



# TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

## EXECUTIVE DIRECTOR

James R. Hine

January 29, 1996

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Dear Mr. Alwin:

Thank you for providing the Department of Protective and Regulatory Services with the opportunity to respond to the draft audit findings contained in your report, *Contract Administration at Health and Human Service Agencies (CM-3)*. Each of the recommendations contained in the report is repeated below, followed by the Department's response in bold type with "General" recommendations addressed first and PRS specific recommendations later. I appreciate the work done by your staff in preparing the report and look forward to your continued assistance in developing a more efficient performance-based system of contract administration.

### **Contract Administration at Health and Human Services Agencies January 16, 1996, Draft Report**

#### **General Recommendations For All Health and Human Services Agencies**

##### *State Auditor Recommendation:*

*"Develop and implement contract provisions to hold all contractors accountable for the appropriate and effective use of State funds." (page 23)*

*Set specific restrictions in contracts that identify allowable and unallowable costs in a manner similar to federal cost principles.*

*Establish in contract terms a means of recovering inappropriately used amounts, including a cost-settlement requirement at contract end to facilitate recoupment.*

*Unit-rate contracts should limit reimbursement to the lower of either the rate or an amount reasonable, necessary and allowable.*

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**Department of Protective and Regulatory Services' Response:**

**The Department agrees with this recommendation and is in the process of implementing new contract provisions. On January 26, 1996 the board adopted contract rules allowing the Department to renegotiate contracts with 24-hour child care providers through an enrollment process. With the opportunity to renegotiate unit rate contracts, the Department has added contract provisions that identify allowable and unallowable contract costs by reference to the federal cost principles in OMB circulars A-110, A-122 and A-87. The Department's authority to recoup amounts spent for unallowable costs is also included in the new contract. Additionally, the Department is negotiating performance outcomes to be included in the contract. These new provisions will become effective on September 1, 1996. Enforcement of these provisions will ensure that costs relating to unit rate contracts are allowable and reasonable.**

**All other contracts, except direct agreements with family foster parents, will also include the provisions for allowable and unallowable costs and the Department's authority to recoup unallowable costs. These provisions will become effective on September 1, 1996.**

*State Auditor Recommendation:*

*"Develop methods of establishing contractor payments that reflect only the necessary and reasonable costs of providing services." (page 23)*

*Agencies should identify standard elements of cost and pay similar rates for similar services.*

*Contractors should adhere to state guidelines, where applicable, which restrict travel reimbursements and other types of expenditures.*

*Standard rates should reflect reasonable and necessary costs and should be adjusted to accommodate unique provider situations.*

*Steps should be taken (audit, sanctions, mandatory training) to ensure accurate cost reports.*

**Department of Protective and Regulatory Services' Response:**

**The Department acknowledges the potential benefit of standard elements of cost statewide and the establishment of comparable rates for similar services across agencies. We are participating in the review of these issues through committees established by the Health and Human Services Commission and will continue to cooperate in that effort.**

The Department recognizes that rates should reflect reasonable and necessary costs. Through PRS riders 14 and 15 of the General Appropriations Act the legislature froze current foster care rates to enable the Department to review the methodology and the rates established by that methodology. PRS is to issue a report to the Health and Human Services Commission, the Legislative Budget Board, and the Governor's Office of Budget and Planning advising them if the current methodology and rates reimburse the median costs of allowable services. From September 1994 until October 1995 a workgroup of providers, provider associations, consultants, and departmental staff met several times to review and amend the reimbursement methodology. Subsequently, the Department incorporated the amendments and presented the methodology to the board for discussion at their work session on January 25, 1996. The methodology will be presented at the March 22, 1996 board meeting for approval to publish the proposed rules in the Texas Register. The Department expects extensive comment and will be presenting the proposed rules to the board on May 24, 1996 for adoption. Following adoption a final report will be issued as required.

*State Auditor Recommendation:*

*"Establish centralized oversight responsibility for contract management of service providers, in particular fiscal monitoring." (page 24)*

*Review total state funding of providers, not just agency-by-agency totals, to detect double billings.*

*Coordinate audits with other state agencies to avoid duplication of effort.*

*Centralize contractor information to allow for analysis of data.*

**Department of Protective and Regulatory Services' Response:**

The Department agrees that some auditing efficiencies would result from an interagency centralized audit function. As previously mentioned, we are participating in committees established by the Health and Human Services Commission and believe that many benefits can be achieved through greater cooperation and information sharing among state agencies. A financial monitoring process built on interagency data and risk assessment is currently being developed as part of the newly assigned responsibilities of the Office of Contract Administration. Audit information from other state agencies will be incorporated into Contract Administration's risk analysis methodology and will be used to prioritize contract auditing tasks. Systematic financial monitoring of purchased services will begin by November 1, 1996.

**This payment information will be made available to all state agencies for use in their assessments of contractors and to identify any double billing that may occur.**

*State Auditor Recommendation:*

*"Use competitive procurement procedures whenever possible." (page 24)*

**Department of Protective and Regulatory Services' Response:**

**The Department agrees with this recommendation. Many PRS contracts are competitively procured. Unit rate services procured through open enrollment are related to the level of care system which is currently being reviewed by the Sunset Commission. The Department will work with the Commission to foster competition in terms of cost and quality. Occasionally, as with the Department's statewide guardianship contract, only one provider is available to provide critically needed services.**

### **State Auditor Recommendations Specific To PRS**

*State Auditor Recommendation:*

*"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. The Department should also establish a time frame within which this methodology will be revised."*

**Department of Protective and Regulatory Services' Response:**

**The rate methodology was presented to the board at their work session on January 25, 1996. The rate methodology for 24-hour child care facilities will be brought before the board on March 22, 1996 for approval to publish in the Texas Register. The Department expects extensive comment on the publication. The methodology will be brought before the board for final approval at the board meeting on May 24, 1996.**

*State Auditor Recommendation:*

*"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 report data 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."*

**Department of Protective and Regulatory Services' Response:**

**The Department recognizes the value of accurate cost report data and stronger sanctions as proposed. The rate setting and cost report functions have recently been moved to the Office of Contract Administration. The Department is currently reviewing the functions to improve performance and will incorporate the State Auditor's recommendations to become effective September 1, 1996.**

*State Auditor Recommendation:*

*"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, the Department 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 the Department."*

**Department of Protective and Regulatory Services' Response:**

**The Department agrees with this recommendation and will incorporate provisions requiring all contract expenditures to meet federal cost principals for allowability (Federal OMB Circulars A-110, A-122, and A-87). The new contracts will become effective on September 1, 1996.**

**In preparation for the new contracts, PRS staff responsible for residential treatment center contracts were trained in January 1996. Federal cost principles of allowability were extensively reviewed during that training. Prior to June 1996 all other PRS contract managers will be trained on federal cost principles. In March and April of 1996, PRS 24-hour child care providers will receive an orientation to the new contract provisions relating to allowability of contract costs. All other contractors who provide purchased services will be educated through distribution of written material prior to June 1996.**

**All PRS contracts will be amended prior to September 1, 1996 to clearly require providers to refund to PRS any amounts which the Department determines are not allowable under federal cost principles.**

*State Auditor Recommendation:*

*"Add provisions to child placing agency contracts which ensure that the Department is in compliance with all regulations regarding the amount of per day unit rate a child placing agency may retain prior to paying the actual foster care home."*

**Department of Protective and Regulatory Services' Response:**

**The Board met on January 25, 1996 and discussed the rate methodology including the amount of the per day unit rate a child placing agency may retain prior to paying the actual foster care rate. The methodology will be brought before the board on March 22, 1996 for approval to publish in the Texas Register. On May 24, 1996 the methodology will be brought before the board for final approval. When approved this will be placed in each contract.**

*State Auditor Recommendation:*

*"Given the increased number of potential contractors which did not exist when the Department initially began using the enrollment process, the Department 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."*

**Department of Protective and Regulatory Services' Response:**

**The Department has begun a review of its procurement methods for 24-hour care and will make every reasonable effort to foster competition, both in terms of cost and quality, among service providers. Given the large number of potential contractors, the Department's selection of contractors should be based on the contractors' documented ability to achieve positive outcomes for PRS clients. The Department plans to work with the Sunset Commission to determine the best competitive process that will accomplish the desired result.**

**Meanwhile, the Department has continued its efforts to refine outcomes measures by meeting with providers. In February 1996 we will be conducting regional meetings with providers to refine outcome measures and definitions. As part of the enrollment process for 24-hour child care any new measures to be incorporated will be adopted in new contracts to take effect September 1, 1996.**

*State Auditor Recommendation:*

*"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."*

**Department of Protective and Regulatory Services' Response:**

**The Department's regional contract staff need increased support and training to effectively perform their jobs. The PRS Office of Contract Administration was established in November 1995 to provide policy direction and support to regional staff and to develop standard methods for performing contracting functions. The Office has created a central data base containing information on approximately 1,000 agency contracts. In January, the Office provided training to PRS regional contract staff on procedures for procuring 24-hour child care services, risk analysis methods, and the definition of allowable contract expenditures. Additional tasks assigned to the Office of Contract Administration include the following:**

- **Development of an agency-wide contract risk analysis to be complete by April 1, 1996**
- **Revision of the Department's Contract Administration Handbook to be complete by May 1, 1996**
- **Training of regional and state office contract staff will be completed by June 1, 1996**
- **Administration of financial and performance monitoring of contractors with systematic financial monitoring to begin by November 1, 1996**

*State Auditor Recommendation:*

*"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 staff in Department headquarters."*

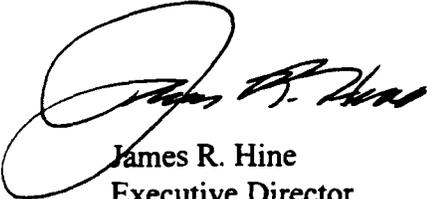
**Department of Protective and Regulatory Services' Response:**

**The Department agrees with this recommendation. Approximately 600 of the 1,000 PRS contracts for purchased services are competitively procured. The remaining contracts, approximately 400, are for 24-hour child care services which are procured through open enrollment. These contracts contain a unit rate which is driven by the level of care system. This level of care system is currently being reviewed by the Sunset Commission. The Department is working with the Commission to make every reasonable effort to foster**

**competition. Other contracts that are not competitively procured must be reviewed and approved by the Department's Office of Contract Administration in Austin. Five requests for noncompetitive procurements have been approved during this fiscal year. All approved non-competitive procurements were made from organizations that were the only available provider of the service.**

Again, thank you for the opportunity of responding to the draft recommendations.

Sincerely,



James R. Hine  
Executive Director



# Texas Department of Health

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January 29, 1996

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

Dear Mr. Alwin:

On January 16, 1996, your office provided us a draft report entitled *Contract Administration At Health And Human Service Agencies* and requested that we review and provide written comments on the report.

Your office conducted the first audit of contracts in October 1994 and has spent 846 hours on TDH contracts since then. We are pleased with your finding "that TDH's contracts with providers generally include the provisions necessary to hold contractors accountable for spending State funds appropriately."

We are interested, however, in making continued improvements in our contracting system. Since the release of your October 1994 audit report, we have demonstrated our commitment to improving all aspects of contracting for client services. Your office has been kept fully apprised of these initiatives and enhancements that include the following highlights:

1. "Assurance form" for nonprofit Boards.
2. Incorporate explicit sanctions procedures for non-compliance in contracts.
3. Require "letter of good standing" from other State agencies on contractors' performance.
4. A new personal computer server database on contractor performance.
5. Expand risk assessments.
6. Incorporation of performance measures in contracts.

January 29, 1996

7. Changing the method of contracting for Maternal and Child Health Care (Title V) services from cost reimbursable to fee-for-service at the beginning of fiscal year 1996. Instead of paying the salary costs for certain positions, we now pay for performance in the form of specific outputs. We anticipate this change will result in a 25 percent reduction in cost without a reduction in services. This change, paying for performance, conforms with the recommendations made in the report issued by your office in October 1994, *A Review of Contract Monitoring of Purchased Services*.

Our comments concerning your findings at the Department and comments on the draft recommendations are attached. As we were unaware of the specific findings and observations about the Department until we received the draft report, we could not provide this information earlier. Should you find that time constraints prevent modification of the report to recognize our views, you are requested to include them throughout the report where you discuss the related findings at the Department.

We appreciate the opportunity to submit these comments and look forward to receiving a copy of your final report. If I can be of further assistance, please feel free to call upon me at 458-7353.

Sincerely,

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

## **TDH Comments on Findings Concerning Contractor Selection Financial Monitoring and Budget Approval at TDH**

### **Section 8-A: Contract Budget Approval and Contractor Selection for Cost Reimbursement Contracts Should Be Strengthened**

We agree that TDH's process for evaluating proposed budgets for cost reimbursement contracts does not insure that maximum contract amounts reflect only reasonable and necessary costs to provide the services. While all of the program areas included in this review agree that improvements can and should be made in both procedures and documentation of the budget review process, it is only the first step in obtaining reasonable assurance that the cost incurred by the contractor and reimbursed by the Department is reasonable and necessary to provide the services. Additional steps include cost reporting by the contractor; fiscal monitoring, audits, and audit resolution by the Department.

With respect to the "questioned costs" of \$297,954, we note that the definition of "questioned costs" used in the report is not limited to unreasonable and unnecessary costs or those costs specifically disallowed by State or Federal guidelines, but also costs "which do not conform to requirements set forth in the conditions of the award/contact." Our examination of the findings at the eight TDH contractors showed that nearly two-thirds of the "questioned costs," \$189,000, was questioned simply because the contractor did not fully comply with a general provision in the contract that all subcontracts be in writing. This condition had already been identified by TDH monitoring and was being corrected by the contractor. The contractor's response to the draft report showed that agreements had been executed with 5 of the providers related to \$47,935 questioned by our auditors. These costs, primarily for physician and other medical services provided to clients, were not questioned by the Fiscal Monitoring Section because such costs are not considered unreasonable or unnecessary (unallowable) just because the current service agreements were not in writing.

Our examination of the total costs "questioned" by the State Auditor indicated that less than \$4,000 (4/100 of 1 percent of the total audited) is unreasonable and unnecessary (unallowable) and will result in the adjustments to the contractors' claims.

#### ***Auditor Follow-Up Comment***

*We do not agree with TDH's assertion that it is acceptable for providers to violate specific terms of the contract. In order to be considered allowable under federal requirements, a cost must conform to both the limitations/exclusions set forth in the cost principles and in the award (contract). TDH's contracts contain a provision which requires that all subcontracts entered into by a provider be in writing and subject to the terms of the contract between TDH and the provider. Our review (as well as TDH's review) found that the provider did not have written contracts with its subcontractors as required by TDH contract provisions and, therefore, we questioned the payments made to the subcontractors.*

*We originally questioned \$211,251 in payments made to subcontractors without a written contract, but reduced the amount to \$189,000 based on documentation of two contracts submitted by the provider. Other information submitted by the provider was not sufficient to warrant the reduction of the questioned subcontractor payments. Our basis and rationale for these decisions was discussed at several meetings with TDH personnel.*

*While it is true that the condition had already been identified by TDH monitoring, TDH did not question the costs associated with the payments to the subcontractors, but rather recommended that the contractor maintain and update annual service agreements for the providers. As of January 23, 1996, we had not received documentation that the provider had updated or prepared the required service agreements.*

### **Contracts Include Many of the Provision Necessary to Ensure Contractor Accountability**

We agree that TDH contract provisions are adequate to ensure contractor accountability. As noted in the report, the contracts require the contractors to obtain an agency-wide independent financial and compliance audit and provide that contract expenditures comply with federal cost principles for allowability. Specific provisions in our agreements with local government and nonprofit contractors require the application of federal cost principles not only to federal funds, but all State funds the contractors receive from TDH. The required independent financial and compliance audits, including the allowability of cost claimed for reimbursement, had been completed at each of the eight TDH contractors included in this review.

We agree that all contract amendments should be in writing. Our contracts include specific provisions that require amendments be in writing. The actual issue discussed in the audit report is the Department's attempted use of a single contract form for both cost reimbursed and fee-for-service contracts. We have recognized that the approach may lead to confusion and are developing separate contracts for the different type of contracts.

### **TDH Does Not Have A Formal Process for Determining the Reasonableness of Contractors Budgets**

We agree that TDH's process for evaluating proposed budgets for cost reimbursement contracts does not insure that the final and approved budget reflects a fair and reasonable amount for the purchased services. While all of the program areas included in this review agree that improvements can and should be made in both procedures and documentation of the budget review process, it should be recognized that budget review is only the first step to insure cost reimbursed under these contracts is reasonable and necessary to provide the services. Additional steps include cost reporting by the contractor, independent audits, and fiscal monitoring and audit resolution by the Department. Approved budgets generally determine the maximum a

contractor can be paid. The amount the contractor is actually paid is determined primarily by contractor claims and audits of the claims. The independent audits of these contractors resulted in the recovery of \$338,218 that had been reimbursed by TDH in fiscal year 1995.

We generally agree with the reported observations concerning budget review by the HIV Bureau. However, it should be recognized that the budgets for most sole source providers (counseling and testing) are severely restricted with the vast majority of the costs associated with staff salaries, fringe benefits and related travel. Supply costs are strictly limited. Additionally, the budgets for HIV service contractors are reviewed and approved by the local consortia before submission to TDH. The Bureau does agree that improvements are warranted and will develop written guidelines for assessing the budgets that include limits on categories of costs such as travel and supplies.

In those instances where the Bureau approved budgets for amounts greater than originally requested by the contractors, the Bureau also increased the scope of the proposed project, either in area or target population. This is an accepted procedure to fill service gaps and reach unserved or undeserved [sic] populations.

As noted in the report, the Title V program is now on a fee-for-service basis and not subject to the budget review processes of cost reimbursable contracts. We will make the recommended improvements in Title X budget reviews. The conversion of Title X procurement to full and open competition if [sic] fiscal year 1997 will provide further assurance that the proposed budgets are appropriate.

### **Current Fiscal Oversight Should Be Strengthened To Allow Follow-Up Opportunities in Areas of High-Risk**

The statement concerning fiscal monitoring by Grants management, "However, regardless of the nature or extent of the findings identified, additional months are not tested to ensure that similar expenditures were not made and claimed in other months" is incorrect. While it is correct that additional tests are not routinely undertaken, testing has been expanded when justified. Under present policy, monitors are allowed to expand their review if circumstances justify additional work. It is neither efficient nor effective to use the limited monitoring resources to expand tests based on insignificant or isolated findings in the test period. In fiscal year 1995, Grants Management completed risk assessments and target selection programs to better direct the limited resources to potential problem providers. Grants Management's monitoring efforts resulted in the recovery of \$440,408 in unallowable costs from contractors in fiscal year 1993.

Our review of all of the costs "questioned" indicates that less than \$4,000 is actually unallowable. While there may be compliance questions concerning the other costs "questioned," there is sufficient evidence to show the costs were for services that were provided and that the costs were reasonable and necessary.

The examples cited in the report are neither accurate nor representative of the total cost "questioned" by the auditors. Although two-thirds of the questioned cost represents cost incurred by a single contractor simply because subcontracts were not in writing, the condition is not included as an example.

- The \$7,923 amount represents TDH's 39 percent share of a major (\$20,398) communication system, not "questionable telephone repair services." Although contract provisions restrict purchases from related parties and the system was purchased from a related party, our review indicated that the costs from non-related parties were generally to that paid [sic]. TDH's share of questionable service calls that appear unreasonable and unnecessary amount to less than \$500 and will be recovered.
- The \$10,000 in purchases made the last day of the contract were used for clients in the following contract period. Of the total, \$5,000 was spent for the inventory of nutritional supplements that was distributed directly to clients during the following contract period.
- The \$1,780 in expenditures that were over allocated to TDH should have been charged to another State agency and will be recovered. The \$3,464 in payments found to have been made without documentation required by program standards are adequately documented to determine that the costs were reasonable, necessary, and incurred for housing eligible clients.
- The \$5,400 of expenditures described in the report as being made "without obtaining the documentation required by the contract" fully comply with documentation requirements in the contract. Although the documentation does not meet all of the HIV program documentation guidelines, the expenditures are documented to show the costs were incurred for eligible services provided to eligible clients at a reasonable cost.

### **Auditor Follow-Up Comment**

*The wording in the report has been subsequently changed to reflect the fact that TDH does not routinely test more than one month of expenditures. We contend that a sample of one month every year (or in some cases, every two years) is not sufficient to adequately identify inappropriate expenditures or "red flags" which might indicate the need for additional testing. In addition, the \$189,000 in questioned costs associated with the subcontractor payments (the "two thirds of the questioned cost . . .") was included as an example in the original draft report, but was removed as a specific example at TDH's request since the issue had already been questioned by TDH monitors.*

*We do not agree with TDH's assertion that less than \$4,000 of costs we questioned are unallowable. TDH's willingness to overlook contractor expenditures which are clearly unreasonable and unnecessary or in direct violation of the terms of the contract causes us to further question the effectiveness of their contract administration*

process. The objective of this audit was to point out questionable practices and uses of public funds, and the examples cited in the report are representative of such.

For example, the \$7,923 (TDH's portion of the total expense) in questionable telephone expenditures were made to a company which employed the husband (ex-husband for part of the period tested) of the provider's executive director. The husband was listed as the salesperson on each of the invoices we reviewed. Although some of the \$7,923 is related to the purchase of equipment and moving the telephone system from one office to another, we still question the reasonableness and prudence of the expenditures.

Our review of invoices indicates a minimum of \$1,200 (TDH's allocation of the total spent on these types of services) was paid for service calls such as:

- \$125 for providing the contractor with a list of phone numbers with dialing instructions
- \$80 for wiring a phone line to the fax machine on May 22, 1995, although this service was previously included on an invoice dated April 13, 1995
- \$75 for reconnecting a power cord at the base of the telephone
- \$80 for turning the telephone ringer back on

As to the \$10,000 in purchases made on the last day of the contract, the other \$5,000 was used to purchase Wal-Mart gift certificates on March 31, 1995, which was the last day of the contract. When we conducted our field review in September 1995, the contractor still had not distributed the gift certificates. The gift certificates were kept in an unlocked drawer, and the contractor had no formal method of tracking the certificates. As a result, it would be difficult to determine if these funds were subsequently used appropriately or not.

During several meetings to discuss these findings, TDH reported that it had approved and encouraged these purchases, but is changing its policies governing such expenditures. However, because the items in question were not used to provide benefits to clients during the contract term, we considered them as questioned costs for the purposes of this report.

The questioned payments made without documentation relate to funds disbursed to clients for assistance with housing costs. During our review of client files, we found that funds were frequently given directly to the clients, and the clients were allowed to write out their own receipts indicating that payment was made to someone else for rent or utilities. Rental contracts were not present in some of the files examined. All of the items mentioned above are violations of program requirements, therefore, we questioned the costs associated with them.

**Competitive Processes Used to Select Cost-Reimbursement Contract Providers Do Not Ensure that the Best Contractor Receives the Award**

There are a number of valid and proper reasons that HIV prevention, intervention and education contracts are not always awarded to the contractor whose proposal received the highest combined average score. For example, a contractor with an application score lower than others might be selected because the contractor is proposing to serve a broader target population than the other applicants. These decisions are based on criteria in the RFPs and are fully documented. The reasons lower scoring applications are selected are documented in the files and available for review.

The HIV Bureau is also concerned about the wide variations in scores. To address this concern, the Bureau is considering options such as using mock applications to illustrate standards, training, and elimination of high and low scores.

During fiscal year 1996, while competition for the Maternal and Child Health Care (Title V) programs were limited to existing providers, the process was competitive and a number of providers were not refunded.

Family Planning (Title XX) contracts are not automatically awarded to existing contractors. Existing providers have been refunded based upon satisfactory performance as judged by annual written applications, on-site clinical and administrative quality assurance reviews and on-site fiscal reviews by Grants Management. Any new funding, including funds made available from contractors that are not refunded, is competitively awarded. Current plans are to award all Title XX contracts on a competitive basis in fiscal year 1997.

**Section 8-B: Controls Over Unit Rate Contracts Do Not Prevent the Inefficient Use of State Funds Provider Expenditures Made Under Unit Rate Contracts Are Not Monitored**

We do not agree that "because the unit rates developed for WIC contracts are subjectively determined, TDH still does not have reasonable assurance that providers are reimbursed only for reasonable and necessary costs." The WIC contracts are essentially cost reimbursement contracts with the rates paid during the contract period establishing a limit on the amount of allowable cost that will be reimbursed. WIC contractors are required to account for and report their actual cost. The cost is monitored by WIC fiscal monitoring personnel and audited by independent certified public accounting firms. Actual reimbursements are limited to those cost [sic] found to be reasonable and necessary and under the cap established by the rates already paid.

### **Rates Do Not Align With Costs to Provide Services**

While we agree that the methodologies used to set unit rates should be formalized and documented, we do not believe the current WIC rates have resulted in the payment of unnecessary or unreasonable costs. As previously stated, there are a number of procedures, other than setting rates, which provide reasonable assurances that WIC reimbursements are limited to reasonable and necessary costs.

As stated in the report, Title V and XX rates are based on Medicaid rates. Medicaid generally sets these rates, rates for medical services and supplies, on the basis of reasonable and customary charges by the providers, not the cost of providing the service. As noted in the report, Title XX rates have not been increased along with increases in Medicaid rates. As a result, nearly half of the Title XX rates are less than Medicaid rates for the same service.

With the exception of rates for a few procedures that are not included in Medicaid, the rates paid to Title V providers are the same as Medicaid rates. The rates for the few procedures not directly from Medicaid are based on Medicaid rates augmented to consider the additional services included in the Title V procedure. Although the augmentation was not based on quantitative data, the amounts represent a small fraction of the total program payments. As noted elsewhere, the use of unit rates in the Title V program is expected to reduce program cost by 25 percent without any reduction in client services.

### ***Auditor Follow-Up Comment***

*As there are no restrictions over how the contractors who are paid a fixed unit rate ultimately use the funds, it is essential that the rate-setting process ensures that there is a reasonable correlation between the costs of service delivery and the rate paid. We agree that basing rates for medical services on prevailing rates is an acceptable method of establishing contractor payments. Our primary concern is that the fees which are not based on Medicaid rates are subjectively determined. As TDH does not audit the actual expenditures of providers reimbursed a unit rate (with the exception of the WIC Program), there are no assurances that contractors are paid a fair and reasonable rate for the services provided.*

### **Competition for Awarding Some Programs' Contracts Is Limited, And the Results of Proposal Evaluations Are Not Always Adequately Documented**

We agree that competition in awarding WIC contracts is limited and that the results of proposal evaluations can be better documented. The criteria used in the evaluations and the results of the evaluations will be better documented in the future. With respect to competitive awards, it should be recognized that WIC has had difficulty in finding enough contractors to provide services statewide. The Department's investment in equipment and training in the current contractors [sic] along with the federal requirement that the contractors provide health service further limits the use of

competitive awards. However, as noted in the report, as new funds become available, new contracts are awarded on a competitive basis.

Title XX provider applications are not automatically renewed, irrespective of content. The providers are evaluated on the basis of their applications, on-site clinical and administrative quality assurance reviews, and on-site fiscal monitoring and independent audits. Poorly performing providers are not refunded and their allocations are competitively awarded. Although the contracts have not been competitively awarded since the program was transferred from DHS in 1993, we plan to award all Title XX contracts on full and open competitive basis [sic] in fiscal year 1997 and beyond.

## TDH COMMENTS ON OVERALL RECOMMENDATIONS

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

Cost reimbursable contracts awarded by TDH do contain explicit requirements that all costs claimed for reimbursement by the contractors be allowable in accordance with applicable federal cost principles. In addition to fiscal monitoring by TDH, all such contracts are audited in accordance with federal requirements to determine the contractors' compliance with this and other requirements. To the extent such audits disclose unallowable costs claimed by the contractors for reimbursement, the amounts are recovered.

Unit rate or fee-for-service contracts require considerable administrative effort in establishing fair and reasonable payments rates for contractors. This is particularly true in those instances where the rates are based on cost reports or factors other than already accepted Medicaid rates. Once appropriate rates are established, we do not believe that unit rate contracts should routinely contain provisions that limit the contractor's reimbursement to the lower of the rate paid or the contractor's reasonable, necessary, and allowable costs to provide the services. Similarly, we do not believe that a cost settlement based on an audit at the end of the contract term would be appropriate. Such an arrangement would essentially be a cost reimbursable contract with the provisional payments (rates) paid during the term of the contract representing an additional ceiling on reimbursements. Such an arrangement would negate the administrative simplicity of unit rate contracts and prove quite costly, both to the State and the contractor, to administer. The WIC program does use this method, but primarily as a means to limit reimbursements to available statewide funding.

TDH's fee-for-service contracts are, for the most part, for professional medical services. Prevailing rates or reasonable charges, not cost, are an accepted method of paying for these services throughout government.

### ***Auditor Follow-Up Comment***

*As mentioned in our recommendations, we agree that provisions which limit compensation and require cost settlements at the end of the year may increase administrative requirements and, potentially, the cost of contract administration. However, this is just one of the options available to enhance controls over contractors' use of public funds. Ultimately, it will be up to agency management as well as the appropriate oversight bodies to determine the trade-offs between the costs of better controls and the costs of inappropriate expenditures.*

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

We agree that there should be a standard method to identify cost elements used in determining cost based reimbursement unit rates and that such a method would help ensure various agencies pay the same contractor similar rates for similar services.

As noted previously, we do not believe that unit rate contracts should routinely include end-of-term cost settlements. Such a provision would require the contractor to specifically account for the service cost and the agency to audit and settle the contract costs. The absence of the administrative effort and cost to do these tasks is the main advantage unit cost contracts have over the cost reimbursable contracts.

We agree that cost reports used in developing cost based unit rates should be accurate and, to the extent feasible, sanctions should be developed and implemented for false reporting.

We agree that the review of proposed budgets for cost reimbursable contracts should be strengthened. While some TDH programs follow well developed criteria, the procedures used by others are not as fully developed and documented. (The Department's Contract Leverage Team has addressed this area and improvements will be forthcoming.)

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

We agree that a single audit of a provider's total state funding is appropriate. All contractors receiving \$25,000 or more from TDH do undergo a single audit by an independent certified public accounting firm to determine, in part, if the contractor has complied with federal cost principles with respect to all federal funds and those State funds received from TDH. Such an audit of federal funds received from the federal government is required by federal laws and regulations. We require the same audit of State funds received from TDH by specific provision in each contract. Single audits had been performed on all eight of the TDH contractors included in this review. We have already completed quality assessments of two of the audits and we will soon be taking actions to address any deficiencies found in these audits.

We also agree that a centralized contractor data base would be helpful in several ways. Such a data base of health and human services contractors is one of the expected outcomes of the work now underway in the task force headed by the Health and Human Services Commission.