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A Report on

# **On-site Audits of Residential Child Care Providers**

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# On-site Audits of Residential Child Care Providers

## Overall Conclusion

Three of the five residential child care contractors (providers) audited did not consistently maintain documentation to demonstrate that they accurately reported funds they expended for providing 24-hour residential child care services. Those three providers were:

- Wings of Refuge, Inc. (see Chapter 1).
- Houston Wee Care Shelter, Inc. (see Chapter 2).
- New Encounters, Inc. (see Chapter 3).

The providers receive funds from the Department of Family and Protective Services (Department) for the delivery of goods and services—such as therapy, food, shelter, and clothing—that promote the mental and physical well-being of children placed in the providers' care. Providers deliver those services through contracts with the Department and report their revenue and expenditures on annual cost reports.

Wings of Refuge, Inc. had serious weaknesses in its financial processes. Those weaknesses create a significant risk of misappropriation of federal and state funds. Wings of Refuge did not submit a 2012 cost report until July 2, 2013, which was 93 days after the Department's due date and after auditors were no longer on site. Because of this, auditors were limited in the scope of work that could be performed at that provider. In addition, auditors identified \$62,031 in purchases and cash withdrawals during the 2012 cost reporting period that the provider made in California, although the provider is contracted to provide services for children in Texas. After audit fieldwork was completed, the Department notified Wings of Refuge, Inc. on August 1, 2013, that it would not exercise the renewal option in the provider's current contract for child placing services; therefore, the contract will expire on August 31, 2013.

### Background Information

During fiscal year 2012, the Department of Family and Protective Services (Department) had 386 contracts with 230 providers to provide residential child care on a 24-hour basis.

Auditors selected for this audit the following types of licensed providers with which the Department contracts:

- **Child placing agency:** An entity that places children in adoptive homes or other residential care settings.
- **Residential treatment center:** A general residential operation for 13 or more children or young adults that exclusively provides treatment services for children with emotional disorders.

The Department received approximately \$358,056,594 for providing services to the 27,208 children in foster care during fiscal year 2012.

Approximately 68 percent of the funding for those services comes from the federal government and approximately 32 percent comes from the State.

Texas Government Code, Section 2155.1442(b), requires the Health and Human Services Commission to contract with the State Auditor's Office to perform on-site audits of selected residential child care providers that provide foster care services to the Department.

Sources: Unaudited information provided by the Department.

Two providers audited generally had adequate documentation to demonstrate that they accurately reported the funds they expended for providing 24-hour residential child care services. Those two providers were:

- Refuge House, Inc. (see Chapter 4).
- Children of Diversity, Inc. (see Chapter 5).

Auditors identified internal control weaknesses at all five providers. Those control weaknesses are the responsibility of the providers and not the external accountants. Specifically:

- Two providers lacked detailed, written policies and procedures for key financial processes.
- Two providers did not have adequate segregation of duties.
- Two of the four providers that had external accountants did not conduct reviews of the financial information their external accountants prepared.
- One provider created its general ledger from bank statements instead of financial transaction documents such as revenue receipts, invoices, and purchase receipts.

Auditors also identified instances of noncompliance with cost-reporting requirements at three providers audited. As stated previously, one provider did not submit a 2012 cost report until audit fieldwork had been completed. In addition, all five providers fully complied or substantially complied with background check requirements.

Two of the three providers audited that are child placing agencies (Refuge House, Inc. and Children of Diversity, Inc.) generally paid their foster parents the required amounts according to the children's level of care and days of service. However, those two providers should improve their documentation of and compliance with foster parent monitoring requirements. Children of Diversity, Inc. did not conduct any unannounced foster parent monitoring visits and did not conduct all quarterly visits for 7 (70 percent) of 10 foster homes tested. The third provider that is a child placing agency (Wings of Refuge, Inc.) did not accurately calculate the reimbursement rates for foster parents for 21 percent of the items tested.

Auditors also communicated other, less significant issues separately in writing to each provider.

## ***Summary of Management's Response***

Four of the providers audited agreed with the recommendations that were addressed to them. One provider, Wings of Refuge, did not agree with the findings that transactions reflected on its bank statements were not reflected in its general ledger, its general ledger did not reflect double-entry bookkeeping, and that it was inappropriate to report transactions in a suspense account. It also disagreed with the findings that because it did not maintain complete financial records, it was at risk of (1) allowing fraudulent activity to occur undetected and (2) misappropriating federal and state funds. Wings of Refuge did not provide any additional information in its management response to cause the State Auditor's Office to modify the conclusions in this report.

The detailed management responses from the five providers audited are presented in Appendices 6 through 10 beginning on page 46.

## ***Summary of Information Technology***

Four of the five providers relied on accounting systems that external accountants maintained. In addition, four of the five providers did not have a valid contract in place establishing the responsibilities and expectations regarding the services being provided and requiring that adequate controls be in place to secure the accounting system and the provider's financial data. Only two providers had policies and procedures regarding information technology and the security environment over the accounting system used to create their general ledgers.

## ***Summary of Objective, Scope, and Methodology***

The objective of this audit was to perform on-site financial audits of selected providers and included verifying that the selected providers were spending federal and state funds on required services that promote the well-being of foster children in their care.

The scope of this audit included performing work at five providers to assess the appropriateness, reasonableness, and necessity of expenditures that providers made during each provider's fiscal year 2012 cost reporting time period. In addition, auditors tested payments received from the Department during each provider's fiscal year 2012 cost reporting time period.

The audit methodology included judgmentally selecting five providers based on (1) risk factors the Department uses in its annual statewide monitoring plan and (2) the providers' contract status as reported by the Department. Additionally, the audit methodology included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of the tests; and interviewing management and staff at the Department and providers.

Auditors assessed the reliability of the data used in the audit and determined the following:

- Two (40 percent) of the 5 providers had financial data that was not sufficiently reliable to perform audit procedures.
- Two (40 percent) of the 5 providers had financial data that was sufficiently reliable to perform audit procedures.
- One provider's financial data was of undetermined reliability.

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## Detailed Results

Chapter 1

### Wings of Refuge, Inc.

| Wings of Refuge, Inc.<br>Background Information <sup>a</sup>  |  |
|---|--|
| Location  | Houston, TX  |
| Contract services audited                                     | Child placing agency   |
| Number of children served                                     | 39   |
| Average length of a child's stay in days                      | 127.3  |
| Total revenue from the Department                             | \$264,899  |
| Total revenue for child placing agency                        | Could not be determined  |
| Federal tax filing status                                     | Non-profit status has been revoked by the Internal Revenue Service     |
| Number of staff at year end                                   | Wings of Refuge, Inc. used contract labor during the reporting period. |
| <sup>a</sup> From January 1, 2012, through December 31, 2012. |  |

Sources: The Department of Family and Protective Services, the provider, and analyses conducted by the State Auditor's Office.

Wings of Refuge, Inc. (provider) had serious weaknesses in its financial processes. As a result of those weaknesses, auditors determined that data necessary to perform the audit objectives was unreliable, and auditors could not determine whether the provider accurately reported funds it expended for providing child placing services. The weaknesses in the provider's financial processes also create a significant risk of misappropriation of federal and state funds.

The provider did not submit a 2012 cost report as required by the Department of Family and Protective Services (Department) before the end of fieldwork for this audit. Although the 2012 cost report was due on March 31, 2013, the provider did not submit its 2012 cost report until July 2, 2013, which was 93 days after the due date. Furthermore, auditors determined that the data contained in the provider's general ledger was unreliable for purposes of this audit. Because of that, auditors were limited in the scope of work that could be performed at the provider.

Auditors noted that the provider had purchases and cash withdrawals listed on its Houston bank statements for the 2012 cost reporting period (January 2012 through December 2012). Those charges were for purchases and cash withdrawals that occurred in California, even though the child placing services took place in Texas. Those charges did not appear on the general ledger that the provider submitted to the State Auditor's Office. In addition, auditors could not determine whether those purchases were made using Department funds because the provider deposited other revenue sources into the Houston account throughout the 2012 calendar year.

The onsite manager of the provider's Houston office did not have access to the provider's financial information, debit and credit cards, or bank accounts. That information is maintained at the provider's California office and was not reviewed by anyone in the Houston office during the 2012 cost reporting period.

In addition, auditors determined that the provider:

- Submitted all subcontracted employees and volunteers hired after January 1, 2011, and active during fiscal year 2012 for background checks to the Department. However, the provider should improve its background check processes to ensure that employees clear background checks before their start dates.
- Submitted all active foster parents, occasional caregivers, and household members for background checks to the Department. However, the provider should improve its background check processes to ensure that each foster parent, occasional caregiver, and household member clears background checks before the foster home's verification date.
- Complied with foster parent monitoring requirements. For the 11 foster homes active during the 2012 cost reporting period, the provider appropriately conducted all required monitoring visits in a timely manner.

After audit fieldwork was completed, the Department notified the provider on August 1, 2013, that it would not exercise the renewal option in the provider's current contract for child placing services; therefore, the contract will expire on August 31, 2013.

#### Wings of Refuge Management Response

In its management response, Wings of Refuge did not agree with the findings that transactions reflected on its bank statements were not reflected in its general ledger, its general ledger did not reflect double-entry bookkeeping, and that it was inappropriate to report transactions in a suspense account. It also disagreed with the findings that because it did not maintain complete financial records, it was at risk of (1) allowing fraudulent activity to occur undetected and (2) misappropriating federal and state funds.

#### Auditor Follow-Up Comment

Wings of Refuge did not provide any additional information in its management response to cause the State Auditor's Office to modify the conclusions in this report.

Wings of Refuge's detailed management response is presented in Appendix 6 beginning on page 46.

Chapter 1-A

**The Provider Should Improve Its Compliance with Cost Report Requirements**

The provider did not comply with cost report requirements for the 2012 cost reporting period. The provider did not submit a 2012 cost report until July 2, 2013, which was 93 days after the due date and after auditors were no longer on site. The 2012 cost report was due on March 31, 2013. Auditors were unable to perform certain audit procedures related to the accuracy of the information reported in the provider's 2012 cost report because it was submitted after auditors had completed fieldwork for this audit. Because of this, auditors were limited in the scope of work that could be performed at the provider.

The Department may excuse a provider from submitting a cost report if the provider meets one of the following criteria for the cost reporting year:

- The Department terminated or did not renew its contract with the provider.
- The provider administered only basic level services.
- The total number of state-placed days was 10 percent or less of the total days of service.
- The total number of Department-placed days was 10 percent or less of the total days of service.

However, the provider did not meet any of the criteria listed above. In addition, the Department did not excuse the provider from submitting the 2012 cost report.

The Health and Human Services Commission (Commission) uses provider cost reports to determine the daily rates that providers are paid for taking care of foster children (see Appendix 5 for additional information about daily rates). Not reporting financial information on a cost report could cause the Commission to set the daily rates at inappropriate amounts.

**Recommendation**

The provider should prepare and submit its cost report in accordance with Department requirements and on time.

## The Provider Has Serious Weaknesses Over Its Financial Processes

As stated previously, the provider did not submit a 2012 cost report in a timely manner. As a result, auditors could not complete the necessary audit procedures related to the cost report. Auditors performed additional procedures to gain some assurances that the provider's financial information was complete and accurate. Auditors determined that the provider did not have a reliable general ledger for the 2012 calendar year. Specifically:

### Suspense Account

A suspense account is an account for the temporary entry of charges, credits, or doubtful accounts receivable pending determination of their ultimate dispositions.

### Double-entry Bookkeeping

Double-entry bookkeeping is a system of keeping accounting records that recognizes the dual nature of every financial transaction. In that system, every transaction is entered twice in an account. The first entry records a change in the assets (called a "debit"). The second entry, which mirrors the first entry, records a change in the equities (called a "credit").

- There were \$27,063 in transactions held in a suspense account. Transactions should not be reported in a suspense account (see text box for the definition of a suspect account).
- Transactions reflected on the provider's bank statements were not reflected in the general ledger provided to auditors.
- The general ledger did not reflect double-entry bookkeeping (see text box for the definition of double-entry bookkeeping).

According to the *Minimum Standards for Child-Placing Agencies* (Title 1, Texas Administrative Code, Section 749.161(b)), a provider must maintain complete financial records. By not maintaining complete financial records, the provider is at risk of:

- Allowing fraudulent activity to occur undetected.
- Misappropriating federal and state funds.

In addition, auditors reviewed, in detail, all of the provider's 2012 calendar year bank statements. Auditors identified \$62,031 in purchases and cash withdrawals on those bank statements that occurred in California, although the child placing services take place in Texas. The provider asserted that those purchases and cash withdrawals were the result of identity theft. However, the provider had not submitted a claims dispute form to its banking institution until June 2013, after auditors questioned the transactions. The dispute form the provider submitted to the bank disputed only the charges from November 2012 through February 2013. However, auditors determined that those charges were made throughout the 2012 cost reporting period. Examples of the purchases, all made in California, included charges made at restaurants, department stores, and female clothing stores such as Grand Lux Café, Nordstrom, Macy's, Lerner (metrostyle), Lane Bryant, Victoria's Secret, and Kate Spade. Auditors could not determine whether those purchases were made using Department funds because the provider deposited other revenue sources into its Houston account throughout the 2012 calendar year.

In addition, the onsite manager of the provider's Houston office did not have access to the provider's financial information, debit and credit cards, or bank accounts. That information was maintained at the provider's California office and was not reviewed by anyone in the Houston office during the 2012 cost reporting period.

While the provider had some internal controls in place, auditors identified significant deficiencies in the provider's controls in several areas. Auditors could not verify that the provider completed bank reconciliations every month, and the provider did not review its 2012 bank statements in a timely manner. The provider's chief financial officer stated that she reconciled the statements on a monthly basis; however, as stated previously, there were \$62,031 in expenditures that management asserted were the result of identity theft. Those expenditures should have been identified during the bank reconciliations if those reconciliations were performed on a monthly basis. The weaknesses in the provider's processes for reconciling banks statements are further support for the unreliability of the provider's general ledger.

In addition, an independent auditor's report on the provider's parent organization for the fiscal year ended December 31, 2011, identified \$458,737 in delinquent payroll taxes at the provider payable to the Internal Revenue Service (IRS), the California Franchise Tax Board, and the State of California Employment Development Department. The provider's parent organization had \$1.8 million in outstanding loan balances and a net operating loss of \$299,594 in 2011. The parent organization had net operating losses in 2009 and 2010, as well.

The provider did not submit IRS Form 990 (Return of Organization Exempt From Income Tax) for three consecutive years. As a result, the IRS revoked the provider's tax-exempt status in May 2012. As of June 12, 2013, the provider's tax-exempt status remained revoked.

The provider generally complied with the Department's contractual guidelines for child placing agencies regarding the reimbursement of foster parents, with some exceptions. The provider had supporting documentation for all 29 foster parent payments tested. However, it did not correctly calculate the reimbursement rates to its foster parents for 6 (21 percent) of those 29 payments tested.

The provider outsources its information technology services. However, the provider did not have a valid contract in place for the 2012 cost reporting period. Specifically, the provider did not sign the contract. In addition, the provider does not have policies and procedures for its information technology and the security surrounding its information technology environment.

## Recommendations

The provider should:

- Ensure that bank reconciliations are performed in a timely and appropriate manner.
- Ensure that it operates on a sound fiscal basis as required by the Texas Administrative Code.
- Ensure that all contracts contain all parties' signatures.
- Develop and implement written policies and procedures for information technology and the security surrounding the information technology.

Chapter 1-C

### **The Provider Generally Complied with the Department's Background Check Requirements; However, There Are Areas for Improvement**

The provider submitted all employees, active foster parents, occasional caregivers, and household members for background checks to the Department in accordance with Department requirements. As of June 2013, the provider had current background checks for all 20 employees and volunteers who performed services for the provider and for all 38 active foster parents, occasional caregivers, and household members who were active during the 2012 cost reporting period. However, the provider should strengthen its background check process by ensuring that employees, foster parents, occasional caregivers, and household members clear a background check prior to their hire or contract dates.

The Department requires that those individuals clear a name-based background check before they provide direct care to children or have direct access to the children in the provider's care. The Department requires providers to submit individuals for a subsequent background check at least once every 24 months after the initial check. (See Appendix 3 for additional information about background check requirements.)

#### **Employees**

As of June 2013, all 20 subcontracted employees and volunteers hired after January 1, 2011, and active during calendar year 2012 had current background checks. However, 9 (45 percent) of the 20 subcontracted employees and volunteers tested had background checks that were not cleared before their start dates. For those 9 individuals, background checks were submitted between 1 day and 343 days late. The provider completed subsequent

background checks for the two individuals who required a background check to be performed within 24 months after the initial check.

## **Foster Parents, Occasional Caregivers, and Household Members**

As of June 2013, all 38 foster parents, occasional caregivers, and household members active during the 2012 cost reporting period had current background checks. However 16 (42 percent) of those 38 foster parents, occasional caregivers, and household members tested had background checks that were not cleared before their start dates. For those 16 individuals, background checks were submitted between 1 day and 193 days late. The provider completed subsequent background checks for the seven individuals who required a background check to be performed within 24 months after the initial check.

Auditors also requested that the Department of Public Safety perform criminal background checks for all individuals who were current employees, foster parents, occasional caregivers, and household members in March 2013. There were no reported offenses that may violate the Department's rules.

## **Recommendation**

The provider should ensure that background checks are performed in a timely manner and in accordance with the Department requirements.

### Chapter 1-D

## **The Provider Conducted Monitoring Visits at Foster Homes in Accordance with Department Requirements**

The provider complied with foster parent monitoring requirements. For the 11 foster homes active in during the 2012 cost reporting period, the provider appropriately conducted all 22 required monitoring visits in a timely manner. Furthermore, all quarterly monitoring visits were signed by the appropriate parties. Monitoring visits are the primary way for the provider to help ensure that foster homes comply with all Department standards.

**Houston Wee Care Shelter, Inc.**

| Houston Wee Care Shelter, Inc.<br>Background Information <sup>a</sup> |                              |
|---|------------------------------|
| Location  | Spring, TX                   |
| Contract services audited   | Residential treatment center |
| Number of children served   | 30                           |
| Average length of a child's stay in days                              | 97                           |
| Total revenue from the Department                                     | \$361,725                    |
| Total revenue for residential treatment center services               | \$610,958                    |
| Federal tax filing status   | Non-profit                   |
| Number of staff at year end   | 12                           |
| <sup>a</sup> From January 1, 2012, through December 31, 2012.         |                              |

Houston Wee Care Shelter, Inc. (provider) did not maintain adequate supporting documentation to demonstrate that it accurately reported funds it expended for providing 24-hour residential child care services. The provider did not have adequate supporting documentation for \$11,289 (57 percent) of the \$19,870 in direct and administrative expenditures the provider included on its 2012 cost report that auditors tested. In addition, the provider did not maintain adequate supporting documentation to ensure that it appropriately paid and recorded payments to hourly employees. Twenty-five (83 percent) of the 30 payroll expenditures tested were not supported by timesheets, invoices, or a service agreement.

The direct and administrative costs the provider incurred included (1) programmatic expenditures and (2) administrative expenditures related to operating a residential treatment center. Those expenditures are intended to provide for the mental and physical well-being of the children placed in the provider's care.

Sources: The Department of Family and Protective Services, the provider, and analyses conducted by the State Auditor's Office.

Auditors also tested revenues that the provider reported on its 2012 cost report. The provider did not maintain adequate documentation for \$19,227 (27 percent) of the \$70,467 in payments it received from the Department of Family and Protective Services (Department) that auditors tested. Therefore, auditors were unable to determine whether the Department paid the provider the correct amount or whether the provider accurately reported those revenues on its cost report. Auditors identified additional errors in the provider's reporting of revenues, expenditures, and related-party transactions on its 2012 cost report (see Chapter 2-A).

The provider outsources its accounting function to an external accountant. However, the provider did not have a signed, written contract in place for the 2012 cost report period. The provider's accountant created the general ledger from bank statements instead of financial transaction documents, such as revenue receipts, invoices, and purchase receipts.

In addition, the provider submitted all employees for background checks to the Department in accordance with the Department's requirements.

Houston Wee Care Shelter, Inc.'s management responses are presented in Appendix 7 beginning on page 50.

Chapter 2-A

**The Provider Should Improve Its Compliance with Cost Report Requirements**

The provider did not consistently comply with cost report requirements when it prepared its 2012 cost report. Auditors identified errors in the provider's reporting of revenues, expenditures, and related party-transactions. Specifically, the provider:

**Related Party**

A related party is defined as a person or organization related to the provider by blood/marriage, common ownership, or any association, which permits either entity to exert power or influence, either directly or indirectly, over the other. In determining whether a related-party relationship exists with the provider, the tests of common ownership and control are applied separately.

Control exists where an individual or organization has the power, directly or indirectly, to significantly influence or direct the actions or policies of an organization or institution. If the elements of common ownership or control are not present in both organizations, the organizations are deemed not to be related to each other. The existence of an immediate family relationship will create an irrefutable presumption of relatedness through control or attribution of ownership or equity interests where the significance tests are met.

The following persons are considered immediate family for cost-reporting purposes: (1) husband and wife; (2) natural parent, child, and sibling; (3) adopted child and adoptive parent; (4) stepparent, stepchild, stepsister, and stepbrother; (5) father-in-law, mother-in-law, brother-in-law, son-in-law, sister-in-law, and daughter-in-law; (6) grandparent and grandchild; (7) uncles and aunts by blood or marriage; (8) first cousins; and (9) nephews and nieces by blood or marriage. Disclosure of related-party information is required for all allowable costs reported by the provider.

Source: The Health and Human Services Commission's *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*.

- Did not maintain adequate supporting documentation for all expenditures reported on its 2012 cost report.
- Did not report correctly some cost report line items; including line items that should have been allocated to other areas.
- Did not disclose all related-party transactions on its 2012 cost report (see text box for the definition of a related party).
- Did not consistently maintain documentation supporting payments it received from the Department.

The Health and Human Services Commission's (Commission) *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report* (cost report instructions) requires providers to maintain records that are accurate and sufficiently detailed to substantiate financial information on the cost report and include only

allowable expenditures incurred or accrued during the cost reporting period. (See Appendix 4 for additional information about cost report requirements.)

The Commission uses provider cost reports to determine the daily rates the providers are paid for taking care of foster children. (See Appendix 5 for additional information about daily rates.) Not reporting accurate financial information on a cost report could cause the Commission to set the daily rates at an inappropriate amount.

**The provider did not maintain adequate supporting documentation for expenditures reported on its 2012 cost report.**

The provider did not maintain adequate supporting documentation for 47 (60 percent) of the 78 direct care, administrative, and programmatic expenditures tested. Those expenditures accounted for \$11,289 (57 percent) of the \$19,870 in direct care, administrative, and programmatic expenditures the provider included on its 2012 cost report that auditors tested.

## Houston Wee Care Shelter, Inc.

The provider also did not maintain sufficient supporting documentation for all 30 payroll expenditures tested. Twenty-four (80 percent) of the 30 payroll expenditures tested did not have documentation in the employee's personnel file supporting the employee's pay rates. In addition, 25 (83 percent) of the 30 payroll expenditures tested were not supported by timesheets, invoices, or a service agreement. Those expenditures accounted for \$44,890 (54 percent) of the \$83,890 in payroll expenditures tested. In addition, the personnel files of the two highest paid employees lacked support for each employee's salary during the 2012 cost reporting period.

As a result of the provider's lack of adequate documentation, auditors were unable to determine whether all of the expenditures tested were for allowable costs and accurately reported on the provider's 2012 cost report.

The provider did not correctly report some cost report line items, including line items that should have been allocated to other areas.

Auditors identified several items that were not reported correctly on the 2012 cost report. Specifically:

- Utilities were overstated by \$719.
- Maintenance was understated by \$687.
- Employee benefits were understated by \$2,430.

In addition, one employee's salary and benefits should have been allocated between case management and administrative cost report items because the employee performed both functions. However, the provider included all of that employee's salary in the case management line item.

The provider did not disclose all related-party transactions on its 2012 cost report.

The provider did not disclose a loan payment to a related party in the amount of \$849 on its 2012 cost report. That amount should have been reported in supporting schedules. However, the provider did report two other related-party transactions appropriately.

The provider did not consistently maintain documentation supporting payments it received from the Department.

The provider did not maintain documentation, such as children's levels of care and days of service, that supported the payments it received from the Department for 7 (23 percent) of the 30 payments tested. The unsupported payments totaled \$19,277 (27 percent) of the \$70,467 in payments tested. As a result, auditors were unable to determine whether the Department's payments to the provider were accurate and whether the provider reported those payments accurately on its 2012 cost report.

In addition, the provider incorrectly reported Department revenue on its 2012 cost report. The provider should have reported it received \$361,725 in Department revenue; instead, the provider reported it received \$610,958. The reasons for the difference were due to the provider (1) incorrectly including Harris County revenue as Department revenue, instead of reporting the Harris County revenue separately; (2) not including a month of revenue on the general ledger; and (3) listing a different level of care than the level of care for which it received reimbursement from the Department.

## Recommendations

The provider should:

- Maintain complete and accurate supporting documentation that fully supports all financial transactions included on its cost report.
- Prepare its cost report in accordance with requirements. To help ensure that, the provider should:
  - ♦ Regularly review the financial information used to complete its cost reports to identify and correct errors in a timely manner.
  - ♦ Report and disclose all related-party costs in accordance with the Commission's applicable cost report instructions.

Chapter 2-B

## The Provider Should Strengthen Controls Over Its Financial Processes

The provider lacked detailed, written policies and procedures for key financial processes and did not have sufficient controls in place over other financial processes. In addition, the provider did not have policies and procedures regarding information technology and the security environment over the accounting system used to create its general ledger. Detailed policies and procedures are important tools for helping all employees understand the provider's processes, holding employees accountable for following them, and helping maintain consistency in the performance of key processes.

The provider did not have policies and procedures for key financial processes and did not have sufficient controls in place for other financial processes.

The provider lacked detailed, written policies and procedures for key financial processes and did not have sufficient controls in place over other financial processes. Specifically:

- The provider did not have policies and procedures in place for the recording, processing, and reporting of revenue and expense transactions.

## Houston Wee Care Shelter, Inc.

- The provider did not review financial information once it was entered into the accounting system or review financial information once it was prepared by the external accountant.
- The provider did not review cash withdrawals.
- The provider did not have adequate segregation of duties over the expenditure process.

The provider did not have policies and procedures regarding information technology and the security environment over the accounting system.

The provider relies on a third-party accounting system maintained online. The provider did not have policies and procedures regarding information technology and the security environment over the accounting system used to create its general ledger. In addition, the provider outsources its bookkeeping and accounting functions to an external accountant. However, the provider did not have a signed, written contract in place for the 2012 cost reporting period. Furthermore, the provider's accountant created the general ledger from bank statements instead of financial transaction documents, such as revenue receipts, invoices, and purchase receipts.

While the provider can use bank statements to verify that it disbursed funds, bank statements do not provide detailed information regarding the item(s) purchased; the individual who made the purchase; whether the purchase was a business expense; and, in some cases, from which vendor the provider purchased the item(s). That may result in costs being misreported on the provider's cost report.

### Recommendations

The provider should:

- Develop and implement written policies and procedures for key financial processes.
- Develop and implement written policies and procedures for its use of information technology.
- Ensure that all contracts contain all parties' signatures.
- Ensure that financial transaction documents are used to generate its general ledger.

Chapter 2-C

## **The Provider Complied with the Department's Background Check Requirements**

The provider submitted all employees for background checks to the Department in accordance with the Department's requirements. Of the 21 employees who worked for the provider during the 2012 cost reporting period, all had current background checks and all applicable subsequent background checks required for the previous 24 months.

Auditors also requested that the Department of Public Safety perform criminal background checks for all individuals who were current employees and subcontractors in March 2013. There were no reported offenses that may violate the Department's rules. (See Appendix 3 for additional information about background check requirements.)

| New Encounters, Inc.<br>Background Information <sup>a</sup>   |                              |
|---|------------------------------|
| Location  | Corsicana, TX                |
| Contract services audited                                     | Residential treatment center |
| Number of children served                                     | 23                           |
| Average length of a child's stay in days                      | 170.6                        |
| Total revenue from the Department                             | \$493,592                    |
| Total revenue for child placing agency                        | \$530,471                    |
| Federal tax filing status                                     | Non-profit                   |
| Number of staff at year end                                   | 7                            |
| <sup>a</sup> From January 1, 2012, through December 31, 2012. |                              |

Sources: The Department of Family and Protective Services, the provider, and analyses conducted by the State Auditor's Office.

New Encounters, Inc. (provider) did not always maintain documentation to demonstrate that it accurately reported funds it expended for providing 24-hour residential child care services. The provider did not have adequate supporting documentation for \$21,246 (37 percent) of the \$58,093 in direct and administrative costs and for \$23,000 (65 percent) of the \$35,550 in payroll costs that the provider included on its 2012 cost report that auditors tested.

The direct and administrative costs the provider incurred included (1) programmatic expenditures and (2) administrative expenditures related to operating a residential treatment center. Those expenditures are intended to provide for the mental and physical well-being of the children placed in the provider's care.

Auditors also tested revenues that the provider reported on its 2012 cost report. The provider had supporting documentation for all 29 payments it received from the Department of Family and Protective Services (Department) tested. Those payments totaled \$61,984.

However, auditors identified errors in the provider's reporting of expenditures and related-party transactions on its 2012 cost report (see Chapter 3-A).

The provider outsources its accounting function to an external accountant. However, the provider did not have a signed, written contract in place for the 2012 cost reporting period.

In addition, auditors determined that the provider submitted all employees for initial background checks to the Department in accordance with the Department's requirements. However, the provider did not submit one employee for a required subsequent background check within the required time frame.

New Encounters, Inc.'s management responses are presented in Appendix 8 beginning on page 53.

Chapter 3-A

**The Provider Should Improve Its Compliance with Cost Report Requirements**

The provider did not consistently comply with cost report requirements when it prepared its 2012 cost report. Auditors identified errors in the provider's

reporting of expenditures and related-party transactions. Specifically, the provider:

- Did not maintain adequate supporting documentation for all expenditures reported on its 2012 cost report.
- Did not correctly report some cost report line items, including line items that should have been allocated to other areas.
- Did not disclose all related-party transactions on its 2012 cost report.
- Did not use the accrual basis of accounting to prepare its 2012 cost report.

The Health and Human Services Commission's (Commission) *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report* (cost report instructions) requires providers to maintain records that are accurate and sufficiently detailed to substantiate financial information on the cost report and include only allowable expenditures incurred or accrued during the cost reporting period. (See Appendix 4 for additional information about cost report requirements.)

The Commission uses provider cost reports to determine the daily rates the providers are paid for taking care of foster children. (See Appendix 5 for additional information about daily rates.) Not reporting accurate financial information on a cost report could cause the Commission to set the daily rates at an inappropriate amount.

The provider did not maintain adequate supporting documentation for expenditures reported on its 2012 cost report.

The provider did not maintain adequate supporting documentation for 25 (39 percent) of the 64 direct care, administrative, and programmatic expenditures tested. Those expenditures accounted for \$21,246 (37 percent) of the \$58,093 in direct care, administrative, and programmatic expenditures the provider included on its 2012 cost report that auditors tested.

In addition, for 3 (38 percent) of the 8 payroll expenditures tested, the provider did not have adequate documentation in the employees' personnel files supporting the employees' pay rates, such as timesheets, invoices, or a service agreement. Those expenditures accounted for \$23,000 (65 percent) of the \$35,550 in payroll expenditures tested.

As a result of the provider's lack of documentation, auditors were unable to determine whether all of the expenditures tested were for allowable costs.

The provider did not correctly report some cost report line items.

Auditors identified several items that the provider did not report correctly on its 2012 cost report. Specifically:

- The provider allocated to maintenance a \$21,714 expenditure for constructing a driveway. That expenditure should have been capitalized and reported as a leasehold improvement. The amount of additional depreciation that should have been included in the cost report for that item was \$814. In addition, the provider misclassified a \$2,000 expenditure as allowances; that expenditure should have been classified as maintenance.
- The provider classified an employee’s salary as a direct care expense. However, based on the employee’s explanation of his duties, the provider should have allocated that employee’s salary to both administrative and case management expense line items. Because the provider did not require its salaried employees to submit timesheets, auditors could not determine the proportion of the employee’s salary that should have been allocated to each line item. For employees who perform both direct care services and administrative services, the cost report instructions require providers to document the portion of the employee’s costs applicable to the delivery of direct care services based upon daily timesheets.

The provider consistently maintained supporting documentation for payments it received from the Department.

Auditors tested revenues that the provider reported on its 2012 cost report.

The provider had supporting documentation for all 29 payments it received

from the Department. Those payments totaled \$61,984. However, for two payments, the provider did not receive the correct amounts from the Department. The provider did not have documentation showing that it notified the Department about those errors.

The provider did not report any related-party transactions on its 2012 cost report.

The provider did not disclose several related-party transactions that should have been included on its 2012 cost report (see text box for the definition of a related party). Specifically:

- The provider did not disclose a related-party lease between the provider and its executive director. In addition, the provider did not have a signed lease agreement in place between the two parties. The provider also reported the full cost (\$30,000) of the lease on its 2012 cost report instead of the cost to the related party (\$5,632).
- The provider did not disclose a related employee’s salary on its 2012 cost report supporting schedules as required by the cost report instructions. That

**Related Party**

A related party is defined as a person or organization related to the provider by blood/marriage, common ownership, or any association, which permits either entity to exert power or influence, either directly or indirectly, over the other. In determining whether a related-party relationship exists with the provider, the tests of common ownership and control are applied separately.

Control exists where an individual or organization has the power, directly or indirectly, to significantly influence or direct the actions or policies of an organization or institution. If the elements of common ownership or control are not present in both organizations, the organizations are deemed not to be related to each other. The existence of an immediate family relationship will create an irrefutable presumption of relatedness through control or attribution of ownership or equity interests where the significance tests are met.

The following persons are considered immediate family for cost-reporting purposes: (1) husband and wife; (2) natural parent, child, and sibling; (3) adopted child and adoptive parent; (4) stepparent, stepchild, stepsister, and stepbrother; (5) father-in-law, mother-in-law, brother-in-law, son-in-law, sister-in-law, and daughter-in-law; (6) grandparent and grandchild; (7) uncles and aunts by blood or marriage; (8) first cousins; and (9) nephews and nieces by blood or marriage. Disclosure of related-party information is required for all allowable costs reported by the provider.

Source: The Health and Human Services Commission’s *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*.

employee's salary was \$30,000 for calendar year 2012.

- The provider did not disclose a \$2,288 payment it made to a related party on its 2012 cost report supporting schedules as required by the cost report instructions.

The provider did not use the accrual basis of accounting for the cost report.

The provider used the cash basis of accounting instead of the accrual basis of accounting as required by the Department. Title 1, Texas Administrative Code, Section 355.102 (c), states that a provider is responsible for accurate cost reporting and for including on its cost report all costs incurred, based on an accrual method of accounting, that are reasonable and necessary.

### Recommendations

The provider should:

- Maintain supporting documentation for all financial transactions, including revenue and expense transactions supporting the cost report.
- Prepare its cost report in accordance with requirements.
- Report and disclose all related-party costs in accordance with the Commission's applicable cost report instructions.
- Ensure that it uses the accrual basis of accounting as required by the Texas Administrative Code and the cost report instructions.

#### Chapter 3-B

### The Provider Should Strengthen Controls Over Its Financial Processes

While the provider has some controls over key financial processes in place, the issues discussed in Chapter 3-A can be attributed to weaknesses in the provider's financial processes. As a result, the provider should strengthen controls over its financial processes by developing and implementing written policies and procedures for its key financial processes and segregating key financial-related duties.

The provider hired an external accountant to perform the majority of the provider's financial activities, including bookkeeping and bank reconciliations. However, the provider does not have a written contract with its external accountant establishing the responsibilities and expectations regarding the services being provided and requiring that adequate controls be in place to secure the accounting system and the provider's financial data.

The provider lacked detailed, written policies and procedures.

The provider did not have detailed, written policies and procedures for its key financial processes. Specifically, the provider did not have detailed, written policies and procedures for accounting for revenues and expenditures, reviewing payroll, performing bank reconciliations, performing reconciliations of Department revenue, and recording financial transactions in its general ledger. Policies and procedures are important tools for helping all employees understand the provider's processes, holding employees accountable for following them, and helping maintain consistency in the performance of key processes.

The provider did not segregate key financial-related duties and ensure that supervisory reviews were conducted.

The provider did not adequately segregate duties for completing bank deposits and writing checks. Specifically, only one person receives and deposits all checks. In addition, there is no supervisory review when checks are written. Segregating key financial duties helps to reduce the risk of fraud and distributes the workload related to financial processes.

The provider did not have a formal contract with its external accountant.

The provider hired an external accountant to perform the majority of the provider's financial activities, such as preparing and maintaining the general ledger and creating financial statements. The provider was responsible for maintaining the supporting documentation for its financial data and providing all of the necessary financial documentation to its external accountant. However, there is no written contract between the provider and its external accountant establishing the responsibilities and expectations regarding those activities. Having a formal contract in place will ensure that the external accountant is held responsible for safeguarding the provider's financial information.

## Recommendations

The provider should:

- Implement segregation of financial duties that includes individuals other than the executive director.
- Develop and implement written policies and procedures, including required levels of review, for key financial processes.
- Develop a formal contract with its external accountant and ensure that the contract contains provisions that outline the responsibilities and expectations regarding the contracted activities.

## **The Provider Complied with the Department's Background Check Requirements**

The provider submitted all employees and subcontractors for initial background checks to the Department in accordance with the Department's requirements. The provider had current background checks for all 10 employees and subcontractors who worked for the provider during the 2012 cost reporting period. However, 1 (12 percent) of 8 employees and subcontractors requiring a subsequent background check did not have an applicable subsequent background check performed within 24 months after the initial check as required. The provider conducted that employee's subsequent background check three months after it was due. Title 40, Texas Administrative Code, Section 745.625, requires a provider to submit a request for a background check for all persons required to have a background check every 24 months after each person's background check was first submitted.

In addition, as stated previously, although the provider had some controls over the conducting of background checks for its employees, the provider did not have documented policies and procedures for background checks or criminal indictment reporting by employees.

Auditors also requested that the Department of Public Safety perform criminal background checks for all individuals who were current employees and subcontractors in March 2013. There were no reported offenses that may violate the Department's rules. (See Appendix 3 for additional information about background check requirements.)

### **Recommendations**

The provider should:

- Ensure that all employees receive a background check within 24 months after their initial check as required by the Texas Administrative Code.
- Develop and implement written policies and procedures for conducting background checks and the reporting by employees of criminal indictment information to the Department.

| Refuge House, Inc.<br>Background Information <sup>a</sup>     |                      |
|---|----------------------|
| Location  | Dallas, TX           |
| Contract services audited                                     | Child placing agency |
| Number of children served                                     | 275                  |
| Average length of a child's stay in days                      | 186.8                |
| Total revenue from the Department                             | \$3,213,085          |
| Total revenue for child placing agency                        | \$3,215,780          |
| Federal tax filing status                                     | Non-profit           |
| Number of staff at year end                                   | 13                   |
| <sup>a</sup> From January 1, 2012, through December 31, 2012. |                      |

Sources: The Department of Family and Protective Services, the provider, and analyses conducted by the State Auditor's Office.

Refuge House, Inc. (provider) had adequate documentation to demonstrate that it accurately reported funds it expended for providing 24-hour residential child care services. The provider had adequate supporting documentation for \$80,647 (94 percent) of the \$85,753 in direct and administrative expenditures and for all \$98,164 in payroll costs that the provider included on its 2012 cost report that auditors tested.

The direct and administrative costs the provider incurred included (1) programmatic expenditures and (2) administrative expenditures related to operating a child placing agency. Those expenditures are intended to provide for the mental and physical well-being of the children placed in the provider's care.

Auditors also tested revenues that the provider reported on its 2012 cost report. The provider had supporting documentation for all 30 payments it received from the Department. Those payments totaled \$53,348. However, auditors identified errors in the provider's reporting of

expenditures and related-party transactions on its 2012 cost report (see Chapter 4-A).

The provider outsources its accounting function to an external accountant. However, the provider did not have a signed, written contract in place for the 2012 cost reporting period (January 2012 through December 2012).

In addition, auditors determined that the provider complied with the Department's requirements for background checks. The provider:

- Submitted all employees, foster parents, occasional caregivers, and household members for initial background checks in accordance with the Department's requirements.
- Submitted all employees, foster parents, occasional caregivers, and household members for applicable subsequent background checks as required.

The provider conducted monitoring visits at foster homes in accordance with Department requirements. For the 23 foster homes active during the 2012 cost reporting period, the provider appropriately conducted all 23 required monitoring visits in a timely manner.

Refuge House, Inc.'s management responses are presented in Appendix 9 beginning on page 56.

Chapter 4-A

### **The Provider Had Adequate Supporting Documentation for Expenditures Reported on Its Cost Report**

The provider had adequate supporting documentation for \$80,647 (94 percent) of the \$85,753 in direct, administrative, and programmatic expenditures the provider included on its 2012 cost report that auditors tested. The expenditures that were not supported accounted for only \$5,106 (6 percent) of the total direct, administrative, and programmatic expenditures tested.

In addition, the provider maintained sufficient supporting documentation for all 32 payroll expenditures totaling \$98,164 tested. Specifically:

- For all 32 payroll transactions, the amount paid was supported by documentation in the provider's personnel files.
- For all 24 applicable payroll transactions requiring timesheets, the provider had timesheets that supported the time charged by the employees.

However, for 18 (75 percent) of 24 payroll expenditures requiring a supervisory review of timesheets, the timesheets did not include signatures to indicate that they had received supervisory review for approval. In addition, the provider does not require supervisory review and approval of timesheets for the chief executive officer and chief information officer. According to the Health and Human Services Commission's (Commission) *Specific Instructions for the Completion of the 2012 Texas 24- Hour Residential Child Care Cost Report* (cost report instructions), daily timesheets documenting the time worked for the specific residential care contract are required for all salaries directly charged and reported on the cost report. Approval of timesheets is important to help ensure the accuracy of time reported, such as total hours spent on foster care activities.

### **Recommendations**

The provider should:

- Maintain supporting documentation for all financial transactions and consistently review and approve expenditures.
- Ensure that all timesheets receive a supervisory review.

## The Provider Should Improve Its Compliance with Cost Report Requirements

The provider should improve its financial processes and compliance with cost report requirements. The provider did not consistently comply with cost report requirements when it prepared its 2012 cost report. Auditors identified errors in the provider's reporting of expenditures and related-party costs. Specifically, for the 2012 cost report, the provider:

- Reported \$1,627 in unallowable costs.
- Misclassified \$9,595 in expenditures.
- Did not accurately report all related-party transactions.

The cost report instructions require providers to maintain records that are accurate and sufficiently detailed to substantiate financial information on the cost report and include only allowable expenditures incurred or accrued during the cost reporting period. (See Appendix 4 for additional information about cost report requirements.)

The Commission uses provider cost reports to determine the daily rates the providers are paid for taking care of foster children. (See Appendix 5 for additional information about daily rates.) Not reporting accurate financial information on a cost report could cause the Commission to set the daily rates at an inappropriate amount.

**The provider included unallowable costs on its 2012 cost report.**

The provider reported \$1,627 in unallowable costs related to a foster parent training cruise. According to the provider's management, the provider's trainers were unable to attend the cruise due to a scheduling conflict. As a result, that expense should not have been included on the provider's 2012 cost report.

**The provider misclassified some items on its 2012 cost report.**

**The provider misclassified \$9,595 of expenditures on its 2012 cost report. Specifically:**

- The provider misclassified one payroll transaction for \$7,861 as a direct care expense; however, according to the employee's job duties and timesheet, that transaction should have been reported as an administrative expense. It should be noted that this error did not have a net effect on the total costs reported.
- The provider misclassified \$1,734 in costs related to a cruise (separate from the cruise discussed above) as a training expense; however, because

no training occurred on the trip, that cost should have been reported as a foster family recruiting and retention expense.

The provider did not correctly report all related-party transactions.

The provider did not report all related-party transactions as required by the 2012 cost report instructions (see text box for the definition of a related party). Specifically:

#### Related Party

A related party is defined as a person or organization related to the provider by blood/marriage, common ownership, or any association, which permits either entity to exert power or influence, either directly or indirectly, over the other. In determining whether a related-party relationship exists with the provider, the tests of common ownership and control are applied separately.

Control exists where an individual or organization has the power, directly or indirectly, to significantly influence or direct the actions or policies of an organization or institution. If the elements of common ownership or control are not present in both organizations, the organizations are deemed not to be related to each other. The existence of an immediate family relationship will create an irrefutable presumption of relatedness through control or attribution of ownership or equity interests where the significance tests are met.

The following persons are considered immediate family for cost-reporting purposes: (1) husband and wife; (2) natural parent, child, and sibling; (3) adopted child and adoptive parent; (4) stepparent, stepchild, stepsister, and stepbrother; (5) father-in-law, mother-in-law, brother-in-law, son-in-law, sister-in-law, and daughter-in-law; (6) grandparent and grandchild; (7) uncles and aunts by blood or marriage; (8) first cousins; and (9) nephews and nieces by blood or marriage. Disclosure of related-party information is required for all allowable costs reported by the provider.

Source: The Health and Human Services Commission's *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*.

- The provider did not report a lease with a related-party in the appropriate cost report schedule. In addition, the provider reported the full amount of the lease (\$92,610), when it should have reported only the cost to the related party.
- The provider accurately reported a professional services contract for \$5,000 in the appropriate line item in its 2012 cost report. However, the provider did not disclose the related party in the supplemental schedule to its cost report.
- The provider did not report the correct amount for another lease with a related-party. The provider reported the full amount of the lease (\$21,600), when it should have reported only the cost to the related party (\$17,562).

The provider consistently maintained supporting documentation for payments it received from the Department.

Auditors tested revenues that the provider reported on its 2012 cost report. The provider had supporting documentation for all 30 payments it received from the Department. Those payments totaled \$53,348.

#### Recommendations

The provider should:

- Prepare its cost report in accordance with requirements.
- Accurately reflect employees' payroll costs in the appropriate cost report categories.
- Report and disclose all related-party costs in accordance with the Commission's applicable cost report instructions.

### The Provider Should Improve Controls Over Its Financial Processes

The provider had policies and procedures related to processes including expenditures, revenues, travel, purchasing, and information technology. In addition, the provider has some adequately designed controls over its financial processes. However, auditors identified some controls that the provider should improve. Specifically:

- The provider did not perform independent reviews of the external accountant's bank reconciliations. A review of the accountant's bank reconciliations could help the provider to (1) verify account balances and clear discrepancies and (2) identify errors or omissions. Without periodic reviews of bank reconciliations, the provider is at increased risk of fraudulent transactions going undetected.
- The provider hired an external accountant to perform the majority of its financial activities, including the preparation of its general ledger, financial statements, and cost report. However, the provider did not have a written contract with its external accountant establishing the responsibilities and expectations regarding the services being provided and requiring that adequate controls be in place to secure the accounting system and the provider's financial data. In addition, the external accountant is authorized to make payments for the provider without the provider's prior approval.

### Recommendations

The provider should:

- Review all bank reconciliations prepared by the external accountant.
- Ensure that it has a formal contract in place with its external accountant that details the activities to be performed and the controls that must be in place to secure the provider's financial data.

Chapter 4-D

**The Provider Complied with the Department's Background Check Requirements**

The provider submitted all of its employees, foster parents, occasional caregivers, and household members for background checks in accordance with Department requirements. As of March 2013, the provider had current background checks for (1) all 83 employees, subcontractors, and volunteers who worked at the provider during the 2012 cost reporting period and (2) all 220 foster parents, occasional caregivers, and household members who were active during the 2012 cost reporting period.

**Employees**

As of March 2013, all 83 employees, subcontractors, and volunteers hired after January 1, 2011, and active during calendar year 2012 had current background checks. The provider also completed subsequent background checks for all 10 individuals who required a background check to be performed within 24 months after the initial check.

**Foster Parents, Occasional Caregivers, and Household Members**

As of March 2013, all 220 active foster parents, occasional caregivers, and household members active during the 2012 cost reporting period had current background checks. In addition, all 92 foster parents, occasional caregivers, and household members who required a background check before the provider verifies the foster home, had those checks. The provider also completed subsequent background checks for all 48 individuals who required a background check to be performed within 24 months after the initial check.

Auditors also requested that the Department of Public Safety perform criminal background checks for all individuals who were current employees, foster parents, occasional caregivers, and household members in March 2013. There were no reported offenses that may violate the Department's rules. (See Appendix 3 for additional information about background check requirements.)

Chapter 4-E

### **The Provider Conducted Monitoring Visits at Foster Homes in Accordance with Department Requirements**

The provider substantially complied with foster parent monitoring requirements. For the 23 foster homes active during the 2012 cost reporting period, the provider appropriately conducted all 23 required monitoring visits in a timely manner. However, for 2 (9 percent) of 23 foster homes tested, the quarterly monitoring reports were not fully documented and signed due to employee turnover. Monitoring visits are the primary way for the provider to help ensure that foster homes comply with all Department standards.

#### **Recommendation**

The provider should ensure that all required quarterly monitoring visits are fully documented and signed.

| Children of Diversity, Inc.<br>Background Information <sup>a</sup> |                      |
|--|----------------------|
| Location   | Houston, TX          |
| Contract services audited  | Child placing agency |
| Number of children served  | 77                   |
| Average length of a child's stay in days                           | 176.5                |
| Total revenue from the Department                                  | \$865,426            |
| Total revenue for child placing agency                             | \$865,426            |
| Federal tax filing status  | Non-profit           |
| Number of staff at year end  | 7                    |
| <sup>a</sup> From January 1, 2012, through December 31, 2012.      |                      |

Sources: The Department of Family and Protective Services, the provider, and analyses conducted by the State Auditor's Office.

Children of Diversity, Inc. (provider) had adequate documentation to demonstrate that it accurately reported funds it expended for providing 24-hour residential child care services. The provider had adequate supporting documentation for \$71,687 (99.8 percent) of the \$71,780 in direct and administrative expenditures and for all \$13,903 in payroll costs that the provider included on its 2012 cost report that auditors tested.

The direct and administrative costs the provider incurred included (1) programmatic expenditures and (2) administrative expenditures related to operating a child placing agency. Those expenditures are intended to provide for the mental and physical well-being of the children placed in the provider's care.

Auditors also tested revenues that the provider reported on its 2012 cost report. The provider had supporting documentation for all 31 payments it received from the Department of Family and Protective Services (Department). Those payments totaled \$60,370. However, auditors identified errors in the provider's reporting of expenditures. Those errors were due to misclassifications on the cost report.

The provider outsourced its accounting, human resources, and information systems functions to a third-party service provider. Although the provider had policies and procedures for financial accounting and background checks, it should strengthen those policies and procedures. In addition, the provider uses an accounting system that is maintained by a third-party service provider. That accounting system had controls in place that are designed sufficiently and operating effectively.

In addition, auditors determined that the provider substantially complied with the Department's requirements for background checks. Specifically, the provider:

- Submitted all employees, subcontractors, and volunteers for initial background checks to the Department in accordance with the Department's requirements.
- Submitted all foster parents, occasional caregivers, and household members for applicable subsequent background checks as required.

The provider did not comply with foster parent monitoring requirements. For 7 (70 percent) of 10 foster homes tested, the provider did not conduct one or more required quarterly monitoring visits.

Children of Diversity, Inc.'s management responses are presented in Appendix 10 beginning on page 61.

Chapter 5-A

### **The Provider Substantially Complied with Cost Report Requirements**

The provider substantially complied with cost report requirements when it prepared its 2012 cost report. The provider generally maintained adequate supporting documentation for non-labor and payroll-related expenditures. However, auditors identified errors in other areas of the provider's 2012 cost report, including cost report line items that were misclassified.

The Health and Human Services Commission's (Commission) *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report* (cost report instructions) requires providers to maintain records that are accurate and sufficiently detailed to substantiate financial information on the cost report and include only allowable expenditures incurred or accrued during the cost reporting period. (See Appendix 4 for additional information about cost report requirements.)

The Commission uses provider cost reports to determine the daily rates the providers are paid for taking care of foster children. (See Appendix 5 for additional information about daily rates.) Not reporting accurate financial information on a cost report could cause the Commission to set the daily rates at an inappropriate amount.

The provider maintained adequate supporting documentation for expenditures reported on its 2012 cost report.

The provider had adequate supporting documentation for \$71,687 (99.8 percent) of the \$71,780 that auditors tested. Of the 66 non-labor expenditures tested, 61 (92 percent) had adequate supporting documentation. The 5 expenditures that did not have adequate supporting documentation totaled only \$93. In addition, the provider had adequate supporting documentation for all 10 payroll expenditures tested. Those payroll expenditures totaled \$13,903.

The provider misclassified items on its 2012 cost report.

The provider misclassified \$7,577 in costs reported on its 2012 cost report. Specifically:

- The provider included a \$1,950 payment for a foster family holiday banquet in direct care expenses. That cost should have been reported as a foster family recruiting and retention expense.
- The provider included \$2,396 in reimbursements to its staff for mileage in other transportation costs. However, mileage reimbursement to direct care staff for the use of a personal vehicle should be reported as a direct care expense.
- The provider included \$366 in employee drug-screening costs in advertising and recruiting costs. Those costs should have been reported as medical supplies and staff vaccination costs.
- The provider included \$1,892 in costs related to employee parties as travel, training, and seminars expenses. Employee-relations costs (such as parties and service awards) should have been reported as other administrative expenses.
- The provider included \$973 in bank charges in other administrative expenses. Those charges should have been reported as professional service and consulting fees.

## Recommendation

The provider should prepare its cost report in accordance with requirements.

Chapter 5-B

## The Provider Should Strengthen Its Financial Processes

The provider had policies and procedures related to financial processes including expenditures, revenues, travel, human resources, and purchasing. In addition, the provider has some controls over its financial processes that were adequately designed and operating effectively. However, auditors identified some financial processes and policies and procedures that should be improved.

The provider outsources its accounting, human resources, and information systems functions to a third-party service provider. Although management asserted that it conducted independent reviews of the third-party service provider's bank reconciliations, there was no documentation to support the assertion that a review was performed. A review of the accountant's bank

reconciliations can help the provider to (1) verify account balances and explain discrepancies and (2) identify errors or omissions. Without periodic reviews of bank reconciliations, the provider is at increased risk of fraudulent transactions going undetected.

In addition, the provider did not have sufficient policies and procedures over foster parent monitoring and the preparation of the cost report.

The provider uses a third-party accounting system that is used to create the cost report. That system is maintained by the third-party service provider and has logical access, physical security, and backup and recovery controls that are designed and operating effectively. The provider had a valid contract in place with the third-party service provider. In addition, the provider had policies and procedures that addressed the controls discussed above.

The provider generally complied with the Department's contractual guidelines for child placing agencies regarding the reimbursement of foster parents. The provider paid its foster parents the required amounts according to the children's levels of care and days of service. All 31 payments tested had adequate supporting documentation indicating the correct payment amount and calculation of days of service. Those payments totaled \$60,370.

### Recommendations

The provider should:

- Conduct and document reviews of the bank reconciliations performed by its third-party service provider.
- Develop and implement policies and procedures for foster parent monitoring and cost report preparation.

Chapter 5-C

### **The Provider Generally Complied with the Department's Background Check Requirements; However, It Should Improve the Timeliness of Those Checks**

The provider submitted all employees, active foster parents, occasional caregivers, and household members for background checks in accordance with Department requirements. As of June 2013, the provider had current background checks for all 13 employees and subcontractors who performed services for the provider and for all 38 active foster parents, occasional caregivers, and household members who were active during the 2012 cost reporting period.

However, the provider should strengthen its background check process by ensuring that employees, foster parents, occasional caregivers, and household members clear a background check prior to their hire or contract dates. The Department requires that those individuals clear a name-based background check before they provide direct care to children or have direct access to the children in the provider's care. The Department requires providers to submit individuals for a subsequent background check at least once every 24 months after the initial check. (See Appendix 3 for additional information about background check requirements.)

## Employees

As of March 2013, all 13 employees and subcontractors hired after January 1, 2011, and active during calendar year 2012 had current background checks. However, 2 (15 percent) of the 13 employees and subcontractors tested had background checks that were not cleared before their start dates. For those 2 individuals, the provider submitted the initial background checks 13 days and 48 days late.

## Foster Parents, Occasional Caregivers, and Household Members

As of March 2013, all 38 active foster parents, occasional caregivers, and household members active during the 2012 cost reporting period had current background checks. However, 1 (3 percent) of the 38 foster parents, occasional caregivers, and household members tested had a background check that was not cleared before that individual's start date. For that individual, the provider submitted the initial background check 82 days late.

Auditors also requested that the Department of Public Safety perform criminal background checks for all individuals who were current employees, foster parents, occasional caregivers, and household members in March 2013. There were no reported offenses that may violate the Department's rules. (See Appendix 3 for additional information about background check requirements.)

## Recommendation

The provider should ensure that background checks are conducted according to Department requirements.

## Chapter 5-D

### **The Provider Did Not Conduct Monitoring Visits at Foster Homes in Accordance with Department Requirements**

The provider did not comply with foster parent monitoring requirements. Overall, for 7 (70 percent) of 10 foster homes tested, the provider did not conduct one or more required quarterly monitoring visits.

For nine families that required quarterly monitoring visits during the first and second quarters of 2012:

- Four (44 percent) did not have a monitoring visit in the first quarter of 2012.
- All nine had a monitoring visit in the second quarter of 2012.

For the 6 families that required quarterly monitoring visits during the third quarter of 2012, 2 (33 percent) did not have a monitoring visit in the third quarter of 2012.

None of the 3 families that required quarterly monitoring visits during the fourth quarter of 2012 received a monitoring visit in the fourth quarter of 2012.

In addition, the provider did not conduct any unannounced supervisory visits. Title 40, Texas Administrative Code, Section 749.2815, requires that at least one supervisory visit per year must be unannounced. Monitoring visits are the primary way for the provider to help ensure that foster homes comply with all Department standards.

### **Recommendation**

The Department should perform all quarterly monitoring of foster homes as required and document whether visits were announced or unannounced.

# Appendices

Appendix 1

## **Objective, Scope, and Methodology**

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### **Objective**

The objective of this audit was to perform on-site financial audits of selected residential foster care contractors (providers) and included verifying that the selected providers were spending federal and state funds on required services that promote the well-being of foster children in their care. Texas Government Code, Section 2155.1442 (b), requires the Health and Human Services Commission to contract with the State Auditor's Office to perform on-site audits of selected residential child care providers that provide foster care services to the Department.

### **Scope**

The scope of this audit included performing work at five providers to assess the appropriateness, reasonableness, and necessity of expenditures that providers made during each provider's fiscal year 2012 cost reporting time period. In addition, auditors tested payments received from the Department of Family and Protective Services (Department) during each provider's fiscal year 2012 cost reporting time period.

### **Methodology**

The audit methodology included judgmentally selecting five providers based on (1) risk factors the Department uses in its annual statewide monitoring plan and (2) the providers' contract status as reported by the Department. Additionally, the audit methodology included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of the tests; and interviewing management and staff at the Department and providers. Auditors assessed the reliability of the data used in the audit and determined the following:

- Two (40 percent) of the 5 providers had financial data that was not sufficiently reliable to perform audit procedures.
- Two (40 percent) of the 5 providers had financial data that was sufficiently reliable to perform audit procedures.
- One provider's financial data was of undetermined reliability.

Auditors selected non-statistical samples, primarily through random selection, to be representative of the population. In those cases, results may be extrapolated to the population, but the accuracy of the extrapolation cannot be

measured. In some cases, auditors used professional judgment to select additional items for testing. Those sample items generally were not representative of the population and, therefore, it would not be appropriate to extrapolate those results to the population.

Information collected and reviewed included the following:

- Information from interviews with the Department's residential child care program management and staff.
- Department program monitoring and licensing reports for the providers.
- Contracts between the Department and the providers.
- Providers' cost reports and supporting documentation.
- Providers' financial records and supporting documentation, including payroll, direct and administrative expenditures, and revenues received from the Department.
- Providers' personnel files.
- Providers' bank statements.
- Providers' files, monitoring plans, and payment records for foster parents.
- Providers' policies and procedures, including policies and procedures for information technology.

Procedures and tests conducted included the following:

- Testing criminal history background checks performed on employees and foster parents.
- Testing foster parent records.
- Testing internal and information resource controls at providers.
- Testing expenditures related to services provided to children.
- Testing related-party expenditures and contracts.
- Testing payroll records.
- Testing payments made to foster care parents.
- Comparing each provider's state foster care revenue with Department records.
- Comparing each provider's general ledger to each provider's cost report.

Criteria used included the following:

- U.S. Office of Management and Budget circulars A-87, A-110, and A-122.
- Title 40, Texas Administrative Code, Chapter 19.
- Title 1, Texas Administrative Code, Chapter 15.
- Texas Government Code, Section 2155.1442.
- Contracts between the Department and providers.
- The Department's *Minimum Standards for General Residential Operations and Residential Treatment Centers and Minimum Standards for Child-Placing Agencies*.
- The Health and Human Services Commission's *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*.

### Project Information

Audit fieldwork was conducted from April 2013 through June 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. The objective of this audit was to perform on-site financial audits of selected providers by verifying that the selected providers spent federal and state funds on required services that promote the well-being of foster children in their care. The scope of this audit was limited because Wings of Refuge, Inc. did not submit the fiscal year 2012 cost report as required by the Department before the end of fieldwork for this audit. That issue is explained in detail in Chapter 1 of this report. The 2012 cost report was due on March 31, 2013, and the provider did not submit its 2012 cost report until July 2, 2013. The cost report is the basis for determining whether the providers are spending the federal and state funds as required. Additionally, auditors determined that Wings of Refuge Inc.'s general ledger was not reliable. As a result auditors would not have been able to provide assurance about the information in the 2012 cost report and could not give assurance that the provider had spent funds as required. Other than the scope limitation reported for that provider, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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

- Michael A. Simon, MBA, CGAP (Project Manager)

- Jennifer D. Brantley, MS, CPA (Assistant Project Manager)
- Amy M. Cheesman
- Erin Cromleigh
- Michelle DeFrance, CPA, MA
- Anna Howe
- Jules Hunter, CPA, CIA
- Uvaldo Valdez
- Jennifer R. Wiederhold, CGAP
- Julia Youssefnia, CPA
- J. Scott Killingsworth, CIA, CGAP, CGFM (Quality Control Reviewer)
- Ralph McClendon, CISSP, CCP, CISA (Audit Manager)

## ***Selected Requirements for Residential Child Care Providers***

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The following is a summary of selected Health and Human Services Commission and Department of Family and Protective Services requirements in the Texas Administrative Code, as well as selected requirements in the Health and Human Services Commission's *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*. The requirements are related to residential child care providers' boards of directors, cost reporting, financial records, background checks, and foster parent monitoring.

### **Board of Directors**

- Title 40, Texas Administrative Code, Section 749.131, states that a provider's board of directors must not have a majority of voting members who have a conflict of interest, including, but not limited to, the following: (1) employees working at a provider, (2) family members of the owner or a member of the board of directors, (3) paid consultants, or (4) other individuals who benefit financially from the provider.
- Title 40, Texas Administrative Code, Section 749.131, states that a provider's board of directors is responsible for ensuring that the provider remains fiscally sound and that the provider's services and programs comply with the provider's policies.

### **Cost Reporting**

- **Accurate Cost Reporting.** Title 1, Texas Administrative Code, Section 355.102 (c), states that the provider is responsible for accurate cost reporting and for including in its cost report all costs incurred, based on an accrual method of accounting, that are reasonable and necessary.
- **Allowable and Unallowable Costs.** Title 1, Texas Administrative Code, Section 355.102 (a), states that allowable and unallowable costs are defined to identify expenses that are reasonable and necessary to provide contracted client care and are consistent with federal and state laws and regulations. When a particular type of expense is classified as unallowable, the classification means only that the expense will not be included in the database for reimbursement determination purposes because the expense is not considered reasonable and/or necessary. The classification does not mean that the providers may not make the expenditure.
- **Allowable Costs.** Title 1, Texas Administrative Code, Section 355.102 (f), states that allowable costs are reasonable and necessary. Costs are "reasonable" if the amount spent is what a prudent and cost-conscious buyer would have spent. "Necessary" costs are appropriate and related to

the provider's business and are not for personal or other activities not directly or indirectly related to the provision of contracted services.

- Related-party Transactions. Title 1, Texas Administrative Code, Section 355.102 (i) (6), states that disclosure of all related-party transactions on the cost report is required for all costs reported by a provider, including related-party transactions occurring at any level in the provider's organization. The provider must make available, upon request, adequate documentation to support the costs incurred by the related party.

#### Financial Records

- Title 1, Texas Administrative Code, Section 355.7101 (15), requires providers to ensure that all records pertinent to services rendered under their contracts with the Department of Family and Protective Services are accurate and sufficiently detailed to support the financial and statistical information contained in their cost reports. It also requires providers to retain records for at least 3 years and 90 days after the end of the contract period.
- The Health and Human Services Commission's *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report* lists in more detail the records that should be retained, such as all accounting ledgers, journals, invoices, purchase orders, vouchers, canceled checks, timecards, payrolls, mileage logs, minutes of board of directors meetings, workpapers used in the preparation of the cost report, trial balances, and cost allocation spreadsheets.

#### Background Checks

- Title 40, Texas Administrative Code, Section 745.615, requires providers to request background checks for any person 14 years of age or older who has unsupervised access to children in care and who will regularly or frequently be staying or working at the provider's operation or prospective adoptive home while children are in care. Additionally, Title 40, Texas Administrative Code, Sections 748.363 and 749.553, require providers to include proof of the requests for background checks in the individuals' files.
- Title 40, Texas Administrative Code, Section 745.625, requires providers to submit a request for a background check at the time they hire an individual; at the time they contract with someone who requires a background check; at the time a person applies to be a foster parent; and at the time they become aware of anyone requiring a background check under Title 40, Texas Administrative Code, Section 745.615. It also requires the provider to request a background check every 24 months after the initial background check.

### Foster Parent Monitoring

- Title 40, Texas Administrative Code, Section 749.2815, requires providers to conduct supervisory visits in the foster home at least quarterly, and at least one supervisory visit per year must be unannounced. Each visit must be documented in the foster home, and the documentation must be signed by the foster parent(s) present for the visit and the child placement staff conducting the visit.

## ***Criminal Convictions and Other Findings That May Prohibit an Individual from Being Present at a Residential Child Care Provider***

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Title 40, Texas Administrative Code, Section 745.613, states that the purpose of a background check<sup>1</sup> is to determine whether a person has any criminal or abuse and neglect history and whether the person's presence is a risk to the health or safety of children in the person's care.

Title 40, Texas Administrative Code, Section 745.611, defines background checks as searches of different databases. There are four types of background checks:

- Name-based criminal history checks are conducted by the Department of Public Safety for crimes committed in the state of Texas.
- Fingerprint-based criminal history checks are conducted by the Department of Public Safety and the Federal Bureau of Investigation for crimes committed in the State of Texas and crimes committed anywhere in the United States, respectively.
- Central registry checks are conducted by the Department of Family and Protective Services. The central registry is a database of people who have been found by the Department of Family and Protective Services' Child Protective Services unit, Adult Protective Services unit, or Licensing unit to have abused or neglected a child.
- Out-of-state central registry checks are conducted by the Department of Family and Protective Services of another state's database of persons who have been found to have abused or neglected a child.

Title 40, Texas Administrative Code, Section 745.651, specifies the types of criminal convictions that may preclude an individual from being present at a residential care provider. The various types of convictions are detailed in three charts<sup>2</sup> that specify whether a conviction permanently or temporarily bars a person from being present at an operation while children are in care, whether a person is eligible for a risk evaluation, and whether a person who is eligible for a risk evaluation may be present at the operation pending the outcome of the risk evaluation. Based on those charts, the following types of criminal convictions may preclude an individual from being present at a residential care provider:

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<sup>1</sup> The Texas Administrative Code referenced in this appendix uses the term "criminal history check," which is referred to as a "background check" in this report.

<sup>2</sup> The Department of Family and Protective Services (Department) publishes the three charts every January in the *Texas Register* and are available on the Department of Family and Protective Services' Web site at [www.dfps.state.tx.us/Child\\_Care/](http://www.dfps.state.tx.us/Child_Care/).

- Title 5 (Offenses Against the Person). Examples of these offenses include criminal homicide, kidnapping and unlawful restraint, trafficking of persons, sexual offenses, and assaultive offenses.
- Title 6 (Offenses Against the Family). Examples of these offenses include prohibited sexual conduct, enticing a child, criminal nonsupport, harboring a runaway child, violation of a protective order or magistrate's order, and sale or purchase of a child.
- Title 7, Chapter 29 (Robbery).
- Title 9, Chapter 43 (Public Indecency), or Title 9, Section 42.072 (Stalking).
- Title 4, Section 15.031 (Criminal Solicitation of a Minor).
- Title 8, Section 38.17 (Failure to Stop or Report Aggravated Sexual Assault of a Child).
- Any like offense under the law of another state or federal law.

For any felony offense that is not specifically enumerated in the relevant chart and is within 10 years of the date of conviction, the person must have an approved risk evaluation prior to being present at the operation while children are in care.

Title 40, Texas Administrative Code, Section 745.657, specifies that the following types of central registry findings may preclude an individual from being present at a residential care provider:

- Any sustained finding of child abuse or neglect, including sexual abuse, physical abuse, emotional abuse, physical neglect, neglectful supervision, or medical neglect.
- Any central registry finding of child abuse or neglect (whether sustained or not), where the Department of Family and Protective Services has determined the presence of the person in a child care operation poses an immediate threat or danger to the health and safety of children.

Title 40, Texas Administrative Code, Section 745.659, specifies several possible consequences of having either a conviction listed in Title 40, Texas Administrative Code, Section 745.651, or a central registry finding in Title 40, Texas Administrative Code, Section 745.657:

- A person is permanently barred and must not be present at an operation while children are in care.

- A person is temporarily barred and may not be present at an operation while children are in care pending the outcome of the administrative review and due process hearing.
- A person must not be present at a child care operation while children are in care, unless a risk evaluation is approved.
- The Department of Family and Protective Services will notify the provider regarding which of the three actions must be taken.

## ***Selected Requirements for the Residential Child Care Cost Report***

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According to the Health and Human Services Commission's (Commission) *Specific Instructions for the Completion of the 2012 Texas 24-Hour Residential Child Care Cost Report*, the purpose of the cost report is to gather financial and statistical information for the Commission to use in developing reimbursement rates for foster care. The following is a summary of selected requirements in those instructions.

- **Cost report submission.** Each residential child care provider that has a contract with the Department of Family and Protective Services (Department) to provide residential child care services during the fiscal year is required to submit a *2012 Texas 24-Hour Residential Child Care Cost Report* (cost report) to the Commission. A separate cost report should be submitted for each separately licensed facility that the provider operates. The cost report must cover all of the provider's 24-hour residential child care activities at the licensed facility during the reporting period, including all programs that are not related to the Department.
- **Accounting method.** All revenues, expenses, and statistical information submitted on the cost reports must be based upon an accrual method of accounting.
- **Recordkeeping.** Providers must maintain records that are accurate and sufficiently detailed to support the legal, financial, and statistical information reported on the cost report. Cost report workpapers must be maintained for a minimum period of 3 years and 90 days following the end of each reporting period.
- **Direct costing.** Direct costing must be used whenever reasonably possible. Direct costing means that costs incurred for the benefit of, or directly attributable to, a specific business component must be charged directly to that particular business component.
- **Cost allocation methods.** Whenever direct costing of shared costs is not reasonable, it is necessary to allocate those costs either individually or as a pool of costs across the business components sharing the benefits. The allocation method must be a reasonable reflection of the actual business operations. Any allocation method used for cost-reporting purposes must be consistently applied across all contracted programs and business entities. Any change in allocation methods for the current year from the previous year must be fully disclosed on the cost report. The provider must obtain prior written approval from the Commission to use an unapproved allocation method.

- Reporting revenue. Providers must report the following revenue types separately: (1) Department revenue; (2) Medicare revenue; (3) Medicaid revenue; (4) private payments; (5) gifts, grants, donations, endowments, and trusts; (6) appropriations from state or local government sources; (7) gain on sales of assets; (8) interest; and (9) other.
- Reporting expenses. Only adequately documented, reasonable, necessary, and allowable program expenses incurred or accrued during the reporting period are to be reported in the cost report. The costs covering all of the providers' activities must be reported in accordance with the published cost-finding methodology, as well as with state and federal laws, rules, and regulations regarding allowable and unallowable costs.

## Health and Human Services Commission's 24-hour Residential Child Care Facilities Rates

All 24-hour residential child care providers are paid a fixed daily rate for each child placed in their care based on the child's service level of care. Child placing agencies are required to reimburse foster families for clients receiving services under a contract with the Department of Family and Protective Services. Table 1 lists the 24-hour residential child care rates for fiscal years 2011 and 2012.

Table 1

| 24-hour Residential Child Care Daily Rates<br>Fiscal Years 2011-2012               |                                       |  |  |
|--|---------------------------------------|--|--|
| Child's Service Level Classification <sup>a</sup>                                  | Daily Rate to Foster Family per Child | Daily Rate to Child Placing Agency per Child | Daily Rate to Residential Treatment Center per Child |
| Basic  | \$22.15                               | \$ 39.52                                     | \$ 42.18   |
| Moderate   | \$38.77                               | \$ 71.91                                     | \$ 96.17   |
| Specialized  | \$49.85                               | \$ 95.79                                     | \$138.25   |
| Intense  | \$88.62                               | \$175.66                                     | \$242.85   |
| <sup>a</sup> Emergency Shelter services are also provided at the rate of \$115.44. |                                       |  |  |

Source: The Department of Family and Protective Services.

## Management's Response from Wings of Refuge

5777 West Century Boulevard  
Suite 910  
Los Angeles, CA 90045

**Wings of Refuge**  
FAMILY SERVICES AGENCY

PH: 310.670.6767  
FAX: 310.670.2626  
www.wingsofrefuge.org

HEALING  
FAMILIES  
CHILDREN  
COMMUNITIES

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*Reuniting Families and Building Sustainable Communities Through Economic and Community Development*

August 20, 2013

State Auditor's Office

Attn: Michael Simon

Re: Management Response to State Auditor's Office (SAO) Financial Audit of Residential Child Care Providers

Dear Mr. Simon:

Below please find Wings of Refuge Family Services Agency (WOR) management responses to the On-site Audit of Residential Child Care Providers Report issued by the SAO August, 2013. We humbly submit the following response to be included in final report.

Chapter 1-A

**Recommendation:** The provider should prepare and submit its cost report in accordance with Department requirements and on time.

**Management Response:** WOR is in agreement with this finding. WOR in the 2011 and 2012 fiscal years did not have a staff person who was certified to complete the annual Cost Report. The Agency relied on third party outside preparers. In addition, the delay in getting the cost report prepared was based on key staff within the WOR Houston office resigning their position with limited notice given and remaining staff in both Houston and Los Angeles have to verify, validate and review all documents of both a programmatic and fiscal nature in a limited amount of time.

Chapter 1-B

**Recommendation:** The Provider Has Serious Weakness Over its Financial Processes

**Management Responses:** WOR concurs that there were some weaknesses over its Financial Processes. These weaknesses were directly related to limited staff in the Houston office with accounting skills and the processes utilized for approval and authorization of transactions in a satellite location separate from the

corporate offices. Management sought and received Board of Directors approval to provide delegated signing authority to local Administrator of the Houston Office to provide the Administrator with access to all bank account information via online and telephone inquiry access.

- Suspense Account balances are directly related to funds either deposited or withdrawn from the account in relation to the identity theft issue. This account was utilized as stated in the definition in the text box provided in the report. A suspense account is an account for the temporary entry of charges, credits, or doubtful accounts receivable pending determination of their ultimate dispositions.
- Transactions reflected on the provider's bank statements were not reflected in the general ledger. WOR has included all banking activity in the general ledger. Items are posted in the suspense account as stated above if they are not directly attributable to Houston operations.
- The general ledger did not reflect double-entry bookkeeping. WOR disagrees with this comment as all entries are posted utilizing a computerized accounting system that will not allow a system of single entry accounting.
- Allowing fraudulent activity to occur undetected. WOR management disagrees with this finding in part to the extent that WOR allowed fraudulent activity to occur. Based on the fact that two claims were filed with the banking entity involved and provided to the SAO as verification. The initial banking activity was identified as a bank error in processing deposits and withdrawals belonging to another bank customer into the WOR account. The fraudulent characterization was not denoted or formalized by the banking entity until they had completed their review of all transactions covering a period of six months.
- Misappropriating federal and state funds. WOR management disagrees with this statement based on the fact that claims reports have been submitted within a 45 day window of notification that transaction did not belong to WOR. The copy of a police report has also been provided to substantiate that a case is open for identity theft of the sole bank authorized signer for WOR.  
The WOR onsite manager did not have access to the providers debit/card, or bank accounts as she was new to this position during the time of the on site audit, however all financial information including invoices, direct deposit remittance advices are handled directly by the Houston onsite manager and summarized and forwarded to the Los Angeles office via email. All financial transactions and deposits during the 2012 calendar year were reviewed, authorized and reconciled by the Houston administrator. The California office data processed all payments to vendors and foster parents and reconciled monthly bank statements to include the activities of the Houston office in the general financial reports for the

WOR organization as one entity. The current status of WOR tax status has been provided as an attachment to this document. The State of California has the organization in good standing with all returns submitted and the IRS has received all returns and we await their reinstatement documentation as well.

**Recommendations:** The provider should ensure that bank reconciliations are performed in a timely and appropriate manner.

Management Response: WOR acknowledges that there may be some concern based on past practices of preparing bank reconciliations in a timely fashion. However, bank statements for the period of 2012 cost reporting were prepared timely and maintained in an electronic database. When the reports were printed the print date is the date printed not the date prepared. In the future, WOR staff will print a hard copy of all bank reconciliations to insure that the appropriate validations are in place to reflect reports are prepared timely.

**Recommendation:** The provider should ensure that it operates on a sound fiscal basis as required by the Texas Administrative Code.

Management Response: WOR concurs with this and has created a process for documenting and review of all financial processes that must be in place prior to the start of any new program designs to ensure sound financial practices are implemented and followed.

**Recommendation:** The provider should ensure that all contracts contain all parties' signatures.

Management Response: WOR agrees with this recommendation and has implemented fiscal policy that requires all contracts to be issued from the California office following existing fiscal policies and procedures in regards to on boarding contract labor.

**Recommendation:** The provider should develop and implement written policies and procedures for information technology and the security surrounding the information technology.

Management Response: WOR agrees with this recommendation and has begun the implementation process with management staff to create and produce an Information Technology Workgroup to create policies and procedures for WOR Information Technology operations.

#### Chapter 1-C

**Recommendations:** The provider should ensure that background checks are performed in a timely manner and in accordance with Department requirements.

Management Response: WOR agrees with this recommendation. Currently, a foster parent, back-up/respite caregiver, volunteers, intern, or employee are not allowed to start with the agency until a background check and fingerprints have been cleared.

Chapter 1-D

WOR conducted monitoring visits according to the requirement.

Thank you for your time and attention to these responses. Should you have further questions or concerns please feel free to contact me.

Sincerely,



Valerie Jackson, PH.D.  
Administrator, Houston

  
Renee Mancito  
CEO/President

**Management's Response from Houston Wee Care Shelter, Inc.**

---

Houston Wee Care Shelter, Inc.  
28915 So. Plum Creek Dr.  
Spring, TX 78386  
281-363-4020

August 23, 2013

State Auditor's Office  
ATTN: Michael Simon  
P.O. Box 12067  
Austin, TX 78711-2067

Re: Management Response to State Auditor's Office (SAO) Financial Audit  
of Residential Child Care Providers.

Dear Mr. Simon,

Below please find Houston Wee Care Shelter Inc.'s (HWCS) management  
response to the On-site Audit of Residential Child Care Providers Report  
issued by the SAO August 23, 2013. We humbly submit the following  
responses to be included in the final report.

**Chapter 2-A**

**Recommendation:**

Maintain complete and accurate supporting documentation that fully  
supports all financial transactions included on its cost report.

**Mgmt Response:** Houston Wee Care Shelter is in agreement with the  
findings. We have begun to address the deficiencies. Houston Wee Care  
Shelter is implementing a new filing system to improve the maintenance  
and accuracy of supporting documentation for financial transactions.

**Recommendation:**

Prepare its cost report in accordance with requirements. To help ensure  
this, the provider should:

- Regularly review the financial information used to complete its cost reports to identify and correct errors in a timely manner.
- Report and disclose all related-party costs in accordance with the Commission's applicable Cost Report Instructions.

**Mgmt Response:** The Houston Wee Care Shelter Chief Financial Officer will be responsible for submitting financial documentation to the agency's external accountant for entry into the general ledger. A thorough quality control review of the postings will be done periodically to insure accuracy.

On a monthly basis, the Houston Wee Care Shelter Administrator will review all financial information posted in the records used for the preparation of the cost report. The new procedure will allow us to identify and correct errors in a timely manner.

#### **Chapter 2-B**

##### **Recommendation:**

Develop and implement written policies and procedures for key financial processes.

Develop and implement written policies and procedures for its use of information technology.

**Mgmt Response:** Houston Wee Care Shelter is currently creating written policies and procedures for key financial processes and information technology. Once completed, the Houston Wee Care Shelter board of directors will review and approve the new policies. The staff will then be trained on the new procedures.

##### **Recommendation:**

Ensure that all contracts contain all parties' signatures.

**Mgmt Response:** Houston Wee Care Shelter will ensure that all contracts contain the signatures of all parties participating in the contract. Additionally, the shelter will set up a log to track contract terms and expiration dates to insure effective vendor due diligence.

**Recommendation:**

Ensure that financial transaction documents are used to generate its general ledger.

**Mgmt Response:** Houston Wee Care Shelter will ensure that all financial transaction documents will be used to generate the general ledger. A system will be implemented to reference source documents to general ledger postings that will insure that an adequate audit trail is established. Additionally, this will provide certainty that all financial documents are properly considered in postings.

Thank you for your time and attention to these responses. Should you have any further questions or concerns please feel free to contact me, Dr. Gloria Cantu, at 713-503-1458, or Kathryn Ross, at 281-806-4342.

Sincerely,



Dr. Gloria Cantu, Ed.D., LPC  
Program Director



Kathryn Ross, M.A.  
Administrator

*Management's Response from New Encounters, Inc.*

---

**NEW ENCOUNTERS  
RESIDENTIAL TREATMENT**

4121 FM Road 637  
Corsicana, Texas 75109  
903-874-1577

August 16, 2013

State Auditor's Office  
ATTN: Michael Simon  
PO Box 12067  
Austin, Texas 78711-2067

RE: Management Response to SAO

Chapter 3A

Recommendation:

The provider should maintain supporting documentation for all financial transactions supporting the cost report.

Response:

I will enhance the files for maintaining supporting documentation in files, pay rates, time sheets, invoices, etc.. to support the expenditures.

Recommendation:

The provider should prepare its cost report in accordance with requirements.

Response:

Yes, in reviewing this, I made mistakes in placing some in the wrong lines in the cost report, and should have depreciated the expenditure for the driveway. As of now, I am planning on contracting another person to complete the cost reports in the future.

Recommendation:

The provider should report and disclose all related party costs in accordance with the Commission's applicable Cost Report Instructions.

Response:

We have done this every year, except for 2012. The reason we did not do it for 2012 was because I was no longer on the board of directors. As a result, the board indicated that I was no longer a related party and this is why it was not documented on the cost report. We will continue to do what we have done every year.. reporting related party costs.

Recommendation:

The provider should ensure that it uses the accrual basis of accounting as required by the Texas Administrative Code and the Cost Report Instructions.

Response:

My external accountant who completes all financial documentation will be notified by this next week that they made some errors in accrual documentation. They do know it is all to be on accrual, but apparently they had made some mistakes. The accrual method has always been used but apparently they have made some mistakes.

Chapter 3-B

Recommendation:

The provider should implement a segregation of financial duties that includes individuals other than the executive director.

Response:

We will implement a supervisory review, and implementation from others in regards to writing checks, deposits, etc.. in financial aspects. We will begin this this month.

Recommendation:

The provider should develop and implement written policies and procedures, including required levels of review, for key financial processes.

Response:

We will begin to increase our policies and procedures for key financial processes in order to maintain consistency. Goal is to complete renewed policy by September 2013.

Recommendation:

The provider should develop a formal contract with its external accountant and ensure that the contract contains provision that outline the responsibilities and expectations regarding the contracted activities.

Response:

I will meet with our external accountant and process with him the responsibilities and expectations that need to be implemented and a formal contract will be completed and executed. Complete by September 2013.

Chapter 3-C

Recommendation:

The provider should ensure that all employees receive a background check within 24 months after their initial check as required by the Texas Admin. Code.

Response:

Yes, we were three months late for one person per the background check. We will avoid making this mistake again and will obtain all within 24 months ongoing.

Recommendation:

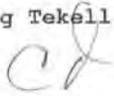
The provider should develop and implement written policies and procedures for conducting background checks and the reporting by employees of criminal indictment information to the department.

Response:

We will develop the policies in regards to the checks and reporting. Will complete it by September 2013.

If further information is needed, let me know.

Craig Tekell, Executive Director



## Management's Response from Refuge House, Inc.



...a Home is in the Heart of Every Child.

Dallas - San Antonio

August 16, 2013

### State Auditor's Office

ATTN: Michael Simon  
P.O. Box 12067  
Austin, Texas 78711-2067

**RE: Management Response to State Auditor's Office (SAO) Financial Audit of Residential Child Care Providers**

To, Michael Simon:

This letter is written as a response to findings provided by the State Auditor's Office sent to Refuge House, Inc. August 9<sup>th</sup>, 2013 by Managing Senior Auditor, Michael Simon. The letters and documents issued to Refuge House, Inc. provided results based on the agencies June 2013 On-Site Audit conducted by a State Auditor's Office team at the request of the Department of Families and Protective Services.

Written below are management responses to be included within the Final version of the State Auditor's Office issued report; On-site Audits of Residential Child Care Providers for Refuge House, Inc.,

#### Overall Conclusion:

*No Management Response Required*

#### Chapter 1:

*No Management Response Required*

#### Chapter 2:

*No Management Response Required*

#### Chapter 3:

*No Management Response Required*

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**Chapter 4:**

*Refuge House, Inc.  
3585 Timberglen Rd.  
Dallas, Texas 75287*

**Chapter 4 – A:**

**Recommendation:** Maintain supporting documentation for all financial transactions and consistently review and approve expenditures.

**Mgmt. Response:** *Refuge House, Inc. did not have the supporting documentation for a total of \$5, 106. (6%) of the total non-labor expenditures. The CEO of Refuge House, Inc. understands this is a very low dollar amount and not considered a substantial finding however, the agency will strive to lower this percentage by ensuring all documentation for non-labor expenditures are collected and maintained along with each correlating months financial records. If an expenditure is unsupported with documentation, an explanation will be provided and associated with the transaction. This action will be jointly accomplished by both Refuge House personnel and the external accountant. Please note that any minor mistake in this area was not intentional but that of human error.*

**Recommendation:** Ensure that all timesheets receive a supervisory review.

**Mgmt. Response:** *For the period under review during this audit, no policy required review and sign-off of the CEO and CIO timesheet, particularly because these were not direct care roles and they are filled by the Co-Founders of the Agency. Effective August 19, 2013 Refuge House management will ensure that all timesheets are reviewed and signed. This recommendation will help Refuge House, Inc. better support the Agency's Cost Report.*

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**Chapter 4 – B:**

**Recommendation:** Prepare its cost report in accordance with requirements.

**Mgmt. Response:** *Refuge House, Inc. had minimal reporting errors within its 2012 cost report. Beginning September 2013 the Refuge House, Inc. CEO and external accountant will review all allowable and non-allowable expenditures, classifications and any related party transactions to prevent these minor errors (Example: Allowable vs. Unallowable costs, Misclassifications, and Related-Party Transactions.) from occurring in the future. These reviews will take place during one or more of the weekly financial meetings that take place between the CEO and External Accountant. Documentation to support the review of these expenditures will be listed in the External Accountants monthly outline, as described in the Agency's Chapter 4-C response.*

**Recommendation:** Accurately reflect employees' payroll costs in the appropriate cost report categories.

**Mgmt. Response:** *Refuge House CEO and external accountant will coordinate to ensure that all payroll costs are accurately and appropriately documented. CEO and Cost Report preparer will review payroll costs specifically prior to submitting future reports.*

**Recommendation:** Report and disclose all related-party costs in accordance with the Commission's applicable Cost Report Instructions.

**Mgmt. Response:** *Refuge House, Inc. CEO and External Accountant will review and ensure all related-party transactions are appropriately documented by detailing the information monthly within the approved outline providing a continued reminder of the three standard transactions that are required to be listed. This minor error was not intentional but that of an oversight.*

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**Chapter 4 – C:**

**Recommendation:** Review all bank reconciliations prepared by the external accountant.

**Mgmt. Response:** *In an effort to continue to prevent increased risk and fraudulent transactions from occurring within the Refuge House Organization the CEO and the External Accountant have held weekly meetings, each Thursday, to review all financial matters involving Refuge House, Inc.. These meetings have always included all bank reconciliations prepared by the External Accountant at a minimum of monthly. Moving forward, beginning August 2013 the Refuge House, Inc., CEO will begin to sign and date an outline drafted by the External Accountant, using their letterhead, listing all financial documents and bank reconciliations prepared by the External Accountant. The signed document will be filed and maintained with all monthly financial billing of the External Accountant. (These outlines will be signed and dated no later than the 15<sup>th</sup> of the following month for each month reviewed.)*

**Recommendation:** Ensure that it has a formal contract in place with its external accountant that details the activities to be performed and the controls that must be in place to secure the provider's financial data.

**Mgmt. Response:** *Refuge House, Inc., will continue to accept monthly billing invoices from its External Accountant however effective Aug 16, 2013 a formal contract outlining the activities to be performed and the acknowledgment and agreement to follow the Refuge House, Inc. Financial Control Manual to ensure the agency's financial data is secure. A copy of the Refuge House Personnel Manual, Risk Management Plan, MIS Policy & Procedure Manual, and Financial Control Manual will be provided to the external accountant for reference purposes.*

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**Chapter 4 – D:**

**Recommendation:** Ensure that all required quarterly monitoring visits are fully documented and signed.

**Mgmt. Response:** *Although Refuge House, Inc. does complete a monthly home monitoring report that meets all RCCL and DFPS requirements, in addition to being completed more frequently than either monitoring entity requires and is physically signed by both the foster parents and the RH Case Manager at the time of the visit, Refuge House, Inc. did fail to have new staff complete 2 of the prior employees full Quarterly Report, however did have each monthly home monitoring report attached. Refuge House, Inc. will begin to require the completion of these reports, by the employee replacing the former worker, who initially started the document. If this takes place the Refuge House, Inc. staff will clearly document where in the report they started in order to prevent someone reviewing the information from believing the individual who signed the document prepared the entire report.*

In conclusion Refuge House, Inc. submits these responses in an effort to correct would like to thank each member of the team send by the State Auditor's Office for their professionalism, support and guidance throughout the entire audit process. If you have any questions please contact Michele L. Gorman, CEO, at (972) 849-7337 or (972) 662-5112

Thank You,

Michele L. Gorman  
Founder/CEO  
Refuge House, Inc.

cc. Tracy Portnoy, External Accountant  
Matt Cole, Board President  
Jeannie Duarte, Board Secretary  
Norman Ladd, Legal Counsel  
Council on Accreditation

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## Management's Response from Children of Diversity, Inc.



### Bank Reconciliation & Cost Report Preparation

#### Bank Reconciliation and Review

- A "Transaction Detail by Account" report for each bank account will be exported into Excel and sent to the Executive Director for review and approval each month. Any changes or corrections requested by the Executive Director to the general ledger account(s) will be made and finalized in Quick Books by accounting.
- An email will be sent to the Executive Director with notification that the monthly bank reconciliation reports along with the check register, are saved onto the network at *N: Executive/Accounting/*

#### Cost Report Preparation

- Executive Director will review "Transaction by Detail Account" reports each month to review and approve the coding of all transactions.
- Quarterly financials will be submitted to the Executive Director and the Board for review throughout the year.
- Upon the close of COD's fiscal year, a final and complete set of financial reports will be sent to the Executive Director and Board for review.
- COD's QuickBooks data file is forwarded to an independent CPA for review and processing of the organization's Cost Report.
- The independent CPA will send back a draft of the report for review by the Accounting Department and the Executive Director.
- The Executive Director, Accounting Director, and CPA will ensure that all items coded are matched appropriately with Cost Report guidelines.
- Once approved by all 3 parties, the Cost Report will be submitted by the CPA, and the final report will be filed on the COD network in the Executive Folder.



## Response for Misclassification

- \$1,950 payment for a foster family holiday banquet. Should have been reported as a "foster family recruiting and retention expense."

Answer: Future holiday parties of this nature will be coded to foster family recruiting and retention expense."

- \$2,396 in reimbursement for staff mileage was coded transportation costs, should have been coded to direct care expense.

Answer: The transportation should have been coded to direct care expense. This has been noted and will be coded that way for the next report.

- \$366 of employee drug screening costs was coded to advertising and recruiting. The SAO response says they should have been coded as medical supplies and staff vaccinations.

Answer: COD will code these expenses per auditors request and recommendation moving forward.

- \$1,892 in costs related to employee parties was coded as travel, training, and seminar expenses. These costs should have been reported as other administrative expenses.

Answer: These types of expenses will be coded as other administrative expenses moving forward.

- \$973 in bank charges was coded as other administrative expenses. Audit reports that these expenses should have been coded to professional service and consulting fee.

Answer: COD will code these expenses per auditors request and recommendation moving forward.



August 22, 2013

Re: SAO Report – Quarterly Monitoring of Foster Homes

In an effort to ensure that quarterly announced and unannounced monitoring of foster homes is completed as required, Children of Diversity has implemented an updated quarterly review form that depicts whether or not there were deficiencies and whether or not the monitoring was announced or unannounced. The form is then uploaded into the managing information system used by this agency called Extended Reach. Extended Reach notifies the agency at sixty (30) days, thirty (30) days and the day of when a quarterly review is approaching or needs renewing. The system alerts the Executive Director, the Licensed Administrator, and the supervisor so that the quarterly can be completed and uploaded into the system. This implemented system ensures that quarterlies are conducted according to Department requirements and foster homes comply with all Department standards.



August 22, 2013

Re: SAO Report – Back Ground Checks

In an effort to ensure that active employees, foster parents, occasional caregivers, frequent visitors, and household members receive timely background checks, Children of Diversity has implemented a new managing information system, Extended Reach. Extended Reach notifies the agency at sixty (60) days, thirty (30) days and the day of when a background check or other information is about to expire or needs renewing. With background checks, the system alerts the Executive Director and the Licensed Administrator so that the current information can be entered. This implemented system ensures that background checks are conducted according to Department requirements.

## Related State Auditor's Office Work

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| Related State Auditor's Office Work |   |                |
|-------------------------------------|---|----------------|
| Number                              | Product Name  | Release Date   |
| 13-036                              | An Audit Report on Caseload and Staffing Analysis for Child Protective Services at the Department of Family and Protective Services | May 2013       |
| 12-050                              | A Report on On-site Audits of Residential Child Care Providers  | August 2012    |
| 11-049                              | A Report on On-site Audits of Residential Child Care Providers  | August 2011    |
| 10-043                              | A Report on On-site Audits of Residential Child Care Providers  | August 2010    |
| 10-007                              | A Report on On-site Audits of Residential Child Care Providers  | September 2009 |
| 08-046                              | A Report on On-site Audits of Residential Child Care Providers  | August 2008    |
| 07-044                              | A Report on On-site Audits of Residential Child Care Providers  | August 2007    |
| 07-030                              | An Audit Report on Residential Child Care Contract Management at the Department of Family and Protective Services                   | April 2007     |
| 07-002                              | A Report on On-site Audits of Residential Child Care Providers  | October 2006   |

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The Honorable David Dewhurst, Lieutenant Governor, Joint Chair

The Honorable Joe Straus III, Speaker of the House, Joint Chair

The Honorable Thomas “Tommy” Williams, Senate Finance Committee

The Honorable Jim Pitts, House Appropriations Committee

The Honorable Harvey Hilderbran, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Health and Human Services Commission**

Dr. Kyle Janek, Executive Commissioner

### **Department of Family and Protective Services**

Mr. John J. Specia, Jr., Commissioner

### **Board Members and Executive Directors of the Following Providers Audited**

Children of Diversity, Inc.

Houston Wee Care Shelter, Inc.

New Encounters, Inc.

Refuge House, Inc.

Wings of Refuge, Inc.



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