

An Audit Report on Contract Administration at the Texas Youth Commission

Table of Contents

Key Points of Report

Executive Summary	1
--------------------------------	---

Section 1:

Contract Monitoring Does Not Currently Ensure That Contractors Consistently Provide Quality Services	5
---	---

Documentation Is Insufficient to Determine the Extent of Contractor Monitoring	5
--	---

Current Monitoring Efforts Are Not Sufficiently Focused On Performance	6
--	---

Monitoring Visits Are Not Scheduled Based On Risk	7
---	---

Noted Deficiencies Are Not Tracked to Ensure Corrective Action Is Taken	8
---	---

Section 2:

Inadequate Fiscal Oversight Increases the Risk That Funds Will Be Spent Inappropriately	10
--	----

Rate-Setting Methodology Does Not Ensure That the State Pays a Fair and Reasonable Rate for Services	11
--	----

Contractor Financial Controls Are Not Reviewed	12
--	----

Controls Over Start-Up Funds Do Not Ensure that Funds Are Necessary and Properly Spent	14
--	----

Section 3:

Contractor Selection Process Does Not Ensure That the Best Contractor Receives the Award	16
---	----

The Majority of Contracts Are Not Competitively Awarded	16
---	----

Weaknesses in Bid Evaluation Procedures Impacts Effectiveness of Competitive Award Process	17
--	----

Table of Contents, concluded

Management's Response 19

Appendices

1 - Objective, Scope, and Methodology 24

2 - Issue For Further Study 26

Key Points Of Report

An Audit Report on Contract Administration at the Texas Youth Commission

September 1995

Key Facts And Findings

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

Contact

Kay Wright Kotowski, CPA, Audit Manager (512) 479-4755



Office of the State Auditor

Lawrence F. Alwin, CPA

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

Executive Summary

Although the Texas Youth Commission (Commission) has made recent progress in its contract administration process, significant problems remain to be addressed. Problems currently exist with the Commission's ability to adequately monitor contractors' performance and financial accountability and to objectively select the most qualified contractors. The Commission has made recent progress in developing contract performance measures to hold residential service providers accountable for delivering quality services and by increasing the use of the competitive award process.

An effective contract administration system ensures that the State's needs are met while also protecting the rights of taxpayers. Sound contract administration and management begins with the decision to contract for a service and includes all of the activities related to evaluation of contractor performance through contract close-out. To enhance overall contract administration, the Commission will need to improve:

- monitoring processes by selecting contractors for review based on defined risk factors, documenting all visits and results, and ensuring noted deficiencies are corrected and reported
- financial oversight of contractors by developing a rate-setting methodology, reviewing provider financial operations, and limiting expenditures of providers receiving start-up funds to approved budgets
- contractor selection processes by reviewing the qualifications of all potential service providers prior to contract award and improving the current competitive award process

During fiscal year 1994, the Texas Youth Commission spent approximately \$14.2

million on contracts with various service providers. These contractors provided psychiatric assessments, counseling, and treatment; attended to the health and dental needs of Commission youth; and housed 696 of the 2,498 youth committed to the Commission's care. As a result of changes passed by the 74th Legislature, the Commission will need to rely even more on contracted residential care and related non-residential services to serve some 1,650 additional youth expected to be committed to the Commission's care in the coming years. Therefore, it is essential that the Commission's administration of contracted services be strengthened.

Contract Monitoring Does Not Currently Ensure That Contractors Consistently Provide Quality Services

The Commission's oversight of contractor performance does not provide sufficient information to determine if state funds are allocated to contractors who consistently provide the best services. We found that none of the 46 contract files randomly selected for review had been monitored on a quarterly basis as required by Commission policy. Thirty-five of the 46 files did not have documentation that the Commission had visited the provider at all during fiscal year 1994. In addition, four contracts were renewed with contractors despite current performance problems, as evidenced by contract performance measures. We also found that monitoring visits generally focused on contract compliance issues rather than contractor performance.

Executive Summary

To better monitor contractor performance, the Commission should develop systematic methods for:

- selecting providers for monitoring visits (based on defined risk factors)
- determining what monitoring procedures to conduct during the visit
- documenting and reporting results
- ensuring noted deficiencies are corrected

Inadequate Fiscal Oversight Increases the Risk That Funds Will Be Spent Inappropriately

The Commission's current level of fiscal oversight does not ensure that the agency receives the best value for its contracting dollars. Our review of Commission service providers found that the rates paid to contractors sometimes exceed the costs to provide services. In addition, we found that a contractor spent start-up funds on questionable items such as plant and flower arrangements and excessive travel expenses.

Currently, the Commission does not have a means to systematically set rates for contracts and does not adequately monitor contractor financial controls or the use of start-up funds. The Commission basically relies on the rate ceilings approved by the Health and Human Services Commission to ensure that the rates it pays to contractors are reasonable for the services provided and does not audit or review contractors' financial operations to determine if state resources are spent efficiently. State statutes do not specifically require the Commission to limit contractors' expenses to certain categories of cost. However, this does not preclude the Commission from including these limitations as requirements in contracts for purchased services. Inadequate fiscal oversight decreases the accountability over

contracting dollars and increases the risk of fraud, waste, and abuse.

To increase fiscal accountability over State funds we recommend that the Commission:

- Develop a rate-setting methodology based on reasonable and allowable costs of services
- Evaluate current financial monitoring efforts to determine what procedures should be implemented to ensure that state funds are spent in a manner to provide the best quality services. Consideration should be given to incorporating Federal cost principles related to the allowability of contractor expenditures in all contracts.
- Review proposed start-up fund budgets to ensure that all expenses are reasonable and necessary for beginning program operation and limit use of start-up funds to amounts and line items approved in the start-up fund budget.

Contractor Selection Process Does Not Ensure That the Best Contractor Receives the Award

The majority of Commission contractors are selected through an informal process which does not ensure that the selected contractor has demonstrated competence or is the best qualified. Only 11 of the 46 contracts we tested were competitively awarded using a Request for Proposal (RFP). The remainder of the contractors were chosen through an informal process which differed depending on in which region the contract was awarded.

Executive Summary

We recommend that the Commission develop and document a process for reviewing contractor qualifications, determining demonstrated competence, and awarding non-RFP contracts.

Summary of Management's Responses

TYC fundamentally concurs with the key recommendations contained in Section 1 of this report and the issues raised as important in Sections 2 and 3. TYC has developed a formal risk assessment instrument which has been applied to all contract providers, implemented an annual monitoring schedule based on risk assessment, and established documentation standards and a control system for all monitoring activities. TYC is working toward the completion of a rate-setting methodology that will reflect sound business practices and will result in the agency being able to pay reasonable rates without sacrificing anything in terms of performance. TYC has increased financial control requirements which insure the agency receives the best value for its contracting dollars and further reduce risk to taxpayers.

TYC acknowledges the areas of concern found in this audit. The agency is very serious about rectifying problem areas and strengthening contract administration. While this audit focused on areas where the TYC needs to improve its contract administration process, there has been significant progress in this area over the last five years. The report noted the agency's progress in contract performance measures and the use of competition in awarding contracts. The agency has increased the number of secure beds for adjudicated delinquents at reasonable cost which produce the desired results as well. TYC will build upon past progress to improve operations in a way that balances contract compliance, contractor performance, and contract cost.

Summary of Audit Objectives and Audit Scope

The objective of the audit was to evaluate and report on the effectiveness of the Texas Youth Commission's administration of its purchased service contracting process, as required by Government Code, § 321.015 (a) and (b) (1).

The scope of this audit was limited to contracts for program-related purchased services.

Section 1:

Contract Monitoring Does Not Currently Ensure That Contractors Consistently Provide Quality Services

The Commission's oversight of contractor performance does not provide sufficient information to determine if state funds are allocated to contractors who consistently provide the best services. Commission monitors -- Contract Specialists -- do not employ systematic methods for:

The Commission Divides Monitoring Responsibilities

The Commission has divided the responsibility for monitoring contractor performance among several groups:

The Contract Care Administration Division (located at its central office) assists regional personnel in implementing agency policy on monitoring.

Four **Contract Specialists** (located throughout the State in the regional offices) schedule monitoring visits, conduct the visits, and report on contractor performance.

Case Managers (also located in the regional offices) review the progress of their assigned youth and can provide general information on contractor performance to the Contract Specialists.

A **private, contracted monitor** reviews each contractor's compliance with level of care standards and compares services provided to Commission youth to the youths' needs.

- selecting providers for monitoring visits
- determining what monitoring procedures to conduct during the visit
- documenting and reporting results
- ensuring noted deficiencies are corrected

We found that none of the 46 contractors randomly selected for review had been monitored on a quarterly basis as required by Commission policy and that four contracts were renewed with contractors despite current performance problems. Furthermore, we found that monitoring visits generally focused on contract compliance issues rather than contractor performance.

Section 1-A:

Documentation Is Insufficient to Determine the Extent of Contractor Monitoring

Monitoring visits and results are not adequately documented. Commission policy requires its Contract Specialists to conduct a minimum of quarterly on-site visits to every contractor and to document the results of those visits. However, we found in a test of 46 randomly selected contract files that:

- None of the 46 contracts had documentation that the provider had been visited by a Contract Specialist on a quarterly basis as required by current Commission policy.
- Nineteen of the 46 contracts (41 percent) did not have documentation of *any*

type of monitoring (either by Commission personnel or by its contracted monitor) during fiscal year 1994. During this time period, the Commission expended approximately \$815,000 on these 19 contractors.

- Thirty-five of the 46 contracts (76 percent) did not have documentation in the monitoring file that the Commission had visited the provider during fiscal year 1994.

Contract Specialists confirmed that they neither visit every contractor quarterly, nor do they document all deficiencies found and corrective actions taken. On average, the Contract Specialists spend only 20 to 25 percent of their time monitoring contracts. Each Specialist has additional duties besides monitoring, such as conducting investigations, acting as a community liaison, or developing new contractors. The Contract Specialists' job functions vary depending on the needs of the region and Regional Director. As a result, the Contract Specialists report having insufficient time (and, in the case of one region, insufficient travel budget) to fulfill the monitoring job requirements as specified in the position job description and Commission policy.

Contract Specialists report directly to the Regional Director and indirectly to the Chief of Community Placement at Central Office. The Regional Director evaluates the job performance of the Contract Specialist. The Chief of Community Placement has not had input into these evaluations and has no mechanism by which to enforce the Commission's policy governing monitoring visits. However, the Regional Directors report to the Director of Community Service (to whom the Chief of Community Placement also reports). Therefore, given the current organizational structure, it is the Director of Community Placement who is responsible for ensuring that Contract Specialists have the necessary resources with which to fulfill their job requirements and then to hold them accountable for properly monitoring contractor performance.

Residential Contract Performance Measures

The Commission has developed eight performance measures to judge the performance of residential-care contractors:

- Percent of Positive Movement
- Percent of Negative Movement
- Escapes Per Ten Students
- Percent of Youth With One Escape
- Felonies Per Ten Students
- Misdemeanors Per Ten Students
- Confirmed Mistreatments Per Ten Students
- Percent of Early Movement

To be eligible for a rate increase, the contractor is required to achieve an above average rating in 75 percent of these performance measures. The Commission also reviews performance measure results prior to contract renewals.

Section 1-B:

Current Monitoring Efforts Are Not Sufficiently Focused On Performance

When monitoring visits are made, activities conducted by Commission monitors still focus more on compliance than performance. If the Commission cannot assess the effectiveness of services provided, it cannot determine if the State's money is paid to those contractors who are providing the best services. For example, the Commission contracts with a private company for some of its monitoring needs. These monitors review service contractors' compliance with level of care guidelines and determine whether or not the contractor actually provides the medical care, recreational activities, education, and therapeutic services specified in the guidelines for a given

level of care. But, the monitors do not review what effect these services have had on the youth placed in the program.

Similarly, Commission Contract Specialists focus their attention on compliance with contractual requirements rather than focusing on provider results. While contractual compliance is important, without adequately monitoring performance on an ongoing basis, the Commission cannot ensure that contractors are consistently providing quality services which meet program objectives.

To help track contractor performance, the Commission has developed outcome and output measures for residential-care contracts. Of the 46 contracts we reviewed, 34 (74 percent) incorporated the Commission's standard measures. During fiscal year 1994, the Commission expended approximately \$3.9 million under these 34 contracts. The remainder of the contracts we tested were for non-residential services, and the Commission has not yet developed performance measures for these types of services.

Although existing measures are a good starting point for assessing the effectiveness of residential services, the agency's Contract Specialists do not routinely use them in this manner. Our review found that the Specialists rely on performance measure reports primarily only when preparing annual provider evaluations and not for routine, ongoing assessment and monitoring of provider performance.

Additionally, Contract Specialists have not necessarily used performance measures results to determine when to recommend contract renewal. For each of the contracts we reviewed which included performance measures (34 of 46), we also reviewed provider performance and compared this performance to the timing of contract renewals. Of the 34 contracts with measures, we found that four contracts (or approximately 12 percent) had been renewed despite poor performance and that little or no monitoring was conducted and/or documented by Commission Contract Specialists prior to contract renewal. (We defined problem performance as three or more below average performance measures for one or more reporting quarters.)

Finally, contract "boilerplates" rely on licensure standards and/or level of care guidelines to define the statement of work. However, none of these standards included all expected services (such as perimeter security measures), and few contracts included contractor proposals. As a result, the statements of work in the Commission's contracts are often vague and do not contain sufficient detail to hold contractors accountable for providing required services.

Section 1-C:

Monitoring Visits Are Not Scheduled Based on Risk

None of the Commission's Contract Specialists uses a formal, systematic method for selecting providers for monitoring or for determining what monitoring procedures to conduct during the visit. Therefore, there is no assurance that the monitoring functions

are focusing on the riskiest areas, or that limited monitoring resources are used in the most efficient manner. All Contract Specialists report using an informal, undocumented means for setting priorities for their visit and report relying on their

experience and managerial skills to determine procedures to be performed.

Performance Measures Have Not Been Used to Select Contractors for Monitoring

In the past, performance measures have not necessarily been used to determine when to monitor a contractor. For example, our review of contracts in effect during fiscal year 1994 found that eight contractors (of the 34 contracts examined with performance measures) had not been monitored and/or visits had not been documented by the Commission within one month of receiving performance reports with three or more measures below average.

Beginning in fiscal year 1995, the Commission's Contract Care Division adopted a new policy requiring certain monitoring activities based on performance measures' results. Given the recent implementation of this policy, we are uncertain as to the extent of Contract Specialists' compliance with it.

While each Contract Specialist's methodology for setting priorities may be valid and appropriate for their region, the process for determining the priorities is informal and undocumented. As a result, the Contract Specialists could inadvertently overlook a contractor and not visit a contractor whose program was at risk. Furthermore, should the Contract Specialist leave the Commission, there would be no record of planned monitoring visits and no record of monitoring activities that could/should be performed on monitoring visits.

Commission General Operating Policy (Number 41.15) requires the Contract Specialist to "develop a schedule to monitor all service agencies based on service agents performance and needs." However, we found no additional guidance to Contract Specialists on how to best evaluate performance and needs. In April 1992, the Commission's Internal Auditor reported that

"[t]he frequency of monitoring for residential programs has been defined, but the content and coverage of the monitoring has been left up to the individual contract specialists." Almost three years later, this condition still exists.

Section 1-D:

Noted Deficiencies Are Not Tracked to Ensure Corrective Action Is Taken

Monitors do not systematically track contractor deficiencies or corrective action. In six of the 46 contracts (13 percent) we reviewed, program or compliance deficiencies had been identified and documented in the contract file by either the Commission or its contracted monitor, but the file did not contain documentation that the deficiency had been resolved. These deficiencies generally involved non-compliance with level of care standards. The Commission does not have written procedures for tracking deficiencies but General Operating Policy Number 41.15 requires the Contract Specialist to:

- Complete a follow-up report with a corrective action plan within five days of the visit in which deficiencies were found.
- Follow up with the service agency in the time frame designated in the previous monitoring.
- Document completion of corrective action.

Our review of contract monitoring files found that this policy was not being followed. Additionally, of the 46 contracts sampled, five (or approximately 11 percent) included

guarantees (that is, minimum payment clauses). None of the contracts reviewed with guarantees had provisions allowing the Commission to suspend guarantees should performance problems surface. (All five contracts did contain clauses allowing the Commission to terminate the contract. However, contract termination may not always be the best option when a contractor is experiencing performance problems.)

Of the five contracts sampled with guarantees, two contractors had periods of poor performance (as evidenced by three or more measures below average for more than one reporting quarter). Additionally, one of the five contracts with guarantees did not include performance measures. Therefore, while minimum payments were guaranteed to the contractor, the Commission had no objective method for gauging this contractor's performance.

Recommendations:

To improve its oversight of contractor performance and better ensure that contractors consistently provide quality services, the Commission should:

- Develop statements of work which explicitly define the nature of the services to be provided. Proposals (or other information used to define performance) should be included in each contract in order to hold the contractor accountable for providing the exact services agreed upon at the time of selection.
- Develop a formal risk assessment process to determine what contractors and which areas of contractor operations are the riskiest. Each Contract Specialist should document his/her planned work (on a periodic basis) and the process used to develop the plan.

Additionally, performance measure results should be considered in the risk assessment process used by Contract Specialists for selecting contractors for monitoring. Contracts with providers who have poor performance measures should not be renewed prior to receiving technical assistance from Contract Specialists and developing necessary corrective action plans to address deficiencies.

- Develop and enforce minimal documentation standards for monitoring visits and results. Additionally, management should review the current policy requiring quarterly monitoring visits and determine if sufficient resources are committed to implementing the policy and if the objective of the policy could be achieved in a different manner.
- Develop a formal system for tracking contractor deficiencies and corrective action. Such a system would provide Contract Specialists with better information with which to monitor performance trends and ensure all deficiencies are addressed in a timely fashion.

- Consider including a provision in all contracts with guarantees allowing suspension of guaranteed payments should a contractor's performance fall below specified levels (as indicated by current performance measures).

Section 2:

Inadequate Fiscal Oversight Increases the Risk That Funds Will Be Spent Inappropriately

The Commission's current level of fiscal oversight is not sufficient to ensure that the agency receives the best value for its contracting dollars. The Commission does not have a means to systematically set rates for contracts and does not adequately monitor contractor financial controls or the use of start-up funds. State statutes do not specifically require the Commission to limit contractors' expenses to certain categories of cost. However, this does not preclude the agency from including these limitations as requirements in contracts for purchased services. Inadequate oversight decreases accountability over contracting dollars and increases the risk of fraud, waste, and abuse.

The Commission basically relies on the rate ceilings approved by the Health and Human Services Commission to ensure that the rates it pays to contractors are reasonable for the services provided. While the Health and Human Services Commission is responsible for establishing *maximum* rates, each agency that contracts for services is responsible for developing its own methodology for setting rates. However, the Commission does not have its own formalized methodology to calculate contract rates and to ensure that its rates are the most cost-effective. As a result, our review of service providers found that the rates paid to contractors sometimes exceed the costs to provide services.

Furthermore, the Commission does not audit or review contractors' financial operations to determine if state resources are spent efficiently. State statutes and Commission policies do not govern or restrict the manner in which private contractors spend funds received from the Commission. Because the Commission does not have a rate-setting process and does not monitor the fiscal controls of contractors, there is no assurance that contractors spend taxpayers' money in a manner which provides the most benefits to citizens. In fact, in our review of three Commission contractors, we found examples of unreasonable and inappropriate expenditures by providers. However, we did not identify any instances of fraud at these three providers.

In some instances, the Commission provides start-up funds to contractors as an incentive for providing unique services. However, we found that the agency does not have adequate controls to ensure these funds are spent appropriately and according to

approved budgets. For example, funds were spent on questionable items, such as plant and flower arrangements and excessive travel expenses.

Section 2-A:

Rate-Setting Methodology Does Not Ensure That the State Pays a Fair and Reasonable Rate for Services

The Commission does not have a formalized rate-setting process. The Commission pays contractors according to maximum rates established by the Health and Human Services Commission for each level of care and for emergency shelters. Article 601b of the State Purchasing and General Services Act requires the Commission to negotiate its contracts to “achieve fair and reasonable prices at rates which do not exceed any maximum provided by law.” Because the Health and Human Services Commission is responsible only for establishing *maximum* rates for residential care, each agency that contracts for such care must still develop its own methodology for setting the rates it pays providers.

The Commission relies on “market-forces” and on past experience with a provider to negotiate rates with contractors and uses the Health and Human Services Commission’s rate ceilings to provide a reasonableness check on negotiated rates. However, we noted significant weaknesses in the methodology used to establish the ceiling rates. (See Appendix 2.) As a result, there is no assurance that the Commission’s rate reflects only true and reasonable costs incurred by the provider to provide the contracted service. During our review of Commission providers, we found the following indications that the cost to provide the services was less than the rate paid:

- Large accumulation in non-profit providers’ fund balances, which indicates that the costs to provide the services are actually less than the rate paid by state and local agencies. For the three providers we visited, fund balances totaled over \$1.6 million.
- Different rates being charged by the contractor to different state agencies for the same services. As a result, the agencies paying the higher rates are, in effect, “subsidizing” the agencies paying the lower rates.

Recommendation:

The Commission should develop a rate-setting methodology based on reasonable and allowable costs of services. Consideration should be given to limiting contractor payments to the lower of the negotiated rate or the actual cost to provide the services.

Section 2-B:

Contractor Financial Controls Are Not Reviewed

The Commission’s current financial controls are not sufficient to ensure that providers

spend state resources efficiently. The Commission does not require its contractors to obtain independent financial audits, nor does it review the financial operations of contractors. Instead, the Commission relies on the Department of Human Services' reviews of providers' 24-Hour Child Care Facilities Cost Reports to ensure that contractors adequately control their resources and expend them in the most efficient manner. These cost reports are contractually required to be submitted only by residential-care contractors and emergency shelters and are used only in rate-setting calculations.

The Commission has few controls to ensure that providers spend state resources efficiently. For example, while contracts require contractors to maintain their books according to generally accepted accounting principles, financial audits are not required. In the past ten years, the Commission has reviewed the financial operations of only two providers. The Commission severed its relationship with one of these two providers because the agency found that the contractor was financially unfit.

Although the Department of Human Services reviews cost reports, the objective of the review is to ensure that only "allowable" expenses are used when calculating and recommending level of care rate ceilings. If the Department of Human Services deems an expense "unallowable" for cost reporting purposes, the expense can still be incurred -- it just cannot be included on the cost report. Thus, there are no controls over how a Commission provider actually spends its funds.

Our review of Commission providers found the following:

- At one provider, the provider's accounting records clearly indicated that the cost to provide services was far less than the reimbursement received from the Commission, the Texas Commission on Alcohol and Drug Abuse, and the several county juvenile probation departments who used the provider. The provider had been monitored numerous times by its funding and licensing agencies without incurring any reduction in contracted rates.

Moreover, three years prior to our review, the Commission's Contract Specialist noticed this situation, but never took steps to resolve the problem.

- This same provider's cost report had recently been audited by the Department of Human Services. While the audit resulted in the \$223,105 of unallowable costs, the Department of Human Services' auditor did not report that the cost to provide services was substantially less than the total revenues received by the provider from various state agencies.
- At all providers reviewed, we found inadequate supporting documentation for various expenses, especially travel expenses. In addition to poor documentation, we found that travel expenses were often reimbursed at an amount above approved state travel rates. The Commission does not require providers to establish and enforce travel policies.
- The Commission also does not require providers to allocate expenditures against providers' various sources of funds. As a result, expenses associated

with out-patient counseling services could be commingled with expenses for residential services, and the true cost of each service is undeterminable. The Department of Human Services' cost report methodology does require providers to allocate costs using a "reasonable" method, but we found that two of the three providers we visited did not employ approved methodologies.

- Neither state statutes nor Texas Youth Commission policy prohibit providers from using state funds to purchase real property. On the other hand, federal regulations prohibit providers from using proceeds from federal contracts to purchase property without prior approval of federal funding sources. We found that one provider had purchased a new building using funds from one state agency without prior approval of that agency and that another provider was using state funds to purchase real property. Again, while the purchase of real property is not against state statute, the use of funds for this purpose raises questions regarding who should ultimately own the property.

Recommendations:

The Texas Youth Commission should evaluate current financial monitoring efforts to determine what procedures could be implemented to ensure that state funds are spent in a manner to provide the best quality services. Overall, the level of financial monitoring should provide the Commission with some assurance that contractors' internal controls are effective and that financial data is accurate and properly reported. The necessity for field audits should be included in the Contract Specialists' risk assessment processes, and consideration should be given to requiring independent financial audits of providers receiving large contracts.

When providers serve more than one state agency (as many of the Commission's providers do), the agency should coordinate its monitoring of provider financial operations with the monitoring of other funding agencies.

Additionally, the Commission should consider incorporating federal cost principles (such as those in OMB Circulars A-87, A-122, A-110, and A-102 and Federal Acquisition Regulations 48 CFR Ch. 1) related to the allowability of contractor expenditures in all contracts. Including requirements for expense allowability and reasonableness as well as exclusions of specific types of expenses would help ensure that contractors use state funds in the most cost-effective manner.

Section 2-C:

Controls Over Start-Up Funds Do Not Ensure That Funds are Necessary and Properly Spent

The Commission views start-up funds as an "incentive" for providing unique services

and does not fully evaluate the contractor's need for these funds prior to awarding them nor does it regulate what these funds may be spent on once the contract has been awarded. From 1990 to 1995, the Commission awarded over \$2 million in start-up funds to 11 providers. Our review indicated that some of these funds have been spent on questionable items such as plant and flower arrangements and excessive travel expenses.

Commission Start-Up Fund Policies

Commission policy allows start-up funds to be awarded only when there is a critical need for services which cannot be met by existing programs. All start-up funds paid to contractors must be awarded through a competitive Request for Proposal process. In addition, start-up funds may be awarded only if the Commission cannot identify service providers willing to start programs without financial assistance.

The Commission requires providers who are awarded start-up funds to submit a letter of credit. The letter of credit is a guarantee by the service provider's bank that if the provider defaults by not providing the contracted service, the bank will repay a portion of the start-up funds. (The amount to be repaid is calculated based on the total start-up funds paid less the amount of start-up funds earned to date.)

For the 11 providers receiving start-up funds from 1990 to 1995, we found no documentation that the Commission tried to identify providers willing to start programs without first offering start-up funds. In fact, in some instances, the Commission specified the amount of start-up funds it was willing to pay in the Request for Proposal. By so doing, the Commission, in effect, provided an open invitation for the bidders to request start-up funds regardless of need.

We also reviewed the Commission's most recent award of start-up funds in detail. Our analysis of the ten proposals submitted in response to this Request for Proposal indicated that there were six providers willing to start programs for less than the \$750,000 in start-up funds specified in the Request for Proposal. In fact, one of the providers was willing to provide the services without any

financial assistance. The contractor who was ultimately awarded the contract received the award based on the Commission's determination that this contractor was better able to provide the needed services than any other contractor. However, since there was a contractor willing to provide services without financial assistance, the Commission did not comply with its own policy which specifies that start-up funds can be provided ONLY if they cannot identify any provider willing to provide services without financial assistance.

Furthermore, once the contract was awarded, the Commission did not hold the contractor accountable for limiting expenditures to amounts or items specified in the approved start-up budget, but rather focused only on the total sum of the start-up funds provided to the contractor. Although the funding assistance agreement states that the Commission agrees to reimburse the service provider \$750,000 in accordance with the start-up budget and narrative, Commission staff indicates that their emphasis is on ensuring that services are provided, not on how the start-up funds are spent. Thus, if the contractor indicated that the funds were necessary to purchase equipment but later spent those funds on travel, the Commission would not take exception as long as the total does not exceed the approved total for start-up funds.

The funding agreement also specifies that use of the funds is limited to the expenditures necessary to make the program operational and to secure the first 24 months of program operations. However, during our review of invoices we noted questionable expenditures such as:

- \$4,399 for plant and flower arrangements
- duplicate payments for a total of \$16,069
- lodging totaling \$321 for two executives for a one-night stay at the Four Seasons Hotel
- reimbursement of telephone calls of \$61 and \$105 from one executive who flew in from Florida (also reimbursed by the State) just for the ground breaking ceremony of the facility
- a \$79 claim submitted by an executive for dining with the county judge at the Old San Francisco Steakhouse in Austin

Commission staff, during their review of invoices submitted for reimbursement, also noted some of these expenditures. But while the expenses were noted, the Commission did not exclude these items when reimbursing the contractor. There are currently no state statutes which prevent the Commission from reimbursing the contractor for these types of expenditures. However, it is questionable as to whether these expenditures are really necessary to make the program operational and are the best use of taxpayers' funds.

Recommendations:

To better ensure that start-up funds are reasonable and necessary to make the program operational and that funds awarded do not exceed the true cost to start operations, the Texas Youth Commission should:

- Discontinue the practice of disclosing anticipated start-up fund amounts to prospective providers.
- Review proposed start-up fund budgets to ensure that all expenses are reasonable and necessary for beginning program operations.
- Limit use of start-up funds to amounts and line items approved in the start-up fund budget. To do so, the Commission will need to track invoices submitted for reimbursement by expense category.

Section 3:

Contractor Selection Process Does Not Ensure That the Best Contractor Receives the Award

The majority of Commission contractors are selected through an informal process which does not ensure that the selected contractor has demonstrated competence or is the best qualified. (For purposes of this report, "best contractor" is defined as the contractor who submitted the most economical proposal capable of meeting the State's needs with the highest probability of success.) Only 11 of the 46 contracts we tested

were competitively awarded using a Request for Proposal. The remainder of the contractors were chosen through an informal process which differed depending on in which region the contract was awarded.

The State Purchasing and General Services Act permits the Commission to award contracts through negotiation, but requires that the selection of service providers be based on provider qualifications. The Commission uses a competitive bid process to award some residential service contracts and an informal negotiating process to award both residential and non-residential contracts. For those contracts which are not awarded through the competitive Request for Proposal process, the Commission does not have a formalized selection procedure to ensure that the selected contractor has demonstrated competence or is the best qualified to perform the contracted services.

Section 3-A:

The Majority of Contracts Are Not Competitively Awarded

The majority of the existing contracts at the Commission were not awarded using a competitive bid process. Only 11 of the 46 contracts we reviewed were awarded using a Request for Proposal. These 11 contracts accounted for \$2.4 million of the total \$6.3 million the agency expended on our sampled contracts during fiscal year 1994. (The Commission expended approximately \$14.2 million on all contracted services during fiscal year 1994.) Although the use of a competitive Request for Proposal process provides some assurance that contractors are fairly and objectively selected, at the time of our review, only 20 contracts have been awarded through the competitive process since the Commission started using it around 1987. The remainder of the contracts -- both for residential and non-residential services -- were awarded primarily based on recommendations by Regional Directors and Contract Specialists.

The Commission is exempt from the competitive award procedures outlined in Article 601b of the State Purchasing and General Services Act. However, the statute does require that the agency negotiate fair rates and states that contractor selection "shall be based upon the qualifications and demonstrated competence of the provider." Since the process used by each region to identify, screen, and recommend a selection varies considerably and is largely undocumented and informal, there are no assurances that contracts are awarded based on the qualifications and demonstrated competence of the provider.

In many cases, service providers approach the Commission offering to provide services. The Commission then checks the certification of the provider and determines if the provider is licensed or accredited by another state agency or if they meet TYC core standards. If the provider is deemed to be responsible, then the provider is asked to prepare a proposal for services in writing. The proposal is then reviewed to determine if the program will adequately address an identified need. The review of the proposal is not documented, and there is no set standard for reviewing the proposals. In fact, for 35 of the 46 contract files we reviewed, there was no proposal.

Recommendation:

The Texas Youth Commission should develop and document a standardized process for reviewing contractor qualifications, determining “demonstrated competence,” and awarding contracts which are not competitively selected using a Request for Proposal. This process should be sensitive to the time constraints of the staff asked to implement the new policy as well as the cost of the proposed system.

Section 3-B:

Weaknesses In Bid Evaluation Procedures Impact Effectiveness of Competitive Award Process

<p style="text-align: center;">Bid Evaluation Procedures</p> <p>The Commission evaluates proposals received under the Request for Proposal process in the following general areas:</p> <ul style="list-style-type: none">. Understanding of the scope of services to be provided.. Reasonableness of cost proposal. Financial condition and resources allocated to program. Past history and experience in providing services. Adequacy of proposed system of service. Access to appropriate site and other resources

Overall, the procedures used by the Commission to competitively award contracts are designed to prevent favoritism and select the best overall contractor. The use of the competitive Request for Proposal process has increased in recent years, and improvements have been made over time to strengthen the process. However, we noted several weaknesses in the bid evaluation procedures which may affect the Commission’s ability to select the best contractor.

The Request for Proposal process is used to award contracts for unique services or when start-up funds are involved. Eleven of the 46 contracts we reviewed were competitively awarded using a Request for Proposal process. Each proposal received is first reviewed to ensure that it is responsive to the Request for Proposal and is then evaluated based on factors specified in the

Request for Proposal. The following weaknesses in the process used to evaluate the proposals could prevent the best contractor from receiving the award:

- Of the 11 proposals that were awarded contracts under the 10 Requests for Proposals we reviewed, the selection committee evaluated three proposals using different criteria than those listed in the Request for Proposal. However, each of these contracts was awarded prior to 1991, and we found no discrepancies in recent awards.
- In two of the 10 Requests for Proposals reviewed, the highest ranked proposal from the initial evaluation was not selected for contract award because voting after the oral presentations took precedence over the initial scoring of the proposals. In these cases, it appears that emphasis on particular evaluation criteria changed after the initial evaluation. For example, one of the reasons these two providers were selected was because, after the oral presentations, the selection committee decided the provider’s location was better suited than that of the providers who were ranked higher in the initial evaluation, even though location was considered as part of the initial evaluation. Changing the

emphasis of evaluation criteria after the evaluation has already begun can result in the selection of a contractor that may not meet the intended purpose of the Request for Proposal.

- During the initial evaluation of the proposals, the selection committee relies only upon the information provided by the vendor to evaluate the qualifications of the applicant and past history and experience in providing like services. Although this area is allocated 20 of the 100 points available during the initial evaluation, no other information is obtained to evaluate the experience, integrity, reputation, or track record of the vendor.

Obtaining additional information about a potential vendor and verifying the qualifications and past history of a potential vendor provides the necessary assurance that the provider is responsible. In some cases, we noted that references were checked after the initial evaluation phase. However, if the past history and qualifications are considered as part of the initial evaluation, the references should be checked prior to the evaluation so that the evaluator has sufficient information available to score the proposal.

Recommendations:

Texas Youth Commission management should consider the following to strengthen the Request for Proposal process used to competitively award contracts:

- Ensure that the emphasis of evaluation criteria is not changed during subsequent phases of the proposal evaluation. This can be accomplished by clearly stating the evaluation criteria and process for each phase of the evaluation in the Request for Proposal.
- If qualifications and past history are evaluated during the initial scoring of the proposal, ensure that the selection committee researches the background and verifies the qualifications and past history of potential vendors prior to the initial evaluation of the proposals.

Management's Response

STEVE ROBINSON
Executive Director
JAY LINDGREN
Deputy Executive Director



TEXAS YOUTH COMMISSION

August 25, 1995

4900 North Lamar
P. O. Box 4260 • Austin, Texas 78765
(512) 483-5000 (voice)
(512) 483-5089 (fax)

Mr. Lawrence F. Alwin, C.P.A.
State Auditor
P. O. Box 12067
Austin, TX 78701

Dear Mr. Alwin:

I received correspondence from your office on August 14, 1995, requesting that the agency review and provide written responses to the recommendations made in your draft report entitled *Contract Administration at the Texas Youth Commission*. We fundamentally concur with the key recommendations contained in Section 1 of this report and the issues raised as important in Sections 2 and 3. TYC will implement controls that will cost effectively address these issues, eliminate perceived deficiencies and reduce risk for taxpayers.

The Texas Youth Commission has taken many steps over the past eighteen months to reduce overall costs and increase efficiencies within the agency. We worked very closely with key legislative staff and committees, the Criminal Justice Policy Council and the Texas Department of Criminal Justice to ensure that we are taking necessary steps to get the most for the least. TYC also worked with key legislators during the 74th Legislative Session in support of removing the agency from the levels of care system which had artificially raised some contract rates. The agency is committed to taking steps to improve our contract administration system to ensure that all services are provided in the most cost efficient manner while maintaining high levels of performance. Texas does not have a comprehensive system for determining what are allowable and unallowable costs for the purchase of services, and I look forward to taking a leadership role in this area as we improve our contract administration system.

Contract Monitoring

The recommendations in Section 1 of the report address monitoring of contract programs. TYC agrees with the recommendation to include statements of work in each boilerplate contract. This was implemented before the on-site audit work was completed by the audit review team. Monitoring of contract providers ensures that they are providing the services agreed upon in the statement of work as well as their program performance. Current policy is to monitor private

COMMISSION MEMBERS

GARY D. COMPTON
Chairman
Amarillo

MARELLA B. KING
Vice-Chair
Austin

PETE HARRELL
Austin

LEONARD E. LAWRENCE, M.D.
San Antonio

JOHN W. ODAM
Houston

EDNA TAMAYO
Harlingen

Mr. Lawrence Alwin, C.P.A.
Page 2
August 25, 1995

vendors on a quarterly basis; however, as noted in the audit report, TYC has been deficient in its written documentation of these activities. TYC will have clear documentation standards and a centralized system for tracking program deficiencies and implementing corrective action plans before this report is formally issued by your office. Field staff and their supervisors will receive training on this system September 13-15, 1995. I have communicated to staff that as far as I am concerned, if it is not in writing, we have not done it, and my expectation is that we will show significant improvement in this area immediately.

We also agree that a formal risk assessment process should be developed and that TYC's performance measure results should be considered in the risk assessment process. Performance measures that have been utilized by TYC for several years plus additional risk factors, such as level of program use, pattern of above or below average performance in previous quarterly reports, annual amount paid to provider, financial controls within agencies, and length of time contracting with the State will be combined to develop a formal risk assessment instrument for use by our agency. TYC's Chief of Internal Audit will be assisting in the development of this instrument, and his department will process the results. Programs of higher risk will be monitored more frequently, will be monitored more comprehensively, and will be audited financially. Until the instrument is implemented, a determination of the number staff needed cannot be made; however, it is estimated three additional employees with the credentials necessary to perform financial audits will be needed. This will be completed and implemented before the December 1995 performance measures report is due.

Fiscal Oversight **Rate Setting**

Section 2 of the report addressed fiscal accountability over State funds. TYC agrees that a rate-setting methodology should be based on necessary and reasonable costs for the services provided by vendors. TYC has been aware of the weaknesses in the State's system of establishing ceiling rates for some time, and is very pleased that the legislature supported our request to exclude TYC from the current Health and Human Services Commission rate-setting structure. TYC's current policies are modeled after what staff thought were best practices of other states which were surveyed in 1990. The agency favors a cost finding approach consistent with the privatization efforts of TDCJ, the policies of the Council on Competitive Government, current best efforts by other states, and the State Auditor's draft report on cost-based decision making. Although we have some reservations concerning the applicability and effectiveness of federal grant standards in securing quality services at the lowest cost, we are open to all ideas for improving the rate-setting system. This is a very important and complicated issue with implications for the entire state. TYC will begin immediately to work on it. The first step the agency is taking is to enlist the

Mr. Lawrence Alwin, C.P.A.
Page 3
August 25, 1995

support of the Comptroller of Public Accounts, the State Auditor, and experts in rate-setting. The goal is to complete the entire revision of this process by June 30, 1996. I want TYC's rate-setting methodology to reflect sound business practices and to result in its being able to pay reasonable rates without sacrificing anything in terms of performance.

Currently, the Texas Youth Commission represents only 5.4% of the approximately \$200 million that is expended on residential beds for children and youth in Texas by various State agencies. The majority of the contracts in this State have been based on flat rates set by other agency boards which do not vary regardless of the provider's costs or performance. While it is very difficult for TYC to take a leadership role in this area and to negotiate lower rates under this type of overall State structure, we have been successful in doing so. This has been accomplished in spite of the fact that TYC places the most violent and difficult adjudicated delinquent youth in the state. The Texas Youth Commission currently has negotiated lower rates in 35% of its contracts, and we are the only agency in the State system of care that negotiates performance based contracts for residential care.

TYC intends to build on the strengths in its system as we establish a systematic rate-setting methodology. It is essential that the \$1.6 million in federal funding that the agency generates by complying with the rate-setting methodology of the Texas Department of Protective and Regulatory Services, the single State agency for Federal Title IV-E funding, not be jeopardized. It is true that in the past TYC has have relied on the TDPRS rate-setting methodology. In fact, because of federal regulations, the state would actually lose money for some contracts if it negotiated a lower rate. This is an example of how rate-setting is a system issue.

Start-Up Funds

In the area of start-up fund budgets, the Texas Youth Commission establishes a Request for Proposal review committee with responsibility for reviewing proposed start-up budgets to ensure that all expenses are reasonable and necessary to establish a new program. The agency intends to improve its documentation of these efforts immediately. Through the use of start-up funding support, TYC has been able to initiate contracts with some excellent service providers in the last five years which has resulted in 270 new beds in the juvenile justice system at an average cost of less than \$7,000 per bed. TYC is not a grant giver and will only provide funding support that is directly connected to the delivery of new beds. In the case noted in the audit report, the State received the availability of 96-beds in a secure correctional facility worth in excess of \$5 million in less than 90 days for less than \$750,000 in start-up funds.

Mr. Lawrence Alwin, C.P.A.
Page 4
August 25, 1995

In each instance where start-up funds have been provided, the State's interest has been protected by an irrevocable letter of credit to secure performance of the contract. While the TYC does adjust some items that are submitted for reimbursement at the time of payment, all questionable and unreasonable items are reconciled before the final payment of start-up funds. The duplicate payment, plant and flower arrangements and travel expenses mentioned in the audit have already been adjusted out of the payment schedule by the vendor. All other expenses for start-up were in accordance with the amended start-up funds budget and were reasonable and necessary. TYC will further improve in this area by establishing a policy that requires a financial audit based on risk before closing out any future start-up fund contracts as well as establishing allowable and unallowable costs for these funds prior to the issuance of any future Request for Proposals. This will be submitted to the *Texas Register* for publication by October 1, 1995. We believe that these efforts will ensure that State funds are spent in a manner that provides the best quality services, though it may not incorporate all of the Federal cost principles recommended by the auditors.

Contractor Selection

In the final section of the report, it is recommended that TYC develop and document a process for reviewing contractor qualifications, determining demonstrated competence, and awarding non-RFP contracts. Although our agency does have a formal process in place, for certain service contracts requiring specific credentials and services, we agree that this process should be enhanced. TYC will include the non-residential purchase of professional services as well as residential services in this process. The agency will begin immediately to standardize this process for all contracts and complete it by the end of the calendar year.

As stated in the audit, TYC designed procedures to prevent favoritism and to select the best over-all contract and have made improvements over time to strengthen the Request for Proposal process. The auditors recommended that qualifications and past history should be verified prior to the initial evaluation of all proposals. We are able to implement this with only a minor change in our current evaluation procedures.

Management Perspective

TYC acknowledges the areas of concern found in this audit. The agency is very serious about rectifying problem areas and strengthening contract administration. While this audit focused on areas where the Texas Youth Commission needs to improve its contract administration process, I want to restate that there has been significant progress in this area over the last five years. The report noted the agency's progress in contract performance measures to hold providers accountable for delivering quality services and the

Mr. Lawrence Alwin, C.P.A.

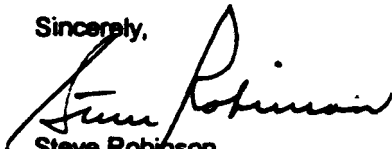
Page 5

August 25, 1995

use of competition in awarding contracts. The agency has significantly impacted the availability of secure quality programs for adjudicated delinquents in the state as well. TYC will build upon this to continue to improve agency operations, increase oversight of contractor performance and financial controls, and improve overall program performance. It is my goal that TYC balances contract compliance, contractor performance and contract cost; all are equally important. The Texas Youth Commission will be taking the steps that are necessary to achieve this balance.

The audit report has been helpful in focusing our efforts toward improvement, and we look forward to receiving a copy of the final report. If I can be of any further assistance, please feel free to call upon me at 483-5001.

Sincerely,

A handwritten signature in cursive script that reads "Steve Robinson". The signature is written in black ink and is positioned above the printed name and title.

Steve Robinson
Executive Director

Objective, Scope, and Methodology

Objective

The objective of the audit was to determine if the Texas Youth Commission's (Commission) contract administration of program-related purchased services was sufficient to ensure that state funds were spent appropriately and effectively. We focused on determining the following:

- Do procedures used to select contractors ensure that the best contractor is fairly and objectively selected?
- Are contract provisions sufficient to hold the contractor accountable for delivering quality services?
- Are contract monitoring functions sufficient to ensure that contractors consistently provide quality services?
- Are contract monitoring functions sufficient to ensure that contracts spend state funds appropriately?

Scope

The scope of this audit included purchased client service contracts in effect during fiscal year 1994. We included contracts for residential services, psychiatric assessments, counseling and treatment services, and health and dental services. Our sample consisted of 46 contract files with contracts randomly selected from each of the Commission's five regions. We also reviewed the financial records of three Commission service providers to determine if state funds were spent appropriately.

Areas addressed during our review include:

- contract provisions
- contract monitoring methodologies, policies, and practices
- contractor selection policies and practices
- rate-setting methodology, policies, and practices
- policies and practices related to the use of start-up funds

Methodology

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

Information collected to accomplish our objectives included the following:

- Interviews with management and staff of the Commission's Central Office
- Interviews with the Contract Specialists and Regional Directors from each of the five regions
- Interviews with Executive Directors and accounting staff from three Commission service providers
- Interviews with staff from the Department of Human Services and the Health

- and Human Services Commission
- Documentary evidence such as:
 - Policies and procedures related to contract administration and rate-setting
 - Applicable state statutes and guidelines
 - Commission contract files/contractor selection files

Procedures and tests conducted:

- Tests of contract provisions.
- Tests of 46 randomly selected contract files to determine if contractors had been monitored in accordance with Commission policies.
- Tested contractor selection process. For the 11 contracts in our sample of 46 which were awarded through the Request for Proposal process, reviewed process to determine if contractors were fairly and objectively selected in accordance with Commission policies. For remaining contracts, reviewed contract files to determine if provider was selected based on demonstrated competence.
- Tested revenue and expenditures transactions at the service providers to determine if funds were spent appropriately.
- Reviewed invoices submitted by contractor for reimbursement of start-up expenditures.

Criteria used:

- Best business practices related to contract administration
- Federal guidelines and cost principles - OMB Circulars A-87, A-122, A-110, and A-102 and Federal Acquisition Regulations 48 CFR Ch. 1
- Contract management model developed by the State Auditor's Office
- Standard auditing criteria
- 24-Hour Residential Child Care Cost Report Methodology

Fieldwork was conducted from February 15, 1995, through June 30, 1995. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Auditing Standards
- Generally Accepted Government Auditing Standards

There were no significant instances of non-compliance with these standards.

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

- Cynthia L. Reed, CPA (Project Manager)
- Julie L. Cleveland
- Eric B. Corzine
- Ryan G. Simpson
- Rose Ann Munoz
- Kay Wright Kotowski, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Appendix 2:

Issue for Further Study

Consider Establishing Statewide Rate-Setting Methodology

Our review identified weaknesses in the the rate-setting methodology relied on by the Texas Youth Commission (Commission). In addition, previous State Auditor's Office reports (*Rate Setting For Children's Residential Care*, SAO Report No. 95-022, November 1994) and *A Management Control Audit of the Department of Protective and Regulatory Services*, SAO Report No. 95-003, September 1994) have also identified weaknesses in the methodology used to set rates used for children's residential services. As mentioned in Section 2 of this report, the Commission currently uses the ceiling rates established by the Health and Human Services Commission to provide a reasonableness check on negotiated rates. However, there are inherent weaknesses in the methodology used to establish the ceiling rates. Specifically:

- **The methodology for calculating ceilings for 24-hour residential child care rates is largely undocumented and out-of-date.**

Currently, the methodology for calculating rate ceilings for residential child care is not documented other than in the actual computer program used to calculate the ceilings and in a few memos and other informal correspondence prepared by the manager of the Department of Human Services' Rate Analysis Unit. The computer program used to calculate the rate ceilings was developed by the former Health and Human Services Coordinating Council.

The Health and Human Services Commission inherited the current methodology from the Coordinating Council and has not updated or formally adopted this methodology. As a result, the methodology for calculating the rate ceilings is not available for provider review, and the accuracy of ceiling calculations cannot be readily verified.

Moreover, the current methodology was developed approximately eight years ago and was influenced by several providers. Staff of both the Health and Human Services Commission and the Department of Human Services' Rate Analysis Unit believe the methodology to be "obsolete" and incapable of reflecting today's environment or today's cost of care.

- **Rate ceilings for fiscal year 1995 have never been formally approved.**

The Health and Human Services Commission approved rate ceilings for fiscal year 1994 but did not ever formally adopt the recommended rates calculated by the Department of Human Services for fiscal year 1995. The Commission's responsibility for approving ceiling rates was established through the Commission's enabling legislation (HB 7) and a rider to the General Appropriations Act. Specifically, this rider states that

"None of the funds appropriated to the various state agencies for residential placements of clients shall be expended by the agencies unless the rates paid for residential placements do

not exceed the maximum amount for each level of care recommended by the Health and Human Services Commission.”

- **The Health and Human Services Commission does not have a process for reviewing and approving waivers to exceed approved rate ceilings.**

The Commission does not review agencies' compliance with maximum rates and does not have a process to review and approve waiver requests to exceed maximum rates. According to Commission staff, each agency can decide on a case-by-case basis when to exceed the ceiling rates. Justification for exceeding the maximum rate should then be documented in the child's individual case plan.

To assist agencies in developing contracted rates that more accurately reflect the cost to provide services, consideration should be given to establishing a statewide, standardized rate-setting methodology for purchased client services. The methodology should define standardized elements of cost to be used in negotiating contracted rates. In addition, a standardized rate-setting methodology would help to ensure that consistent rates (to any single provider) are paid for like services regardless of the funding source.