Section 7-A:

## Weaknesses in Contract Provisions and Financial Monitoring of Unit-Rate Contracts, As Well As in the Calculation of Unit Rates Themselves, Increase the Risk That Funds Will Be Used Inappropriately

DPRS' unit-rate contracts do not limit contractors' use of public funds to the reasonable and necessary costs of providing services. Although we found over $1.6 million in questionable expenditures, these expenditures are not violations of the contract provisions as currently written. As there are no restrictions over the use of funds, DPRS focuses its monitoring efforts on delivery of services, not the appropriateness of contractor expenditures. In addition, multiple weaknesses in the agency's procedures for calculating unit rates result in some providers receiving compensation which exceeds the reasonable and necessary costs of providing services.

**Unit-Rate Contracts Do Not Hold Contractors Accountable For The Appropriate Use of Public Funds.** The Department's unit-rate contracts for residential treatment and child placing agency services do not hold contractors accountable for **how** they spend public funds. It is critical that the contract language contain clear provisions outlining the definitions of allowable and unallowable costs, as well as the manner in which the contractor will report the status of its financial position to DPRS in order to ensure funds are spent appropriately.

The Child Placing Agency and Residential Treatment Center contracts currently consist of the same three-page agreement. The current contracts are open-ended and contain no ending or renewal dates. We noted the following weaknesses in the contracts which limit the contractors' fiscal accountability:

- Contract provisions do not limit contractor expenditures to the reasonable and necessary costs of providing services. The contracts do not specify the definitions of allowable and unallowable costs, nor do they contain references to federal cost principles which would offer guidance in the determination of allowable versus unallowable costs.

- Contract provisions do not contain explicit language requiring the contractor to reimburse the agency for inappropriate expenditures.

- Contracts do contain provisions requiring the contractor to meet licensing standards. One of the licensing standards, as specified in the Texas Administrative Code, is that a facility must submit a copy of its financial audit to the agency's Licensing Division. However, when we inquired with DPRS licensing staff about what is done with these audit reports, we found that the Licensing Division only requires these audit reports from contractors who are handling adoptions.

- The Child Placing Agency contracts contain no provisions limiting or prohibiting the retaining of a portion of the reimbursement rate at the Child Placing Agency prior to paying the actual foster care home. This is contradictory to the federal

Department of Health and Human Services Administration for Children and Families Policy Announcement 82-01 which prohibits this activity.

In a 1994 survey conducted by DHS, foster families reported that they were paid a wide variety of rates by child placing agencies. For example, DPRS pays child placing agencies $82.64 per day for children assessed at Level of Care 4. However, survey results indicated that foster care families with which these children reside only received from $21.00 per day to $65.00 per day from the child placing agencies.

DPRS has taken steps to address some of the deficiencies in the contracts. A recent rule change approved by the DPRS board will begin limiting the 24-hour child care services contracts to two-year terms beginning in January 1996. Contracts may be renewed upon expiration of the two-year term. DPRS has also drafted a new revision of the contract for residential services, but this revision is not yet in use. However, the proposed revisions do not address or correct the issue of child placing agencies retaining a portion of the reimbursement rate.

**Monitoring of unit-rate contractors does not focus on fiscal accountability.** DPRS' current monitoring efforts focus on service delivery instead of the appropriateness of contractors' expenditures. Both aspects are important, but since the contracts themselves do not restrict the use of state funds, monitoring has historically focused on the quality of services delivered. The primary form of fiscal control over unit-rate contractors consists of an annual requirement for the contractor to submit a cost report to be used in the rate-setting process. Also, prior to 1994, all contractors were not even required to submit a cost report.

Although the Texas Administrative Code clearly outlines the definitions of allowable and unallowable costs for 24-hour care services, the requirements only restrict the expenditures which can be included on the cost report, not what the contractor can actually use the funds for. Consequently, contractors are still allowed to spend state funds on items that may be otherwise considered inappropriate as long as the costs are not included on the cost report.

The confusion regarding allowable and unallowable costs is best illustrated by a comment made by one contractor we visited. When we brought certain questionable costs to this contractor's attention, the contractor responded by stating that, as long as these costs were not included on the contractor's annual cost report, the State was not really funding the expenditures, and, therefore, they were acceptable. Because contractors are not compensated for only the costs they report on their cost reports, this is an invalid premise.

During our review of contractors, we found significant examples of inappropriate expenditures which could be considered unallowable if contracts limited provider expenditures according to criteria contained in the Texas Administrative Code or federal cost principles. Examples include the following:

- One contractor engaged in numerous questionable related-party transactions involving the executive director, the executive director's family members, or other contractor employees. Examples of these transactions include the purchase of the executive director's home, purchase of land from the executive director, and payment of monthly deferred compensation to the executive director's former husband who had previously worked for the contractor. The dollar amounts associated with these related-party transactions totaled over $1.2 million.

- One residential treatment center contractor was using the executive director's home as one of its campuses. This location was not properly licensed, and the contractor owed the residential treatment center $58,903 in accumulated monthly advances.

- Two contractors made inappropriate expenditures of contract funds or expenditures which could not be supported by adequate documentation. These inappropriate or unsupported expenditures totaled $299,319. Examples of these purchases included purchases of employee gifts, the purchase of land and blueprints for a church complex, questionable training expenditures, and fund-raising costs which exceeded fund-raising proceeds.

- One contractor employed questionable payroll-related practices such as the loans and advances to employees. Costs questioned in this category totaled $47,192.

In addition, we found that three contractors had weaknesses in internal controls. These weaknesses included things such as failure to document accounting or purchasing policies and procedures, failure to conduct regular inventories of property and equipment or record who has been assigned responsibility for these items, and failure to maintain up-to-date personnel files and correctly record employee hours worked.

DPRS has recognized the need to improve financial monitoring of its contractors and has recently reassigned staff to form a new Contracts Office within the agency's Financial Division. Plans are underway to hire additional staff for this office as well. The primary purpose of this office is to develop and implement an accountable, auditable, and user-friendly contracting system for the agency. It is intended that DPRS program staff will work jointly with the new Contracts Office to develop a means of assessing the quality of contractor services.

**Weaknesses in the agency's procedures for calculating unit rates result in some contractors receiving compensation which exceeds the reasonable and necessary costs of providing services.** The current rate-setting process does not ensure that reimbursement rates for Child Placing Agency and Residential Treatment Center contracts reasonably align with the costs of providing services. The rates under DPRS' Level of Care system are established using cost report data submitted annually by contractors supplying 24-hour care services. Under this system, contractors are paid a unit rate per child per day based upon six different levels of care.

The effects of the weaknesses in DPRS' rate-setting process are illustrated by comments from one of the residential treatment contractors reviewed. Specifically, the contractor's executive director indicated that the reimbursement rate for a Level of Care 6 child was too high, and the reimbursement rates for Levels of Care 4 and 5 children were too low. The director stated that, as a result, this facility used the "profit" from the rate received for Level of Care 6 children to help finance the services provided to Levels of Care 4 and 5 children. We were unable to verify this statement, however, as the contractor's accounting records were not organized in a fashion allowing us to see the actual costs incurred in providing services to Levels of Care 4, 5, or 6 children individually.

The weaknesses in DPRS' rate-setting processes have been reported on previously. In a September 1994 report, *A Review of Management Controls at the Texas Department of Protective and Regulatory Services* (SAO Report No. 95-003), the State Auditor's Office identified the following weaknesses in the rate-setting process associated with the Level of Care system used to reimburse contractors of 24-hour care (including child placing agencies and residential treatment centers):

- The methodology used to set rates is based upon a number of untested assumptions and assumes that the type, amount, and quality of care provided from one child to the next is uniform within each Level of Care and among contractors.

- Certain categories of costs are excluded from the rate-setting process without empirical justification.

- Cost reports used during the rate-setting process do not directly capture costs by individual Level of Care.

- The accuracy of the cost report data used in the rate-setting process is questionable since there is limited audit coverage of these cost reports, and cost report training is not mandatory for contractors.

During our project we found that, although DPRS formed a rate-setting task force and a number of modifications to the process have been discussed, *the rate-setting methodology remains unchanged since the September 1994 State Auditor's Office report.*

During the time since DPRS separated from DHS, DHS has performed rate-setting tasks on behalf of DPRS through an interagency agreement. (See the description of DHS' rate-setting process in Section 6.) This agreement was not renewed this year, and, as a result, starting at the end of December 1995, the rate-setting task must be performed by DPRS staff who are not experienced in performing these tasks. The following are concerns over DPRS' efforts to modify the existing rate-setting methodology:

- Although DPRS has collected contractor time study data which would help to refine the rate-setting methodology, this data has not yet been factored into the rate setting.

- The format of the 1994 cost reports required of contractors was modified in order to fit a proposed rate-setting methodology existing in February 1995. However, the February 1995 proposed rate-setting methodology was never adopted. Consideration has also been given at DPRS to not requiring contractors to submit 1995 cost reports. This would be detrimental to DPRS for the following reasons:

  - If DPRS implemented a revised rate-setting methodology and no cost report data had been collected, they would not be able to use the revised methodology.

  - If there are no 1995 cost reports, there will be no cost report field audits or desk reviews. These field audits and desk reviews are the primary auditing tools currently in use to monitor 24-hour care contractors. If contractors are not required to submit 1995 cost reports, their knowledge, education, and training on cost report preparation will suffer.

  - If there are no 1995 cost reports, DPRS will have no cost report data base from which to perform a risk analysis and begin contractor financial reviews.

Additionally, it should be noted that a rider to the General Appropriations Act, 74th Legislature, R.S., requires DPRS to examine the reimbursement methodology for Foster Care payments and determine the extent to which the methodology and the rates established under the methodology cover the median cost of allowable services. Another rider specifies that DPRS may not reduce Foster Care rates during the 1996-1997 biennium.

Section 7-B:

## Contract Provisions, Financial Monitoring, and Budget Approval for Cost-Reimbursement Contracts Is Not Sufficient to Ensure Contractor Accountability

DPRS' cost-reimbursement contracts do not always include contract provisions which hold contractors accountable for how contract funds are spent. Many contract budgets are set regionally with only limited guidance provided by agency headquarters in Austin. Further, the adequacy of DPRS' financial monitoring of cost-reimbursement contracts varies significantly between the types of contracts.

**Contracts do not consistently contain provisions which hold contractors accountable for how contract funds are spent.** Cost-reimbursement contracts for all of the programs reviewed did not include provisions which clearly specify allowable and unallowable costs or contractor financial reporting requirements. As the contractor is reimbursed for actual costs incurred, it is essential that contract provisions limit contractor expenditures to those reasonable and necessary for the operation of the program. In addition, most of the contracts reviewed contained no provisions requiring contractors to submit an annual audit report prepared by a certified public accountant. This requirement is usually standard for cost-reimbursement contracts.

**Many contract budgets are set regionally with only limited guidance provided or standardization imposed by DPRS headquarters in Austin.** DPRS' process for establishing budgets for cost-reimbursement contracts is not sufficient to ensure that the contract reflects the reasonable and necessary costs of providing services. The budgets for adoption brokers, in-home casework and case management, and preparation for adult living contracts are set regionally with only limited guidance provided by staff at DPRS headquarters. Although it is important to allow the regions a certain amount of flexibility in setting budgets so that differences in geography and demographics can be recognized, without providing some standard guidelines regarding the maximum amounts which should be paid for services, DPRS cannot be assured that it is paying the most reasonable amount for these services.

For example, DPRS has designated its own staff to serve as coordinators of the agency's Preparation for Adult Living (PAL) Program. DPRS also contracts to provide services such as training in association with this program. Therefore, the operation of this program is a joint effort on the part of the DPRS' PAL coordinator and the contractor providing the services comprising this program. In reviewing one PAL contract, we found that one of the agency's PAL coordinators would routinely send letters to the PAL contractor requesting that a variety of payments be made for miscellaneous goods or services that individuals such as foster parents or trainers had provided in association with the PAL program.

The goods and services were items such as airline tickets for trainers who provided PAL training, books and tuition for PAL program participants, and videos used in a PAL training session. Maximum allowable rates for these goods or services were not specified in the PAL contract. The letters sent by the agency's PAL coordinator to the contractor for reimbursement were not always accompanied by attached receipts or invoices to support the costs of the goods or services for which reimbursement was requested. The contractor felt obligated to make these payments, however, as the request for payment was coming directly from DPRS itself. We identified this issue as an additional weakness in the agency's internal controls.

The manner in which the agency's regional offices are allocated funds for contracting from the agency's legislative appropriations also impacts the establishment of contractor budgets. After legislative appropriations are made to DPRS, the total amount of funding available for each program is determined. Funds are then allocated for each individual program to each of the 11 regional offices based upon a different formula for each program. Uncertainty about the regional funding formulas may make planning and budgeting more difficult.

**The adequacy of the agency's financial monitoring of cost-reimbursement contracts varies based upon the contract type.** DPRS does not routinely monitor the financial records of cost-reimbursement contractors to determine appropriate use of funds. DPRS conducts an annual financial review of the services to Runaways and At-Risk Youth contractors. Although this review is not comparable to a full financial review of expenditures, it does include testing of a small number of salary, fringe benefit, travel, equipment, supply, and other expenditures.

On the other hand, in the case of other contracts such as In-Home Casework and Case Management contracts, Post Adoption contracts, PAL contracts, and Guardianship contracts, the extent of financial monitoring conducted is solely dependent upon the actions which may (or may not) be taken by DPRS regional staff to monitor the financial aspects of the contract. In other words, in the case of these contracts, there is no standardized statewide financial monitoring system in place.

Section 7-C:

## DPRS' Procedures for Awarding Contracts Should Be Improved to Better Ensure That the Best Contractors Are Objectively Selected

DPRS' contractor selection procedures do not ensure that the most qualified contractors are always selected. The process used to select the contractors varies significantly depending upon the type of contract.

**Selection of contractors through an enrollment process diminishes competition among contractors for obtaining initial contracts.** The use of an open enrollment process limits DPRS' ability to objectively select the most qualified and efficient contractors. Contracts for Child Placing Agency and Residential Treatment Center services are awarded contracts through the use of an enrollment process. The enrollment process requires that a potential contractor obtain a Child Placing Agency license or a Residential Treatment Center license and meet the Level of Care standards applicable to the level(s) of children that the potential contractor wishes to serve. Specifically, the potential contractor must first obtain a license through DPRS' Licensing Division, and the potential contractor is then subject to a Level of Care standards review by Youth for Tomorrow, a private contractor hired by DPRS to perform these types of reviews.

During the enrollment process, the potential contractor coordinates with an Institutional Placement Coordinator in the nearest DPRS regional office. Once the license is obtained and the Level of Care standards have been verified, a contract is initiated at the DPRS regional office and subsequently approved at DPRS headquarters in Austin. We verified that the enrollment requirements were met for a sample of Child Placing Agency contractors and Residential Treatment Center contractors, and we found no discrepancies.

According to DPRS officials, the process of selecting contractors through an enrollment process originated during a time in which the number of potential contractors was relatively low, and, consequently, it was believed that a competitive bidding process was not feasible. As reimbursement rates have increased in recent years, the number of potential contractors has also increased. However, DPRS continues to select contractors through the enrollment process.

DPRS has chosen to use the increased number of contractors as leverage in becoming more selective about the contractors with which it will place children. It is important to note that simply having a Child Placing Agency contract or a Residential Treatment

Center contract with DPRS does not guarantee that DPRS will place any children with that contractor or that the contractor will receive any payment from DPRS. In summary, in response to the increased number of potential contractors in recent years, DPRS has chosen not to change to a competitive bid process for contracts, but, rather, to become more selective about the contractors with which it places children.

DPRS' board has made recent changes to the rules governing the enrollment process which will enable DPRS to be somewhat more selective in contracting for 24-hour care. These rule changes will afford agency staff greater latitude in rejecting potential contractors through the enrollment process. The rule changes require the Office of Protective Services for Families and Children to inspect and approve the potential contractor's physical facilities and operations and assess the usable space and equipment, proximity, and access to needed resources and services and the potential contractor's capacity to protect the health and safety of children in its care.

**Contractors for certain types of contracts are informally selected by DPRS with no competitive procedures, while other types of contracts are awarded regionally through competitive procurement processes which are not standardized across DPRS regional offices.**

- **Adult Guardianship and Adoption Broker Contracts** - Traditional competitive procurement procedures are not used to select the Adult Guardianship and Adoption Broker contractors. In the case of the Adult Guardianship contract reviewed, DPRS attempted to informally locate contractors who were willing to provide this service. However, according to DPRS officials, very few contractors were willing to provide this service, and DPRS eventually had to contract with the few contractors who agreed to provide the service.

  Although DPRS is currently considering conducting a competitive procurement for this service, certain barriers to this type of procurement process exist. Once a legal guardian is appointed for an individual, this guardian is appointed for the individual's lifetime, and this would obviously conflict with a competitive procurement cycle in which new contractors could potentially be selected every few years. On the other hand, it should be recognized that, in contracting with only a few contractors, DPRS is also running the risk that, if those contractors fail to perform, the viability of the guardianship function itself could be at risk.

  The Adoption Broker contract was developed at one of DPRS' regional offices in response to a perceived problem involving DPRS' ability to contract with adoption agencies in a timely manner. (Although in effect during the period being audited, it should be noted that this contract is no longer in use.) Through the Adoption Broker contract, DPRS' regional office designated a contractor to act as a reimbursing agency for the adoption agencies through which DPRS placed children.

  At the time this broker contract was developed, the DPRS regional office felt this contract was necessary because it was taking too long for DPRS to contract directly with adoption agencies. Through the broker contract process, DPRS only

had to contract with a single reimbursing agency, which, in turn, would contract with numerous adoption agencies. The particular contractor with which the DPRS regional office chose to enter into the broker contract was chosen based upon the fact that the regional office had done business with this contractor in the past and felt it could provide the service. No competitive selection procedures were used.

Although this contract is no longer in use, the need for this type of contract sheds light upon contracting inefficiencies at DPRS, and it serves to illustrate the autonomy of DPRS' regional offices in the contracting process. It also demonstrates a situation in which competitive procurement procedures could have been, but were not, used.

- **In-Home Casework and Case Management and Preparation For Adult Living Contracts -** The In-Home Casework and Case Management and Preparation for Adult Living contractors were selected through a competitive procurement process which varied depending upon which of DPRS' regional offices awarded the contract. For each of these contracts, the DPRS regional office is responsible for developing its own Request for Proposal (RFP), soliciting bids, evaluating bids, and selecting contractors. Without a standardized process for contractor evaluation and selection, there is no assurance that the best contractors have been fairly and objectively selected.

  Two issues were presented in a September 1994 State Auditor's Office report titled *A Review of Management Controls at the Texas Department of Protective and Regulatory Services* (SAO Report No. 95-003). This report stated that each region's contracting function operates independently and is not required to follow a statewide process. In addition, this report indicated that regional contract managers are self-trained on the job through the use of the *Contract Administration Handbook*, and that, without centralized oversight of contract personnel, there is an inability to detect or correct inaccurate or inconsistent contract practices. During this review, we concluded that these conditions still existed.

- **Post Adoption Services and Services to Runaways and At-Risk Youth Contracts -** The Post Adoption Services and Services to Runaways and At-Risk Youth contractors were selected through competitive procurement procedures which were managed by staff at DPRS headquarters in Austin. In the case of Post Adoption services, headquarters issued the RFP and evaluated bids, and the bid evaluations were then sent to the various DPRS regional offices for final contractor selection and negotiation. We reviewed the procurement procedures used to select contractors for Post Adoption Services during fiscal year 1994 and found that this process appeared to result in an unbiased selection of contractors. We found that the RFP provided clear specifications, all qualified proposals were scored consistently, and that proposals which did not meet the minimum qualifications were not considered. No weaknesses in this contractor selection process were identified.

We also reviewed the February 1995 procurement procedures used to select contractors for Services to Runaways and At-Risk Youth contractors. We found that, in general, this process appeared to result in an unbiased selection of contractors, that the RFP provided clear specifications, and that all qualified proposals were scored consistently.

Recommendations:

We commend DPRS' efforts to form a new Contracts Office and implement a formal system for monitoring the financial aspects of its contractors. DPRS should ensure that this office implements a process which includes the elements of a contractor risk assessment procedure to select contractors for review, periodic on-site reviews of the financial records of high-risk contractors, and follow-up procedures to ensure the financial issues identified at contractors have been resolved.

In addition, we acknowledge that the enrollment process allows DPRS to contract with a wide variety of contractors in various geographical areas of the State and that this process also allows DPRS to have more selection among the contractors with which DPRS will place children. However, as this selection process does not provide for a high level of competition among contractors for initial contracts, it also results in a relatively high number of contracts which must be approved and monitored.

We recommend the following:

- Take action to promptly comply with the legislative requirement to examine rate-setting methodology. Efforts in this area should include work to address and correct the known weaknesses in the current rate-setting methodology. DPRS should also establish a time frame within which this methodology will be revised.

- Continue to require all contractors for 24-hour care services to submit cost reports annually, but make attendance at cost report training mandatory for all contractors. If cost reports continue to be used as a basis for establishing unit rates, methods to verify the accuracy of provider-reported cost data should be strengthened. The number of field audits should be sufficient to provide reasonable assurance that the reported costs are accurate. Stronger sanctions should be developed and implemented for reporting false data on cost reports. In addition, cost report training should be mandatory for all programs.

- Review and amend each contract type to ensure that the contracts contain clear provisions which set forth the definitions of allowable and unallowable costs under the contract. Additionally, DPRS should review and amend its contracts to ensure that the contracts contain adequate provisions describing the process by which funds spent on unallowable costs will be refunded to DPRS.

- Add provisions to the Child Placing Agency contracts which ensure that DPRS is in compliance with all regulations regarding the amount of the daily unit rate a Child Placing Agency may retain prior to paying the actual foster care home.

- Given the increased number of potential contractors which did not exist when DPRS initially began using the enrollment process, the agency should perform an analysis to determine whether 24-hour care contractors should continue to be selected through an enrollment process, or whether a selection process involving the submission of competitive bids should be implemented.

- Enhance the guidance regarding contractor selection procedures provided to regional offices. For example, guidance should encompass things such as maximum recommended payment rates for contracted services, the necessary elements of an RFP and a competitive contractor selection process, and centralized contracting training sessions through which regional office staff could obtain formal instruction regarding the contracting process.

- Whenever possible, strive to contract with potential contractors through competitive procurement procedures. Reasons for not awarding contracts through a competitive process should be thoroughly documented and approved by DPRS headquarters staff.

Section 8:

## The Department of Health's Contractor Selection, Financial Monitoring, and Budget Approval Processes Require Strengthening to Ensure Contractor Accountability

Current processes used by TDH to award contracts, establish rates and contract budgets, and monitor financial performance do not consistently ensure that:

- only reasonable and necessary costs are charged to the contract
- contractor compensation (contract rates and budget amounts) is aligned with the cost to provide services
- the best contractor is objectively selected

However, we did find that cost-reimbursement contract provisions are generally designed to hold contractors accountable for spending public funds appropriately. We reviewed eight TDH providers whose contracts totaled over $10.2 million. Figure 7 (on the following page) shows the programs included in our review and a summary of the selection and rate-setting methodology for each:

Figure 7
**Summary of TDH Contracts Reviewed**

| Program | Contractor Selection | Payment Methodology |
|---|---|---|
| **HIV/AIDS**<br>Ryan White/Title II CARE Grant;<br>Housing Opportunities for People with AIDS (HOPWA);<br>State Services Grant | Selection for these programs generally entails a two-step process:<br><br>First, TDH contracts with 26 administrative agencies (one in each of the 26 HIV Service Delivery Areas throughout the State) who are selected by a consortia of local organizations and individuals. Each consortia selects an administrative agency using its own locally developed criteria.<br><br>Second, administrative agencies use a competitive bid process to select subcontractors and award contracts. (Administrative agencies can also provide services and may contract for those services they do not provide.) | TDH allocates total grant funds for these programs to the administrative agencies using a formula which considers total AIDS cases, area population, and estimates of persons living in poverty.<br><br>All HIV contracts are cost-reimbursement. |
| **HIV/AIDS**<br>Early Intervention Program (EIP); Education | Competitive bid process. | Contracts are cost-reimbursement with a maximum contract amount. Maximum amount is awarded based on proposed budget, amount of funding available, and whether the project plan is reasonable. |
| **Maternal Child Health Care (Title V)** | Competitive bid process, but Requests for Proposals are sent only to current contractors. | Cost-reimbursement until FY 1995; now, fee-for-service. Fees based on Medicaid rates. |
| **Family Planning (Title X)** | Current providers generally renewed after submitting an application; new providers selected using a competitive bid process. | Cost-reimbursement. |
| **Family Planning (Title XX)** | Current providers generally renewed after submitting an application. | Fee-for-service; fees based on Medicaid rates. |

Figure 7 (concluded)

| Program | Contractor Selection | Payment Methodology |
|---|---|---|
| **Medical Transportation** | Competitive bid process. | Unit-rate negotiated between TDH and contractor based on budget and estimated regional need for services. |
| **Women, Infants, and Children (WIC) Nutrition Program** | Existing contracts automatically renewed; new contractors are informally selected. | Cost-reimbursement up to a maximum amount. The maximum amount is calculated using unit rates for seven levels of providers.<br><br>(Rate scales are based on provider salaries, rent, and benefits. Rate tables were developed in approximately 1978 with adjustments to tables and additional scales developed over time. Providers are assigned to one of the seven rate scales based on provider salaries, population density, number of clinics, and the size of the provider.) |

Section 8-A:

## Contract Budget Approval and Contractor Selection for Cost-Reimbursement Contracts Should Be Strengthened

While contract provisions used by TDH generally hold contractors accountable for how they spend contract funds, TDH's process for evaluating proposed budgets for cost-reimbursement contracts is not sufficient to ensure that maximum contract amounts reflect only the reasonable and necessary costs to provide services. Our review of TDH service providers identified $297,294 in questioned costs for the cost-reimbursement contracts reviewed. For purposes of this report, questioned costs include costs which are either:

- not reasonable and necessary to the program objectives
- are specifically disallowed by state or federal guidelines
- do not conform to requirements or limitations set forth in the conditions of the contract award

Furthermore, the competitive processes used to select providers do not always ensure that the best contractor receives the award. During the period of our review, TDH's HIV/AIDS, Title X (Family Planning), and Title V (Maternal Child Health Care) programs used cost-reimbursement contracts.

**Contracts Include Many of the Provisions Necessary to Ensure Contractor Accountability.** Cost-reimbursement contracts for the programs reviewed include the provisions necessary to hold contractors accountable for the appropriate use of public funds. TDH has developed a general contract which contains sufficient provisions for financial reporting and monitoring. Each program tailors the general contract to meet

its needs, and none of the programs tested weakened the provisions of the general contract. The general contract requires:

- providers to submit routine financial reports
- contractors receiving $25,000 or more in total federal/state financial assistance to obtain an agency-wide independent financial and compliance audit
- contract expenditures to comply with federal cost principles for allowability
- providers to refund any funds claimed and received which TDH determines to be ineligible for reimbursement
- providers to develop, implement, and maintain financial management and control systems that meet or exceed the requirements stipulated by the Uniform Grants and Contract Management Act

Although these general provisions are only intended to apply to cost-reimbursement contracts, we found that TDH included the same provisions in the Family Planning (Title XX) contract, which reimburses contractors a fixed rate on a "fee-for-service basis." However, during our review of a Title XX provider, we found that TDH personnel had told the provider verbally that it was not required to adhere to the contract provisions. Once a contract has been signed and executed by both parties, any changes to the requirements should be made with a written contract amendment.

**TDH Does Not Have A Formal Process for Determining the Reasonableness of Contractor Budgets**. Evaluation of budgets proposed by contractors is not adequate to ensure that the final and approved budget reflects a fair and reasonable amount for the purchased services. As cost-reimbursement contracts provide little incentive to spend less than the maximum specified in the contract, it is essential that the final budget reflect the most appropriate use of state funds. We found the following weaknesses in processes used to establish the final approved budgets:

- The HIV Bureau reviews proposed budgets for reasonableness based only on experience with other providers. Ranges of acceptable costs by category have not been developed, and no documentation that determines the costs to provide services is maintained. In fact, during our review of providers' proposed budgets, we found three instances in which contractors received more funding than they requested:

  - One provider requested $25,675 in HIV/AIDS Early Intervention Projects (EIP) funds but was awarded $37,553 (46 percent more than was requested).
  - Another EIP provider requested $21,336 but was awarded $31,336 (47 percent more than was requested).
  - One HIV/AIDS State Education provider requested $36,078 but was awarded $43,471 (20 percent more than was requested).

- Title X (Family Planning) budgets are reviewed for reasonableness; however, there are no written guidelines on what is reasonable. In reality, maximum contract amounts are set regionally based on the availability of funds.

Without thorough analysis of proposed budgets, TDH does not have adequate assurances that maximum contract amounts are based on the most appropriate or cost-effective use of public funds.

**Current Fiscal Oversight Process Should Be Strengthened To Allow Follow-Up Opportunities in Areas of High Risk.** In order to ensure that contractors use state funds in accordance with the terms of the contract, the Grants Management Division performs at least biennial fiscal reviews of providers who receive $25,000 or more per year from state and federal sources at least once every two years. The fiscal reviews include the following:

- completing an internal control questionnaire
- reconciling reported expenditures for a given quarter to provider records
- testing expenditures and supporting documentation for one month

During their review, monitors select one month from a sample quarter to trace expenditures to quarterly budget reports and supporting documentation. If questioned costs are identified in the sample, TDH either requests reimbursement for the questioned amount or withholds that amount from future reimbursements. *However, additional months are not routinely tested to ensure that similar expenditures were not made and claimed in other months.*

All eight of the TDH providers we reviewed had been reviewed by TDH prior to our audit. However, our review of providers still found instances of potential questioned costs and weaknesses in providers' systems of internal controls not identified by the TDH audits. For example:

- We reviewed one HIV/AIDs provider and found $102,299 in questioned costs. Examples of the questioned costs include:

  - Payments of $7,923 made to a related party for purchases of equipment made without the benefit of a competitive procurement process and questionable telephone repair services such as turning the phone ringer on and plugging a power cord into the wall.
  - $10,000 in purchases made on the last day of the contract. The items purchased were not disbursed to clients during the contract period.
  - $1,780 in expenditures which were overallocated to TDH and $3,115 in payments made without the documentation required by program standards.

- At another HIV/AIDS provider, we found over $5,400 of expenditures which were made without obtaining the documentation required by the contract.

Although the financial reviews provide some assurance that funds are used appropriately, limiting the reviews prevents monitors from detecting additional instances of inappropriate expenditures.

**Competitive Processes Used to Select Cost-Reimbursement Contract Providers Do Not Ensure that the Best Contractor Receives the Award.** The current processes used by TDH to award its cost-reimbursement contracts do not ensure that the best contractor is fairly and objectively selected. For contracts which are competitively awarded, the effectiveness of the competitive process is hindered by awarding contracts to other than the highest ranked bidder and by the lack of clear criteria for proposal evaluation. Other programs limit competition to existing contractors. Contract renewals for these programs are based solely on a review of provider applications for continued funding.

TDH uses competitive bidding to select contractors for the HIV/AIDS Early Intervention Projects (EIP) and Education Grants Programs. The criteria used to evaluate potential contractors are included in the Request for Proposal (RFP), and an evaluation instrument with points for each criterion is developed for raters to use in scoring the proposals. Two internal and two external reviewers as well as regional staff use the evaluation instrument to score the proposals. A combined average score is calculated for each proposal and is to be used to select the provider for contract award.

However, the proposal with the highest combined average score in a region or city is not always the provider selected. For example, in our review of awards of EIP and Education Grant funds, we found:

- In 5 of the 8 groupings of providers by region, EIP contract awards were made to providers who did not have one of the grouping's highest combined average scores.

- Three EIP applicants from one regional provider grouping had higher average scores than 6 of the 9 providers who were ultimately awarded contracts. (Two of these three providers were awarded one-time funding, however.)

- For the Minority Education awards, 2 of the 13 applicants from a major metropolitan city received contracts. Three applicants from this same city did not receive funding but had higher average scores than one or both of the providers who received contracts.

Additionally, raters' scores of provider proposals vary considerably. For example, for the nine providers who received EIP contracts, low and high scores varied by as much as 46 points (of 110 points maximum). This suggests that the evaluation instrument's criteria are not clearly defined. TDH does not train evaluators on the use of the instrument and relies on the reported expertise of the external raters to ensure understanding of the evaluation instrument.

In some cases, TDH limits competition to current providers. By limiting competition to current providers, TDH does not have adequate assurances that the best contractor is selected to provide the services. During fiscal year 1994, competition for the Maternal Child Health Care (Title V) programs was limited to current providers. RFPs were sent only to existing providers. Family Planning (Title X) contracts are automatically awarded to existing contractors (unless there are significant unresolved

problems). New providers are solicited only if additional funds become available during the year. Beginning in fiscal year 1996, TDH plans to open competition for Title V and Title X funding to all parties interested in providing the services.

Section 8-B:

## Controls Over Unit-Rate Contracts Do Not Prevent the Inefficient Use of Public Funds

Current controls over unit-rate contracts are not adequate to ensure the appropriate and effective use of public funds. Unit-rate contracts reimburse the contractor a fixed rate for each unit of service delivered without respect to the actual costs of providing the services. Instead of monitoring the appropriateness of provider's expenditures made under unit-rate contracts, TDH relies on developing contract rates which reasonably align with providers' costs to provide services to ensure that its contracting dollars purchase the most possible services. However, current processes for developing these rates are not adequately controlled or documented to ensure rates align with costs. Additionally, although some programs will use competitive bidding to award future contracts, competition for past unit-rate contract awards has been limited.

**Provider expenditures made under unit-rate contracts are not monitored.** TDH does not typically test expenditures to determine the reasonableness and allowability of expenses for unit-rate contracts. The only financial aspect of unit-rate contracts reviewed by TDH is provider billings. The Grants Management Division selects a sample of client files to review documented services against provider billings for the Title V and Title XX programs. Although regional managers monitor Medical Transportation providers, the monitoring focuses on how well providers maintain financial and programmatic records, not on how providers spend their funds.

Because the WIC Program reimburses actual expenses up to a maximum amount calculated using predetermined unit rates, the WIC Program does review selected provider expenditures. WIC has its own monitoring division (separate from Grants Management) which is responsible for financial, compliance, and performance monitoring of WIC providers. WIC monitors conduct biannual on-site reviews of providers in which they:

- Check for compliance with program policies (as required by WIC regulations).
- Determine that costs associated with the program are allowable and that prior approval was obtained for certain expenditures.
- Review enrollment records to determine that reimbursed funds were calculated accurately.

We reviewed one WIC provider and found no material questioned costs. However, because the unit rates developed for WIC contracts are subjectively determined, TDH still does not have adequate assurance that providers are reimbursed only for reasonable and necessary costs.

**Rates do not align with costs to provide services.** TDH has not developed its rates using formal methodologies which ensure contract compensation does not exceed the reasonable and necessary costs to provide services. Because expenditures made under unit-rate contracts are not subject to the same controls that expenditures made under cost-reimbursement contracts are, strong controls over the process used to develop unit rates are critical to ensure providers receive only fair and reasonable compensation to provide services. However, TDH's rate-setting processes do not provide these assurances. Specifically:

- WIC providers are reimbursed actual costs up to a maximum amount as calculated using predetermined unit rates. However, the unit rates which serve as "caps" on provider reimbursements have not been systematically calculated based only on necessary costs to provide services. Instead, the unit rates have evolved over time. According to TDH management, initial rates were established based on historical provider expenditures, but there is no documentation of the actual methodology used to develop these rates. Additionally, there are no written procedures on changing the rate scales, and there is no documentation showing how and when rates were increased in the past.

- Fee-for-service amounts for Title V (beginning in 1995) and Title XX programs are based on Medicaid rates. However, for some services, the Title V and Title XX fee-for-service rate differs from the Medicaid rate, and this variation is not based on a cost analysis.

  - Title XX rates have not increased with increases in Medicaid rates. Title XX rates for new services (services not included in the Medicaid rates) are determined by analyzing the costs to provide that service. TDH determines the fair market cost of any products used in delivering the service, plus a subjective "mark-up." The labor costs to deliver the services is determined by surveying providers to obtain a cost estimate. The estimated product cost and labor cost are combined to obtain the unit rate for these services.

  - Title V rates are based on Medicaid, with the exception of services which include outreach and case management activities. Since Medicaid does not allow for outreach and case management services, the Title V rates for procedures which include these services have been increased by 50 percent for prenatal and child health visits and by 25 percent for all other services. These increases are not based on analysis of the costs to provide these services, but have been subjectively determined. Therefore, it is difficult to ensure that these rates align with the cost to provide services.

**Competition for awarding some programs' contracts is limited, and the results of proposal evaluations are not always adequately documented.** Because TDH is trying to expand the number of current WIC providers, contracts with existing WIC providers are automatically renewed (barring performance problems). New WIC contracts are awarded to providers that submit applications that meet federal criteria for service providers. In the past, TDH has not adequately documented its review of provider applications. The procedures and criteria for evaluating contractors' proposals

are also not documented. As a result, TDH does not have adequate assurances that only qualified providers are awarded contracts. Additionally, should the personnel who currently review provider applications leave the agency, new personnel would not have the necessary information to fairly and consistently review applications.

According to TDH management, provider proposals are reviewed by the WIC Bureau Chief and four department directors who evaluate:

- whether the provider would be financially viable in six months by serving the proposed number of clients in its area
- the quality of personnel employed to provide services
- the provider's ability to provide related health services
- any findings from past reviews (for existing providers)

However, because TDH does not maintain files on its selection process, we could not verify that TDH's process fairly selects the best contractor for WIC services.

Medical Transportation contracts are competitively awarded every four years. Proposals are evaluated against criteria set forth in the RFP by a panel of regional personnel. However, the scoring sheets for evaluating the proposals do not contain guidelines to assist the review panel in scoring proposals.

Title XX (Family Planning) providers are automatically renewed (unless there are unresolved problems) without the benefit of competition. When additional funds become available, TDH selects new providers using competitive bidding. However, the only evaluation tool used for evaluating Title XX applicants is a checklist to ensure all required items are submitted. One criteria listed on the application review checklist for Title XX applicants is whether the provider spent all the previous year's dollars. Without clearly defined evaluation criteria, raters may inconsistently evaluate providers, and the most qualified provider may not be selected to receive the contract.

Recommendations:

- Grants Management should expand testing of expenditures when significant amounts of questioned costs or particular categories of questioned costs are found in its one-month sample.

- Negotiation of unit rates should be conducted by individuals experienced in contract negotiation, and rates should be checked for reasonableness prior to final contract award.

- The selection of WIC providers should be documented and should be made against predetermined criteria for award.

- Scoring sheets for all programs which use a competitive award process should be developed which define acceptable and unacceptable levels of performance for

each criterion used to evaluate proposals. Evaluation criteria should be included in the RFP.

- Guidelines for reviewing the reasonableness of proposed budgets for cost-reimbursement type contracts should be developed. Guidelines should include criteria for evaluating proposed administrative and other fixed expenses relative to service costs.

- Contracts should include only those provisions with which providers will be expected to comply. Changes to contract provisions should be documented in writing and signed by both TDH and the provider so that no misunderstandings regarding performance or reporting requirements can occur.

- The methodology and assumptions for developing rates for unit-rate contracts should be documented and formalized.

Section 9:

## The Department of Mental Health and Mental Retardation's Contract Administration over Purchased Services Does Not Ensure That the State Receives the Best Value for its Contracting Dollars

Weaknesses in TDMHMR's contract administration of unit-rate contracts, as well as in the calculation of the unit rates themselves, prevent the agency from ensuring that contractors are only compensated for the reasonable and necessary costs of providing services. In addition, the processes used to establish the budgets for the Community Mental Health and Mental Retardation Centers (Community MHMR Centers) and to monitor contractors do not ensure that public funds are used in the most cost-effective manner.

TDMHMR administers several different types of contracts for purchased services, and the agency's contractor selection procedures vary depending upon the type of contract. However, it is important to recognize that TDMHMR is obligated to award certain contracts using specific procedures. We reviewed four TDMHMR providers whose contracts totaled over $19 million. The types of contracts reviewed during this project, as well as the corresponding contractor selection procedures and payment methodology, are listed in Figure 8.