented, or documentation was not available to verify that corrective actions had been taken. Some of the outstanding findings date back to 1992.

Without coordination of monitoring activities, management does not have complete information with which to form an overall assessment of the effectiveness of a service provider. As illustrated in the examples above, each separate division tends to focus on its individual responsibilities. As a result, it is difficult to determine whether corrective actions are being taken or that the overall objectives of the program have been met. Moreover, if the monitoring function cannot ensure that contractors take corrective action on a timely basis, contractors may continue to make the same errors.

Section 3-B:

State Agencies Do Not Have A Formal Mechanism To Share Information With Each Other

We found that there is no formal mechanism in place for state agencies to share information related to contractors or contracting procedures. Although the objectives of the programs are different, some providers receive funds from multiple agencies. The majority of the programs we reviewed indicated that they did not solicit information from other agencies regarding contractors or contracting processes.

The need to improve communication and coordination has been recognized. The Single Audit Managers' Forum (Forum) is an informal organization made up of audit managers and internal auditors from various state agencies. All of the agencies reviewed participate in this organization. The Forum was established to help state entities who provide state or federal funds to subrecipients (contractors) comply with state and federal laws requiring single audits. To meet this objective, the Forum has begun work on the development of:

- a data base of subrecipients and identification of a primary state oversight agency
- a uniform single audit guide
- minimum contracting requirements
- criteria for referring substandard audits to the Texas State Board of Public Accountancy

Section 3-C:

Most Agencies Do Not Have Standardized Criteria To Evaluate Contractor Performance

During our review of contractor files, it was often difficult to tell whether the performance of the contractor was adequately monitored or not. None of the contracts we reviewed contained clear statements of how contractor performance would be evaluated. The majority of programs had standardized checklists for the contract monitor to use in assessing contractors' compliance with contract provisions. However, many of the programs have not established criteria which clearly defines what is acceptable or unacceptable performance.

Without standardized criteria, the agency does not have consistent, comparable data on which to base decisions about purchases of services. Program monitors are in a position to identify trends and problems before they become significant issues. However, there is a risk of inconsistent analysis of service providers based on the experience level of the program monitors. Ultimately, the information obtained from the monitoring visits may not be sufficient to hold the contractor accountable for specific levels of performance.

Some of the specific areas of concern noted during our review include:

- At the Texas Commission on Alcohol and Drug Abuse, concerns about consistency among the program monitoring staff members prevented us from being able to adequately assess the quality of the program monitoring. The contents of the work files and extent of supporting documentation varied extensively from one monitor to another.

In addition, evaluation of performance is left up to the assigned program monitor. The monitor's background, area of specialty, knowledge, and experience will all impact this assessment.

- At the Texas Department of Health (TDH), the programs under the Bureau of Maternal and Child Health and HIV Programs do not have policy and procedure manuals to guide the monitors in assessing performance of the service providers. With the exception of the Special Supplement Food Program for Women, Infants, and Children Program, all of the other TDH program level site visit audits are subjective. None of the other programs reviewed had established criteria to assess effectiveness.

In addition, the HIV-Surveillance and Texas State Legalization Impact Assistance Grant programs did not have monitoring tools for program monitors to use.

- At the Department of Protective and Regulatory Services, the regional offices do not use standard procedures or evaluation tools to monitor purchased service contractors. Each region's contracting function operates independently and is not required to use standard procedures or tools.

- At the Texas Department of Mental Health and Mental Retardation, contract managers for the community centers do not have standardized procedures or criteria to evaluate contractors' performance. In addition, the level of documentation contained in the workfiles varies from manager to manager, and the workfiles do not reflect the current status of the contractor.
- Only two of the programs reviewed had actually established specific benchmarks to use in evaluating contractor operations.
 - The Child Care Management Services Program (CCMS) administered by the Department of Human Services has developed a system to ensure that the contractors are held to consistent standards. This system requires contract monitors to score, tabulate, report, and analyze findings which result from site visits of the contractors. Contractors whose scores fall below a 90 percent benchmark accuracy rate are put under a service improvement agreement. The objective of the 90 percent benchmark is to ensure that service improvement needs are consistently addressed.
 - The Standards and Quality Assurance Division (SQA) of the Texas Department of Mental Health and Mental Retardation has developed mandatory levels of compliance to help evaluate Community Center operations. For mental health services, a Community Center is required to be in 100 percent compliance with requisite standards and in 90 percent compliance with remaining standards. For mental retardation services, a Community Center is required to have 85 percent compliance with requisite standards and 75 percent compliance with the remaining mental retardation standards. If these mandatory levels are not met, the Community Center must develop a service improvement plan.

The SQA Division has also begun development of an inter-rater reliability system. The system will be used to evaluate scores and ratings made by reviewers when monitoring community centers. When fully developed and implemented, the system should provide management with information that will allow them to assess consistency among the SQA reviewers.

Section 3-D:

Sanctions Contained In Contract Provisions Are Inadequate

The contracts reviewed lack effective sanctions to hold the contractor accountable for failing to meet the intended objectives of the programs. For the majority of the programs reviewed, the only sanctions available to the funding agency are to terminate the contract or to suspend distribution of funds. However, the contracts are vague in this respect and do not specify when these sanctions apply. The contracts state only that the agency has the right to impose the sanctions.

We also noted that most programs do not have contingency plans to continue service delivery. This may prohibit disciplinary actions from being taken unless there is a serious violation. Program personnel may feel compelled to continue contracting with service providers that do not perform satisfactorily because there are a limited number of service providers available.

Only two programs, the Special Supplemental Food Program for Women, Infants, and Children (WIC) at TDH and the Long Term Care Nursing Facility Program at the Department of Human Services (DHS), had contract provisions which allowed the agencies to assess monetary penalties against the contractor for contract violations.

- The contract for the WIC program contains very specific sanctions which allow them to suspend a vendor's license. The length of the suspension is directly correlated to the amount of disallowed monies discovered during the field visit. In addition, they may negotiate a civil monetary penalty.
- As of June 1993, DHS had assessed \$1,273,853 in Medicaid penalties. However, as of May 2, 1994, \$1,170,216, or approximately 92 percent of the penalties, were uncollected.

Development of effective sanctions will give the agency a method to hold contractors accountable for the services they are providing for the State.

Recommendation:

We recommend that each agency:

- Develop procedures which will ensure coordination between the various monitoring functions. In some cases, this should include having a combined team from all responsible divisions make one site visit to the contractor and issue a single report on the overall operations of the contractor.
- Develop standard procedures and common criteria for assessing contractor operations. Include clear statements regarding how contractor performance will be evaluated in the contracts. Develop procedures which require and verify consistent application of the criteria.
- Develop standardized procedures for documenting contractor performance. The results of all monitoring activities should be formally documented. The documentation should be sufficient to support whether contractors are in compliance with all of the contract provisions and to determine if previous errors have been corrected.
- Develop effective sanctions for non-performance, and include them in the contract provisions. Care should be taken to ensure that the sanctions do not compromise client care.

Objective, Scope, and Methodology

Objective

Our objective was to evaluate and report on the effectiveness of the audit (monitoring) programs performed by the executive branch of state government, including audits of contractors and subgrantees, as required by Government Code 321.015 (a) and (b) (1). The audit evaluated the audit programs in place as of June 1994.

The evaluation focused on answering the following questions:

- Are contract monitoring functions sufficient to ensure that state and federal funds are spent effectively?
- Are contract monitoring functions sufficient to ensure that state and federal funds are spent appropriately?
- Are monitoring functions within the State consistent?
- Are monitoring functions efficient?

Scope

The scope of this audit was limited to contracts for program-related purchased services. By using fiscal year 1993 data obtained from the FACTS system, we identified six agencies which accounted for 96 percent of the \$10.7 billion of statewide expenditures for purchased services.

We did not directly evaluate the performance of the contractors providing services. Instead, we focused on the effectiveness of the monitoring functions performed by the supervising agencies. In addition, we did not distinguish between subrecipients or contractors for purposes of this audit.

The agencies included in this audit were:

- Texas Department of Transportation
- Texas Department of Human Services
- Texas Department of Health
- Texas Department of Mental Health and Mental Retardation
- Texas Department of Protective and Regulatory Services
- Texas Commission on Alcohol and Drug Abuse

The contract monitoring work done at the Texas Department of Transportation (TXDOT) and the Texas Department of Protective and Regulatory Services was done in conjunction with management control audits performed at those agencies. The issues and recommendations related to TXDOT's contract monitoring processes, along with management's responses, are contained in the management control audit report to be issued in the first quarter of fiscal year 1995.

We narrowed our scope to the programs which made up 80 percent of the purchased service expenditures within each agency. (See Appendix 3 for details regarding the programs reviewed at each agency.)

Areas addressed during our review include:

- contract monitoring activities
- contract monitoring methodologies
- internal controls over contract monitoring
- information sharing and coordination by agencies

Methodology

The methodology used on this audit consisted of collecting information, performing audit tests and procedures, analyzing the information, and evaluating the information against pre-established criteria.

Information collected to accomplish our objectives included the following:

- Interviews with management and staff of the agencies
- Documentary evidence such as:
 - Program-specific policies and procedures related to contract monitoring
 - Applicable state statutes and guidelines

Procedures and tests conducted:

- Tests of contracts and contract monitoring files

Criteria used:

- Contract management model developed by the State Auditor's Office
- Standard auditing criteria

Fieldwork was conducted from April 18, 1994, through June 30, 1994. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

There were no significant instances of noncompliance with these standards.

The audit work was performed by the following members of the State Auditor's staff:

- Cynthia L. Reed, CPA (Project Manager)
- Marshall McDade, Jr., CPA
- Carleton S. Wilkes, CPA
- Marilyn K. Polston, MBA
- Donna K. Todd
- Kevin R. Todd
- J. Scott Killingsworth
- Roberto E. Montealegre, III
- Christina D. Hurr
- Rose Ann Munoz
- Texas Department of Protective and Regulatory Services Management Control Audit Team
- Kay Wright Kotowski, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Agency Efforts To Incorporate Outcome Assessment

AGENCY/PROGRAM	EFFORTS TO ASSESS OUTCOME MEASUREMENT
Texas Department of Health/ Family Health Services	<p>Contractor is required to submit "Performance Based Objectives" (PBOs). These are reviewed for reasonableness at the beginning of the contract term.</p> <p>Contractor is required to submit a status report each quarter, but the results are not verified.</p> <p>Program personnel reported that the results of the PBOs are not used to evaluate contractor performance, but rather to provide technical assistance. There is no penalty assessed for not meeting PBOs, however, technical assistance is offered to assist the contractor to meet the objectives.</p>
Texas Department of Health/ Family Planning Title X	<p>Contract provisions include estimated number of people to be served.</p> <p>Contractors are required to submit "objectives." Evaluation of contractor performance is not based on the achievement of these objectives.</p> <p>Program personnel indicated that the main purpose of these objectives is to identify areas where they can provide technical assistance.</p>
Texas Department of Health/ Community Oriented Primary Care (COPC)	<p>Contract provisions include estimated number of people to be served. These are considered to be "goals," and their primary purpose is to identify possible areas to offer technical assistance.</p> <p>Contractors are required to report outcome measures annually. The information is not used to assess performance of individual service providers. The information is compiled and reported in the COPC Fiscal Year Annual Report. The reported numbers are not verified.</p>
Department of Human Services/Child Care Management Services (CCMS)	<p>During fiscal year 1993, the CCMS program used informal "benchmarks" to assess contractor performance. These benchmarks were not formally required in the contracts or in the program regulations.</p> <p>During fiscal year 1994, benchmarks were monitored at the state and regional level for each CCMS contractor.</p> <p>In addition, during fiscal year 1994, the CCMS program was in the process of proposing formally required performance standards, including the use of monetary penalties (recoupment) if required.</p>

<p>Texas Commission on Alcohol and Drug Abuse/ Chemical Dependency Treatment</p>	<p>Beginning with fiscal year 1994 contracts, TCADA has established specific performance standards for detoxification, residential, outpatient, and outpatient-methadone treatment models, and includes these standards in the contract provisions.</p> <p>However, the language in the contract states "the Commission will <u>consider</u> contractor's progress in meeting the performance standards in decisions regarding contract renewal and increases and decreases in contract amounts" (underline added). Thus, there are still no specific penalties tied to failure to achieve the established results.</p>
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Description Of Programs Included In Audit (Listed by Agency)

TEXAS DEPARTMENT OF HUMAN SERVICES

Program: Nursing Home Vendor Payment Program

Purpose of Program: This program provides nursing facility services to eligible Medicaid clients. In addition to room and board, clients receive services necessary to meet highest practical levels of physical, mental, psychological, and social well-being. DHS reimburses facilities for the care they give, basing payments on the level of effort necessary to adequately care for clients.

Program: Intermediate Care Facilities for the Mentally Retarded Program

Purpose of Program: This program provides institutional care and treatment for people with mental retardation or related conditions, including room, board, and active treatment to help clients function as independently as possible. Four levels of care are provided in residential settings ranging from small group homes to large state schools.

Program: Child Care Management Services (CCMS)

Purpose of Program: The CCMS program provides care and supervision for children in a variety of settings. Twenty-seven CCMS contractors purchase child care for children from ages 0 through 12 on behalf of DHS. All licensed and registered child care providers who also meet liability insurance requirements can sign vendor agreements with the CCMS contractor for their area. Clients may choose to accept child care placement with any CCMS system vendor or to be reimbursed for self-arranged care provided by other eligible care providers. Vendors (the actual child care providers) are reimbursed through the CCMS contractors for services provided. TDHS disperses funding through CCMS to over 4,500 subcontract providers for child care provided for JOBS and other programs.

TEXAS DEPARTMENT OF HEALTH

Program: Community Oriented Primary Care (COPC)

Purpose: This program funds providers for delivering primary health care services to those who are eligible, specifically the low-income uninsured individuals.

The service providers are required to provide or ensure services from six priority areas. The six priority service areas are as follows:

- . Diagnosis and treatment
- . Emergency services
- . Family planning
- . Preventive services, including immunizations
- . Health education
- . Laboratory and x-ray

Program: Family Health Services Program

Purpose: This program funds providers to provide or ensure health services to women and children, especially low-income individuals. The services include family planning services and preventive child health services.

Program: Special Supplemental Food Program for Women, Infants, and Children (WIC)

Purpose: WIC is a nutrition program designed to correct and prevent improper mental and physical growth in the fetus, infant, and young child. The Food and Nutrition Services of the U.S. Department of Agriculture provides the Texas Department of Health with funds to administer the WIC program. The Department administers the program through local health clinics and private non-profit health agencies in the State of Texas.

Program: HIV Services (includes HIV Prevention, HIV Services and HIV Surveillance)

Purpose: The HIV Prevention program provides information, education, and prevention services to all citizens of Texas.

Programs are implemented through public health regions, local health departments, and community-based organizations.

The HIV Services program provides statewide assistance to HIV Care Consortia in providing health and social services to persons with the HIV infection. Program staff assist Consortia to maximize state, federal, and local dollars in order to provide quality care in a cost effective manner.

The HIV Surveillance program measures the number of confirmed cases of AIDS and newly diagnosed HIV infections in the State. The Surveillance program conducts ongoing seroprevalence surveys to measure the extent of HIV infection in Texas.

Program: Texas State Legalization Impact Assistance Grant (SLIAG)

Purpose: This program permits certain aliens who have been living in the U.S. illegally to obtain lawful resident status and eventually qualify for citizenship. The purpose of the SLIAG program is to alleviate the financial impact on state and local governments that may result from providing services to newly legalized aliens participating in the amnesty program.

SLIAG is essentially a reimbursement program. It is intended to defray costs incurred by state or local governments in providing public health, public assistance, and educational services to eligible legalized aliens.

TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

Program: Child Protective Services (CPS)

Purpose: Substitute care is either provided by foster care providers (independents) who have agreements with CPS or through foster homes under the direct administration of CPS. These services are funded by the federal Foster Care program with a percentage match of state funds.

Foster care providers include child placing agencies, basic institutions, institutions serving developmentally disabled children, residential treatment centers, therapeutic camps, halfway houses, and emergency shelters.

TEXAS DEPARTMENT OF MENTAL HEALTH AND MENTAL RETARDATION

Program: Community MHMR Centers

Purpose: TXMHMR contracts with local Community Centers to provide an array of services to mentally ill and retarded citizens near their homes. These services include diagnosis and evaluation, referral, outpatient services, inpatient services, day activities, emergency services, education and training, consultation, workshops, and supervised living arrangements.

TEXAS COMMISSION ON ALCOHOL AND DRUG ABUSE

Program: Alcohol and Substance Abuse

Purpose: This program plans, develops, coordinates, evaluates, and implements programs for the prevention, intervention, treatments, and rehabilitation of alcoholism and drug dependencies.

Program: Criminal Justice Treatment Initiative

Purpose: This program is aimed at addressing the root cause of crime, effecting a fundamental change in the lives of those prisoners completing the program and, in turn, reducing the number of released prisoners who relapse into criminal behavior.

Divisions Responsible For Contract Monitoring (By Agency)

TEXAS DEPARTMENT OF HUMAN SERVICES

Nursing Home Vendor Payment Program

Office of the Inspector General (OIG)

The OIG performs on-site reviews of contractors for the Nursing Home Vendor Payment Program and the Intermediate Care Facility for the Mentally Retarded Program for compliance with contractual requirements. OIG tests the financial records for appropriate expenditures and support for billings submitted to DHS. This includes data related to the number of clients and the number of days the client has been in the nursing facility. A written report is prepared and sent to the contractor and to the Billing Unit for resolution. The OIG does not track the resolution of these findings.

The OIG is also responsible for reviewing all of the single audit reports submitted by the program. However, the OIG is not responsible for tracking that the reports have been received or for ensuring that the findings have been followed up on.

Billing Unit

The Billing Unit uses a computer system to determine the amount due to each contractor. Twice a month, the computer generates a billing statement which is based upon data supplied by the contractors. This data includes client qualification information as well as admission and discharge information.

The Billing Unit is also responsible for resolving findings in the OIG audit reports. In addition, this unit recoups funds from private companies for services paid by Medicaid for clients in facilities.

Provider Enrollment Unit

This unit maintains the contractors for all nursing facilities. In addition, staff monitor results of licensing surveys for potential impact on contracts. This unit notifies facilities of Medicaid penalties and tracks the payment of those penalties.

Provider Reimbursement Section

This section recommends rates for reimbursement to DHS's Board. This group reviews the cost reports submitted by the nursing homes and determines the per diem rates the nursing homes are allowed to charge.

Utilization and Assessment Review Unit

This unit is responsible for administering inpatient utilization and nursing home case mix assessment review programs. They periodically review the clients' records to determine if the proper Texas Index for Level of Effort (TILE) rate has been assigned, and calculate any contractor over- or under-payments.

Licensing and Certification Unit

This unit performs surveys of nursing facilities to assess compliance with state licensing requirements and federal Medicaid certification. These surveys include compliance with federal requirements and review of quality of care as defined by state licensing and federal Medicaid standards.

This unit does not specifically review for any contractual requirements other than those relating to state and federal requirements needed for licensing and certification purposes.

Child Care Management Services

Quality Assurance Unit

This unit designs, maintains, and supports monitoring systems and activities administered by regional staff who monitor contracts at three levels: monthly reviews which include examining the client as well as vendor files on a sample basis, quarterly reviews which include the review of budget and billing areas, and annual reviews which include interviews and observation.

Resource Management Unit

This unit performs the contract administration function.

Program Development Unit

This unit is responsible for developing policies and guidelines.

TEXAS DEPARTMENT OF HEALTH

Grants Management

This division performs financial monitoring of the majority of contracts over \$25,000 (except those for the WIC program).

Internal Audit Division

Performs desk reviews of all independent CPA audit reports, which are required from all contractors over \$25,000.

Program Divisions

Each program we reviewed has their own set of monitors who audit the contractors for performance aspects.

WIC Program

The WIC program is unique from the other programs within TDH because it has its own monitoring division separate from the Grants Management division, known as the Local Agency and Vendor Management Division, Bureau of WIC Nutrition. This division is responsible for doing the financial and compliance monitoring as well as performance monitoring for the WIC program.

TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

Residential Child Care Licensing (RCCL)

RCCL is responsible for enforcing the State's child care licensing standards. RCCL reviews foster home files, but does not inspect every home annually for compliance.

Youth For Tomorrow

Youth For Tomorrow is an independent evaluator who is under contract with CPS to review the case reports of foster children at levels of care three through six, on a semi-annual basis. Youth For Tomorrow is also contracted to annually review individual facilities' level of care service system indicators.

TEXAS DEPARTMENT OF MENTAL HEALTH AND MENTAL RETARDATION

Internal Audit Department

This department performs contract compliance audits of Community Centers. They also perform desk reviews of the financial audits of community centers performed by independent CPAs, and perform a quality control review of the CPA's working papers.

Standards and Quality Assurance Division

This division is responsible for auditing the quality of the services provided by the Community Centers. This division is separated into two sections, the Mental Health section and the Mental Retardation section.

Assistant Deputy Commissioners

These individuals are considered to be the contract managers. They have the ultimate responsibility for monitoring the contract, and provide technical assistance, policy interpretation, and guidance to the Community Centers.

TEXAS COMMISSION ON ALCOHOL AND DRUG ABUSE

Contract Monitoring Division

This division provides on-site monitoring of service providers to assess compliance with contract and quality of services.

Grants and Contracts Division

This division processes and analyzes monthly billings and financial reports submitted by contractors. This division also maintains the official copy of all contracts.

Auditing Division

This division is responsible for performing desk reviews of audit reports prepared by independent CPAs. They also perform special investigations of contractors which involve financial and accounting issues.

Appendix 5:
Management's Responses



Texas Commission on Alcohol and Drug Abuse

BRINGING TEXAS A NEW VIEW OF HUMAN POTENTIAL.

September 2, 1994

Cindy Reed, Project Manager
Contract Monitoring Project
Office of the State Auditor
Two Commodore Plaza
206 E. Ninth Street, Suite 1900
Austin, Texas 78701

Dear Ms. Reed:

Enclosed you will find the Texas Commission on Alcohol and Drug Abuse's response to the Review of Contract Monitoring of Purchased Services report dated August 1994.

If you have any questions or need any additional information, please contact Valerie Korba, Assistant Deputy Director for Funding and Program Management, at 867-8836.

Sincerely,

Otis E. Williams
Deputy Executive Director
for Finance and Administration

OEW:dm

Enc.



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710 BRAZOS STREET
AUSTIN, TEXAS 78701-2676
512-867-8700
TEX-AN: 243-8700

Response from the Texas Commission on Alcohol & Drug Abuse
to the SAO Draft Report "Review of Contract Monitoring of Purchased Services"

Management Response to Recommendation (p. 11):

We concur with the recommendation and will work to implement it in a timely manner. This work will begin during FY95, but will not be fully implemented until FY96. Effective 8/8/94, the program monitoring function moved from the Funding and Program Management Division to the Auditing Department of the Program Compliance Division. With this move, the activity and focus of the function will shift from being primarily compliance activity to include an appropriate combination of both compliance monitoring and assessment of outcomes. TCADA is initiating the process of Converting Our Resources and Environments (CORE). CORE is an initiative of the governing board of TCADA, and will work to accommodate current conditions and future evolution to obtain quality, cost effective care for clients and cost effective results for all Texans. This process will look at what we are funding, how we are funding and who we are funding. We hope to complete the process by January 1, 1995, and to incorporate the results into our funding processes for FY96 awards.

Management Response to Recommendation (p. 13):

We concur with the recommendation and will work to implement it in a timely manner. As previously stated, the program monitoring function has been moved to the Auditing Department in order to provide a more systematic, effective approach to compliance reviews of funded service providers. Audit reports of FY94 contractors are due to TCADA during FY95 and will be reviewed by department staff. Field audits will be made based on a risk assessment to be developed by the Auditing Department during FY95.

Management Response to Recommendation (p. 18):

We concur with the recommendation and will work to implement it in a timely manner. As previously stated, the program monitoring function has been moved to the Auditing Department in order to provide a more systematic, effective approach to compliance reviews of funded service providers. The monitoring process will be redesigned as a result of this move. This move also results in improved coordination between departments as the compliance functions of monitoring, auditing, licensure and investigations are all contained in the Program Compliance Division. The Auditing Department already has standard procedures for financial audits, and will be developing standard procedures and common criteria for assessing and documenting contractor operations and performance. Additional sanctions have been added to TCADA's FY95 contracts and award provisions, and the results of the CORE process TCADA is initiating may clarify the sanctions for non-performance in the FY96 contracts and award provisions.

Texas Department of
Mental Health and Mental Retardation

Dennis R. Jones, M.S.W., M.B.A.
Commissioner



Central Office
P.O. Box 12668
Austin, TX
78711-2668
(512) 454-3761

August 30, 1994

Mr. Lawrence F. Alwin, CPA
State Auditor of Texas
Office of the State Auditor
P.O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Alwin:

The following is a response to the draft report of the "Review of Contract Monitoring of Purchased Services, August 1994". Prior to the beginning of this review, the Office of Internal Audit, in cooperation with the offices of Mental Health and Mental Retardation, began a comprehensive review of this agency's contracting processes. A number of the issues identified in this report were identified for further review by the internal audit staff. Because of the size and complexity of the systems and the substantial interrelatedness of several major activities, the project will not be completed until some time in FY '95.

Section 1

Contract Monitoring Functions Do Not Focus on the Most Important Factors of Contractor Performance

**Recommendation: Restructure contract monitoring functions...
Develop a risk assessment process...**

TXMHMR Response: The Office of Internal Audit is conducting a comprehensive performance audit designed to assist management (1) to identify appropriate outcome measures, (2) to develop appropriate risk factors, (3) to enhance current monitoring activities relative to contract expectations, and (4), to enhance the contract information and negotiation processes.

Section 2

Financial Monitoring Does Not Always Adequately Ensure That State and Federal Funds Are Spent Appropriately

Recommendation: We recommend that each agency evaluate current financial monitoring procedures...

TXMHMR Response: An integral part of the comprehensive performance audit mentioned in Section 1 is a review of all current monitoring activities relative to the contracts. While the current level of effort in this agency relative to Single Audit Act requirements is substantial and includes quality control reviews of each community center's financial auditor's work at least biennially, Internal Audit's activity is also under review.

The organizational placement of the audit responsibility is significant and cannot be overemphasized. Responsibility for adequate control systems is placed with management of each specific entity. A major component of that responsibility is the annual financial audit. Audit requirements placed on the independent auditors through federal, professional and agency mandates also tend to provide assurances about internal control reviews. Those same authoritative bodies require that duplication of effort be avoided. It is state law that requires each community mhmr center have an annual financial audit. Similarly, this agency is charged with reasonable oversight. Included in our process is follow-up on deficiencies to provide assurances to our contract managers and to center management that control weaknesses and other deficiencies are appropriately addressed.

Section 3

Lack of Standardized Monitoring Processes Make It Difficult To Assess Overall Performance of the Contractor

Recommendation: We recommend that each agency:

Develop procedures to ensure coordination...common criteria for assessing contractor operations...standardized procedures for documenting contractor performance...effective sanctions for non-performance...

TXMHMR Response: A work group within Central Office (SemiTex) has been working with reported data to identify trends and comparative information to assist the contract managers in reviewing community center data and negotiating contracts. The end result of this activity has been to identify common criteria through a standardized review of reported data elements.

Mental Health Services is developing a data base system of standardized information for documentation of contractor performance and sharing of performance information. The data base will be accessible to major monitoring groups such as Standards and Quality Assurance and Internal Audit staffs.

The nature of sanctions in this environment is that each scenario presents unique issues that require equally unique solutions, always considering the effect the solutions may have on our consumers. We continue to review the issue of sanctions as it relates to the deployment of policies that provide sufficient flexibility for contract managers to effect an appropriate outcome for our consumers, while, at the same time, ensuring appropriate levels of performance are received from contractors.

Please contact Tom Martinec (323-3147) in the Office of Internal Audit if additional information is required.

Sincerely,



Karen Hale
Acting Commissioner

cc: Jaylon Fincannon, Deputy Commissioner, MR Services
Steven Shon, M.D., Deputy Commissioner, MH Services
Sally Anderson, Deputy Commissioner for Management and Support
Gretchen Claiborne, Associate Deputy Commissioner, MR Community
Services
Ed Calahan, Associate Deputy Commissioner, MH Community Services

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September 12, 1994

Ms. Cynthia L. Reed, CPA, Project Manager
Office of the State Auditor
206 E. Ninth St., Suite 1900
Austin, TX 78701

Dear Ms. Reed:

Re: Management's Responses to Report

We are pleased to provide the following responses to report for the recently completed Contract Monitoring Project for TDHS contracts for purchased services during FY 1993:

Recommendation #1:

● **Licensing and contract monitoring:**

We agree that the contract monitoring function should evaluate the success of the provider in delivering quality services that are consistent with the program's objectives. However, if the agency is also responsible for the licensing of that provider group, the contract monitoring should not duplicate the licensure activities. For example, in nursing facility surveys, the surveyors are assessing whether the facility provides quality and appropriate care. With the changes resulting from the Nursing Home Reform Act in OBRA 1987, the survey process has evolved to more outcome monitoring, rather than just whether paper requirements are met. We believe that it is in the best interest of the state and taxpayers to coordinate the two functions of licensing and contract monitoring so that there is minimal duplication and all important aspects are evaluated. We will continue to coordinate these two functions in nursing facility surveys.

● **Risk assessment:**

TDHS used risk assessment to determine that all Child Care Management Services (CCMS) contracts should be monitored because each CCMS contractor:

- Manages more than \$1 million in expenditures for CCMS operations and child care (most CCMSs manage much more than this)

John H. Winters Human Services Center • 701 West 51st Street
Central Office Mailing Address P.O. Box 149030 • Austin, Texas 78714-9030
Telephone (512) 450-3011 • Call your local DHS office for assistance.

- Manages care for 16 different funding streams, including 15 funding streams that are all or partly federal
- Manages care for approximately 30 different TDHS client eligibility groups
- Is relatively new
- Provides functions and services that are under high public and political scrutiny

TDHS also used risk assessment to determine the CCMS functions and activities that should be monitored.

- Monitoring cost per contract:

TDHS monitoring cost per CCMS contract appears relatively high compared with other state agencies reviewed; however CCMSs manage care for approximately 60,000 children per day in care with over 4,500 subcontracted child care vendors, which means that the relevance and impact of monitoring extends to a far greater universe than just the 27 CCMS contractors.

- Outcomes:

CCMS contractors provide essential functions of client services, vendor management and financial management. The TDHS monitoring system addresses both compliance monitoring and outcomes for these CCMS functions. In addition to monitoring critical output measures, TDHS has published proposed rules defining outcomes in terms of minimum acceptable levels of performance in six different areas. All of these areas will be clearly defined to contractors, will be routinely monitored by TDHS, and will be included in a system that tracks and evaluates the attainment of both compliance and outcomes. In addition, TDHS is publishing proposed rules addressing financial recoupment methodologies for costs associated with the non-attainment of minimum performance levels for two key outcome measures:

- Accuracy and timeliness of determination and redetermination of client eligibility
- Maintenance of valid vendor agreements

The sanctions system will apply to FY 1995; however, the actual sanctions that will be applied will be adopted sometime in January 1995, pending approval of the Board of Human Services.

Recommendation #2:

- Financial monitoring:

The CCMS monitoring system has a strong emphasis on measures of contractor performance in ensuring that state and federal funds are spent properly and are accurately accounted for. TDHS' risk assessment has determined that routine field audits of CCMSs are not necessary because of the scope of the CCMS monitoring system and the fact that all CCMS contractors receive single audits. However, TDHS has established levels of noncompliance on key CCMS monitoring standards below which the need for a special review or special field audit must be assessed.

Recommendation #3:

- Standardized contract monitoring within agency:

In FY 1994, TDHS established a Contract Council. The purpose of the Council is to develop and maintain contract policies and procedures and address management issues common to more than one program/support area. The Council is made up of representatives from State Office and the Field from all areas of the TDHS that have contracting activities. This Council is scheduled to meet, at minimum, on a quarterly basis and is currently in the process of determining priority contracting areas (i.e., monitoring and evaluation; training; etc.) for the Council to focus on in FY 1995. This audit finding will be included in the Council's deliberations.

- Single audit tracking:

During FY 1994, TDHS established procedures for CCMS program follow-up on single audit report findings and began work on a single audit tracking system. CCMS program activities planned for FY 1995 include: (1) completion of work on an automated database and tracking system, (2) inclusion of written procedures in the Purchase of Service (POS) handbook and the CCMS contractor manual, (3) beginning drafting a compliance guide for CCMS to be used by independent auditors, (4) establishing coordination and communication protocols between programs and contract managers for resolution of audit findings, and (5) identifying needed communication points and protocols with other state agencies and federal cognizant agencies.

- Coordination among monitoring functions:

Routine monitoring of CCMS contractors consists of the CCMS monitoring system administered by TDHS regional contract staff and independent audits; CCMS monitoring is designed not to duplicate the content of the audits. Some CCMS contractor agencies also have contracts with TDHS for other functions, such

as the child care food program, but TDHS monitoring of these other functions should not duplicate what is covered in CCMS monitoring.

- Standard procedures and criteria for assessing contractor performance:

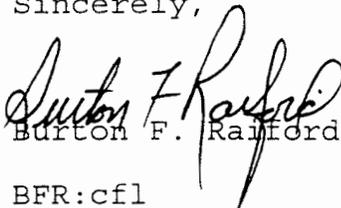
TDHS has developed rules, contract language and contractor manual materials which clearly state how CCMS contractor performance will be evaluated and has developed procedures which require and verify consistent application of monitoring criteria.

- Standardized procedures for documenting contractor performance and development of effective sanctions for non-performance:

TDHS formally documents the results of CCMS monitoring activities. TDHS assesses contractors' performance in regard to compliance and performance standards and enters into service improvement agreements with contractors not meeting standards. TDHS performs follow-up monitoring to determine if performance has improved. TDHS has published proposed rules and procedures for financial recoupment for noncompliance with certain standards and for other actions that may be taken in regard to contractor non-compliance. The sanctions system will apply to FY 1995; however, the actual sanctions that will be applied will be adopted sometime in January 1995, pending approval of the Board of Human Services.

We appreciate the professionalism of your staff in performing this project.

Sincerely,


Burton F. Rainford

BFR:cfl



TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

EXECUTIVE DIRECTOR
Janice M. Caldwell, Dr. P.H.

September 12, 1994

Mr. Larry Alwin, State Auditor
Office of the State Auditor
P.O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Alwin:

Thank you for the opportunity to provide comments regarding the recommendations in the Contract Monitoring Report. Since the review of the contracting process at the Department of Protective and Regulatory Services (PRS) was done as a portion of the Management Control Audit, my comments will parallel those provided in our previous response.

The first recommendation in the report relates to the need for restructuring of the contract monitoring function to include the appropriate combination of compliance monitoring and assessment of outcomes and to develop a risk assessment process.

We have already begun to address these issues by creating a work group composed of contract manager representatives from regions to develop a statewide policy and procedure on contract monitoring. Their work should be completed by January 1995. A risk assessment process was the first product delivered in draft form. Work still needs to be completed on some of the risk factors specifically pertaining to contracts for 24 hour child care.

The mission of the work group includes the development of the procedures to use in follow up that are consistent with the current Texas Administrative Code. The lack of such a system was identified as a problem and requirements were added to our new automated system being developed. A manual system for recording and tracking results of monitoring is being devised that can readily be transferable to the new automated system.

The issue of evaluation, including the development of outcome measures and outputs that will be used in monitoring and included in contracts, was identified by the agency and the Texas Legislature some time ago. As a result the Governor's Child Abuse Program Evaluation Committee [Group] (CAPEG) was established. CPS actively participates in CAPEG, which is charged with ensuring that a means to evaluate purchased services in child abuse programs is developed. An instrument that was developed by the Department of Human Services (DHS) is used by one of our regions which was included in the DHS pilot. This instrument is planned

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as our starting point for a work group on evaluation.

The work group working with CAPEG will begin meeting as soon as the monitoring work group completes its product, scheduled for January 1995. It is anticipated that this group's work will take several years to complete because we have many services that we purchase and there are inherent difficulties in designing and implementing a cost effective service evaluation system that is valid and reliable. It is planned that the group's products could be released as they are developed for each service, so that CPS can begin formal evaluations while the group is working on other services.

The second recommendation relates to evaluation of current financial monitoring procedures. We are addressing this through our work group on monitoring and some additional training for our contract management staff who are responsible for financial and compliance monitoring. Some of our staff need training on the conducting of financial monitoring, especially in the area of how much testing needs to be done and in how to conduct tests when the contractor is using automated bookkeeping systems. In addition, we are implementing a more aggressive financial monitoring program for contractors of 24 hour child care.

The final set of recommendations relate to developing procedures for coordination between the various monitoring functions, common criteria for assessing contractor operations, documenting contractor performance and sanctions.

Contract monitoring is the responsibility of our contract managers. When conducting monitoring, they usually go as a team with billing technicians and, sometimes, program staff that have expertise in the service area. This process of coordinated monitoring, which includes Youth for Tomorrow Foundation (YFT), our contractor for monitoring Level of Care Standards, still needs to be developed for the contractors who provide 24 hour child care. We are doing that now and we anticipate a new system to be in place by August 1995.

We are in the process of developing new procedures for assessing the performance of contractors for 24 hour child care. The University of Texas at Austin is beginning a project which will use variables identified by Youth For Tomorrow Foundation (YFT), to further identify trends, outcomes, and relationships between the variables. This information will be used by our evaluation work group to develop an evaluation instrument for this type of contract. This issue is also being addressed by this work group for all contracted services. We will be including evaluation terms in future contracts, as the evaluation components are developed.

The documenting of contractor performance is being addressed by the monitoring work group. Standardized instruments are being developed to do this that will also document our follow up efforts when contractor performance is inadequate.

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We are adding to our sanctions for non-performance by identifying all of the sanctions that can be used prior to the consideration of termination. These are being included in the new contract provisions for contractors of 24 hour child care. Provisions pertaining to specific services are also being added to other contracts (e.g. the right of PRS to remove any employee of a contractor or subcontractor from performing under the contract).

Sincerely,



Janice M. Caldwell, Dr. P.H.

JMC:tev



Texas Department of Health

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Deputy Commissioner for Programs

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Deputy Commissioner for Administration

1100 West 49th Street
Austin, Texas 78756-3199
(512) 458-7111

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September 14, 1994

Mr. Lawrence F. Alwin, C.P.A.
State Auditor
P.O. Box 12067
Austin, Texas 78701

Dear Mr Alwin:

I received your correspondence of August 16, 1994, requesting us to review and provide written comments on your draft report entitled *Review of Contracting Monitoring of Purchased Services*. We fundamentally concur with the key recommendations contained in the report. These include:

- contract monitoring functions should include an appropriate combination of compliance monitoring and assessment of outcomes;
- an agency's level of fiscal monitoring should provide some assurance that contractors' internal controls are effective and that financial data is accurately and properly reported;
- procedures should be developed to ensure coordination between various monitoring functions; and,
- sanctions should be developed for non-performance of contract provisions.

As you may be aware, our performance-based contracting system has received national and State recognition in its innovative approach to contracting with local governments. We have contracts with local health departments throughout the State that contain specific performance-based objectives (PBOs). Our agency has been moving in this direction for several years in order to eventually have PBOs in all contracts when appropriate.

Unfortunately, some existing federal and State laws governing our grant and contracting activities tend to restrict reporting rather than encouraging more appropriate and meaningful accountability for grant funding. For example, some of our contractors are mandated by legislation to provide certain services or outputs. These required services are generally recognized as resulting in desired outcome, but neither our agency nor the contractor have the

option of changing services to alter outcomes. When outcomes are predictable, merely measuring and tracking the number of people who receive a particular service does indicate how successful the contractor has been at achieving the intended objectives of the program.

For those contracts containing PBOs, the program performance review should reflect a mixture of community needs assessment, organizational self-assessment by the contractor, evaluation of outcomes and processes for appropriateness and effectiveness of intervention, and onsite technical assistance visits. This is currently being instituted in one of our new and innovative programs, Community-Oriented Primary Care, which is working with its contractors to educate them as to the importance of outcome measurement. These contractors are being assisted in developing appropriate data tracking systems. A unified data set of indicators will result that could be used by various departmental programs to assist them in both compliance monitoring and outcome assessment.

We do not totally agree that all contract monitoring should be standardized. Every contractor is different in the amount of resources available to provide services, the needs of the population served, political constraints, and the presence or absence of other providers to address the population's needs. Although it is unrealistic to expect every contractor to achieve the same level of performance, it is realistic to expect quality clinical practices.

We also do not agree that our family planning contract monitoring is inadequate. Outcome measures are carefully documented for each contractor. Births averted through the family planning program are measured, as well as their associated welfare costs savings, resulting in a cost/benefit ratio for this program.

Overall your report is a good starting point for State agencies to reexamine existing contract monitoring procedures. If others are interested, we would be glad to share our experience with incorporating PBOs into contracts and how shortcomings in accomplishing these objectives have been used by our agency as justification and documentation for eliminating or reducing funding to certain providers in recent years.

We appreciate the opportunity to submit these comments and look forward to receiving a copy of your final report. If I can be of any further assistance, please feel free to call upon me at 458-7375.

Sincerely,



David R. Smith, M.D.
Commissioner of Health

State Auditor's Office follow-up comments follow on the next page.

Auditor's Follow-Up Comments to Texas Department of Health Responses

We recognize and encourage the efforts taken by the Department to include performance-based objectives (PBOs) in their contracts. However, as stated in Section 1-B of the report, and further detailed in Appendix 2, the use of PBOs within the programs we reviewed still fall short of holding contractors accountable for achieving specific results.

Our recommendation related to the standardization of contract monitoring is not intended to suggest that each contractor be held to the same level of performance, only that they be evaluated using consistent criteria established by the agency. As stated in Section 3-C of the report, the programs we reviewed under both the Bureau of Maternal and Child Health and HIV do not have policy and procedure manuals to guide contract monitors in assessing performance of the service providers.

The information cited in Section 1-A of the report regarding the family planning program was obtained from the fiscal year 1993 Annual Report for the Bureau of Community Oriented Primary Care, which is published by the Department. There was no evidence in this report or in any of the other program policies, monitoring tools, or contracts we reviewed which indicate that the births averted through the family planning program or their associated welfare cost savings are tracked or evaluated during the contract monitoring process.

Copies of this report have been distributed to the following:

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