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An Audit Report on Contract Administration at Selected State Agencies - Phase Four

September 1996

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Key Points of Report

An Audit Report on Contract Administration at Selected State Agencies - Phase Four

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Overall Conclusion

Questionable expenditures identified at additional Texas Department of Human Services (DHS) and Texas Department of Protective and Regulatory Services (DPRS) contractors reinforce concerns regarding weaknesses in contract administration previously cited in our Office's February 1996 report (*Contract Administration at Selected Health and Human Services Agencies - Phase Three*, SAO Report No. 96-047). Until these weaknesses are adequately addressed, contractors can continue to enrich themselves at the expense of both taxpayers and the clients who are eligible to receive quality services. Both the Texas Department of Housing and Community Affairs (TDHCA) and the Texas Juvenile Probation Commission (TJPC) have implemented adequate contract administration systems, although specific aspects of these systems need to be strengthened.

Key Facts and Findings

- We identified \$614,374 in questionable expenditures included on contractor cost reports during reviews at ten DHS nursing facility contractors, and \$386,507 in questionable expenditures included on contractor cost reports during reviews at five DHS primary home care contractors.
- We identified \$1,062,686 in questionable expenditures included on contractor cost reports during reviews at five DPRS residential treatment center contractors. In addition, during our review period, DPRS did not limit the portion of the payment rate that child placing agency contractors could retain prior to paying foster care families. In response to our February 1996 report, DPRS began implementing a corrective action plan.
- TDHCA needs to strengthen its oversight of contractors through formalization and expansion of certain monitoring procedures, enhanced coordination between the agency's program divisions and its Compliance Division, and through combined monitoring of multiple programs.
- TJPC needs to strengthen contract administration controls when TJPC funds flow from local juvenile probation departments or judicial districts to subcontractors. TJPC also needs to formalize its existing financial monitoring procedures to avoid instances in which financial discrepancies go undetected, as well as enhance specific controls within its existing program monitoring procedures.

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This audit was conducted in accordance with Government Code § 321.015(a) and (b)(1).

Executive Summary

Questionable expenditures identified at additional Texas Department of Human Services (DHS) and Texas Department of Protective and Regulatory Services (DPRS) contractors reinforce concerns regarding weaknesses in contract administration previously cited in the State Auditor's Office February 1996 report (*Contract Administration at Selected Health and Human Services Agencies - Phase Three*, SAO Report No. 96-047). These weaknesses limit the State's ability to protect public funds from fraud, waste, or inefficient use. We identified \$1,000,881 in questionable expenditures included on contractor cost reports at additional DHS nursing facility contractors and primary home care contractors, and \$1,062,686 in questionable expenditures included on contractor cost reports at additional DPRS residential treatment center contractors.

Previous reports issued by our Office have underscored the need for greater controls over contract administration at DHS and DPRS. Due to the serious nature of the issues identified in previous reports, we continued our examination of contracting at DHS and DPRS. The examination was also expanded to include a review of contract administration at the Texas Department of Housing and Community Affairs (TDHCA) and the Texas Juvenile Probation Commission (TJPC). Reviews of contract administration at TDHCA and TJPC indicate that, while both of these agencies have implemented adequate contract administration systems overall, there are specific aspects of these systems which need to be strengthened.

Implementation of an Effective Contract Administration Model Could Help the State Eliminate Unscrupulous Practices Identified at Several Contractors

Results from financial reviews of forty contractors indicate that, when the components of effective contract administration are not in place, contractors have the opportunity to take advantage of these weaknesses. The State can no longer afford to overlook instances in which agencies have failed to implement all the components of an effective system of contract administration. Good contract administration systems are characterized by:

- Contractor selection procedures which ensure that the best contractors are objectively selected
- Contract provisions which are sufficient to hold contractors accountable
- Payment methodologies which ensure a reasonable price is paid to contractors
- Diligent monitoring of contractors by funding agencies

We focused on reviewing high-risk contractors; therefore, our results should not be considered representative of all contractors. However, our results demonstrate what can occur when the components of effective contract administration are not in place. For example:

- Some contractors are running personal expenditures through their business accounting records.
- Some contractors do not employ proper methods of fund accounting.

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The membership of the boards of directors of some contractors does not ensure proper accountability.

- Some contractors are spending more than state travel restrictions allow for state-funded travel.
- Some contractors are entering into leases with related parties. This appears to allow the related parties to pay off loans for the personal property they lease, and thus acquire personal property with contract funds.

During our field audits of contractors, we also noted that many of the State's contractors have numerous contracts with multiple state agencies. We believe there is a need for a formal monitoring and information sharing mechanism among all state agencies that contract with common contractors. This is an issue we have raised in previous reports.

At a Statewide Level, Certain Actions Could Help Eliminate Current Weaknesses in Contract Administration

There are statewide solutions which could help eliminate the weaknesses in contract administration. For example:

- Agencies could be required by statute to include performance outcome measures within all contracts for services.
- The State could use the restrictions contained within the Federal Office of Management and Budget (OMB) circulars as guidelines for the State's standards for expenditure restrictions.
- Agencies could be required by state law to notify the Internal Revenue Service about

contractors who run personal expenditures through their business accounting records.

- The State could decline to contract with contractors whose boards of directors do not contain external, non-related parties.
- The State could require that any contractor applying for a state contract demonstrate that it is capable of performing proper fund accounting.
- State restrictions on travel expenditures, which currently apply to the travel of state agency employees, could be applied to travel charged to state contracts.
- The State could establish a formal, statewide monitoring and information-sharing mechanism for state agencies that deal with common contractors.

Results From Financial Reviews of Additional Texas Department of Human Services Contractors Reinforce Concerns Identified in Our Office's Previous Review of Contracting

In fiscal year 1995, DHS paid nursing facilities \$1,148,729,754, while primary home care contractors were paid \$290,863,149. We identified a total of \$614,374 in questionable expenditures reported on cost reports at the ten nursing facilities visited. This represents approximately 2.2 percent of the \$28,080,874 in total expenditures reported on these contractors' cost reports after DHS desk audits. We also identified a total of \$386,507 in questionable expenditures at the five primary home care contractors visited. This represents approximately one percent of the \$39,058,311 in total expenditures reported on

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these contractors' cost reports after DHS desk audits.

When the total dollars paid to these contractors and the necessity to stretch each public dollar are considered, the questionable expenditures identified at ten DHS nursing facility contractors and five DHS primary home care contractors are significant. *The funds used to make these questionable expenditures could have been used to provide higher quality care or to provide care to a greater number of clients.* For example, a rudimentary calculation indicates that the \$614,374 in questionable expenditures identified at nursing facilities could have been used to fund 6,115 additional days of service. This number was calculated by dividing the amount of questionable expenditures (\$614,374) by the highest Texas Index for Level of Effort (TILE) payment rate in effect at the time of the review (\$100.46 per day). Similarly, the \$386,507 in questionable expenditures identified at primary home care contractors could have been used to fund 40,471 additional hours of the most expensive primary home care services (Priority 1 Service). This number was calculated by dividing the amount of questionable expenditures (\$386,507) by the Priority 1 Service rate in effect at the time of the review (\$9.55 per hour).

We also traced the majority of the questionable expenditures identified to the cost reports submitted by contractors to DHS. Since cost reports are used by DHS to set the per-unit payment rates for the nursing facility and primary home care programs, we remain concerned about the precision of the DHS rate-setting process.

Other non-financial issues were identified at nursing facility contractors and primary home care contractors. For example, some contractors did not:

- Adequately maintain the confidentiality of client files
- Adequately maintain records of client trust accounts
- Schedule primary home care workers properly
- Possess documented accounting policies and procedures

Results from Financial Reviews of Additional Texas Department of Protective and Regulatory Services Contractors Reinforce Concerns Identified in Our Office's Previous Review of Contracting

In fiscal year 1995, DPRS paid residential treatment center contractors \$65,970,740. We identified a total of \$1,062,686 in questionable expenditures included on contractor cost reports at the five residential treatment centers visited. This represents approximately 7.42 percent of the \$14,328,662 in total expenditures reported on these contractors' cost reports after DPRS desk audits. Strengthening controls over these programs could help reduce the amount of questionable expenditures made with contract funds. *The questionable expenditures included on contractor cost reports at the five DPRS residential treatment centers reviewed could have been used to provide higher quality care or to provide care to a greater number of clients.* Recoupment or elimination of these questionable expenditures in the future could also help alleviate potential budget deficits in DPRS' substitute care strategy.

During the review period, DPRS did not place restrictions on the portion of the payment rate that child placing agency contractors could

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retain prior to paying foster care families. In fiscal year 1995, DPRS paid child placing agency contractors \$31,641,394. Financial reviews of child placing agencies which contract with DPRS indicate that these contractors are retaining varying portions (from 25 percent to 60 percent) of the payment rate prior to paying foster care families.

Our February 1996 report raised concerns regarding DPRS' administration of contracts. DPRS has begun implementing a corrective action plan in response to that report.

While Most of the Texas Department of Housing and Community Affairs' Contract Administration Controls Are Adequate, It Is Critical That TDHCA Strengthen Certain Controls

Results from the review of contract administration controls at the Texas Department of Housing and Community Affairs (TDHCA) indicate that, overall, this agency has implemented an adequate contract administration system. However, certain controls within this system should be strengthened. In particular, oversight of Community Affairs Division contractors needs to be strengthened through formalization and expansion of certain monitoring procedures. Stronger coordination between the agency's program divisions and its Compliance Division is also critical.

While the Texas Juvenile Probation Commission Has Implemented an Adequate Contract Administration System, Certain Controls Within This System Need to Be Strengthened

Given its limited resources (approximately 40 full-time employees), the Texas Juvenile Probation Commission (TJPC) has implemented an adequate system for contract administration. However, certain aspects of the controls within this system need to be strengthened. Specifically, we found the adequacy of contract administration controls diminishes as TJPC funds flow from local juvenile probation departments or judicial districts to subcontractors providing services to juveniles. In addition, certain aspects of TJPC's financial and program monitoring procedures could also be strengthened.

Summary of Management's Responses

Management's responses from the agencies reviewed are presented immediately following Section 7 of this report. With the exception of DHS, the agencies reviewed generally agree with our findings and recommendations.

Objectives, Scope, and Methodology

The primary objectives of this project were to identify instances of fraud, waste, or abuse of taxpayer funds, and to identify specific systemic weaknesses at DHS, DPRS, TDHCA, and TJPC which would allow such instances to occur. To accomplish these objectives, we reviewed:

- Accounting records of 40 contractors to assess their use of state funds

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- Contract provisions
- Contract monitoring methodologies, policies, and practices
- Contractor selection policies and practices
- Contractor payment policies and practices
- Processes used to establish contract budgets

In the case of DHS and DPRS, much of this work began in our Office's February 1996

contracting report and was continued during this review.

While conducting reviews at TDHCA contractors, we also reviewed two Women, Infants, and Children (WIC) Nutrition program contracts administered by the Texas Department of Health (TDH). We identified no issues during these reviews which demonstrated significant weaknesses in TDH's WIC monitoring.

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Section 1:

Overall Assessment

Questionable expenditures identified at additional Texas Department of Human Services (DHS) and Texas Department of Protective and Regulatory Services (DPRS) contractors reinforce concerns regarding weaknesses in contract administration previously cited in our Office's February 1996 report, *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-047). Until these weaknesses are adequately addressed, contractors can continue to enrich themselves at the expense of both taxpayers and the clients who are eligible to receive quality services from these contractors. It is imperative that these issues be addressed in order to ensure that public funds are spent in the most efficient and effective manner for the programs and services which contractors are obligated to provide.

Previous reports issued by our Office have underscored the need for greater controls over contract administration. Specifically, these reports outlined weaknesses in contract administration which limit the State's ability to protect public funds from fraud, waste, or inefficient use. The issues identified during this, our most recent review of contract administration, reinforce the need for stronger controls.

Previous State Auditor's Office reports regarding contract administration include:

- *A Review of Management Controls at the Texas Department of Protective and Regulatory Services* (SAO Report No. 95-003, September 1994)
- *Contract Monitoring of Purchased Services* (SAO Report No. 95-007, October 1994)
- *Follow up to SAO Report # 95-007* (SAO Report No. 95-151, July 1995)
- *Contract Administration at the Texas Youth Commission* (SAO Report No. 96-005, September 1995)
- *A Management Control Audit of the Texas Commission for the Blind* (SAO Report No. 96-008, October 1995)
- *An Audit Report on Management Controls at the Texas Rehabilitation Commission* (SAO Report No. 96-012, October 1995)
- *A Review of Management Controls at the Interagency Council on Early Childhood Intervention* (SAO Report No. 96-020, November 1995)
- *A Report on Management Controls at the Texas Department on Aging* (SAO Report No. 96-030, December 1995)
- *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-047, February 1996)

Due to the serious nature of the issues identified at certain contractors in our February 1996 report, we continued examining the financial records of additional DHS and DPRS contractors during this review. (See Section 3 for detailed information regarding continued reviews at a sample of DHS contractors, and Section 4 for detailed information regarding continued reviews at a sample of DPRS contractors.)

The review of additional DHS and DPRS contractors was a continuation of the work on which we initially reported in February 1996. In response to our February 1996 report, DPRS began implementing a corrective action plan which includes steps to address the weaknesses identified. The implementation of this plan is currently underway.

During this review, we also expanded our examination to review contract administration at the Texas Department of Housing and Community Affairs (TDHCA) and the Texas Juvenile Probation Commission (TJPC). Our reviews of contract administration controls at TDHCA and

TJPC have uncovered significant issues involving these agencies' administration of contracts. While both of these agencies have implemented adequate contract administration systems overall, we have identified specific aspects of these systems which need to be strengthened. (See Section 5 for detailed information regarding our review of TDHCA contract administration, and Section 6 for detailed information regarding our review of TJPC contract administration.)

Section 2: CONTRACT ADMINISTRATION MODEL

Implementation of an Effective Contract Administration Model Could Help the State Eliminate Unscrupulous Practices Identified at Several Contractors

We examined the financial records of 40 contractors receiving funding from a variety of state agencies. Contractors were selected based upon a risk analysis designed to identify high-risk contractors. Therefore, the results from our reviews of these contractors should not be considered representative of all contractors; however, the results from these reviews demonstrate what can occur when the components of effective contract administration are not in place. To illustrate this point, it is necessary to first define the components of an effective system of contract administration, and then demonstrate what can occur when these components are not in place.

Section 2-A:

Components of Effective Contract Administration Include Contractor Selection, Contract Provisions, Contract Payment Methodology, and Contractor Oversight

The State can no longer afford to overlook instances in which agencies have failed to implement all the components of an effective system of contract administration. Each of these components is equally important and can be summarized as follows:

- **Contractor Selection** - The procedures used by agencies to select contractors must ensure the best contractors are fairly and objectively selected. Formal procedures to assess prospective contractors' strengths, weaknesses, and past performance must be established in order to provide assurance that the contractors can perform the job. Where feasible, and unless otherwise prohibited by law or other restrictions, competition among contractors should exist for state contracts.
- **Contract Provisions** - The provisions of the State's contracts must be sufficient to hold contractors accountable for delivery of quality services and to prevent inappropriate and inefficient use of public funds. Contracts with inadequate provisions permit contractors to legally and contractually use

public funds in a manner not consistent with the best interests of the State or the clients who are eligible to receive services.

- **Contract Payment Methodology** - Before entering into contracts, agencies must establish contractor payment methodologies sufficient to ensure that a fair and reasonable price is paid for contracted services. To achieve this, agencies must analyze the cost of these services, as well as the services themselves, in order to determine the most effective payment methodology. *There is no single best contract payment methodology that can be applied to all contracts.* Therefore, agencies must assess the strengths and weaknesses of various payment methodologies such as cost reimbursement or payment per unit of service, and determine which methodology is the most advantageous for each individual program.
- **Contractor Oversight** - Throughout the life of the contracts, agencies must diligently and regularly monitor both the quality of the services provided by contractors and whether these contractors are using public funds effectively and efficiently. When agencies identify contractors that are not meeting these expectations, agencies should impose sanctions upon these contractors. *When contractors demonstrate repeated inability to meet these expectations, they should be denied the privilege of contracting with the State.*

Appendix 3 contains a more detailed explanation of the components of an effective system of contract administration.

Section 2-B:

When All Components of Effective Contract Administration Are Not in Place, Contractors Are Given the Opportunity to Exploit the System at the Expense of the State

Examples of the abuses identified during our visits to 40 contractors contracting with a variety of agencies demonstrate what can occur when the components of effective contract administration are not in place. Although some contractors visited chose not to take advantage of these weaknesses and were genuinely attempting to do a good job for the State, we identified situations in which other contractors clearly recognized these weaknesses and profited from them.

Examples of some of the more common abuses identified include:

- Some contractors are running personal expenditures through their business accounting records. Not only is this misuse of public funds, but it is also a method of tax avoidance. We are coordinating with the Internal Revenue Service regarding all such situations.
- Some contractors are not employing proper methods of fund accounting to adequately segregate their various sources of funds. Without this segregation

of accounting records by fund or program, it is difficult, if not impossible, to track how public funds are spent.

- Membership of the boards of directors of some contractors does not ensure proper accountability. Specifically, we found during our contractor reviews that, when a contractor's board of directors contained no members external to the organization, and was instead composed of related parties, family members, or contractor employees, it was more likely the contractor would abuse contract funds.
- Some contractors are spending more than state travel restrictions allow for travel expenses charged to state contracts.
- Some contractors are entering into leases with related parties which appear to allow these related parties to acquire personal property with contract funds. Specifically, we identified several contractors whose employees appeared to be using contract funds to acquire personal property such as real estate and big ticket items (automobiles and an airplane). The following scenario is common in these situations:
 - A contractor's executive director acquires personal property (such as real estate, vehicles, or an airplane) *in his or her own name, not in the name of the organization which has a contract with the State*. The executive director obtains a personal loan to finance this purchase.
 - The contractor's executive director then leases this item back to the contractor. Using contract funds, the contractor makes "lease" payments back to the executive director, who then uses these funds to pay off his or her personal loan.
 - Eventually, the lease payments pay off the executive director's personal loan for the item, and the executive director owns the item outright. The executive director can also *continue* to lease that item to the contractor and, therefore, continue to profit from it.

During our field audits of contractors, we also noted many of the State's contractors have numerous contracts with multiple state agencies. For example, during fiscal year 1995, 50 Community Action Agencies in Texas received over \$500 million in funding from 83 state entities such as state agencies, boards, commissions, and universities. We believe there is a need for a formal monitoring and information sharing mechanism among all state agencies that contract with common contractors. This is an issue our Office has raised in previous reports. It is noteworthy that, during the past year, a group of representatives from a number of state agencies has begun discussing the design and implementation of a statewide database of contractor information. The goal of this effort is to collect statewide information about the contractors and about how well these contractors are managing their programs. This is the first step toward accumulating centralized, statewide information regarding agency contractors, the

level of funding and services being provided, and the amount of funding associated with particular state and federal programs.

Section 2-C:

Previous State Auditor's Office Reports Have Underscored the Need for Measuring the Effectiveness of Services Provided by Contractors

While this review focused upon the financial aspects of contracting, the quality of the services provided by contractors is also critical. In October 1994 our Office issued *A Review of Contract Monitoring of Purchased Services* (SAO Report No. 95-007), which outlined weaknesses in agency oversight of contractor performance at the Texas Department of Human Services, the Texas Department of Protective and Regulatory Services, the Texas Department of Health, the Texas Department of Mental Health and Mental Retardation, and the Texas Commission on Alcohol and Drug Abuse.

In that report, we described how these agencies' contract monitoring functions focused on determining compliance with state and federal regulations, not on evaluating the success or results of the services provided. These agencies did not focus on evaluating performance outcomes. We noted that compliance monitoring only emphasizes how services are delivered, but it does not provide useful information regarding the effectiveness of services or the efficiency of service delivery. We further concluded that if state leaders cannot assess the effectiveness of the services provided, they cannot ensure state funds are going to those providers that are achieving the desired outcomes.

Section 2-D:

At a Statewide Level, Certain Actions Could Help Eliminate Current Weaknesses in Contract Administration

There are statewide solutions which could help eliminate the weaknesses in contract administration. These solutions include the following:

- Agencies could be required by statute to include performance outcome measures within all contracts for services, and to actively monitor these measures to ensure the State is receiving quality services from its contractors. (The State has partially moved in this direction already by including a rider to the General Appropriations Act, 74th Legislature, requiring health and human service agencies to include clearly defined goals, outputs, and measurable outcomes directly relating to program objectives in program-related client services contracts.)
- The State could use Federal Office of Management and Budget (OMB) circulars as guidelines for the State's standards for expenditures associated with *any* State contract (regardless of whether the contract is funded through

federal or state funds). When deviations from the guidelines are necessary due to unique aspects of a particular contract, those deviations would need to be clearly specified in the contract.

- Agencies could be explicitly required by state law to notify the Internal Revenue Service when contractors are running personal expenditures through their business accounting records.
- To enhance contractor accountability, the State could decline to contract with contractors whose boards of directors do not contain external, non-related parties.
- The State could require any contractor applying for a state contract to demonstrate it is capable of performing proper fund accounting which could provide a proper audit trail for how contract funds are spent.
- State restrictions on travel expenditures, which currently apply to the travel of state agency employees, could also be applied to travel charged to state contracts.
- A formal, statewide monitoring and information-sharing mechanism among all state agencies which contract with common contractors could be established to keep all agencies apprised of instances of noncompliance identified at contractors.

We acknowledge that the implementation of these initiatives is not without some cost to the State. However, if none of these initiatives are implemented, contractors can continue to exploit weaknesses within some agencies' administration of contracts. This practice is also costly to the State. The mere existence of stronger restrictions on contractors could be a deterrent to contractor misuse of public funds. When contractors observe that their peers are penalized for noncompliance with these statewide restrictions, they may be persuaded to place a higher priority on compliance with these restrictions themselves.

Section 3: TEXAS DEPARTMENT OF HUMAN SERVICES

Results from Financial Reviews of Additional Texas Department of Human Services Contractors Reinforce Concerns Identified in Our Office's Previous Review of Contracting

Throughout this report we refer to "questionable expenditures". We consider an expenditure to be questionable if:

- the expenditure is specifically disallowed by the contract

or

- the expenditure does not appear to have any association with the program that a contractor is obligated to provide

or

- the expenditure is not supported by adequate documentation (such as a receipt or an invoice).

During financial reviews of nursing facilities and primary home care providers which contract with the Texas Department of Human Services (DHS), we continue to identify questionable expenditures of contract funds. (See Appendix 2 for a description of the programs reviewed at DHS.) We identified \$614,374 in questionable expenditures reported on contractor cost reports at ten nursing facilities. This represents approximately 2.2 percent of the \$28,080,874 in total expenditures reported on these contractors' cost reports after DHS desk audits. We also identified \$386,507 in questionable expenditures at five primary home care contractors. This represents approximately one percent of the \$39,058,311 in total expenditures reported on these contractors' cost reports after DHS desk audits.

The total dollars associated with the nursing facility and primary home care programs are significant. In fiscal year 1995, DHS paid nursing facilities \$1,148,729,754, while primary home care providers were paid \$290,863,149. Strengthening the controls over these programs could help to reduce the amount of questionable expenditures made with contract funds, and would enhance the effectiveness of the unit rate payment methodology currently in place. Strengthening the controls over these programs could also reduce the frequency with which questionable expenditures are incorporated into the rate-setting process.

In February 1996 our Office issued *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-097), which raised concerns regarding DHS nursing facility contractors and primary home care contractors. Specifically, we identified questionable expenditures made with contract funds which were included on these contractors' cost reports. These cost reports are used by DHS to set the per unit payment rates for these programs. Therefore, due to the concerns identified in our previous report, we conducted additional field audits at ten nursing facilities and five primary home care contractors during this review. We continued to identify questionable expenditures included on contractor cost reports.

We believe the unit rate payment methodology used for these programs is theoretically a sound methodology *only when good controls to assess quality and financial*

compliance are in place and when conditions such as competition are present. When the contractor cost reports used to set payment rates contain questionable expenditures, the effectiveness of the unit rate payment methodology is impaired.

The costs and benefits of a unit rate payment methodology as compared to a cost reimbursement methodology require further study. Our Office intends to conduct a more detailed analysis of alternative payment methodologies in a future audit to begin in fiscal year 1997. It is possible that some of the successful aspects of the cost reimbursement payment methodology could be incorporated into the unit rate payment methodology. Both the unit rate and cost reimbursement methodologies require an investment of resources on the part of the agency engaging in contracting, and it is critical that the optimal methodology is chosen and used effectively.

Another concern brought forth in our February 1996 report was that DHS contracts with nursing facilities and primary home care providers through an enrollment process. As a result, competitive market forces do not have a direct influence upon the payment rates for these programs.

It is important to note that, although we have identified examples of significant questionable expenditures at nursing facilities and primary home care providers, this should not automatically lead to the conclusion that the payment rates for these programs are too high. The existence of questionable expenditures *may* suggest that the rates are too high. However, it is also possible that the rates are a true reflection of the costs of providing quality services, and contractors making questionable expenditures are not providing quality services. A third possibility is that the existence of questionable expenditures could also be the result of a situation in which a contractor is providing quality services but also has a good cost containment system.

We selected the ten nursing facilities and five primary home care contractors for this review based upon an informal risk analysis designed to identify relatively high-risk contractors. We selected the contractors based upon the following:

- Information regarding relatively larger contractors
- Ratio analysis of contractors' cost report data
- Information provided by staff at DHS regarding contractors with programmatic and cost report problems.

Section 3-A:

Questionable Expenditures Identified at Nursing Facility Contractors Demonstrate a Need for Stronger Controls

The following examples of questionable expenditures identified at nursing facilities illustrate why stronger controls are necessary:

- One nursing facility entered into a \$501,000 consulting contract for which there was no evidence that consulting services had been provided. The consultant was the parent of the chief financial officer of the nursing facility.
- Another nursing facility used contract funds to pay a \$13,395 licensing violation fine and included this fine as an expenditure on its cost report.
- Lease payments totaling \$5,863 during one year for a luxury automobile were identified at one nursing facility.
- Also identified were numerous relatively smaller questionable expenditures for items such as baseball tickets, cigarettes, flowers and plants, and undocumented petty cash transactions.

We identified a total of \$614,374 in questionable expenditures reported on cost reports at the ten nursing facilities we visited. This represents approximately 2.2 percent of the \$28,080,874 in total expenditures reported on these contractors' cost reports after DHS desk audits. These contractors received \$19,408,626 in Medicaid revenue from DHS during the year reviewed.¹ The total amount of questionable expenditures identified resulted from our reviews of judgmentally selected expenditures made by these ten nursing facilities only. We did not project total questionable expenditures for the nursing facility contractors visited or for all nursing facility contractors.

Section 3-B:

Other Issues Identified at Nursing Facility Contractors Illustrate a Need for Stronger Controls

In addition to identifying questionable expenditures at the nursing facilities visited, we also identified other practices undertaken by these contractors which demonstrate a need for stronger controls. Examples of these practices include the following:

- At two nursing facilities, representatives from medical supply companies were allowed to review client files and bill Medicare directly for medical supplies. This is a direct violation of the DHS Nursing Facility Requirements for Licensure and Medicaid Certification which specify that nursing facility residents have the right to personal privacy and confidentiality of personal and clinical records. This practice is also prohibited by federal regulation.

In August 1995 federal authorities issued a special fraud alert regarding this practice. In January 1996 the General Accounting Office (GAO) issued a

¹ Although total expenditures exceeded total Medicaid revenue on the cost reports of the nursing facilities visited, this does not necessarily indicate that these contractors incurred a loss. Several cost categories reported on cost reports are aggregated for all clients served, and not just Medicaid clients. Therefore, it is not relevant to compare total costs reported on cost reports with total Medicaid revenue.

report which described how this practice could allow unscrupulous supply companies to obtain all the information necessary to order, bill, and be reimbursed by Medicare for supplies that are not necessary or even provided (see GAO Report No. HEHS-96-18, *Fraud and Abuse - Providers Target Medicare Patients in Nursing Facilities*).

- At one nursing facility, there were no deposit slips for four of the five resident deposits to the resident trust account that we tested. In addition, there was no documentation available for some disbursements from the resident trust account. Also at this nursing facility, resident applied income records were either missing or differed from DHS records of what the resident's applied income should have been. (Applied income is the resident's share of the payment to the nursing facility.)
- At one nursing facility, a resident was overcharged for her share of applied income. The nursing facility corrected this error after we brought this error to its attention.
- Two nursing facilities did not reveal all related parties on the cost reports they submitted to DHS. This is a violation of DHS cost report instructions.
- One nursing facility did not complete all sections of the cost report it submitted to DHS. This is a violation of DHS cost report instructions.
- Three nursing facilities did not have documented accounting policies and procedures.
- At four nursing facilities, copies of Internal Revenue Service (IRS) form 1099s, which must be prepared for contract laborers, could not be produced. In addition, at two nursing facilities, employee bonuses were not included on IRS W2 forms.

We have notified both DHS, and, when relevant, the proper federal authorities about each of the circumstances described above.

Section 3-C:

Questionable Expenditures Identified at Primary Home Care Contractors Demonstrate a Need for Stronger Controls

The following examples of questionable expenditures identified at primary home care contractors illustrate why stronger controls are necessary:

- At one primary home care contractor, a total of \$85,982 in salaries was paid to family members of the contractor's owners. However, there was no evidence that these family members were employed by or conducted any work for this contractor.

- Another primary home care contractor incurred a \$17,375 consultation expenditure which could not be supported by evidence that any consultation work had been conducted.
- Expenditures for a \$22,276 lease with a related party for an airplane, \$13,001 for the pilot's salary, and \$3,727 for airplane fuel were identified at another primary home care provider.
- When allocating salaries to each of its programs, one contractor over allocated \$104,253 of salaries to its primary home care program.
- Also identified were numerous relatively smaller questionable expenditures for items such as employee parties, flowers, and car window tinting.

We identified a total of \$386,507 in questionable expenditures at the five primary home care contractors visited. This represents approximately one percent of the \$39,058,311 in total expenditures reported on these contractors' cost reports after DHS desk audits. These contractors received \$39,048,906 in Medicaid revenue from DHS during the year we reviewed². The total amount of questionable expenditures identified resulted from our reviews of judgmentally selected expenditures made by these five primary home care contractors only. We did not project total questionable expenditures for the primary home care contractors visited or for all primary home care contractors.

In addition, at one primary home care contractor, we noted that salaries of \$615,000 and \$315,000 were reported on the contractor's cost report for the salaries of the contractor's CEO and Director of Nurses, respectively. These individuals owned this facility and appeared to have transferred the profit from the business to their individual salaries and included these amounts on their IRS W2 forms. Obviously, these "salaries" appeared high. However, because DHS does not place a cap on how much of these salaries can be reported on the contractor cost report, we had no strict criteria upon which to question the inclusion of these salaries on the cost report. In a February 1996 field audit of this cost report, which DHS conducted after we had performed our review at this contractor, DHS reduced the total amount of these salaries that could be reported on the cost report to \$209,921. DHS justified this reduction by reasoning that the distribution of profits through these salaries was not in compliance with the contractor's policy regarding employee bonuses.

Section 3-D:

² Although total expenditures exceeded total Medicaid revenue on the cost reports of the primary home care contractors visited, this does not necessarily indicate that these contractors incurred a loss. Several cost categories reported on cost reports are aggregated for all clients served, and not just Medicaid clients. Therefore, it is not relevant to compare total costs reported on cost reports with total Medicaid revenue.

Other Issues Identified at Primary Home Care Contractors Illustrate a Need for Stronger Controls

In addition to identifying questionable expenditures at the five primary home care contractors visited, we also identified other practices undertaken by these contractors which demonstrate a need for stronger controls. Examples of these practices include the following:

- At one primary home care contractor, most of the attendants were scheduled to serve multiple clients during a single day with no allowance for drive time from one client to the next. Therefore, clients could not have received the full hour(s) of service to which they were entitled. In addition, DHS was billed for full hours of service when full hours of service were not provided. Also at this contractor, 3 of 30 attendants whose schedules we tested were scheduled to serve two or more clients simultaneously. We identified this situation in February, June, and October 1994; therefore, this did not appear to be an isolated incident.
- Each primary home care contractor visited offered multiple programs, and we found weaknesses in the manner in which contractors allocated expenditures or revenue among different programs at each contractor visited. For example, one contractor did not have a documented allocation methodology. Another allocated indirect expenditures based upon number of clients rather than number of hours of service. One contractor's expenditure allocation methodology resulted in non-primary home care expenditures being charged to primary home care. One contractor incorrectly allocated interest revenue among programs. Another contractor partially allocated a direct expenditure for another program to its primary home care program.
- At one primary home care contractor, we found inaccurate, missing, and unsigned time sheets. Time sheets are critical in a service for which payment is made on a per-hour basis.
- Three primary home care contractors did not have documented accounting policies and procedures.

We have notified DHS about each of the circumstances described above.

Section 3-E:

The Questionable Expenditures Identified at Nursing Facilities and Primary Home Care Contractors Are Significant

To regard the percent of questionable expenditures identified at nursing facilities and primary home care contractors as insignificant would be an oversimplification. When

the total dollars paid to nursing facilities (\$1.1 billion in fiscal year 1995) and primary home care contractors (\$291 million in fiscal year 1995) and the necessity to stretch each public dollar are considered, the questionable expenditures are indeed significant.

The funds used to make these questionable expenditures could have been used to provide higher quality care or to provide care to a greater number of clients. For example, a rudimentary calculation indicates that the \$614,374 in questionable expenditures identified at nursing facilities could have been used to fund 6,115 days of service for clients assessed at the most expensive Texas Index for Level of Effort (TILE) payment rate in effect during the time period we reviewed. (The most expensive TILE level payment rate during the time period we reviewed was \$100.46 per day: $\$614,374 / \$100.46 = 6,115$.) Similarly, the \$386,507 in questionable expenditures identified at primary home care contractors could have been used to fund 40,471 hours of the most expensive primary home care services (Priority 1 Services). (The most expensive primary home care service payment rate during the time period we reviewed was \$9.55 per hour: $\$386,507 / \$9.55 = 40,471$.)

We traced the majority of questionable expenditures to the cost reports submitted to DHS by these contractors. This is a direct violation of existing DHS rules which clearly specify which expenditures can and cannot be included on these cost reports. However, DHS currently has no sanctions in place to penalize nursing facilities or primary home care contractors for including these expenditures on cost reports. Since these cost reports are used by DHS to set the per unit payment rates for these programs, we remain concerned about the precision of the DHS rate-setting process.

Without adjusting the DHS cost report database to exclude the questionable expenditures, and without recalculating the payment rates based on an adjusted database, we cannot specify how payment rates would have been impacted if the questionable expenditures identified had been excluded from the rate-setting process. Recalculation of the payment rates based on reviews of ten nursing facilities and five primary home care contractors was not our objective. Rather, our objective was to identify weaknesses in the controls surrounding the current payment methodology.

Although a few of the questionable expenditures were not included on contractor cost reports, we still consider the questionable expenditures themselves to be an inappropriate use of public funds. DHS places no restrictions on how nursing facilities or primary home care contractors can actually spend contract funds. DHS only places restrictions on the expenditures that these contractors can include on their cost reports, *but it places no restrictions on how contract funds can actually be spent.* Although placing restrictions on actual expenditures is not an element within the theory of the unit rate payment methodology, we believe this is one reason why contractors are making questionable expenditures.

The absence of restrictions regarding how contract funds can be spent becomes even more critical when one considers that DHS' contract monitoring function focuses on determining compliance with state and federal regulations, but not on evaluating the

success or results of the services provided (as previously reported in *A Review of Contract Monitoring of Purchased Services*, SAO Report No. 95-007).

Section 3-F:

It Is Not Currently Possible to Analyze Cost Report Data to Determine How Incremental Increases in Payment Rates Are Used by Contractors

It is not possible to determine from cost report data whether increases in the payment rates for nursing facilities and primary home care contractors result in an expansion in direct client services, or whether increases in payment rates result in increased contractor profits.

We obtained copies of the DHS cost report database before and after recent payment rate increases and attempted to determine how the incremental increases in payment rates were spent. We found that we could not perform this analysis due to the following:

- Contractors are instructed to include expenditures for all clients (not just Medicaid clients) on certain lines of the cost reports.
- The client Texas Index for Level of Effort (TILE) assessment mix (which determines the payment received for a particular client) among the population of nursing facility residents is not constant over time.
- DHS instructions for what to include within particular cost report line items have changed over the years, thus preventing an analysis of like data over time.

Recommendations for the Texas Department of Human Services

In our February 1996 report, we recommended that DHS implement the following regarding the nursing facility and primary home care programs:

(continued)

Recommendations for the Texas Department of Human Services

(continued)

- DHS should define allowable and unallowable costs under these contracts. DHS should perform a cost settlement at the end of the contract term so that contractor reimbursement is limited to the lower of the rate paid or the reasonable and allowable costs of providing the services.
- DHS methods to verify the accuracy of contractor-reported cost data should be strengthened. Stronger sanctions should be implemented for reporting false data on cost reports.

After conducting additional contractor reviews, we expand on those recommendations as follows:

- First, allowable and unallowable expenditures of contract funds should be defined by DHS and should apply to the actual expenditures made by contractors, not simply to the expenditures that contractors report on cost reports. The successful implementation of this recommendation would require that contractors must demonstrate to DHS that they have proper fund accounting systems which provide a clear audit trail to document how contract funds are spent.
- After defining allowable and unallowable uses of contract funds, DHS should implement a mechanism to recoup contract funds spent on unallowable expenditures. The first step in recouping funds could be to require that contractors refund to DHS unallowable expenditures which are identified by DHS through its desk and field audits of cost reports.

This recoupment mechanism could eventually expand to include elements such as the following:

- Require contractors to submit annual audit reports of DHS contract funds which include specific assurances to DHS from independent auditors regarding whether contractors have complied with contract provisions. For example, independent auditors could specify whether contract funds were spent only on allowable expenditures and whether these expenditures were properly supported by documentation. These audits could be performed using agreed upon procedures promulgated by DHS that specifically relate to the nursing facility and primary home care programs.

(continued)

Recommendations for the Texas Department of Human Services

(concluded)

- Enhance audits already conducted by DHS auditors to review actual contractor expenditures of state funds, as opposed to current DHS audits which focus only on auditing contractor-submitted cost reports. This would involve testing expenditures both included on and omitted from the cost report.
- Impose sanctions on contractors for spending contract funds on unallowable expenditures.
- Impose sanctions on contractors for including unallowable expenditures on cost reports submitted to DHS.
- After defining allowable and unallowable uses of contract funds, DHS should discontinue contracting with organizations which repeatedly spend contract funds on unallowable expenditures. The privilege of contracting with the State should be denied to contractors who demonstrate that they cannot comply with restrictions on the use of public funds.
- Contractor attendance at DHS cost report training should be mandatory and should be a condition of the contract.
- DHS should conduct a study of the costs and benefits of alternative contractor payment methodologies. If the unit rate methodology is determined to be preferable, DHS should consider whether it can gather independent cost data to calculate unit rates and not rely upon contractor-reported cost data.
- DHS should collect data, either through cost reports or through other means, which would enable the agency to identify how its contractors spend incremental increases in payment rates.

We acknowledge that the implementation of these recommendations is not without cost. We also acknowledge that some nursing facility and primary home care contractors could challenge or oppose these tighter restrictions. However, this does not diminish the importance of holding contractors accountable for the use of public funds. We encourage DHS to consider a restructuring of its existing resources in order to implement these recommendations.

Section 4: TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

Results From Financial Reviews of Additional Texas Department of Protective and Regulatory Services Contractors Reinforce Concerns Identified in Our Office's Previous Review of Contracting

During financial reviews of residential treatment centers that contract with the Texas Department of Protective and Regulatory Services (DPRS), we continue to identify questionable expenditures of contract funds. We identified \$1,062,686 in questionable expenditures included on contractor cost reports at the five residential treatment centers visited. In addition, during the review period, DPRS did not place restrictions on the portion of the payment rate that child placing agency contractors could retain prior to paying foster care families. (See Appendix 2 for a description of the programs reviewed at DPRS.)

In February 1996 concerns regarding DPRS residential treatment centers and child placing agencies were reported in *Contract Administration at Selected Health and Human Services Agencies - Phase Three* (SAO Report No. 96-047). The report identified questionable expenditures made with contract funds and included on contractor cost reports for residential treatment centers. In the case of child placing agencies, we reported that DPRS did not place restrictions of the amount of the DPRS payment rate that child placing agencies could retain prior to paying foster care families. Due to the concerns identified in our previous report, we chose to conduct additional field audits at five residential treatment centers and two child placing agencies during this review. The results from these additional reviews reinforce the concerns previously identified.

The review of additional DPRS contractors was a continuation of the work initially reported in February 1996. In response to the February 1996 report, DPRS began implementing a corrective action plan which includes steps to address the weaknesses identified. The implementation of this plan is currently underway. (See Section 4-E for further details regarding this corrective action plan.)

The total funding associated with DPRS contracts for residential treatment centers and child placing agencies is significant. In fiscal year 1995, DPRS paid residential treatment centers \$65,970,740, while child placing agencies were paid \$31,641,394. Strengthening the controls over these programs could help reduce the amount of questionable expenditures made with contract funds, and would help reduce the frequency with which questionable expenditures are included on contractor cost reports.

We selected the five residential treatment centers and two child placing agencies for review based upon an informal risk analysis designed to identify relatively high-risk contractors. We selected contractors based upon the following:

- Information regarding relatively larger contractors
- Ratio analysis of contractors' cost report data

- Information provided by staff at DPRS regarding contractors with programmatic and cost report problems

Section 4-A:

Questionable Expenditures Identified at Residential Treatment Centers Demonstrate a Need for Stronger Controls

We identified a total of \$1,062,686 in questionable expenditures included on contractor cost reports at the five residential treatment centers visited. This represents approximately 7.42 percent of the \$14,328,662 in total expenditures reported on these contractors' cost reports after DPRS desk audits. These contractors received \$8,607,805 in DPRS revenue during the year reviewed.³ The total amount of questionable expenditures identified resulted from our reviews of judgmentally selected expenditures made by these five residential treatment centers only. We did not project total questionable expenditures for the residential treatment center contractors visited or for all residential treatment center contractors.

The funds used to make these questionable expenditures could have been used to provide higher quality care or to provide care to a greater number of clients. Furthermore, recoupment or elimination of these questionable expenditures in the future could also help to alleviate potential budget deficits in DPRS' substitute care strategy.

In the case of two of the contractors included in the review, DPRS has already taken steps to attempt to recoup the funds spent by these contractors on unallowable expenditures, as well as to suspend these contractors' right to contract with DPRS for 24 months. The majority of questionable expenditures identified during this review were identified at these two contractors.

We identified questionable expenditures of contract funds such as the following:

- Lease payments of \$193,176 for a building owned by a contractor's executive director

(In this example, the lease payments were made directly by the residential treatment center to the mortgage company through which the executive director had a loan for this building. In addition, the contractor made additional "lease" payments to the mortgage company to bring down the principle on the executive director's loan. Although this building was listed as

³ Although total expenditures on cost reports exceeded total DPRS revenue for the contractors visited, this does not necessarily indicate that these contractors incurred a loss. Several cost categories reported on cost reports are aggregated for all clients served, and not just DPRS clients. Therefore, it is not relevant to compare total costs reported on cost reports with total DPRS revenue.

an asset on the residential treatment center's balance sheet, the building was actually owned by the executive director.)

- Payment of \$3,291 in personal credit card bills
- \$12,395 in expenditures associated with a home located in New Mexico

(We saw no evidence that any of the children residing at this residential treatment center visited this home.)

- \$39,050 in undocumented petty cash transactions (identified at one residential treatment center)
- Numerous other relatively smaller expenditures such as employee holiday parties, flowers, employee bonuses, and restaurant charges

The majority of questionable expenditures were included on the cost reports submitted by residential treatment center contractors to DPRS. This is a direct violation of existing DPRS rules that clearly specify which expenditures can and cannot be included on these cost reports. However, during the review period, DPRS had no sanctions in place to penalize residential treatment center contractors for including these expenditures on cost reports.

The published DPRS methodology for setting the per unit payment rates for residential treatment centers uses contractor cost report information as input data for the rate-setting process. During our reviews of DPRS contractors, we examined the contractors' 1994 cost reports. However, the 1994 cost reports submitted to DPRS by the contractors have not actually been used by DPRS to set per unit payment rates. According to DPRS officials, the payment rates in effect during the review period (as well as those currently in effect) were established using the 1991 cost reports submitted by contractors. DPRS has not performed rate-setting since that time. Therefore, it is not technically accurate to say that the errors identified on 1994 cost reports were directly incorporated into the current payment rates. However, reviews of the 1994 cost reports illustrate the types of errors which may have also been present on the 1991 cost reports which were used to set rates. Also noteworthy in any discussion of DPRS rate-setting is the fact that a rider to the General Appropriations Act, 74th Legislature, prohibits DPRS from lowering foster care rates during the 1996-1997 biennium.

Although a few of the questionable expenditures identified were not included on contractor cost reports, we still consider the questionable expenditures themselves to be an inappropriate use of public funds. The contract in effect during the time of the review placed somewhat broad restrictions on how residential treatment center contractors can actually spend funds. The absence of specific restrictions regarding how contract funds can be spent becomes even more critical when one considers that DPRS' contract monitoring function focuses on determining compliance with state and federal regulations, but not on evaluating the success or results of the services

provided (as previously reported in SAO Report No. 95-007, *A Review of Contract Monitoring of Purchased Services*). A draft revised contract which DPRS intends to place in effect in September 1996 places more specific restrictions on how contract funds may be spent. For example, the draft contract specifies that contractors must adhere to expenditure restrictions contained within Office of Management and Budget (OMB) circulars.

Section 4-B:

Other Issues Identified at Residential Treatment Centers Illustrate a Need for Stronger Controls

In addition to identifying questionable expenditures at the five residential treatment center contractors visited, other practices undertaken by these contractors also demonstrate a need for stronger controls. Examples of these practices include the following:

- One residential treatment center, incorporated as a for-profit corporation, subcontracted the actual services to a related organization which was incorporated as a non-profit entity. We were unable to account for how \$32,732 of the DPRS funds passed through to the non-profit corporation were used.
- One residential treatment center made \$6,090 in loans to employees, and there was no evidence that these loans were repaid.
- One residential treatment center's payroll reports did not agree to its general ledger, and payroll checks were written outside of its payroll system. Failure to maintain adequate payroll records increases the risk that unauthorized paychecks could be written.
- At one residential treatment center, the total number of client days and the client levels of care reported in the residential treatment center's cost report differed from the contractor's actual records.
- At two residential treatment centers, copies of Internal Revenue Service (IRS) 1099 forms, which must be prepared for contract laborers, could not be produced. At two residential treatment centers, employee bonuses were not included on IRS W2 forms.

We have notified both DPRS, and, when relevant, the proper federal authorities about each of the circumstances described above.

Section 4-C:

During Our Review Period, DPRS Did Not Place Restrictions on the Portion of the Payment Rate That Child Placing Agencies Can Retain Prior to Paying Foster Care Families

As reported in our February 1996 report, DPRS child placing agencies retain a portion of the payment prior to paying foster care families. During the review period, DPRS did not place restrictions on the portion of this payment that can be retained by child placing agencies. A draft contract revision, which DPRS officials plan to implement in September 1996, will place a limit on the portion of the payment that child placing agencies can retain. As of the end of the review, however, DPRS had not determined what this limit would be.

DPRS contracts with child placing agencies to recruit qualified foster care homes. Payments to these foster families flow from DPRS through the child placing agencies.

However, prior to paying the foster care families, the child placing agencies are retaining a portion of the payment sent by DPRS.

Figure 1
Amounts Retained by the Two Child Placing Agency Contractors We Reviewed

Child Placing Agency Contractor 1			
Level of Care	Daily Figures		
	Payment Made by DPRS	Amount Retained by Contractor	Amount Paid by the Contractor to the Foster Care Family
1	Contractor 1 did not contract for Level of Care 1.		
2	\$33.95	\$12.95	\$21.00
3	\$58.08	\$30.08	\$28.00
4	\$82.64	\$49.64	\$33.00
Child Placing Agency Contractor 2			
Level of Care	Daily Figures		
	Payment Made by DPRS	Amount Retained by Contractor	Amount Paid by the Contractor to the Foster Care Family
1	\$15.85	\$ 3.96	\$11.89
2	\$33.95	\$17.44	\$16.51
3	\$58.08	\$34.85	\$23.23
4	\$82.64	\$49.58	\$33.06

The amounts retained by the child placing agency contractors we visited are displayed in Figure 1.

In February 1996 the U.S. Department of Health and Human Services Office of Inspector General (HHS OIG) issued an audit report which specified that DPRS child placing agencies were retaining an average of 38 percent of the DPRS payments prior to paying foster care families. This report also asserted that DPRS does not provide financial guidance to child placing agencies to ensure that foster children in their care receive the full benefits of the maintenance payment. During the review period, DPRS was still not providing

this guidance. Specifically, the contracts in effect during the review period did not prohibit or limit the amount of the payment that child placing agencies can retain.

Although the federal audit report was issued in February 1996, DPRS' response to the report indicated that HHS OIG brought this issue to DPRS' attention in about September 1994. Therefore, DPRS has been aware of this issue for at least two years. In its response to the federal audit report, DPRS argued that child placing agencies should be classified as child care institutions. DPRS contended that, if child placing agencies were classified as child care institutions, the reasonable costs of administration and operation of child placing agencies would be allowable.

At the two child placing agency contractors reviewed, the portion of the payment rate retained by these contractors was used for administrative expenditures and expenditures associated with services for the children placed in foster care homes. However, intermingled within these expenditures were \$14,768 in questionable expenditures for items such as meals, T-shirts, flowers, and a staff holiday party. These expenditures were included on contractor cost reports.

Section 4-D:

DPRS Is Properly Coordinating With Other Agencies Regarding the Services to At-Risk Youth Program

Services to At-Risk Youth (STAR)

Contractors for this program provide services to youths and their families to help them resolve problems leading to running away, truancy, or abusive behavior. A goal of this program is to divert youths from the juvenile justice system and the DPRS Child Protective Services program.

In general, the level of coordination between DPRS and Texas Juvenile Probation Commission (TJPC) regarding the Services to At-Risk Youth (STAR) program is good. These two agencies have established a cooperative alliance based upon the mutual goal of making the STAR program a success. At the time of the review, the coordination between DPRS and the Texas Commission on Alcohol and Drug Abuse (TCADA) was in its initial stages, and the two agencies had begun meeting to discuss strengthening this coordination. Therefore, we were unable to make an assessment of the coordination between DPRS and TCADA.

Results from the review of the STAR program also revealed no overlap between STAR services and the services provided by TJPC and TCADA. However, since STAR services can be provided to children who are also eligible for services under other programs, STAR program monitoring could be enhanced by adding specific monitoring tests to identify any possible instances of double-billing of the services received by a child.

During the review, we also became aware of a conflict between state and federal law regarding the clients who are eligible for STAR program services. State law currently allows clients referred by juvenile probation departments to participate in the STAR program. However, federal law specifies that federal matching funds are not available for this program if juveniles in the juvenile justice system participate in this program.

Until this conflict is resolved, DPRS and TJPC have temporarily agreed not to refer adjudicated juveniles to the STAR program. However, this conflict will not be permanently resolved until the legislature addresses this issue.

Section 4-E:

DPRS Is Implementing a Corrective Action Plan to Address Many of the Issues Identified

In its response to our February 1996 report, DPRS set forth a corrective action plan to address weaknesses in its controls over contract administration. DPRS' target date for implementation of many of the steps within this plan was September 1, 1996. The plan included steps such as the following:

- Implementation of new rules and contract provisions to identify allowable and unallowable contract costs and recoup amounts spent for unallowable costs
- Review of the DPRS payment methodology and stronger sanctions for reporting false data on cost reports
- Review of procurement methods for 24-hour care to foster competition among service providers
- Refinement of outcome measures through meetings with providers
- Establishment of an Office of Contract Administration to provide policy direction and support to regional staff and to develop standard methods for performing contracting functions
- Development of a financial monitoring process

We commend DPRS for establishing this corrective action plan and strongly encourage DPRS to continue implementing this plan. As the review period did not extend through the DPRS September 1, 1996, target date for many of these steps, we could not verify whether DPRS achieved this target date.

Recommendations for the Texas Department of Protective and Regulatory Services

The DPRS corrective action plan addresses many of the recommendations made in our February 1996 report. In that report, we recommended that DPRS implement the following:

- Examine the DPRS rate-setting methodology and address known weaknesses in this methodology.
- Strengthen methods to verify the accuracy of cost report data and impose stronger sanctions for reporting false data on cost reports.
- Define allowable and unallowable expenditures and develop contract provisions which provide for DPRS recoupment of funds spent on unallowable costs.
- Comply with federal regulations regarding child placing agencies, and add provisions to child placing agency contracts to ensure this compliance.
- Enhance guidance provided to DPRS regional offices regarding contract administration.
- Strive to contract with potential contractors through competitive procurement procedures whenever possible.

After conducting additional contractor reviews, we expand on those recommendations as follows:

- Continued implementation of the DPRS corrective action plan should be made a priority. Placing emphasis upon recouping contract funds spent by contractors on unallowable items is critical.
- DPRS should discontinue contracting with organizations that make repeated unallowable expenditures.
- DPRS should conduct a study of the cost/benefit of various alternative compensation methodologies. If the unit rate methodology is determined to be preferable, DPRS should consider gathering its own data to calculate unit rates and not rely upon contractor reported cost data.
- Although we saw no indications of overlapping services among the STAR, TJPC, or TCADA programs, DPRS STAR financial monitoring should be expanded to test for possible duplicate billings from contractors.

Section 5: TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS

While Most of the Texas Department of Housing and Community Affairs' Contract Administration Controls Are Adequate, It Is Critical That TDHCA Strengthen Certain Controls

Results from our review of contract administration controls at the Texas Department of Housing and Community Affairs (TDHCA) indicate that, overall, this agency has implemented an adequate contract administration system. However, certain controls within this system must be strengthened. Specifically:

- Oversight of Community Affairs Division contractors needs to be strengthened through formalization and expansion of certain monitoring procedures.
- To improve financial monitoring of contractors, formalization and strengthening of the coordination between the agency's program divisions and its Compliance Division is critical.
- Effectiveness of contractor oversight could be improved through combined monitoring of multiple programs.
- Contractor accountability could be enhanced through specific improvements in the administration of Community Affairs Division contracts.
- Prior to June 1996 TDHCA policies and procedures for the HOME Investment Partnership Program (HOME) had not been formalized or standardized. In addition, TDHCA underwriting standards for the Housing Trust Fund program have not been formalized.

Total fiscal year 1995 funding associated with the TDHCA programs reviewed was \$161,503,268. During the review, we visited nine organizations contracting with TDHCA. Each of these organizations had multiple TDHCA contracts. We selected the contractors visited based upon an informal risk analysis designed to identify relatively high-risk contractors. (See Appendix 2 for a description of the programs reviewed at TDHCA.)

Section 5-A:

Oversight of Community Affairs Division Contractors Needs to Be Strengthened Through Formalization and Expansion of Particular Monitoring Procedures

Not all of the programs within TDHCA's Community Affairs Division have formalized procedures for handling repeated financial discrepancies identified at contractors. Two programs within this division do have formal procedures for dealing

with continued financial discrepancies. However, other programs, such as the Community Services Block Grant (CSBG), would benefit from a formalized process for addressing repeated financial discrepancies identified at contractors.

The need for formalized procedures for handling repeated contractor financial discrepancies came to our attention when we visited a Community Action Agency⁴ which had multiple contracts for programs within the Community Affairs Division. While we saw no evidence that this contractor had directly misappropriated contract funds, the problems identified significantly increased the risk that contract funds could have been misappropriated. The following examples of serious financial discrepancies were identified at this contractor:

- When we compared copies of monthly expenditure reports maintained at the contractor with monthly expenditure reports submitted to TDHCA, we found that the contractor over-reported \$1,169,180 in expenditures for the Comprehensive Energy Assistance Program (CEAP).
- The contractor charged an excessive amount (\$90,705) for audit fees to its CEAP program.
- We identified an \$8,642 check that was entered twice into the contractor's accounting records for the Emergency Community Services Homeless Grant Program (EHP). Although the contractor eventually corrected this error in its accounting system, this correction was made after TDHCA had been charged for this duplicate entry, and there was no evidence that the contractor ever reimbursed TDHCA for this error.
- \$4,536 in EHP funds and \$2,912 in CEAP funds were loaned to other programs administered by this contractor.
- A \$12,845 correcting entry to a prior fund balance in the EHP program was not reflected in the contractor's check register, and there was no supporting documentation indicating the purpose of the correcting entry or whether this correction was reported to TDHCA.

The examples cited above, as well as several others identified at this contractor, indicated the financial records of this contractor were critically inadequate and largely in disarray. According to TDHCA records, this contractor received \$8,853,331 through its CSBG contract between December 1992 and December 1996, and it received at least \$10,219,847 more from TDHCA through contracts for other programs in fiscal years 1993 through 1995.

⁴ Community Action Agencies are non-profit organizations that have received official designation as Community Action Agencies under the provisions of the Economic Opportunity Act of 1964. These organizations provide a wide range of human services at the community level to help individuals build self-sufficiency and rise out of poverty.

Some of the financial discrepancies identified at this contractor had been detected by TDHCA monitors during previous monitoring visits at least two years ago; however, TDHCA continued to renew this contractor's contracts. In addition, TDHCA continued to allow this contractor to receive monthly advance payments, rather than placing the contractor on a monthly reimbursement basis, an option available to TDHCA.

In addition to developing formalized procedures for handling repeated financial discrepancies identified at contractors, there is also a need for program monitors within TDHCA's Community Affairs Division to review contractor procurement procedures more extensively. When we visited another Community Action Agency which had several TDHCA contracts, we noted that this organization was leasing buildings from a related party. In addition, for the time frame audited, we saw no evidence that this organization had attempted to engage in competitive procurement procedures as required by Office of Management and Budget (OMB) circulars incorporated within TDHCA contracts. In the case of one of these buildings, we obtained evidence indicating that the Community Action Agency had previously purchased this building from the related party. Therefore, the Community Action Agency was the true owner of the building.

All of TDHCA's Community Affairs Division monitoring instruments contain steps to determine whether a contractor's policies, procedures and bylaws include a provision to prohibit conflict of interest. However, only the weatherization program monitoring instrument includes detailed steps to review contractor procurement procedures. Including these detailed steps within the monitoring instruments for all Community Affairs Division programs is critical in ensuring contractor accountability.

While we visited other Community Action Agencies at which we did not identify financial discrepancies as serious of the ones cited above, we contend that, if serious financial discrepancies exist at one contractor, there is a risk that other contractors can engage in similar practices.

It is important to note that, for many of the programs within TDHCA's Community Affairs Division, TDHCA is required by federal law to either award contracts specifically to Community Action Agencies, or to give preference in awarding contracts to Community Action Agencies. Therefore, TDHCA does not have the luxury of having numerous alternative contractors with which to contract. According to TDHCA staff, TDHCA did initiate proceedings to terminate a CSBG contract with a Community Action Agency, and the Federal Government was not completely supportive of TDHCA's efforts. While we acknowledge that these factors place TDHCA in a somewhat more difficult position in terms of imposing sanctions, this does not diminish the need for TDHCA to hold contractors accountable for having proper accounting systems and complying with the terms of their contracts.

Section 5-B:

Formalization and Strengthening of Coordination among TDHCA Program and Compliance Divisions Is Critical

It is critical that TDHCA strengthen and formalize coordination and information sharing between its program divisions and its Compliance Division. While program monitors have responsibilities centering on all aspects of program compliance, staff in TDHCA's Compliance Division have specific financial responsibilities such as performing reviews of financial systems, accounting procedures, and internal controls. Formalizing the coordination between these divisions could help identify and prevent financial discrepancies such as the ones described in the previous section of this report. Historically, staff from TDHCA program areas conducted program monitoring independently of the reviews of contractor financial audit reports. We believe this is one reason the financial discrepancies described in the previous section have been allowed to repeatedly occur.

Recently, the Compliance Division and program monitoring staff have begun to join forces to enhance monitoring and improve contractor accountability. For example, teams comprised of both program monitors and Compliance Division staff have recently conducted monitoring visits at contractors that were selected using a risk-based approach. In addition, the Compliance Division is developing a more formal methodology for identifying high-risk contractors, and is revising monitoring tools to include more focus on complete and accurate accounting records. We strongly encourage TDHCA to place a high priority on continued formalization of this process. In addition to conducting joint monitoring at high-risk contractors, TDHCA should expand the joint monitoring process and apply it not only to high-risk contractors, but to all contractors that contract with TDHCA. This expansion could help identify contractors' financial discrepancies earlier and could prevent these discrepancies from escalating into larger problems which are repeated in subsequent years.

Section 5-C:

Combined Monitoring of Multiple TDHCA Programs Could Improve the Effectiveness of Contractor Oversight

Contract administration at TDHCA could be improved if program monitors conducted joint monitoring visits to review multiple programs simultaneously, rather than monitoring individual programs separately. Many of the entities with which TDHCA contracts have multiple contracts crossing several different TDHCA programs and divisions. TDHCA should take advantage of the opportunities to enhance monitoring that this situation affords. By sharing information regarding the strengths and weaknesses identified at specific contractors, all program monitors could be in a better position to ensure contractor accountability. In addition, the costs associated with monitoring visits could be reduced.

Conducting combined monitoring of multiple programs could help all TDHCA program staff become better aware of particular issues identified at contractors.

Combined monitoring would also enable monitors to determine whether particular deficiencies identified are unique to a particular program, or whether they are indicative of a larger problem which impacts all of a contractor's programs. In addition, in the absence of a coordinated monitoring effort, there is a risk that contractors could include the same expenditure on each of the expenditure reports they submit to TDHCA for multiple programs. For example, a contractor could purchase a piece of equipment and, instead of allocating portions of the cost of that item among all of its contracts, the contractor could charge the full cost of that item to all of its contracts. It is more likely that this type of incident could be detected if monitors from TDHCA's various programs conducted joint monitoring visits of multiple programs.

Although we did not identify any examples such as the one described above during our reviews at TDHCA contractors, without a coordinated monitoring effort this risk is still present.

Section 5-D:

Specific Improvements in the Administration of Community Affairs Division Contracts Could Enhance Contractor Accountability

During reviews at five contractors with multiple contracts for Community Affairs Division programs, we identified specific improvements which could strengthen the monitoring tools used by TDHCA program monitors and enable them to better identify financial discrepancies at contractors:

- Current TDHCA monitoring procedures for the Weatherization Assistance Program (WAP), CSBG, and CEAP programs require monitors to sample and review checks (and supporting documentation) written by the contractor. Requiring the monitor to select this sample based on risk could enhance the effectiveness of this procedure. Requiring the monitor to expand the sample size if discrepancies are noted could also enhance the effectiveness of this procedure.
- Monitoring procedures for the WAP and CSBG programs could be enhanced through testing of both checks and a sample of general ledger journal entries.
- Monitoring procedures for the CEAP program could be enhanced by expanded testing of cash disbursements and verification of performance information regarding the number of persons served.
- Monitoring procedures in which a contractor's policies and procedures are reviewed for adequacy could be simplified if TDHCA monitoring staff created centralized, permanent files for this information and made updates to this information when necessary.

We also identified the following weaknesses in specific contract provisions:

- The Emergency Shelter Grants Program (ESGP) contract does not include the same provision regarding subcontracts that is included within other Community Services contracts. Specifically, other Community Services contracts contain provisions requiring a contractor to notify TDHCA if the contractor intends to engage in subcontracting.
- The CEAP contract does not include the provisions regarding equipment inventories, equipment useful life standards, and allowable expenditures that are incorporated in the Weatherization Assistance Program (WAP) contract.
- The Native American Restitution Program (NARP) contract does not contain a clear provision requiring the contractor to obtain an annual audit.

Section 5-E:

Until June 1996, TDHCA Policies and Procedures for the HOME Investment Partnership Program Were Not Formalized, and Underwriting Standards for the Housing Trust Fund Program Have Not Been Formalized

Until June 1996, TDHCA policies and procedures for the HOME Investment Partnership Program (HOME) were not formalized and standardized. Without policies and procedures, there were no clear standards for how contractor performance was to be evaluated by TDHCA monitoring staff. However, as of June 1, 1996, policies and procedures for the HOME program were completed and implemented by TDHCA.

Prior to the recent implementation of policies and procedures, HOME program monitors had conducted monitoring visits using inconsistent procedures. In addition, until the recent implementation of HOME policies and procedures, there were no documented policies and procedures for follow-up and resolution of deficiencies identified during HOME contract monitoring visits. Without these policies and procedures, there is a risk that deficiencies may not be corrected in a timely manner. TDHCA has never imposed sanctions upon HOME program contractors.

In reviewing a HOME contract at one contractor in particular, we noted another specific weakness in the oversight of HOME contracts. The contract document indicated that the contractor was the owner of the property to be renovated with the HOME funding. However, when we conducted an independent verification of the ownership of this property through information available at the county appraisal district, we learned that the deed for this property specified that the owner of this property was not the contractor; in fact, the true owner was a related party to the contractor. When we brought this matter to the attention of TDHCA, HOME program staff implemented a procedure to verify the owner of record for each property involved in a HOME contract on a semi-annual basis. We commend TDHCA for acting promptly to address this specific weakness.

TDHCA also needs to formalize and approve its underwriting standards for multifamily applications for funding available through the Housing Trust Fund program. As of the time of our review, these standards had been drafted, but had not been approved and implemented. According to the draft, these standards will help to standardize TDHCA credit and underwriting procedures, give a basis for sound credit and underwriting conclusions, and aid in determining the acceptability and financial capacity of applicants. Underwriting standards are critical to the success of the Housing Trust Fund program, and we encourage TDHCA to formally approve and implement these standards.

Section 5-F:

TDHCA Initiated Additional Controls Regarding Community Development Block Grant Contractor Payments

Prior to January 22, 1996, TDHCA required supporting documentation for payment requests under any of the following circumstances:

- When payment requests exceeded \$100,000
- When payment requests exceeded 25 percent of any approved budget category
- When payment requests exceeded 50 percent of the contract amount
- For project activities completed by local staff or for reimbursement of program expenses paid out of local funds
- When TDHCA staff requested additional supporting documentation.

Effective January 22, 1996, TDHCA implemented a new policy requiring that all requests for reimbursement must be accompanied by supporting documentation that justifies payment for each budget line item for which funds are requested.

Recommendations for the Texas Department of Housing and Community Affairs

TDHCA should implement the following to enhance the effectiveness of its contract administration:

- Monitor multiple programs at the same time.

(continued)

Recommendations for the Texas Department of Housing and Community Affairs

(concluded)

- Formalize coordination and communication between its program divisions and its Compliance Division to improve financial monitoring.
- Ensure that the policies and procedures recently formalized for the HOME Investment Partnership program continue to be implemented.
- Ensure that the underwriting standards for the Housing Trust Fund which are currently in draft form be formalized and implemented.

To improve contractor accountability, the TDHCA Community Affairs Division should:

- Formalize and implement procedures for handling repeated financial discrepancies identified at contractors.
- Implement procedures to review contractor procurement procedures, especially those involving related parties, more extensively.
- Require program monitors to select expenditure samples for testing based on risk analysis, and require expansion of the sample size if discrepancies are noted.
- Require program monitors to test both a sample of checks and a sample of general ledger journal entries.
- Expand CEAP cash disbursement testing and performance information verification.
- Consider creating and maintaining centralized permanent files when reviewing contractors' policies to reduce duplication of work.
- Include within the ESGP contract the same provision regarding subcontracts that is included within other Community Services contracts.
- Include within the CEAP contract the same provisions regarding equipment inventories, equipment useful life standards, and allowable expenditures that are incorporated in the WAP contract
- Include within the NARP contract a clear provision requiring the contractor to obtain an annual audit.

Section 6: TEXAS JUVENILE PROBATION COMMISSION

While the Texas Juvenile Probation Commission Has Implemented an Adequate Contract Administration System, Certain Controls Within This System Need to Be Strengthened

Given its limited resources (approximately 40 full-time employees), the Texas Juvenile Probation Commission (TJPC) has implemented an adequate system for contract administration. However, we have identified certain aspects of the controls within this system which need to be strengthened. Specifically:

- The adequacy of contract administration controls diminishes as TJPC funds flow from local juvenile probation departments or judicial districts to subcontractors providing services to juveniles.
- Although TJPC has procedures in place to conduct contract financial monitoring, the informal nature with which these procedures are applied has resulted in some financial discrepancies at local juvenile probation departments and judicial districts going undetected.
- Controls over TJPC's program monitoring could be strengthened.
- Published award procedures for the TJPC Challenge Grant program are not always followed.

Total fiscal year 1995 funding associated with TJPC contracts with local juvenile probation departments and judicial districts was \$46,644,638. During the review, we visited two local juvenile probation departments and one judicial district. As part of each of these visits, we also visited two subcontractors performing services for the local juvenile probation department or judicial district. We selected the contractors visited based upon an informal risk analysis designed to identify relatively high-risk contractors. (See Appendix 2 for a description of the programs we reviewed at TJPC.)

Section 6-A:

Oversight of Subcontractors Receiving TJPC Funds From Local Juvenile Probation Departments and Judicial Districts Needs to Be Strengthened

Currently, TJPC does not contractually require local juvenile probation departments and judicial districts to establish documented contractual agreements with subcontractors. In the absence of documented contracts, subcontractors have not been held accountable for how they spend TJPC funds. In addition, at the juvenile probation departments and judicial districts visited, we saw no evidence that local juvenile probation departments or judicial districts conducted financial monitoring of subcontractors, nor is this required by TJPC. It is important to note, however, that at

the juvenile probation departments and judicial district visited, the majority of TJPC funds were spent at the department or judicial district level for items such as salaries and administrative expenditures. Approximately 30 percent of the TJPC funds received by the local juvenile probation departments and judicial district was used for subcontracting for services such as counseling or residential placement. We did not identify any significant issues regarding the remaining 70 percent of TJPC funds spent at the department or judicial district level.

We identified two local juvenile probation departments at which subcontractors were providing services without a documented contractual agreement. At a judicial district visited, although the district's correspondence indicated that a documented contract with a subcontractor had existed at one time, neither the judicial district nor the subcontractor could provide a copy of the contract. Without a documented contract, there is no mechanism for holding subcontractors accountable for the services they provide or for the manner in which they spend public funds.

We also identified instances in which contractual agreements with subcontractors had been documented, but these contracts contained inadequate provisions. The TJPC contracts with local juvenile probation departments and judicial districts contain important state and federal requirements regarding the use of TJPC funds. However, we identified instances in which the local juvenile probation departments or judicial district did not duplicate those same restrictions and provisions within their contractual agreements with subcontractors. In the absence of these same restrictions and provisions, subcontractors have used TJPC funds for items that are specifically prohibited by the provisions of the TJPC contracts with local juvenile probation departments and judicial districts.

We visited six subcontractors providing services to local juvenile probation departments and judicial districts. The following examples of issues identified at these subcontractors illustrate why greater oversight of subcontractors is necessary:

- At one subcontractor which was operating without a documented contract, we identified \$4,638 in questionable expenditures. This subcontractor provided residential services to the local juvenile probation department.

Examples of these expenditures included \$440 spent on personal clothing, \$35 for rental of a candelabra, \$54 spent on jewelry, and \$29 spent on lace. Many of these expenditures appeared to have been associated with the wedding of an individual related to the subcontractor's executive director. This subcontractor also used \$3,272 in contract funds to give resident juveniles allowances and to pay them for performing chores. However, the TJPC contract with the juvenile probation department specifies that TJPC funds should not be paid as wages or salaries to children receiving juvenile probation services.

- A subcontractor providing residential services was operating with a contract agreement which did not contain all of the state and federal restrictions and

provisions that are contained within TJPC contracts with the local juvenile probation department. At this subcontractor, we found \$1,923 in questionable expenditures.

- A subcontractor providing counseling services did not comply with contract provisions requiring a separate record of the funds received and disbursed under the contract. This subcontractor commingled personal and business finances in the same accounting records. As a result, it was not possible to track how contract funds were spent.
- Another subcontractor providing residential services was paid \$55 per client per day. However, the payment rate specified in the contract between the judicial district and this subcontractor specified that the payment would be \$70 per client per day.

In addition, the two juvenile probation departments visited did not have adequate controls over the safekeeping of contract documents. For example, one juvenile probation department did not maintain complete copies of its TJPC contracts in a central location. Another juvenile probation department was unable to locate contract documents for 8 of 15 residential facilities with which it placed juveniles in fiscal year 1994. Of the seven contracts this juvenile probation department could locate, five did not contain all of the required signatures. Oversight of subcontractors is hindered if signed contract agreements are not adequately documented and retained for future reference.

Section 6-B:

While TJPC Has Procedures in Place for Financial Monitoring, the Informal Nature With Which These Procedures Are Applied Has Resulted in Some Financial Discrepancies Going Undetected

TJPC needs to enhance its financial monitoring to avoid instances in which financial discrepancies at juvenile probation departments and judicial districts go undetected. Although TJPC has procedures in place for conducting financial monitoring, we noted that the informal nature with which these procedures are applied has resulted in some financial discrepancies being overlooked.

Examples from our review demonstrate how the use of more formalized procedures could improve TJPC's financial monitoring. In examining 12 TJPC financial reviews of local juvenile probation departments and judicial districts, we identified the following instances in which financial discrepancies were not detected:

- In its financial monitoring of one juvenile probation department, TJPC did not detect that the juvenile probation department's audited expenditures covered a different time period from the total expenditures reported to TJPC. TJPC

made a recommendation to continue the juvenile probation department's contract based on this data (which was not comparable).

In addition, TJPC did not detect that a list of contract assurances (which attests to compliance with specific contract terms) for this local juvenile probation department had been completed by the department's county auditor, and not by an independent auditor, as required by TJPC.

- In its financial monitoring of another juvenile probation department, TJPC did not detect that the juvenile probation department failed to comply with all contract assurances required by TJPC.
- Information in 4 of the 12 TJPC financial reviews examined indicated that the juvenile probation departments or judicial districts had made expenditures exceeding original budget estimates by more than 15 percent without requesting a formal budget adjustment. (These departments and districts did not exceed their *total* TJPC budgets, but individual adjustments among budget line items exceeded 15 percent.) TJPC requires a formal budget adjustment when expenditures for a budget line item exceed the original estimate for that line item by more than 15 percent. TJPC did not detect these errors in its financial reviews.
- TJPC does not contractually require supporting documentation for independent auditors' assurances that Challenge Grant recipients meet the dollar for dollar matching requirements of this program. Therefore, current financial monitoring procedures at TJPC cannot easily detect whether Challenge Grant recipients have contributed their required share of matching funds to this program.

Section 6-C:

While TJPC's Program Monitoring Is Generally Adequate, Certain Aspects of This Monitoring Could Be Improved

TJPC has clearly documented program monitoring procedures used by TJPC monitors who conduct program reviews at local juvenile probation departments and judicial districts. However, the following specific opportunities for improvement in this area exist:

- The documentation prepared by TJPC program monitoring staff is not routinely reviewed by another monitor or a monitoring supervisor. In our reviews of twelve program monitoring files we identified files with incomplete or missing documentation, inadequate evidence of the monitors' verification of monitoring checklist information, instances of non-compliance which were not included in the monitoring summary report, and missing signatures.
- During years in which the Legislature is not in session, TJPC has conducted program monitoring reviews of 100 percent of the local juvenile probation

departments and judicial districts. When the Legislature is in session, TJPC has had to use some of its monitoring resources to assist in addressing legislative requests. Therefore, when the Legislature is in session, TJPC has conducted program monitoring reviews at approximately one-half of the local juvenile probation departments and judicial districts.

In years during which approximately one-half of the local juvenile probation departments and judicial districts received program monitoring visits, TJPC selected the departments and districts to be reviewed based upon an informal risk assessment. Without performing a more formalized risk assessment process, there is a possibility that the juvenile probation departments or judicial districts at which a review is necessary may not be selected. For example, TJPC does not currently maintain a centralized list of the juvenile probation departments or judicial districts at which there have been prior instances of non-compliance with TJPC standards. Maintaining and tracking this type of data and using it in the risk assessment process could improve the effectiveness of the risk assessment process.

- Members of the TJPC program monitoring staff have backgrounds in the juvenile justice system. TJPC currently has an unwritten policy that a TJPC program monitor will not monitor a juvenile probation department or judicial district in which he or she has worked. TJPC could benefit by formalizing and documenting this policy. TJPC could also benefit by implementing the use of a documented independence form on which monitoring staff certify that there are no factors which would impair their independence when monitoring the specific departments or districts to which they are assigned.

Section 6-D:

Published TJPC Procedures for Awarding Challenge Grants Have Not Always Been Followed

Grant award procedures outlined by TJPC in its fiscal year 1996 Challenge Grant request for proposal (RFP) were not followed. The RFP specified that the Challenge Grant proposals would be reviewed and ranked by an impartial panel to ensure fairness and equity to the applicants. However, when TJPC actually awarded the fiscal year 1996 Challenge Grants, the ranking process described in the RFP was not followed. Specifically, TJPC did not have sufficient Challenge Grant funds to award each qualified applicant the full amount of its grant request. However, instead of ranking the proposals based upon merit as described in the RFP, TJPC chose to award Challenge Grant to all applicants. The amounts of each grant were proportionately reduced by 12 percent so that all proposals could be funded.

Prior to fiscal year 1996, TJPC did not issue a request for proposal (RFP) for this program and awarded these grants to all juvenile probation departments and judicial districts that submitted a Challenge Grant proposal and could meet the dollar for dollar matching requirements of this program. TJPC was able to award Challenge Grants in

this informal manner because the total funding available for the Challenge Grant program, approximately \$1.3 million, was sufficient to fund all proposals submitted.

Section 6-E:

During the Review Period, TJPC Was in the Initial Stages of Awarding Funds for the Construction of Juvenile Facilities

During the review, TJPC was in the initial stages of awarding \$37.5 million to counties for the acquisition, construction, renovation, and equipage of juvenile facilities. Therefore, since this process was in its initial stages, we could not conduct a thorough review of TJPC's monitoring efforts regarding these funds.

As of the time of the review, TJPC had entered into a contract with the Texas Department of Criminal Justice (TDCJ) which required TDCJ to provide assistance in the development of an RFP and evaluation/assessment of the proposals requesting these funds. However, TJPC had not yet contracted with TDCJ for construction management services. A rider to the General Appropriations Act, 74th Legislature, requires TJPC to contract with TDCJ for construction management services for all construction projects associated with this funding.

Section 6-F:

One TJPC Rider to the General Appropriations Act May Be Unnecessary, While Another Rider Conflicts With Statute

A rider to the General Appropriations Act, 74th Legislature, requires local juvenile probation departments and judicial districts to separately account for \$3 million in expenditures of local (non-TJPC) funds. TJPC officials assert that this is an unnecessary requirement, as the increased funding for which the requirements of this rider were originally established was never appropriated. It appears that this rider imposes an unnecessary accounting hardship on local juvenile probation departments and judicial districts, as well as TJPC monitoring staff who must verify compliance with this rider.

Another rider to the General Appropriations Act, 74th Legislature, is in conflict with the Human Resources Code. This rider specifies that, to be eligible for Basic and Diversion Services funding, a juvenile board must demonstrate that the amount of local or county funds budgeted for juvenile services (excluding construction and capital outlay expenses) is at least equal to or greater than the amount of local or county funds spent for juvenile services in the 1994 county fiscal year. However, Human Resources Code, Section 141.082, specifies that the amount of local or county funds budgeted for juvenile services must be equal to or greater than the amount spent in the 1980 county fiscal year. It appears that the more up-to-date requirements of the rider could be incorporated into the Human Resources Code.

Recommendations for the Texas Juvenile Probation Commission

To strengthen its administration of contracts, TJPC should:

- Contractually require local juvenile probation departments and judicial districts to institute financial controls over subcontractors. Specifically, TJPC should contractually require juvenile probation departments and judicial districts to:
 - Establish documented contracts with all subcontractors which include the same restrictions on the use of state funds that are currently included in TJPC's contracts with the juvenile probation departments and judicial districts.
 - Conduct regular financial monitoring of subcontractors to ensure compliance with the provisions of the contract.
 - Impose sanctions upon subcontractors that do not comply with provisions of their contracts.
- Add steps to its regular monitoring of juvenile probation departments and judicial districts to ensure that these entities comply with the requirements regarding subcontractors described in the preceding recommendation.
- Document and formalize its financial monitoring process to attempt to reduce the number of financial discrepancies which can currently go undetected. (This process could be more formalized by use of standard checklists and through routine supervisory reviews of the work performed by financial monitoring staff.)
- Contractually require supporting documentation for independent auditors' assurances that Challenge Grant recipients meet the dollar for dollar matching requirements of this program.
- Implement procedures to routinely review the documentation prepared by program monitoring staff to help ensure consistency of program monitoring and adequacy of monitoring documentation. (This could be accomplished

(continued)

Recommendations for the Texas Juvenile Probation Commission (*concluded*)

though cross review of monitoring work among program monitors or through routine supervisory reviews of the work performed by program monitoring staff.)

- Maintain more formal statistics regarding juvenile probation departments or judicial districts at which there have been prior instances of noncompliance with TJPC standards. This information could be used to perform a more formal risk assessment for years in which not all juvenile probation departments and judicial districts receive monitoring visits.
- Begin using a documented independence form on which monitoring staff certify that there are no factors which would impair their independence when monitoring the specific departments or districts to which they are assigned.
- Follow the Challenge Grant award procedures set forth in the RFP for this program. If TJPC prefers alternative procedures, it should include these procedures in its RFP.

Section 7: TEXAS DEPARTMENT OF HEALTH

Results From Reviews of Additional Texas Department of Health Contractors for the Women, Infants, and Children Nutrition Program Indicated No Weaknesses in the Monitoring of This Program

While conducting reviews at TDHCA contractors, we took the opportunity to review two Women, Infants, and Children (WIC) Nutrition program contracts administered by the Texas Department of Health (TDH). (See Appendix 2 for a description of the WIC program.)

We identified no issues involving the WIC program at one contractor reviewed. While we uncovered issues at the second contractor reviewed, these issues were systemic problems unique to this contractor, and did not demonstrate any significant weaknesses in TDH's WIC program monitoring.

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August 26, 1996

Ms. Nancy McBride, Project Manager
Office of the State Auditor
Two Commodore Plaza
206 East Ninth Street, Suite 1900
Austin, TX 78701

Dear Ms. McBride:

The Texas Department of Human Services (the "Department") appreciates the opportunity to respond to this report regarding contract administration. The continual flow of information regarding questionable expenditures identified by the Office of the State Auditor during the performance of this audit has been beneficial to the Department in its efforts to enhance contractor cost report rules and audits, particularly the risk assessment process.

The Department reaffirms its commitment to effective contract administration of all contracts, and is keenly aware of the responsibility to provide the highest quality of program services in the most efficient and cost-effective manner to the citizens of Texas. The Department has constantly and consistently maintained and, in many cases, enhanced its contract administration policies, procedures, practices, and efforts with available resources. Significant enhancement of resources and diligence have been made and practiced during the last two fiscal years to address concerns raised by the Office of the State Auditor in October 1994 and in response to the rider to the General Appropriations Act, 74th Legislature, Regular Session. These enhancements to the Department's contract administration infrastructure, the focusing of Internal Audit and Office of Inspector General audit resources through risk assessment (to work with program areas in evaluating and enhancing the effectiveness and efficiency of contract administration), and the commitment and use of legal and audit resources to fully support the Health and Human Services Commission workgroup (to improve contract administration) are responsive and effective in addressing concerns raised almost two years ago by the Office of the State Auditor and the legislative mandates of the rider mentioned above.

John H. Winters Human Services Center • 701 West 51st Street
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Ms. Nancy McBride
Project Manager
August 26 1996
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The Department is disappointed with the scope of the audit work of the Office of the State Auditor because the principal focus was only an extended review of nursing facility and primary home care contractors' revenues and expenditures for 1994, the same population targeted during the earlier audits. The report omits any assessment or recognition of enhancements and diligence in contract administration accomplished by the Department during the period since the first report of the Office of the State Auditor on contract administration was issued.

Maintenance of appropriate rate setting methodologies and diligence in contract administration, including enhanced auditing, surveying, and monitoring of fiscal and service deliverables, have been, are, and will continue to be an important part of our core business. The Department is accountable to State and Federal leadership and the citizens of Texas to ensure effective and efficient contract administration; management and staff are committed to correct any significant deficiencies in the Department's policies, procedures, practices, and/or level of effort. The Department has clearly demonstrated its responsibility and commitment noted above, especially during the last two years.

The report of the Office of the State Auditor is clear in that the State auditors examined the financial records of ten nursing facilities and five primary home care contractors providing services to Department clients. These Department contractors were selected based upon a risk analysis designed to identify high-risk contractors. The report states in the Executive Summary - "We focused on reviewing high-risk contractors; therefore, our results should not be considered representative of all contractors." The report states in Section 2 - "Contractors were selected based upon a risk analysis designed to identify high-risk contractors. Therefore, the results from our reviews of these contractors should not be considered representative of all contractors;" The report states in Section 3 - "It is important to note that, although we have identified examples of significant questionable expenditures at nursing facilities and primary home care providers, this should not automatically lead to the conclusion that the payment rates for these programs are too high. The existence of questionable expenditures may suggest that the rates are too high. However, it is also possible that the rates are a true reflection of the costs of providing quality services, and contractors making questionable expenditures are not providing quality services. A third possibility is that the existence of questionable expenditures could also be the result of a situation in which a contractor is providing quality services but also has a good cost containment system."

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Continuing in Section 3 - "We selected the ten nursing facilities and five primary home care contractors for this review based upon an informal risk analysis designed to identify relatively high-risk contractors. We selected the contractors based upon the following:

- information regarding relatively larger contractors
- ratio analysis of contractors' cost report data
- information provided by staff at DHS regarding contractors with programmatic and cost report problems."

The report states in Section 3-A - "The total amount of questionable expenditures we identified resulted from our reviews of judgementally selected expenditures made by these ten nursing facilities only. We did not project total questionable expenditures for the nursing facility contractors we visited or for all nursing facility contractors."

The report states in Section 3-C - "The total amount of questionable expenditures we identified resulted from our reviews of judgementally selected expenditures made by these five primary home care contractors only. We did not project questionable expenditures for the primary home care contractors we visited or for all primary home care contractors."

Based on the information presented in the preceding four paragraphs, it is clear to the Department that the results communicated by the Office of the State Auditor in this report should not be considered representative of the contractor population. The Department, because of the extensive amount of audit work performed on contractor cost reports for these two programs - 185 field audits and 759 desk reviews, supplemented by 96 special field reviews (in connection with providing our Board with additional information regarding the accuracy of the cost data base) of 1994 cost reports, the required survey work performed by the Long-term Care Regulatory staff, and the ongoing contract monitoring by contract managers in these two programs, has a much better understanding of and better information to make judgements about the contractor population. Also, the Department, as previously mentioned, has initiated enhancements in all contract administration areas to improve its understanding, obtain better information, and make better judgements, particularly during the last two years. For example, targets for field audits and desk reviews have been increased to 260 and 1,050, respectively, for these two programs' 1995 cost reports; these audits are currently in progress.

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Project Manager
August 26 1996
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The overall conclusion expressed in the Key Points of Report (cover page) states in part - "Questionable expenditures identified at additional Department of Human Services (DHS).....contractors reinforce concerns regarding weaknesses in contract administration previously cited in our Office's February 1996 report. Until these weaknesses are adequately addressed, contractors can continue to enrich themselves at the expense of both taxpayers and the clients who are eligible to receive quality services....." The Department strongly disagrees with this overall conclusion for several reasons. There are no qualifying words in the conclusion that would inform a reader that it does not apply to the entire population of contractors at the Department. The use of the word "enrich" is strong and inflammatory, giving the reader an impression or judgement that is simply not the case for the majority of the Department contractors ("enrich" means to make rich or richer). There is absolutely no significant evidence as a result of the Office of the State Auditor contract administration audit work at the Department to date to support it. As previously noted, the report states that the State auditors' identification of examples of significant questionable expenditures should not automatically lead to the conclusion that payment rates are too high. In another place in the report, the State auditors say that the questionable expenditures identified were not used to adjust the data base in order to recalculate the payment rates; therefore, the impact of such questionable expenditures on the payment rates is not known (it was not their objective). The report also states that is not possible to determine from cost report data whether increases in the payment rates for Department contractors result in expansion in direct client services or whether increases in payment rates result in increased contractor profits. Having said all this in the body of the report after the strong and inflammatory overall conclusion is stated up front, the overall conclusion, in the Department's opinion, is misleading and is contradictory with the State auditors' findings as reported in the body of the report.

The Department feels confident that the questioned costs noted in the report would not have a significant impact on the unit rates determined using the data bases compiled from all cost reports including these fifteen providers. The Department has increased the number of providers to be field audited during fiscal year 1996 to about 20% to ensure there is not a significant impact on future unit rates. The Department is committed to improving the accuracy of the cost report data bases and will continue to monitor the cost/benefit of increased field audits supplemented by desk reviews of all cost reports not field audited.

The Department noted in the report that the Office of the State Auditor intends to conduct a more detailed analysis of alternative payment methodologies in a future audit to begin in fiscal 1997. The Department will cooperate fully with such an analysis. The Department is interested in a fair, unbiased evaluation with the strengths and weaknesses of each

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alternative methodology presented together with a realistic estimate of the administrative costs to make it work and how those costs compare to those currently being incurred. The Lewin-VHI study commissioned by the Department in 1992 is an example of what such a study or analysis should include.

RESPONSES TO STATEWIDE SOLUTIONS THAT COULD HELP ELIMINATE CURRENT WEAKNESSES IN CONTRACT ADMINISTRATION

- The Department's community care contract rules (Chapter 49) will address performance measures which apply to all services. These rules will be published in the Texas Register in August 1996. Standardized monitoring systems are being developed for all community care programs. A service quality questionnaire is also being piloted to obtain information on client satisfaction with services and to monitor performance and access to services.
- The Department's Contract Council will review whether we should implement a rule requiring all provider agencies contracting with us to have a board of directors which includes external, non-related parties. Special attention will be required for provider agencies which do not have boards, including limited liability companies, sole proprietorships, and general/limited partnerships.
- The Department's Contract Council will review whether we should require provider agencies to demonstrate capability to perform proper fund accounting before applying for a state contract. This requirement will most likely impact small businesses including HUBs.
- The Department recognizes and is continuing to provide resources for stronger compliance audits and enhanced monitoring, particularly in the Long-Term Care Regulatory/Certification, Enrollment, and Billing Services units.

RESPONSES TO RECOMMENDATIONS

The Department's responses to the first two recommendations were included in our January 31, 1996 letter and are repeated here:

- "This recommendation indicates a lack of understanding of: (a) the current prospective cost-based reimbursement system and (b) administrative costs of retrospective cost-settlement systems. As discussed in the overview, prospective reimbursement systems, if properly designed, have strong incentives for overall system cost containment over time. Retrospective cost-settlement systems tend to undermine incentives for cost containment. Furthermore, the Department's

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Project Manager
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evaluation of retrospective cost-settlement systems indicated that these systems tended to require extensive administrative and legal costs which could easily outweigh any potential savings."

- "This recommendation indicates a lack of auditor understanding of the current prospective cost-based reimbursement system. Furthermore, the implementation of a sanction system would result in a dramatic increase in administrative costs, in terms of audit, contract support, fair hearings, and legal staff. The report provides no evidence that the costs of implementing a sanction system of this type could be justified by the potential savings."

The Department's responses to the expanded recommendations are as follows:

- In 1992 the Department commissioned Lewin-VHI, a nationally prominent healthcare research and consulting firm, to complete a study of the current Texas Medicaid reimbursement methodologies utilized in the Nursing Facility and ICF-MR programs and to prepare a report including an evaluation of alternatives to the current system. An alternative under which prospective payments would be linked to individual providers' past expenditures on allowable costs was viewed very favorably by the Department's Board. However, such a system would entail significantly greater administrative costs which were not a part of the Department's legislative appropriations. As a result, this alternative has not been implemented. A system involving retroactive cost settlements with individual providers would entail even greater administrative costs than an individual prospective payment system. In addition, a policy of recouping funds not spent on allowable costs would remove the current incentive for providers to contain costs below the flat-rate payments. In the long run, removal of this incentive would discourage efficient providers from participating in the program and result in a provider base that tended to spend up to whatever limits Department rules would permit. The history of the Medicare cost settlement system provides a good example of the sort of cost escalation that this type of system encourages. The Office of the State Auditor has been furnished a copy of the Lewin-VHI report.
- At its July 19, 1996 public meeting, the Department's Board approved revised rules defining allowable and unallowable costs in greater detail and in a more consistent manner across the various programs administered by the agency. These rules, which are scheduled to become effective September 1, 1996, make attendance at cost report training mandatory, and define appropriate allocation methods and documentation requirements.

- The agency has worked with the Office of the Attorney General to investigate numerous cases of suspected cost report fraud and to assist in evaluating cases to determine whether they warrant prosecution.
- The last recommendation is for the Department to collect data which will enable it to identify how its contractors spend incremental increases in payment rates. Under Section 3-F of the report, the State auditors acknowledged that they attempted to do this and were unsuccessful. Generally, increases in payment rates are the result of increases in costs of direct client services incurred by the providers in a program. If the payment rates were to be increased to provide for a specific expansion in client services, then performance measures would be established for the providers to monitor and report results to the Department. The Department admits that this data collection and analysis is extremely difficult and subjective, and sees no real reason to expand its current procedures in this area unless a rate increase is tied to a mandated or requested expansion of client services.

Again, the Department appreciates the opportunity to respond to this report, if you have questions or need additional information regarding this response, please contact Chuck Lyon, Director, Internal Audit, at 438-3350.

Sincerely,

Terry Trimble

TT:cfl

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Auditor Follow-Up Comment to DHS Response

The types of expenditures of public funds which we identified would be considered totally unacceptable if expended by a state agency. We believe these expenditures should be considered equally unacceptable when expended by contractors acting on the State's behalf. There is a basic disagreement between DHS and the State Auditor's Office on the significance of the problems identified. However, it is our job to make state and agency leadership aware of weaknesses in accountability systems which could lead to inefficient and ineffective use of the State's resources. It will be up to decisionmakers of those entities to choose a corrective path if they believe it is warranted.

We respect DHS' right to express their position regarding our audit report, and we have thoughtfully considered this response and the specific points with which they take exception. After reviewing the information provided in the DHS response, the procedures we followed when conducting this audit, and the results derived from those procedures, we remain confident about the manner in which the results of our work are presented in this report and the conclusions we drew from those results.

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TEXAS DEPARTMENT OF PROTECTIVE AND REGULATORY SERVICES

EXECUTIVE DIRECTOR

James R. Hine

August 12, 1996

Lawrence F. Alwin, CPA
State Auditor
Two Commodore Plaza
206 East Ninth Street
Austin, Texas 78701

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Dear Mr. Alwin:

Over the last six months the Department has been working to improve its system of contract administration by implementing the recommendations made by your office in your *Contract Administration* audit reports. Thank you for providing me with the opportunity to respond to the recommendations contained in your most recent report, *Contract Administration At Health And Human Services Agencies (CM-4)*. In January, 1996 the Department began implementing a corrective action plan to address weaknesses in its contracting practices. Since January, we have made significant progress in improving our contract provisions, developing agency-wide contracting procedures and initiating efforts to recoup unallowable costs incurred by contractors. I feel that your audit report fairly represents our progress in addressing your earlier recommendations, and I appreciate your fair and accurate representation of our efforts.

The material which follows provides an update on the Department's progress in addressing the recommendations made by your Office in the February, 1996 *Contract Administration* report, followed by the Department's response to the expanded recommendations made by your Office in the *Contract Administration At Health And Human Services Agencies (CM-4)* report.

Recommendations Made by the State Auditor's Office in February, 1996

State Auditor Recommendation:

"Examine the DPRS rate-setting methodology and address known weaknesses in this methodology."

The Department agrees with the conclusion of the State Auditor that unallowable expenditures contained in contractor cost reports could impair the accuracy of the rate-setting process. During FY 1997, the Department will develop a competitive procurement process for the selection of 24-hour child care providers, consistent with the State Auditor's recommendation that the Department "use competitive procurement procedures whenever possible." Contractors for FY 1998 will be selected on a competitive "best value" basis which considers the quality, type, accessibility and costs of services. Consequently, at September 1, 1997 the Department will cease to rely on its current rate-setting methodology to establish rates. The Department is continuing to collect cost report data, as recommended by the State Auditor, for use in analyzing provider expenditures.

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State Auditor Recommendation:

“Strengthen methods to verify the accuracy of cost report data and impose stronger sanctions for reporting false data on cost reports.”

Cost reporting requirements have been strengthened in order to gather additional data regarding the financial condition of contractors. The Department’s new contracts allow the agency to require attendance at cost report training. Cost reporting requirements have been expanded to require additional financial information including a cost allocation plan, benefit policies, employee salary ranges (including executive salaries), copies of any related party leases and management agreements, and a reconciliation of cost report data to the provider’s general ledger.

Beginning in August, 1996, the Department will implement a targeted cost report audit strategy to determine the validity of cost report data (*i.e.*, identifying the range of potential error when the data are used for rate-setting functions.) The Department’s FY 1997 contracts require “accurately completed cost reports” and failure to provide accurate data may lead to adverse contractual actions including contract termination.

State Auditor Recommendation:

“Define allowable and unallowable expenditures and develop contract provisions which provide for recoupment of funds spent on unallowable costs.”

The Department’s FY 1997 contracts require contractor expenditures to be reasonable, necessary and allowable as defined in agency rules and federal OMB Circulars. Contract provisions also specify that the Department may “take actions to recoup payments made to the contractor or impose administrative error sanctions based on audit findings of violations of contract requirements.”

State Auditor Recommendation:

“Comply with federal regulations regarding child placing agencies and add provisions to child placing agency contracts which ensure this compliance.”

The Department proposes to resolve the federal audit finding related to child placing agencies by designating in its contracts effective September 1, 1996 the minimum amount that a child placing agency must pay to its foster families. This minimum amount establishes a basis for the Department’s claim for reimbursement of foster care maintenance costs from federal IV-E foster care funds. In addition, the Department’s contracts define the reasonable amount that a child placing agency may retain to pay for administrative costs as 22 percent of the total reimbursement. Expenditures for administrative costs in excess of the recommended 22 percent will be subject to audit and further justification.

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State Auditor Recommendation:

“Enhance guidance provided to DPRS regional offices regarding contract administration.”

The provision of increased training and support for regional employees with contracting responsibilities is a high priority of the Department. The Department has established a contract administration workgroup which has recommended a broad plan for the training and certification of regional contract employees, including training regarding the Department's new Contract Administration Handbook, distributed in May, and updated basic job skills training for contract employees. The Department is currently centralizing the management of regional contract staff in order to establish clear lines of communication and to ensure that business-like, consistent contracting policies are followed.

State Auditor Recommendation:

“Strive to contract with potential contractors through competitive procurement procedures whenever possible.”

The Department agrees that contractors should be selected on a competitive basis. The Department is moving toward a fully competitive system of contractor selection and will develop a procedure for the competitive selection of 24-hour child care providers in regions of the state during FY 1997. Providers will be selected on a competitive basis in FY 1998. The Department anticipates a number of benefits from increased competition, including lower administrative costs and the development of increasingly coordinated systems of care. Selection of 24-hour child care providers on the basis of a competitive proposal, with a proposed project budget, will eliminate the Department's need for its current foster care rate-setting methodology.

Expanded SAO Recommendations Resulting from the Review of Additional Contractors

State Auditor Recommendation:

“Implementation of the DPRS corrective action plan should be made a priority. Placing emphasis on recouping contract funds spent by contractors on unallowable items is critical.”

As mentioned in the report, the Department is currently attempting to recoup unallowable costs identified through the State Auditor's audit of PRS contractors. Recoupment of unallowable costs will remain a priority. The Department will continue to place a high priority on completing its corrective action plan. Stronger recoupment provisions have been placed in the Department's contracts effective September 1, 1996. The next major objective of the plan is implementation of an agency-wide risk-based system of financial and compliance audits to begin in November, 1996. The Department will recoup disallowed costs identified through these compliance audits.

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State Auditor Recommendation:

“DPRS should discontinue contracting with organizations which make repeated unallowable expenditures.”

Under the new contracts, the Department may sanction contractors that make unallowable expenditures and will develop plans to discontinue contracting with providers that make repeated unallowable expenditures. The Department intends to protect public dollars aggressively. Recently, two contractors of the Department were notified that they would not be granted a contract for a period of two years unless issues regarding disallowed costs were resolved.

State Auditor Recommendation:

“DPRS should conduct a study of the cost/benefit of alternative compensation methodologies. If the unit rate methodology is determined to be preferable, DPRS should consider gathering its own data to calculate unit rates and not rely upon contractor cost report data.”

The Department agrees with the State Auditor’s earlier recommendation that competitive procurement provides the best method for establishing the costs of foster care. Over the last six months, a Department taskforce has worked to develop the procurement standards and service definitions necessary to competitively procure foster care. Selection of 24-hour child care providers on the basis of a competitive proposal will eliminate the Department’s need for its current foster care rate-setting methodology.

State Auditor Recommendation:

“Although we saw no indications of overlapping services among the STAR, TJPC, or TCADA programs, DPRS STAR financial monitoring should be expanded to test for possible duplicate billings from contractors.”

The Department recognizes the need for effective controls that prevent double billing by STAR providers. The Department will assign a high priority to auditing STAR providers and will continue to verify that billing errors and double billings are not occurring.

We appreciate the cooperation and assistance of your staff as we work to improve our contracting system. Again, thank you for providing me with the opportunity to respond to your report.

Sincerely,

James R. Hine
Executive

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Director



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August 12, 1996

Mr. Lawrence F. Alwin, CPA
State Auditor
206 East Ninth Street, Suite 1900
Austin, Texas 78701

Dear Mr. Alwin:

Re: Report on Contract Administration at Selected Agencies - Phase Four

The Department concurs with the recommendations of the State Auditor's Office concerning contract administration and have prepared the following responses. We appreciate the in-depth review by your staff and the resulting improvements that will be achieved through the implementation of your recommendations.

Recommendation No. 1: TDHCA should monitor multiple programs at the same time.

Management's Response: The Department concurs that there is opportunity to improve the effectiveness of contractor oversight by coordinating monitoring visits of some programs, particularly those in high risk situations. Beginning in the 1997 fiscal year, the Department will review its monitoring systems, policies, and procedures to ascertain and determine the cases and circumstances when combined monitoring will be effective and efficient.

Recommendation No. 2: TDHCA should formalize coordination and communication between its program divisions and its Compliance Division to improve financial monitoring.

Management's Response: The Department agrees to formalize and strengthen the coordination among programs and compliance divisions, particularly relative to joint monitoring of high risk contractors.

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The development of a high risk based approach to joint monitoring procedures is currently in process. The risk-based system under development will be designed to provide reasonable assurance that the Department's contractors are providing quality services, are complying with applicable regulations, and have adequate controls in place to protect the Department's pass-through funds.

Recommendations No. 3: TDHCA should ensure that the policies and procedures recently formalized for the HOME Investment Partnership program continue to be implemented.

***Management's Response:** The recent implementation of the HOME Program Policies and Procedures Manual in June 1996 should clarify contractor performance standards. The Manual includes follow-up and resolution procedures relating to deficiencies identified during HOME Program contract monitoring visits and provides for the ability to impose an array of sanctions on contractors ranging from withholding funding to deobligating funds. The Manual provides for consistency in applying monitoring procedures. The continued use of the Manual will provide for on-going opportunities to improve the monitoring function.*

Recommendation No. 4: TDHCA should ensure that the underwriting standards for the Housing Trust Fund which are currently in draft form be formalized and implemented.

***Management's Response:** The Underwriting Division, in connection with the Housing Trust Fund, is finalizing underwriting procedures as they relate to the Housing Trust Fund application process. The underwriting standards will be in place for the 1997 fiscal year.*

Recommendations:

No. 5: Formalize and implement procedures for handling repeated financial discrepancies identified at contractors.

No. 6: Implement procedures to review contractor procurement procedures, especially those involving related parties, more extensively.

***Management's Response:** The Department concurs with the need to formalize and expand particular monitoring procedures used in the oversight of the*

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Page 3

Community Affairs Division's contractors. The following will be accomplished during the 1997 fiscal year:

- *Procedures for addressing repeated financial discrepancies will be formalized.*
- *Contractor procurement procedures will be reviewed more extensively during monitoring visits. Detailed procurement review procedures, especially those involving related parties, will be included within the monitoring instruments used for all Community Affairs Division's programs.*

Recommendations:

No. 7: Require program monitors to select expenditure samples for testing based on risk analysis, and require expansion of the sample size if discrepancies are noted.

No. 8: Require program monitors to test both a sample of checks and a sample of general ledger journal entries.

No. 9: Expand CEAP cash disbursement testing and performance information verification.

Management's Response: The Department agrees with the recommendations to improve the efficiency and effectiveness of the monitoring function and intends to implement these recommendations on future monitoring visits.

Recommendation No. 10: Consider creating and maintaining centralized permanent files when reviewing contractors' policies to reduce duplication of work.

Management's Response: The Community Services (CS) section currently maintains an eligibility file (permanent file) for each of its contractors which contains the contractors' policies and procedures. This file system will be expanded to include the Energy Assistance (EA) contractors not common to CS. The contractor eligibility files will be updated as a result of monitoring visits.

Recommendation No. 11: Include within the ESGP contract the same provision regarding subcontracts that is included within other Community Service contracts.

Management's Response: The Department will revise the Emergency Shelter Grants Program (ESGP) contract. The contract will require that the ESGP

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contractor notify the Department of the contractor's intent to engage any subcontractor or organization not identified in the original ESGP contract performance statement.

Recommendation No. 12: Include within the CEAP contract the same provisions regarding equipment inventories, equipment useful life standards, and allowable expenditures that are incorporated in the WAP contract.

***Management's Response:** The Comprehensive Energy Assistance Program contracts will be amended to include the provisions regarding equipment inventory, equipment useful life standards, and allowable expenditures that currently are included in the Weatherization Assistance Program contract.*

Recommendation No. 13: Include with in the NARP contract a clear provision requiring the contractor to obtain an annual audit.

***Management's Response:** The Department has clarified the annual audit requirements of the Native American Restitution Program contract.*

Thank you for the courtesies extended by your staff during the course of their review. Their hard work and dedication have assisted the Department and its staff in instituting some needed changes to make the contract administration process more efficient and effective.

Sincerely,

Larry Paul Manley
Executive Director



TEXAS JUVENILE PROBATION COMMISSION

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EXECUTIVE DIRECTOR
Vicki Wright

August 13, 1996

Nancy McBride
Contract Administration Phase 4 (CM4) Project Manager
Office of the State Auditor
206 East 9th Street, Suite 1900
Austin, Texas 78701

Dear Ms. McBride:

The TJPC responses to the State Auditor's Contract Administration Audit are attached. If you have any questions regarding this document, please don't hesitate to contact either me or Herb Hays.

The staff of TJPC appreciate the professionalism and helpfulness that you and your staff displayed during this audit engagement.

Sincerely,

Steve Bonnell
Deputy Executive Director

RESPONSE TO CONTRACT AUDIT REPORT

Section 6-A: Oversight of Subcontractors Receiving TJPC Funds from Local Juvenile Probation Departments and Judicial Districts Needs to be Strengthened.

All TJPC contracts for FY 1997 have been upgraded to require the local juvenile probation departments and judicial districts to implement a program of contract management for their subcontractors. Specifically, a section has been added to the contract which makes the local departments responsible for contract management. Each department will be required to obtain contractual services on a competitive basis and will be responsible for program and financial monitoring. Restrictions on the use of state funds will be included in the local juvenile probation department's contracts with all subcontractors. Formal written contract management procedures including sanctions for non compliant subcontractors are also required by the new contract. TJPC program monitors will be responsible for determining if the local departments are in compliance with these contract management provisions.

Section 6-B: While TJPC has Procedures in Place for Financial Monitoring, the Informal Nature with which these Procedures are Applied has Resulted in Some Financial Discrepancies Going Undetected

TJPC has developed a formalized financial monitoring checklist to aid in our financial monitoring. (See the attached Sheet entitled "Review of Independent Audit") The TJPC Fiscal Officer reviews this checklist and the work performed by the financial monitor.

The new TJPC contracts for FY 1997 contain an assurance that the matching requirements of the Challenge Grant program have been met. This assurance must be noted by the C.P.A. performing the final audit before the audit is accepted by TJPC.

Section 6-C. Program Monitoring

Documentation prepared by TJPC program staff is now routinely reviewed by the Director of Program Services in order to maintain consistency and to insure that all documentation is completed such as checklists, signatures, etc. It is and has been the philosophy of TJPC that minor standards (those that do not impose a health and safety issue) may not be included in the monitoring report as a

noncompliance. There are probation department budget issues, newly established departments, newly appointed chief probation officers, and other mitigating circumstances that prevent a department from coming into compliance with a particular standard. The program staff provides technical assistance to assist the department in coming into compliance in a timely manner. Determination of any mitigating circumstances and which non-compliant standards will not be included in the monitoring report is accomplished through a division "case staffing" with final approval from the Director of Program Services.

Although instances of a noncompliance not mentioned in the monitoring summary report may have been occurring in the audit year of 1994, the instances are now rare, if at all.

Conducting "program monitoring reviews at approximately one-half of the local juvenile probation departments . . ." is not established policy, is not reoccurring, and was necessary only during the 74th legislative session because of the unusually massive amount of juvenile justice legislation. Review of 100 percent of probation departments in the state is the established policy of TJPC and was achieved in fiscal year '96 and will continue. If it ever becomes necessary in the future to reduce the number of departments to be monitored, a formal risk assessment will be developed to determine which departments should be reviewed and not reviewed.

TJPC has developed and implemented a centralized list of juvenile departments at which there have been prior instances of noncompliance with standards.

The TJPC policy that a program monitor will not review a probation department in which he or she has worked has been formalized. Each monitor must now sign an "Independence Statement" (attached).

Section 6-D: Published TJPC procedures for awarding Challenge Grants have not always been followed

The auditors are correct in their description of what transpired regarding the Challenge Grant program in FY 1996. An independent internal audit of the program in 1995 recommended that departments be awarded funds on the basis of a competitive Request for Proposals, and the recommendation was implemented for 1996. In retrospect, the decision was an ill-advised one for two reasons:

1. The legislation creating the program requires that funds be

awarded to nine departments in three population groups. Theoretically, the highest ranking proposals in a competitive situation would not be distributed evenly within those groups.

2. The program itself is strictly defined in the legislation. All funded programs must follow the same guidelines and procedures. There is very little room then for innovation or comparative evaluation of merit among individual programs.

For these reasons, TJPC has re-instituted a simple application for Challenge Grant funds, rather than a competitive RFP. In the future, funds will be made available to the departments based on their previous level of funding, with adjustments to accommodate any new applicants.

Section 6-F: One TJPC Rider to the General Appropriation Act May be Unnecessary, While Another Rider Conflicts with Statute.

TJPC agrees that Rider #8 of the General Appropriation Act is unnecessary and supports its elimination.

TJPC supports the revision of the Human Resources Code to require that local support for juvenile services be equal to or greater than that *of the first year of the previous biennium*.



Texas Department of Health

David R. Smith M.D.
Commissioner

Carol S. Daniels
Deputy Commissioner for Programs

Roy L. Hogan
Deputy Commissioner for Administration

Randy P. Washington
Deputy Commissioner
for Health Care Financing

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August 8, 1996

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

Dear Mr. Alwin:

On July 29, 1996, your office provided us a draft report entitled *Contract Administration At Selected Agencies, Phase Four*, and requested that we review and provide written comments on the report.

We are pleased that your audit found no weaknesses in TDH monitoring of the program included in your audit.

We are interested, however, in making continued improvements in our contracting system and 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.
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

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Mr. Lawrence F. Alwin, CPA
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August 8, 1996

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*.

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

Appendix 1:

Objectives, Scope, and Methodology

Objectives

The primary objectives of this project were to identify instances of fraud, waste, or abuse of taxpayer funds and to identify specific systemic weaknesses at the Texas Department of Human Services, Texas Department of Health, Texas Department of Protective and Regulatory Services, Texas Department of Housing and Community Affairs, and the Texas Juvenile Probation Commission which would allow such instances to occur. To accomplish these objectives, we focused on determining the following:

- Do contractors 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 payment rates ensure that the State pays a fair and reasonable rate for services provided by contractors?

Scope

The scope of this audit included contracts for the five agencies specified above. The contract periods varied between agencies and programs, but generally we reviewed records for the contractors' fiscal year 1994.

We reviewed the financial records of 40 contractors (including 6 subcontractors) that provide services directly or indirectly to the five agencies specified above. The contractors and subcontractors were judgmentally selected using an informal risk analysis designed to identify high-risk contractors.

Contractors were given a copy of all potential findings and questionable expenditures and were asked to submit additional information which might clear the findings. The questionable expenditures contained in this report have been reduced accordingly for any information subsequently submitted by the contractor.

Our work at the Texas Department of Housing and Community Affairs and the Texas Juvenile Probation Commission 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

(Similar work was previously conducted at the Texas Department of Human Services, Texas Department of Protective and Regulatory Services, and Texas Department of Health

in SAO Report No. 96-047, *Contractor Administration at Selected Health and Human Services Agencies - Phase Three.*)

Methodology

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

Information collected to accomplish our objectives included the following:

- Interviews with management and staff of the Texas Department of Human Services, Texas Department of Health, Texas Department of Protective and Regulatory Services, Texas Department of Housing and Community Affairs, and the Texas Juvenile Probation Commission
- Interviews with executive directors and accounting staff from the 40 contractors visited
- Documentary evidence such as:
 - Policies and procedures related to contract administration and rate-setting practices at the funding agencies
 - Applicable federal and state statutes and guidelines
 - Contract monitoring files/contractor selection files from the funding agencies
 - Accounting policies and procedures used by the contractors
 - Contractors' board meeting minutes

Procedures and tests conducted:

- Review of sufficiency of contract provisions and tests of contractor compliance with contractual terms
- Tests of contractors' revenue transactions to determine if revenue was properly accounted for
- Tests of contractors' expenditures to determine if expenses were reasonable and necessary to the program objectives and specifically allowed by applicable state or federal guidelines
- Tests of contractors' billings to the funding agencies to determine if services billed were actually 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 contractors to determine accuracy of information used in the rate-setting process
- Review of the process used to evaluate contract budgets proposed by contractors

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
- Texas Administrative Code
- 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 January 15, 1996, through June 28, 1996. 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:

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Also, personnel from the Texas Workforce Commission, Texas Department of Mental Health and Mental Retardation, The University of Texas Southwestern Medical Center at Dallas, and the Texas Education Agency assisted us in our work.

Appendix 2:

Description of Agency Programs Reviewed

Texas Department of Human Services		
Program	Description	Fiscal Year 1995 Funding Associated with Program
Nursing Facility	Nursing facility contractors provide eligible Medicaid clients with room, board, institutional services, and medical services.	\$ 1,148,729,754
Primary Home Care	Primary home care contractors provide eligible Medicaid clients with nontechnical, medically related personal care services which have been prescribed by a physician.	\$ 290,863,149

Texas Department of Protective and Regulatory Services		
Program	Description	Fiscal Year 1995 Funding Associated with Program
Residential Treatment Center	Residential treatment center contractors provide residential services to children who are placed in these centers by the Department of Protective and Regulatory Services.	\$ 65,970,740
Child Placing Agency	Child placing agency contractors assist the Department of Protective and Regulatory Services in recruiting qualified foster care homes.	\$ 31,641,394
Services to At-Risk Youth (STAR)	STAR contractors provide services to youths and their families to help them resolve problems leading to running away, truancy, or abusive behavior.	\$ 3,604,532 (increased to \$8,099,705 in fiscal year 1996)

Texas Department of Housing and Community Affairs		
Program	Description	Fiscal Year 1995 Funding Associated with Program
Comprehensive Energy Assistance Program (CEAP)	CEAP contractors provide assistance to persons with an energy related crisis, energy co-payments, elderly assistance, and energy retrofitting, repair and replacement.	\$ 24,269,444
Weatherization (includes Weatherization Assistance, Enhanced Weatherization Assistance, and Weatherization Plus Programs)	Weatherization contractors provide assistance to low-income persons to make their homes more energy efficient, make minor structural repairs, and promote energy conservation.	\$ 4,853,889

Texas Department of Housing and Community Affairs (continued)		
Program	Description	Fiscal Year 1995 Funding Associated with Program
Community Services Block Grant (CSBG)	CSBG contractors use CSBG funds to finance the administration of Community Action Agencies.	\$ 18,760,188
Community Food and Nutrition Program (CFNP)	CFNP contractors implement projects to improve coordination of private and public assistance resources to better serve the nutrition needs of low-income communities.	\$ 349,539
Emergency Community Service Homeless Grant Program (EHP)	EHP contractors provide services to the homeless.	\$ 975,292
Emergency Shelter Grants Program (ESGP)	ESGP contractors provide shelter and services to homeless persons and implement programs to prevent homelessness.	\$ 4,572,000
Emergency Nutrition/Temporary Emergency Relief Program (ENTERP)	ENTERP contractors provide emergency assistance and energy related assistance to low-income persons.	\$ 6,821,309
Community Development Fund	Community Development Fund contractors use community development funds to provide public facilities, housing rehabilitation, and affordable housing.	\$ 52,451,820
Colonia Fund	Colonia Fund contractors use funds for infrastructure improvements and planning services in communities meeting the definition of a colonia.	\$ 7,900,000
Planning and Capacity Building Fund	Planning and Capacity Building Fund contractors use funds for activities designed to increase local government involvement in community and economic development efforts.	\$ 794,000
Texas Capital Fund (jointly administered with the Texas Department of Commerce)	Texas Capital Fund contractors use funds to create or retain permanent jobs, primarily for low- and moderate-income people, by assisting business development and expansion.	\$ 14,881,000
Disaster Relief/Urgent Need Fund	Disaster Relief/Urgent Need contractors use funds for recovery from natural disasters and to resolve threats to public health or safety.	\$ 7,025,490
Housing Trust Fund	Housing Trust Fund contractors use funds to finance, acquire, rehabilitate and develop decent, safe, and sanitary housing.	\$ 7,968,033
HOME Investment Partnership Program	HOME contractors use funds for owner-occupied housing assistance, tenant-based rental assistance, and rental project assistance in order to preserve the supply of safe, decent, affordable housing.	\$ 9,881,264

Texas Juvenile Probation Commission		
Program	Description	Fiscal Year 1995 Funding Associated with Program
State Aid	Local juvenile probation departments and judicial districts use these funds for the provision of basic probation services.	\$ 15,394,285
Community Corrections	Local juvenile probation departments and judicial districts use these funds for residential and non-residential services in order to divert juveniles from the Texas Youth Commission.	\$ 28,103,655
Innovative and Creative Grant	Local juvenile probation departments and judicial districts use these funds for innovative programs for juveniles in the juvenile justice system.	\$ 1,716,869
Challenge Grant	Local juvenile probation departments and judicial districts use these funds for addressing the unique challenges associated with multiple problem youth.	\$ 1,309,211
Border Contracts	Local juvenile probation departments and judicial districts use these funds to address problems associated with foreign juveniles who commit crimes in Texas.	\$ 120,618

Texas Department of Health		
Program	Description	Fiscal Year 1995 Funding Associated with Program
Women, Infants, and Children (WIC) Nutrition Program	WIC contractors provide supplemental food vouchers, nutrition education, and immunizations to low income pregnant and postpartum women, infants, and children identified to be at nutritional risk.	\$ 257,782,467

Appendix 3:

Elements of an Effective Contract Administration System

All four of the control areas are important to an effective system of contract management.

Control Area	Elements
Contractor Selection	<p>Procurement process should be sufficient to ensure that the best contractors are fairly and objectively selected.</p> <ul style="list-style-type: none"> . Whenever feasible, and unless otherwise prohibited by law or other restrictions, contractors should be selected through competitive procurement procedures. . Past performance should be considered in subsequent selection/contract renewal decisions. . Formal, documented procedures should be used to assess prospective contractors' strengths and weaknesses.
Contract Provisions	<p>Contract provisions and agency regulations should be sufficient to hold contractors accountable for delivery of quality services and prevent the inappropriate or inefficient use of public funds .</p> <p>Contract provisions should contain all of the following:</p> <ul style="list-style-type: none"> . Clear statements of services and goods expected from the contractor . Clearly defined performance standards and measurable outcomes . Clear statements of how contractor performance will be evaluated . Sanctions sufficient to hold contractors accountable for failing to meet intended objectives . Appropriate restrictions regarding the contractors' use of public funds . Specific audit clauses which allow the funding agency and other oversight entities access to the contractors' books and records
Payment Reimbursement Methodology	<p>Methods used to establish contractor reimbursement should be sufficient to ensure that the State pays a fair and reasonable price for services.</p> <ul style="list-style-type: none"> . Prior to the contract award, the cost of services, as well as the services themselves, should be analyzed in order to determine the most effective payment methodology. . Approval of proposed contractor budgets should focus on ensuring that proposed expenses are reasonable and necessary to accomplish program objectives. Both program results and contractor efficiency should be considered as part of the budget approval process. . For unit-rate contracts, the rate-setting process should ensure that there is a reasonable correlation between the quality of the services provided, costs of providing the services, and the rate paid.

Control Area	Elements
Contractor Oversight	<p>Contractor oversight should be sufficient to ensure that contractors consistently provide quality services (by measuring performance against well-documented expectations) and that public funds are spent effectively and efficiently.</p> <ul style="list-style-type: none">. Monitoring functions should focus on the outcomes of services provided and the cost-effectiveness/prudence of contractor expenditures in addition to compliance with regulations.. Results of monitoring reviews, audits and investigations should be routinely followed up on to ensure corrective actions have been taken and to identify common problem areas.. A formalized risk assessment process should be used to select contractors for review and identify the level of review necessary at each contractor.. Standardized criteria should be established to evaluate contractor performance.

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