

- **Use competitive procurement procedures whenever possible.**

We agree that competitive procurement should be used whenever *practical*. Although there are instances where competitive procurements are possible, such procurement may not be practical. For example, in the WIC program it is difficult to obtain any contractors in certain areas of the State. Not only does the Department have a considerable investment of equipment and training in the current contractors, federal regulations limit the selection of contractors to health providers. We do, however, support the concept of competitive procurement and plan to expand such procurement to the extent practical.

## TDH COMMENTS ON SPECIFIC RECOMMENDATIONS TO TDH

- We agree. Grants Management does expand testing of expenditures when significant amounts of questioned costs or particular categories of questioned costs are found in its one-month sample.
- We agree. The report does not indicate any concern with the experience levels of unit-rate contract negotiators. To the contrary, the report indicates concern should the current WIC evaluators leave the agency.
- We agree. While the selection of WIC providers is currently made against predetermined criteria, the criteria and the process will be better documented.
- We agree. Scoring sheets for all programs that use a competitive award process that do not currently have such tools will be developed. The evaluation criteria will define acceptable and unacceptable levels of performance for each criterion and be included in the RFPs.
- We agree. Guidelines for reviewing the reasonableness of proposed budgets for cost-reimbursement type contracts will be developed. The guidelines will include criteria for evaluating administrative and other fixed expenses relative to service costs.
- We agree. We are currently developing different types of contracts to include only those provisions that apply to that particular type of contract.
- We agree. The methodology and assumptions for developing rates for unit rate contracts will be formalized and documented.

Texas Department of  
Mental Health and Mental Retardation

Don A. Gilbert, M.B.A.  
Commissioner



January 25, 1996

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Cindy Reed, Project Manager  
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Dear Cindy:

Attached are the responses to the draft findings for the Contract Administration at Health and Human Services Agencies (CM-3)-Audit Report. If you have any questions, please contact Tom Martinec, 323-3147.

Sincerely,

A handwritten signature in black ink, appearing to read "Don Gilbert", written over a horizontal line.

Don Gilbert  
Commissioner

## **Responses to SAO Draft Audit Report on Contracts Management**

### **Recommendation**

Develop and implement contract provisions designed to hold all contractors accountable for the appropriate and effective use of state funds.

### **Response:**

All contractors should be held accountable for services purchased by the state, but the solutions offered under this recommendation and others are the most costly to administer for large state-wide programs. The Department is currently working along with other health and human service agencies in developing recommendations and processes addressing contract management from a system perspective. Important areas being addressed by these agencies including the strengthening of contract language along with various legal issues. The HHSC agencies have developed a recommendation that the agencies immediately use the full range of sanctions available to them, and identify these sanctions in the contract.

Additionally, community centers are required to follow federal cost principles (e.g., OMB Circular A-87 regarding allowable and unallowable costs), and are required to have an annual Single Audit performed by independent CPAs. These CPAs are responsible for assessing each community centers' internal controls and compliance with applicable laws and regulations, including cost principles. In addition, efforts are being made to improving the quality and scope of these independent auditor reviews.

### **Recommendation**

Develop methods of establishing contractor payments that reflect only the necessary and reasonable cost of providing services.

### **Response:**

The Department agrees that a standardized methodology should be used to identify elements of cost to be used in determining the contracted rate, but private providers cannot access the hotel and travel discounts available to the State of Texas.

Total costs do not vary that dramatically across the state for all programs, so varying rates on a geographic basis or through year-end settlements would not be cost effective for all programs.

We agree that sanctions should be strengthened to assure that cost reports are accurate and to deter reporting of false data on cost reports. We also agree that cost report training should be mandatory for all providers.

### **Recommendation**

Establish centralized oversight responsibility for contract management of service providers, in particular, fiscal monitoring.

**Response:**

As stated previously, the Department, along with other health and human service agencies, is working towards making recommendations and developing processes that would address contract management from a HHSC system perspective. An important part of this initiative is the coordination of monitoring activities to eliminate duplication of effort, while allowing each agency the authority to monitor/sanction its own contracts. Potential recommendations in this area include coordinated Single Audits of contractors and development of best practices models among agencies.

**Recommendation**

Enhance its procedures for monitoring the financial aspects of its contracts. The Department should ensure that these procedures include 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.

**Response:**

We agree. The Department is currently working on strengthening the fiscal monitoring of the the community centers. The Department is also involved with the other health and human service agencies in developing a formal risk assessment process to be used in establishing fiscal and programmatic contract monitoring plans. As stated previously, the community centers' independent auditors are responsible for examining the centers' internal controls and compliance with cost principles. The Department is currently working towards improving the quality of these independent auditors' work so that it can used in fiscal monitoring of contractors.

**Recommendation**

Review and amend each of its contracts to ensure that the contracts contain clear provisions which set forth the definitions of allowable and unallowable costs under the contract. Additionally, the Department should review and amend its contracts to ensure that the contracts contain adequate provisions describing the process by which unallowable expenditure amounts will be refunded to the Department.

**Response:**

We agree. The refund of unallowed expenditures is applicable to community centers. The community centers' independent auditors are responsible for ensuring that the centers comply with federal and state cost principles, including the allowability of certain costs. The Department has taken the position that it may recoup funds that have been used inappropriately (services to persons not within the priority population). Controls are currently in place to ensure the recoupment of funds. With regard to funds that may be used inefficiently, the Department's most toward limiting indirect costs is a positive step. As costs are identified, the Department can judge community center efficiency more accurately.

Additionally, the Department is working along with other health and human service agencies in implementing contract language that would more easily allow the recoupment of unallowable costs. The HHSC agencies have developed a recommendation that the agencies immediately use the full range of sanctions available to them, including recoupment of funds, and identify these sanctions in the contract.

**Recommendation**

Take action to promptly comply with the legislative requirement to examine its rate-setting methodologies for the ICF-MR contracts and the home and community-based services contracts. Efforts in this area should also include work to address and correct the known weaknesses in the current rate-setting methodologies.

**Response:**

TDMHMR is presently working on reviewing the reimbursement methodology for both the ICF-MR and the Home and Community-Based Services. Deloitte and Touche have been engaged by the Department to develop new reimbursement methodologies in FY96. Issues concerning the current rate-setting methodologies have already been addressed.

**Recommendation**

Take action to promptly address and correct each of the weaknesses in the Department's contracting process identified by Department internal auditors. As part of this effort, the Department should ensure that contract managers receive formal training in contract negotiation, financial analysis, and contract management. In addition, the funding allocation process should be refined to better reflect the actual cost of providing services, as well as the individual needs of the particular area which the contractor will serve.

**Response:**

The Department agrees that financial training and standardized evaluation criteria would benefit all parties involved in the contracting process. The Department is considering offering formal training to contract managers, or seeking this training outside of the Department. Additionally, contract managers will soon receive financial ratio information about the various community center, as well as instruction on the use of this information as a contract management tool.

## Objective, Scope, and Methodology

### Objective

The primary objective of this project was to identify instances of fraud, waste, or abuse of taxpayer funds and to determine specific systemic weaknesses at the Department of Human Services, Department of Protective and Regulatory Services, Department of Health, and Department of Mental Health and Mental Retardation which would allow such instances to occur. To accomplish this, we focused on determining the following:

- Do service providers spend state funds appropriately and efficiently?
- Do procedures used to select contractors ensure that the best contractor is fairly and objectively selected?
- Do the rate-setting methodologies used to establish reimbursement rates for unit-rate contracts ensure that the State pays a fair and reasonable price for the services?
- Do procedures used to establish contract budgets for cost-reimbursement contracts ensure that the State pays a fair and reasonable price for the services?

### Scope

The scope of this audit included purchased client service contracts for the four agencies specified above. The contract period varied between agencies and programs, but generally we reviewed records for the contractors' most recently completed fiscal year (in most cases fiscal year 1994).

We reviewed the financial records of 20 service providers who provide client services for the four agencies specified above. The majority of the service providers were selected randomly from a list of 100 service providers who received the most funding in fiscal year 1994 from the four agencies included in our review. We also focused our selection on contractors who received funding from more than one state agency. Our work included review of 55 contracts totaling over \$79 million. The contracts covered 35 different programs from the four funding agencies.

Providers were given a copy of all potential findings and questioned costs and were asked to submit additional information which might clear the findings. The questioned costs contained in this report have been reduced accordingly for any information subsequently submitted by the service provider.

Our work at the four funding agencies included the following areas:

- contract provisions
- contract monitoring methodologies, policies, and practices
- contractor selection policies and practices

- rate-setting methodology, policies, and practices
- processes used to establish contract budgets

### **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 Department of Human Services, Department of Protective and Regulatory Services, Department of Health, and Department of Mental Health and Mental Retardation
- Interviews with executive directors and accounting staff from the 20 service providers
- Interviews with staff from the Health and Human Services Commission
- Documentary evidence such as:
  - Policies and procedures related to contract administration and rate-setting practices at the four funding agencies
  - Applicable federal and state statutes and guidelines
  - Contract files/contractor selection files from the funding agencies
  - Accounting policies and procedures used by the service providers
  - Service providers' board minutes

Procedures and tests conducted:

- Review of sufficiency of contract provisions and tests of provider compliance with contractual terms
- Tests of service providers' revenue transactions to determine if revenue was properly accounted for
- Tests of service providers' expenditures to determine if expenses were reasonable and necessary to the program objectives and specifically allowed by state or federal guidelines where applicable
- Tests of service provider billings to the funding agencies to determine if services billed for were rendered and if services were only billed to one funding source
- Tests of the contractor selection processes at the funding agencies to determine if the best contractor was objectively selected
- Tests of cost reports prepared by service providers to determine accuracy of information used in the rate-setting process
- Review of the process used to evaluate contract budgets proposed by service provider

Criteria used:

- Best business practices related to contract administration
- Federal guidelines and cost principles: OMB Circulars A-87, A-122, A-110, and A-102 and Federal Acquisition Regulations 48 CFR Ch. 1
- Contract management model developed by the State Auditor's Office



- Department policies and procedures
- Cost report methodology for applicable programs
- Standard audit criteria

Fieldwork was conducted from August 8, 1995 through December 15, 1995. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Auditing Standards
- Generally Accepted Government 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)
- Julie L. Cleveland
- Susan P. Driver, CPA
- Leslie Bavousett, CPA
- Kimberly Bradley
- Eric B. Corzine
- Janice Engler
- Francine Gutierrez
- J. Frank Guerrero
- Kevin Hannigan
- Mattye Keeling
- Nancy L. McBride
- Kelley Martin
- Angelica Morales-Carrillo
- Marilyn Polston
- Monday Rufus, CPA
- Ryan G. Simpson
- Mary Beth Whitley
- Kay Wright Kotowski, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Also, personnel from the Internal Audit Divisions of the Department of Human Services, Department of Protective and Regulatory Services, Department of Health, and Department of Mental Health and Mental Retardation assisted us in our work.

## Key Points from Selected SAO Reports on Contract Monitoring

***An Audit Report on Contract Administration at the  
Texas Youth Commission  
September 1995  
SAO Report No. 96-005***

### **Key Facts and Findings**

- Contractors for the Texas Youth Commission are not adequately monitored to ensure quality services are provided. None of the 46 contract files randomly selected for review had documentation that the service provider had been monitored on a quarterly basis as required by Commission policy. Four of these contracts were renewed with contractors despite current performance problems.
- The Commission has developed outcome and output measures to gauge the performance of residential care contractors. However, our review found that the Commission's monitors rely on performance measure reports primarily only when preparing annual provider evaluations and not for routine, ongoing assessment and monitoring of provider performance. As a result, available performance data is not used to maximize and focus limited monitoring resources.
- The Commission's current level of fiscal oversight is not sufficient to ensure that the agency receives the best value for its contracting dollar. The Commission does not systematically set rates for contracts and does not adequately monitor contractor financial controls or the use of start-up funds. Our review of Commission service providers found that the rates paid to contractors sometimes exceeded the costs to provide services as evidenced by an accumulation of fund balances. For the three providers we reviewed, fund balances totaled over \$1.6 million. There are no current state statutes which require the Commission to limit contractors' expenses to certain categories of cost. However, this should not preclude the Commission from including reasonable limitations in its contracts.
- The majority of existing contracts at the Commission were not awarded using a competitive bid process. Only 11 of the 46 contracts we reviewed were awarded using a Request for Proposal. While state statute requires the Commission to select contractors based on qualifications and demonstrated competence of the provider, the majority of contracts we reviewed were awarded based only on recommendations by regional directors and contract monitors.

***A Review of Contract Monitoring of Purchased Services***  
**October 1994**  
**SAO Report 95-007**

**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.

***A Management Control Audit of the Texas Commission  
for the Blind  
October 1995  
SAO Report No. 96-008***

**Key Facts and Findings**

- The Texas Commission for the Blind furnishes blind and visually impaired Texans with information needed to make informed decisions and access to services which increase their opportunities for employment or self-sufficiency. With 556.11 full-time equivalent employees, the Commission served 23,494 consumers through various programs during fiscal year 1994. Total appropriations for the year were \$39,060,851.
- Two agency oversight functions, the Board of Directors and internal audit, were not providing sufficient guidance in Commission policy and providing necessary feedback on its programs and operations.
- Although the Commission recognized the need to improve its automated information systems in its current Information Resources Strategic Plan, the Information Resources division still lacks sufficient experienced staff, management controls, and technology to effectively support the agency's programs and administrative needs.
- The purchasing and contract administration processes are not fully developed. Without established and documented benchmarks and performance standards, the agency does not have adequate means of evaluating its purchasing employees' and contractors' performance.
- Agency staff do not verify the approximately \$14 million in sales from the Business Enterprise Program facilities and unmanned vending operations. As a result, there is a continued risk that BEP managers and vending machine companies will underreport the income from their predominantly cash businesses.

***An Audit Report on Management Controls at the  
Texas Rehabilitation Commission***

**October 1995**

**SAO Report No. 96-012**

**Overall Conclusion**

The Commission generally has effective management controls, but it does not have a fully developed contract management system to ensure quality provider services at a reasonable cost.

**Key Facts and Findings**

- The Commission's records show that it spent approximately \$121 million on services for clients during fiscal year 1994, but it has developed formal contracts for only \$2 million. While developing contracts with providers for all client services may not be feasible, the Commission should use contracts when providers meet certain criteria, such as high dollar volume.
- The Commission does not have a formalized cost-based methodology to set rates for client services or an adequate system for monitoring providers' financial controls. This increases the risk that the Commission may be paying too much for some client services.
- The Commission has undertaken a reengineering effort which is expected to increase the agency's efficiency in delivering services to Texans with disabilities. For example, to provide faster delivery of client equipment, the Commission is moving from using a centralized warehouse toward buying from large volume local providers. However, the Commission encountered problems in the initial organization and management of the reengineering project. As a result, it changed its original specifications, which delayed plans for the October 1, 1995, system implementation.
- The Disability Determination Services Division has taken steps to reduce the number of case files waiting for examination and to shorten case processing time. As a result, management reports that the number of cases waiting assignment to an examiner dropped from an average of 9,490 in March 1995 to an average of 1,000. Management also reports that its mean processing time decreased from 90.5 days in April 1995 to 71.3 days in August 1995.

***A Review of Management Controls at the Interagency Council  
on Early Childhood Intervention***

**November 1995**

**SAO Report No. 96-020**

**Overall Conclusion**

The Interagency Council on Early Childhood Intervention (Council) has generally established a strong system of management controls. However, some controls need strengthening. With minor exceptions, the Council is in compliance with applicable laws and regulations.

**Key Facts and Findings**

- The language in provider contracts relating to sanctions for noncompliance or poor performance is vague. This has the potential to hinder the timely enforcement of requirements under the contract.
- Controls over internal audit should be improved. The Council has no internal audit charter. The internal audit contract did not restrict subcontracting, leaving the Council with no control over who would perform the work.
- The Council should strengthen provisions in the contract with the Department of Human Services. The contract's performance standards are not comprehensive, and there are no sanctions for poor performance. This hinders the Council's ability to address poor performance.
- The Council operates with a budget of \$42.7 million and a staff of 64. About one half of its funding is from the Federal Government. Over 90 percent of the Council's funds are disbursed to service providers.

***A Report on Management Controls at the Texas Department  
on Aging***  
**December 1995**  
**SAO Report No. 96-030**

**Overall Conclusion**

The Department does not have traditional, formal contracts in place with those who actually provide program services and has not adequately monitored the Area Agencies on Aging (AAAs) to ensure that high-quality services have been delivered to the appropriate people at a fair price. Developing contracts, implementing efficient and risk-based monitoring practices, and fully analyzing available performance data would better enable the Department to ensure the safe, efficient delivery of quality services.

**Key Facts and Findings**

- The Department has not developed traditional, formal contracts with the 28 AAAs. These AAAs are responsible for administering the \$52 million program for the Department. As a result, the Department has little recourse should performance problems occur.
- The Department has not adequately used available information to measure and manage AAA performance. For example, the Department has not analyzed the cash rates it approves to determine if rates are reasonable. In reviewing reimbursement rates for meals served in a group setting, we found that the Department reimbursement rates ranged from no reimbursement to \$4.00 per meal.
- The Department has not adequately monitored some AAAs, and, in turn, some AAAs have not adequately monitored their providers. For example, we found that as of April 1995, one AAA had not conducted a program monitoring visit since March 1994. AAA providers offer nutrition, transportation, and in-home services to elderly individuals. Therefore, it is important that the AAAs monitor providers to ensure that vehicles are properly maintained, drivers are trained in the safe use of wheelchair lifts and other special equipment, that the possibility of food-borne illness is minimized, and that in-home workers are qualified to perform their duties.
- The rates developed by the Department are not aligned with the actual cash cost to provide services. Volunteer and in-kind contributions are given a value and included in the rates paid to AAAs, clouding the true cash cost of providing services. Changes to the current rate-setting process could improve accountability by making rates comparable among AAAs and with the contracted rates providers have with other agencies.

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