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A Report on

On-Site Audits of Residential Child Care Providers

October 2006

Report No. 07-002



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Overall Conclusion

The five residential child care providers (24-hour providers) we audited spent federal and state funds on items such as direct care staff, food, shelter, and clothing that were necessary to ensure the mental and physical well-being of children in their care. Providers deliver these services through unit rate contracts with the Department of Family and Protective Services (Department).

Under their unit rate contracts, providers are paid an amount per child per day for delivering services. The Department does not control how providers spend the payments, so long as the providers (1) spend these funds legally and (2) account for their expenditures accurately in cost reports they submit to the Health and Human Services Commission (Commission) for rate setting purposes. Expenditures reported as unallowable costs are not included in the cost data used to set unit rates. During calendar year 2005, the Department paid the five providers we audited approximately \$22,465,574.

Each of the providers we audited engaged in related party transactions during 2005. Related party transactions are not unusual in the foster care environment, and the Department has established rules and provisions in its contracts regarding related party transactions. However, the Department's rules and contracts are ambiguous as to whether these requirements apply to (1) how providers actually spend funds on related party transactions or (2) how providers report these types of transactions on the cost reports they submit to the Commission. As a result of this ambiguity, there are inconsistencies in providers' compliance. Specifically:

- In 2005, one provider paid \$92,572 in costs for goods and services provided by related parties that were above the actual costs incurred by the related

Audits of Residential Child Care Providers

During calendar year 2005, the Department contracted with approximately 250 providers to provide residential child care on a 24-hour basis. The Department paid these providers a total of approximately \$354 million during fiscal year 2005. At the end of fiscal year 2005, the Department was providing services to an estimated 19,113 children.

Approximately 63 percent of the funding for these services comes from the federal government and approximately 37 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 financial audits of selected residential child care providers that provide foster care services to the Department of Family and Protective Services.

Related Party Transactions

A related party transaction is a transaction for which there is an exchange of services, equipment, facilities, or supplies between a provider and a person or organization related to the provider through common ownership (including immediate family relationship) or any association that permits either entity to significantly influence or direct the actions or policies of the other.

Title 40, Texas Administrative Code, Section 732.240 (f), specifies that the costs incurred by a provider through related-party transactions must not exceed the actual cost incurred by a related party. The intent of this requirement is to (1) treat the costs incurred by the related party as if they had been incurred by the provider itself in order to avoid the payment of a profit to the provider through the related party and (2) avoid the payment of artificially inflated costs that may result from less-than-arm's-length bargaining.

parties. The Department's rule specifies that the costs providers pay on related party transactions must not exceed the actual cost incurred by the related party. As required by its contract, the provider reported those costs on the cost report it submitted to the Commission.

- The other four providers spent federal and state funds in a manner that was consistent with the intent of the Department's rules. In 2002, one of these providers took action to comply with the Department's rule so that a lease agreement would not be considered a related party transaction. However, the lease agreement then became a "less-than-arm's-length" transaction. The Department's rule specifies that lease costs paid through "less-than-arm's-length" transactions should not exceed the amount that would be allowed if the provider held title to the property.

In addition, the Department does not adequately monitor related party transactions and less-than-arm's-length transactions. The ambiguity in the Department's rules and contracts, combined with the lack of monitoring, creates the potential for providers to spend federal and state funds on unallowable costs. See Tables 1 through 5 in Chapter 1-B of this report for the related party transactions identified at the five providers we audited.

In addition, auditors identified the following:

- Four providers did not comply with their contracts with the Department. For example, providers did not consistently perform required criminal background checks on all of their staff. In addition, providers did not consistently ensure that all of their staff had received required training.
- Each of the five providers audited had insufficient documentation for (1) financial and administrative accounting processes or (2) automated systems.

Key Points

The Department should strengthen its practices to ensure providers' cost reports do not include payments of unallowable costs from related party transactions and less-than-arm's-length transactions.

The Department's current rules and contracts specify that the Department intends to ensure that only allowable costs are paid on related party transactions and less-than-arm's-length transactions. However, the Department should clarify whether its rules and contracts apply to (1) how providers actually spend funds or (2) how they report these types of transactions on the cost reports they submit to the Commission. This lack of clarity has hindered the Department's ability to ensure that providers comply with the intent of its rules.

The Department should monitor providers to ensure that they are not spending federal and state funds on related party transactions and less-than-arm's-length transactions in a manner that is inconsistent with the intent of its rules.

The Department's current contract monitoring practices focus primarily on the quality of the services providers deliver. The Department also should perform financial monitoring to ensure that its providers' related party transactions and less-than-arm's-length transactions comply with the intent of its rules.

Two providers we audited paid potentially unallowable costs for goods or services.

The table below summarizes the costs we identified as potentially unallowable. In these cases, the providers paid costs for goods or services provided by related parties or through less-than-arm's-length transactions that were above the actual costs incurred by the parties providing the goods or services.

Potentially Unallowable Costs Paid by Two Providers - Calendar Year 2005		
Description	Potentially Unallowable Costs Identified	
	Provider A	Provider B
Provider paid potentially unallowable costs to lease property or equipment.	\$39,659	\$5,882
Provider paid potentially unallowable costs for employee services.	36,173	0
Provider paid potentially unallowable costs for services.	16,740	0
Provider paid potentially unallowable costs to lease vehicles.	0	17,696
Totals	\$92,572	\$23,578

The providers we audited did not consistently comply with other contract requirements.

- Three providers did not consistently perform required criminal background checks. Auditors performed criminal background checks on each of the providers' personnel and did not identify any reported offenses that would be considered violations of the Department's rules.
- One provider underpaid a foster care family with whom it placed children by \$5,262.
- Two providers did not consistently ensure that direct care staff and foster care parents with whom it placed children received and maintained required training. Two direct care staff at one of these providers had not received required first aid and cardio-pulmonary resuscitation (CPR) training. The other provider did not ensure that four foster care families with whom it placed children maintained current CPR certifications.

Four providers need to correct weaknesses in their financial or administrative accounting systems.

- Three providers did not maintain adequate documentation of their purchases of food, shelter, and clothing.
- One provider did not ensure that (1) its lease agreement for land, buildings, vehicles and other items was up to date and (2) its personnel files contained adequate documentation of the qualifications of its professionally licensed and direct care staff.
- One provider needs to strengthen the segregation of its financial duties and ensure that its payroll is consistently supported with timesheets that supervisors approve and sign.
- One provider did not have a contract with a foster care family with whom it placed children. Specifically, a contract between the provider and the foster care family was not in place for a five-month period during which the foster care family cared for children.

Selected Recommendations

The Department should consider:

- Strengthening practices to (1) ensure that providers' cost reports continue to identify payments of unallowable costs made with federal and state funds through related party transactions and less-than-arm's-length transactions and (2) ensure that unallowable costs are not authorized or used in the rate setting analysis.
- Ensuring its program staff conducts reviews to verify that providers that engage in related party transactions and less-than-arm's-length transactions are meeting the required standard of care.
- Requesting that the Health and Human Services Commission's Office of Inspector General conduct field audits of cost reports from providers that are considered to be higher risk because they engage in related party transactions and less-than-arm's-length transactions.
- Ensuring that the results of cost report audits are coordinated and communicated between its program staff and the Health and Human Services Commission.
- Ensuring that providers consistently and promptly perform all required criminal background checks on their staff.

Summary of Responses from the Department and the Commission

The Department and the Commission are in general agreement with the recommendations in this report, and their responses are presented in Appendix 3 on page 40.

Summary of Providers' Responses

With the one exception, the providers are in general agreement with the recommendations that were addressed to them, and their responses are presented in Appendix 4 on page 46. However, Provider B did not agree with the findings and two recommendations regarding its lease agreement with a company owned by former members of its board of directors.

Summary of Information Technology Review

The five providers we audited should correct weaknesses in their information system environments to improve the security over automated systems, applications, and data. The weaknesses we identified increase the risk of inadvertent or deliberate alteration or deletion of data, which could affect the providers' ability to ensure the integrity of its data.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the providers.

Summary of Objective, Scope, and Methodology

The audit objective was to verify that providers are spending federal and state funds for contractually required services that promote the well-being of the children placed in their care.

The audit scope included assessing the appropriateness, reasonableness, and necessity of costs paid by providers in calendar year 2005. In addition, our scope included verifying whether providers ensured that their professionally licensed staff and direct care staff met the Department's requirements for qualifications and training.

The audit methodology included judgmentally selecting five residential child care providers based on (1) risk factors the Department of Family and Protective Services uses in its annual statewide monitoring plan and (2) risk factors the Health and Human Services Commission's Rate Analysis Division proposed for selecting residential child care providers for its cost report audits. Additionally, the audit methodology included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of tests;

and interviewing management and staff from the Department, the Office of Inspector General, and providers.

Other SAO Work		
Number	Product Name	Release Date
04-044	A Financial Review of the Department of Family and Protective Services	July 2004
03-046	Review of New Foster Care and Adoption Subsidy Rates Proposed by the Department of Protective and Regulatory Services	August 2003
03-411	A Review of the Department of Protective and Regulatory Services' Foster Care Payments to Child Placing Agencies	March 2003
00-040	An Audit Report on the Department of Protective and Regulatory Services' Administration of Foster Care Contracts	August 2000
97-002	An Audit Report on Contract Administration at Selected State Agencies- Phase Four	September 1996
96-047	Contract Administration at Selected Health and Human Services Agencies- Phase Three	February 1996

Contents

Detailed Results

Chapter 1	
The Department Should Strengthen Its Practices to Ensure Providers' Cost Reports Do Not Include Payments of Unallowable Costs from Related Party Transactions and Less-than-arm's-length Transactions	1
Chapter 2	
Audit of Provider A: Life Support Counseling and Research, Incorporated (doing business as Therapeutic Family Life)	10
Chapter 3	
Audit of Provider B: Youth and Family Enrichment Centers, Incorporated	17
Chapter 4	
Audit of Provider C: The Burke Foundation, Incorporated (doing business as Pathfinders Camp)	25
Chapter 5	
Audit of Provider D: Baptist Child and Family Services (doing business as Baptist Children's Home Ministries)	29
Chapter 6	
Audit of Provider E: El Paso Center for Children, Incorporated.....	33

Appendices

Appendix 1	
Objective, Scope, and Methodology	35
Appendix 2	
Types of Residential Child Care Providers (24-hour Providers)	38

Appendix 3
Responses from the Health and Human Services
Commission and the Department of Family and
Protective Services..... 40

Appendix 4
Responses from the Residential Child Care Providers
Audited..... 46

Detailed Results

Chapter 1

The Department Should Strengthen Its Practices to Ensure Providers' Cost Reports Do Not Include Payments of Unallowable Costs from Related Party Transactions and Less-than-arm's-length Transactions

The Department of Family and Protective Services (Department) should ensure residential child care providers (24-hour providers) spend federal and state funds on related party transactions and less-than-arm's-length transactions in a manner that comply with the intent of its rules. (See text box for examples of related parties.)

Related Parties

A related party is a party that can exercise control or significant influence over the management and/or operating policies of another party, to the extent that one of the parties may be prevented from fully pursuing its own separate interests.

Examples of related parties include:

- Principal owners.
- Management.
- Members of the immediate families of principal owners of the enterprise and its management.

Source: Statement of Financial Accounting Standards No. 57, *Related Party Disclosures*, page 10, March 1982, Financial Accounting Standards Board.

The Department's current rules and contracts specify that the Department intends to ensure that the costs paid on these types of transactions do not exceed the actual costs incurred by the party providing the good or service. However, the Department should clarify whether its rules and contracts apply to (1) how providers actually spend funds or (2) how they report these types of transactions on the cost reports they submit to the Health and Human Services Commission (Commission). This lack of clarity has hindered the Department's ability to ensure providers comply with the intent of its rules.

In addition, the Department should strengthen its contract monitoring practices to ensure that providers' related party transactions and less-than-arm's-length transactions are appropriate, reasonable, and necessary. The Department's current monitoring practices focus primarily on ensuring quality in the provision of services to children and compliance with contract terms and conditions.

Chapter 1-A

The Department Should Clarify Its Rules and Contract Requirements Regarding Providers' Related Party Transactions and Less-Than-Arm's-Length Transactions

The Department's rules and contracts with providers specify that the Department does not want providers to pay unallowable costs on related party and less-than-arm's-length transactions. However, neither the Department's rules nor its contracts are clear about how providers actually should conduct such transactions.

The Department should clarify its rules and contracts.

The Department's Rule Regarding Related Party Transactions

Costs incurred by [providers] under less-than-arms-length (related-party) transactions are allowable only up to the cost to the related party. ...However, the cost must not exceed the price of comparable services, equipment, facilities, or supplies that could be purchased or leased elsewhere.

The purpose of this principle is twofold: to avoid the payment of a profit factor to the provider through the related organization (whether related by common ownership or control), and to avoid payment of artificially-inflated costs which may be generated from less-than-arms-length bargaining.

The intent is to treat the costs incurred by the related organization as if they were incurred by the provider itself.

Source: Title 40, Texas Administrative Code, Section 732.240 (f).

The Department's Rule Regarding Less-Than-Arm's-Length Transactions

Rental costs under less-than-arms-length leases are allowed only up to the amount that would be allowed if the provider held the title to the property.

Source: Title 40, Texas Administrative Code, Section 732.250.

The Department's rules concerning related party transactions and less-than-arm's length transactions are unclear as to whether the rules apply to (1) how providers actually spend funds or (2) how providers report these types of transactions in the annual cost reports they submit (see text box for the rules). The Department's contracts reference those same rules; therefore, this lack of clarity is duplicated in the Department's contracts.

Because the Department's rules and contracts are unclear, there are inconsistencies in providers' compliance. Each of the five providers we audited engaged in related party transactions, and one engaged in less-than-arm's-length transactions:

- One provider paid costs for goods and services provided by related parties in a manner that did not comply with the intent of the Department's rules (see Chapter 2-A of this report for additional details). The provider reported those costs in the annual cost report it submitted to the Commission's Rate Analysis Division as required by its contract.
- Another provider spent funds in a manner that was consistent with the intent of the Department's rule regarding related party transactions. However, the provider was engaged in a "less-than-arm's-length" transaction that was not in compliance with the Department's rules (see Chapter 3-A of this report for additional details).
- Three providers spent funds in a manner that was consistent with the intent of the Department's rule regarding related party transactions.

Without clear guidance concerning related party and less-than-arm's-length transactions in its rules and contracts, the Department cannot reasonably ensure that providers comply with its rules.

The Department should correct inconsistencies between its rules and contracts.

The Department's rules concerning its recovery of funds from providers that do not comply with its rules are inconsistent with the terms of its contracts.

Unit Rate Contracts

The unit rate contract is a concept based on agencies' focusing on the delivery of quality services, not the appropriateness of provider expenditures. The Federal government promotes using the unit rate approach to provide more stability to the budgeting process and equality in provider payments.

Providers are paid a fixed rate for each unit of service delivered. Contracts do not contain provisions that limit the actual expenditures to the reasonable and necessary costs of providing services or require the provider to reimburse funding agencies for any inappropriate expenditure.

The Department's rule (Title 40, Texas Administration Code, Section 732.241) states that, because its contracts are unit rate contracts, the Department will recover funds in only two instances:

- If the provider's payment was not correctly calculated.
- If the provider breached the terms of the contract.

However, the Department's contracts state that the Department can take whatever actions it deems necessary to ensure compliance with the terms and conditions of the contract including, but not limited to, actions such as the recovery of payments identified by (1) contract monitoring or (2) audit findings of violations of contract requirements.

Recommendations

The Department should:

- Clearly specify in its rules and contracts whether its rules concerning related party transactions and less-than-arm's-length transaction apply to (1) how providers actually spend funds or (2) how providers report their costs on their annual cost reports.
- Correct inconsistencies between its rules and contracts.

Chapter 1-B

The Department Should Strengthen its Financial Monitoring by Reviewing Providers' Related Party Transactions and Less-Than-Arm's-Length Transactions

The Department's financial monitoring of providers does not adequately address providers' related party transactions and less-than-arm's-length transactions. The Department has not consistently monitored providers to ensure that providers comply with its rules concerning the costs they pay on related party transactions and less-than-arm's-length transactions.

The Department has structured its contract monitoring primarily to ensure quality in the provision of services to children and compliance with contract terms and conditions. It has limited its monitoring of related party transactions only to identifying the number of leases or rental agreements for buildings and transportation vehicles that each provider has. This excludes monitoring of other common related party transactions such as contracts for services and contracts to lease equipment. The Department does not review

the appropriateness of its providers' related party transactions or less-than-arm's-length transactions and the associated costs.

In addition, the Department relies on the Commission's Office of Inspector General to identify and address unallowable costs associated with providers' related party transactions. The Office of Inspector General reviews these transactions during its desk reviews and field audits of the cost reports providers submit. The findings from those reviews and audits are used in the rate-setting process (see text box for details). The Office of Inspector General

is not responsible for identifying providers' non-compliance with the Department's rules or for taking corrective action against providers.

Rate-Setting Process

The Health and Human Services Commission's (Commission) Rate Analysis Division develops provider payment rates for the Department.

The Commission requires each provider that provides 24-hour residential child care services to submit an annual cost report containing financial information that covers all expenses associated with the provider's activities during the previous fiscal year. The primary purpose of the cost report is to determine a fair and reasonable reimbursement rate for a prudent and cost-effective provider.

The Office of Inspector General's Contract Audits Division conducts both desk reviews and select field audits of the cost reports. These reviews and audits verify that the provider's actual direct and indirect costs are allowable, reasonable, necessary, and properly allocated in compliance with the governing federal and state regulations. Unallowable costs identified are excluded from the rate-setting process.

Each of the five providers we audited engaged in related party transactions. With the exception of Provider A's related party transactions (see Chapter 2 for additional details), we determined that the providers paid reasonable and necessary costs for their related party transactions. Tables 1 through 5 below list the types of related party transactions each provider engaged in during calendar year 2005.

Table 1

Provider A's Related Party Transactions For Calendar Year 2005				
Related Party Services Provided through Employment				
Position	Relationship	Salary ^a	Bonus	Total
Executive Administrator	Spouse of Executive Director	\$77,834	\$1,500	\$79,334
Director of Operations	Executive Director's immediate family	84,269	1,500	85,769
Foster Group Home Supervisor	Executive Director's immediate family	70,361	1,500	71,861
Program Coordinator	Spouse of Foster Group Home Supervisor	41,942	1,238	43,180
Administrative Assistant	Program Coordinator's immediate family	26,272	524	26,796
Direct Care Staff	Program Coordinator's immediate family	25,944	500	26,444
Leased Property and Equipment and Contract Services Provided by Related Parties				
Item Leased	Related Party	2005 Costs		
Training and recreational facility	Company owned by the Executive Director	\$14,196 ^b		
Residential property (A)	Company owned by the Executive Director	38,400 ^c		
Residential property (B)	Company owned by the Executive Director	19,104 ^c		
Cargo trailer	Company owned by the Executive Director	4,200 ^c		
Antique furniture	Company owned by the Executive Administrator	2,760 ^c		
Commercial property	Company owned by the Executive Administrator's immediate family	14,394 ^c		
Contract Services Provided by Related Parties				
Services Provided	Related Party	2005 Costs ^d		
Lawn Care Services (1)	Company owned by the Foster Group Home Supervisor	\$7,200		
Lawn Care Services (2)	Company owned by the Foster Group Home Supervisor	3,780		
Lawn Care Services (3)	Company owned by the Foster Group Home Supervisor	1,440		
Pool Care Services	Company owned by the Foster Group Home Supervisor	2,400		
Housekeeping Services	Company owned by the Executive Administrator's Immediate Family	3,000		

Provider A's Related Party Transactions For Calendar Year 2005		
Lawn Care Services	Company owned by Executive Administrator's Immediate Family	1,500
Total of Provider A's Related Party Costs		\$445,758
<p>^a With the exception of the salary paid to the foster group home supervisor that is discussed in Chapter 2-A, the salaries paid to the program coordinator, administrative assistant, and the direct care staff are reasonable in comparison with the national median of salaries paid by other foster care providers. The reasonableness of the executive administrator's and the director of operations' salary could not be determined because the salary survey did not include information on those positions.</p> <p>^b Costs were determined to be potentially unallowable. See Chapter 2-A for additional details.</p> <p>^c Costs were set above the actual cost to the related party.</p> <p>^d With the exception of the Lawn Care Services (2) and (3) contracts, services were competitively procured.</p>		

Table 2

Provider B's Related Party Transaction For Calendar Year 2005		
Position and Service Provided	Related Party	2005 Costs
Chief Financial Officer	President of the Board of Directors	\$59,800 ^a
Medicaid billing processing	Company owned by the President of the Board of Directors	5,178 ^b
Total of Provider B's Related Party Costs		\$64,978
<p>^a The salary earned in 2005 is less than the national median of \$78,087 for similar positions at facilities with an operating budget between \$1,000,000 and \$2,500,000.</p> <p>^b Cost for services was set at a reasonable rate.</p>		

Table 3

Provider C's Related Party Transaction For Calendar Year 2005		
Position	Related Party	2005 Salary ^a
Assistant Director/Clinical Director ^b	Officer of the Board of Directors	\$50,608
Executive Secretary	Member of the Board of Directors	18,508
Total of Provider C's Related Party Costs		\$69,116
<p>^a The salaries earned in 2005 are less than the national medians of \$66,000 and \$25,000, respectively, for similar positions at facilities with an operating budget between \$500,000 and \$1,000,000.</p> <p>^b This position performs services for other operations delivered by the provider. Those other services were not audited.</p>		

Table 4

Provider D's Related Party Transactions For Calendar Year 2005		
Item Leased	Related Party	2005 Costs ^a
Furniture and equipment lease	Parent company	\$1,305
Building lease	Parent company	360
Vehicle lease	Parent company	175
Total of Provider D's Related Party Costs		\$1,840
^a Costs are based on the annual depreciation rates for the respective items.		

Table 5

Provider E's Related Party Transactions For Calendar Year 2005		
Service Provided and Position	Relationship	2005 Cost
Commercial loan	Bank managed by the Spouse of a Board Member	\$31,459 ^a
Community Relations Coordinator	Spouse of Executive Director	\$6,400 ^b
Total of Provider E's Related Party Costs		\$ 37,859
^a Loan acquired for the construction of a new office building. The interest rates were set at the going prime rate at the time.		
^b Cost for services was set at a reasonable rate.		

The number of related party transactions identified at these five providers reinforces the need for increased monitoring by the Department. Without reviewing providers' related party and less-than-arm's-length transactions to ensure that the goods and services and the associated costs are reasonable and necessary, the Department cannot ensure that providers comply with the intent of its rules.

There has been inconsistency in responses to prior State Auditor's Office reports.

Responses from the Department's predecessor agency (the Department of Protective and Regulatory Services) to prior State Auditor's Office audit reports about providers' financial transactions have been inconsistent. Specifically:

- In response to a February 1996 audit report,¹ the Department of Protective and Regulatory Services stated that contract managers would be trained to understand the allowable contract costs and that its contracts would be amended to clearly require providers to refund any amounts that are determined to be unallowable under federal cost principles.
- In response to a September 1996 audit report,² the Department of Protective and Regulatory Services stated that its contracts allowed it to recoup payments or impose administrative sanctions based on audit findings of violations of contract requirements. It also stated that its new contracts would allow it to sanction or discontinue contracting with providers that incur unallowable expenditures and continue to make unallowable expenditures.
- In response to an August 2000 audit report,³ the Department of Protective and Regulatory Services stated that it would enhance its handbooks and training of contract managers regarding related parties.

However, following the August 2000 audit, the Department of Protective and Regulatory Services was inconsistent in its actions to ensure providers complied with its rules concerning related party transactions:

- In November 2001, the Department of Protective and Regulatory Services adopted rules that stated that the Department would recover unallowable costs only in instances in which a provider's payment was calculated incorrectly or the provider has breached its contract agreement with the Department. As previously discussed in Chapter 1-A, this rule is inconsistent with the Department's current contracts.
- In June 2002, the Department of Protective and Regulatory Services notified one of the providers we audited during this audit that it had identified unallowable costs involving related party transactions. The

¹ *Contract Administration at Selected Health and Human Services Agencies – Phase Three*, State Auditor's Office Report No. 96-047, February 1996.

² *An Audit Report on Contract Administration at Selected State Agencies- Phase Four*, State Auditor's Office Report No. 97-002, September 1996.

³ *An Audit Report on the Department of Protective and Regulatory Services' Administration of Foster Care Contracts*, State Auditor's Office Report No. 00-040, August 2000.

Department requested that the provider repay \$92,884 in unallowable costs (see Chapter 3-A of this report for additional details).

The Department cannot effectively ensure providers comply with the intent of its rules concerning related party transactions and less-than-arm's length transactions if there is inconsistency in its monitoring practices.

Recommendations

The Department should consider:

- Strengthening practices to (1) ensure that providers' cost reports continue to identify payments of unallowable costs made with federal and state funds through related party transactions and less-than-arm's-length transactions and (2) ensure that unallowable costs are not authorized or used in the rate setting analysis. In addition, the Department should consider:
 - ♦ Requiring providers to annually submit adequate documentation of all related party and less-than-arm's length transactions and associated costs.
 - ♦ Establishing a formal annual review of its providers' related party transactions and less-than-arm's-length transactions by its internal audit department to determine the appropriateness, reasonableness, and necessity of the goods or services being provided.
- Requesting that the Health and Human Services Commission's Office of Inspector General conduct field audits of cost reports from providers that are considered to be higher risk because they engage in related party transactions and less-than-arm's-length transactions.
- Ensuring that its program staff conducts reviews to verify providers that engage in related party transactions and less-than-arm's-length transactions are meeting the required standard of care.
- Ensuring that the results of cost report audits are coordinated and communicated between its program staff and the Commission.

Audit of Provider A: Life Support Counseling and Research, Incorporated (doing business as Therapeutic Family Life)

Provider A Background Information Calendar Year 2005	
Contract services audited	Child placing agency/foster group homes
Number of children served	1,737
Average length of a child's stay	289 days
Total payments received from the DFPS	\$17,113,574
Total revenue	\$17,354,530
Federal tax filing status	Non-profit
Ending cash balance on December 31, 2005	\$3,888,722
Approximate number of program staff	97
Program staff turnover rate ^a	24.8 %
^a The turnover rate reported is for both administrative and program staff.	

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

Provider A used the payments it received from the Department to (1) pay the foster care families with whom it placed children and (2) pay costs it incurred for providing 24-hour residential child care services. The services this provider and its foster care families deliver are intended to ensure the mental and physical well-being of children placed in their care on items such as direct care, food, shelter, and clothing. However, auditors identified the following:

- **Potentially Unallowable costs.** This provider paid \$92,572 in potentially unallowable costs for goods and services obtained through related parties.
- **Non-compliance with criminal background check requirements.** This provider did not perform in a timely fashion the contractually required criminal background check for 1 of 37 files that auditors reviewed.
- **Weaknesses in the documentation of purchases.** This provider did not maintain adequate documentation to ensure that its purchases were reasonable and necessary.
- **Weaknesses in access to and the security environment surrounding automated systems, applications, and data.** This provider should make improvements to address weaknesses in the security over its automated systems, applications, and data. The weaknesses auditors identified increase the risk of inadvertent or deliberate alteration or deletion of data.

The Provider Paid Potentially Unallowable Costs for Goods or Services Provided by Related Parties

This provider paid potentially unallowable costs totaling \$92,572 to lease property and equipment and obtain services from related parties.

Title 40, Texas Administrative Code, Section 732.240(f), states that costs incurred through a related party transaction should not exceed the actual costs incurred by the related party to provide the good or service.⁴ The related party transactions for which auditors identified potentially unallowable costs are summarized in Table 6. The potentially unallowable amounts the provider paid to related parties could have been used to provide additional services or enhance the quality of services provided to the children in its care.

Table 6

Potentially Unallowable Costs For Services Provided by and Leases with Related Parties Calendar Year 2005	
Transaction Description	Potentially Unallowable Cost
The provider paid \$57,504 to lease two residential properties that it uses as group homes from a company owned by its executive director	\$ 18,806
The provider paid \$4,200 to lease a cargo trailer from a company owned by its executive director.	4,200
The provider paid \$2,760 to lease antique furniture from a company owned by its executive administrator.	2,457
The provider paid a relative of its executive director an annual salary of approximately \$70,361 to be a foster group home supervisor. A salary survey reported that the national median annual salary for similar positions is approximately \$34,188. ^a	36,173
The provider paid \$14,196 to lease a training and recreational facility from a company owned by its executive director.	14,196 ^b
The provider paid \$16,740 for the care of horses that lived at the training and recreational facility. The horses are owned by the provider's executive director.	16,740 ^c
Total	\$92,572
<p>^a The salary survey was conducted by the Alliance for Children and Families in 2005. The salary figures reported are based on the median (50th percentile) of reported averages.</p> <p>^b Auditors questioned the full \$14,196 paid because the provider lacked documentation to demonstrate the actual use of the training and recreational facility.</p> <p>^c Auditors questioned the full \$16,740 paid because the provider lacked documentation to demonstrate the actual use of the horses by foster care families.</p>	

⁴ The related party's actual cost also may not exceed the fair market value for the good or service.

It would have been more cost-effective if this provider had purchased certain items that it chose to lease. For example:

- The provider leases a cargo trailer at a cost of \$350 a month from a company owned by its executive director. The lease has been in effect since November 1, 1999, and continues indefinitely. The cargo trailer was purchased by the executive director's company for \$8,572. The provider has paid an estimated total of \$25,900 to lease the trailer from November 1, 1999, through December 31, 2005.
- Since October 1, 2004, the provider has leased antique furniture at a cost of \$230 a month from a company owned by its executive administrator. The antique furniture was purchased by the executive administrator's company for \$4,550. The provider will pay a total of \$6,900 over the lease period (October 1, 2004 through March 1, 2007).

In addition, the ownership of the cargo trailer and the antique furniture remains with the companies from which it leases these items.

This provider should terminate its related party lease for the training and recreational facility owned by its executive director.

The lease this provider has for the training and recreational facility that is owned by its executive director may be unreasonable and unnecessary. Specifically:

- The provider lacked documentation to demonstrate that it used the facility a reasonable number of times during calendar year 2005. According to the provider's staff, the facility was used for a total of approximately eight days during calendar year 2005 for quarterly, two-day long training sessions.⁵
- The facility is part of the executive director's personal residence.

This provider paid potentially unallowable related party costs for the care of horses.

The provider paid approximately \$16,740 in potentially unallowable costs for the care of horses that live at the training and recreational facility. The horses are owned by the provider's executive director. Staff reported that the horses are used for recreational activities by foster care families. Although the provider should pay costs associated with the actual recreational use of horses by foster care families, it is unreasonable for the provider to pay for the daily care of the horses.

⁵ Staff also reported that the facility was used as an emergency shelter for approximately five weeks for foster care children that resided in its group homes that were evacuated as a result of Hurricane Rita.

This provider should ensure that the salary of one of its foster group home supervisors is reasonable.

This provider employs a foster group home supervisor who is related to the executive director. The foster group home supervisor's salary totaled approximately \$71,861 in calendar year 2005. According to a salary survey, other providers pay a median salary of approximately \$34,188 for similar positions.⁶ The provider acknowledged that this individual's salary is more than twice the national median, but it asserts that this position involves additional responsibilities that are not typically performed by the average foster group home supervisor. The responsibilities of this position include:

- Management of the development, operations, and maintenance of two group homes.
- Training and mentoring foster parents.
- Marketing.
- Management of special building projects as assigned.

Although these additional responsibilities may not be traditionally performed by a foster group home supervisor, the provider should ensure that the salary it pays for performing those responsibilities is reasonable and properly classified to the appropriate position.

This provider should ensure that services provided by related parties are awarded through a competitive procurement process.

The provider lacked documentation to demonstrate that two service contracts with related parties were awarded through a competitive procurement process. The provider paid \$3,780 and \$1,440 on each of the respective contracts for lawn care services in 2005. The lawn care services are provided by a company owned by the foster group home supervisor previously discussed. The provider requires that any procurement for goods or services that exceeds \$2,500 must be competitively procured. Although one of those contract's cost was below the threshold, the provider should ensure that all contract services awarded to related parties offer the provider the best price and quality and that there are no conflicts of interest in the award of its contracts to related parties.

Recommendations

The provider should:

- Revise its policies and procedures for procuring goods or services to require bids for goods or services to be provided by a related party. In

⁶ The salary survey was conducted by the Alliance for Children and Families.

addition, it should ensure the costs it pays for goods provided by related parties do not exceed the actual purchase cost paid by related parties. These policies and procedures should include maintaining adequate documentation of the price quotes, cost analyses that were performed, the data used in those cost analyses, and the board of directors' approval.

- Ensure that all lease agreements for property and equipment have a specific contract term and do not continue indefinitely.
- Terminate its lease agreement for the use of the training and recreational facility and enter into a per use contract that is approved by the board of directors. This per use contract should:
 - ♦ Ensure that the related party charges only a per use fee for the number of employees that attend training at the facility or the number of families that visit the facility for recreational purposes.
 - ♦ Maintain adequate documentation regarding the employees or foster care families that visit the facility for training or recreational purposes.
- Recoup the funds that were paid for the care of the horses unless adequate documentation of use can be established.

Chapter 2-B

The Provider Should Conduct Criminal Background Checks for All Subcontracted Therapists in a Timely Fashion

This provider did not perform in a timely fashion the contractually required criminal background check for 1 subcontracted therapist from a sample of 37 files that auditors reviewed. The provider performed the criminal background check on March 30, 2005, which was seven months after it subcontracted with this therapist on October 1, 2004.

The Department's licensing rules require providers to perform criminal background checks for all employees and subcontractors within two business days of being hired if they have direct contact with children. Although the subcontracted therapist discussed above had no criminal history, performing criminal background checks after subcontracting increases the risk that children could be placed in the care of inappropriate individuals.

Recommendation

The provider should ensure that it performs criminal background checks before subcontracting with individuals who will have direct contact with children.

The Provider Should Maintain Documentation of Its Purchases and Develop Policies Concerning the Use of Its Credit Cards

This provider should ensure that its direct care staff and executive management provide adequate documentation for (1) the purchases they make and (2) the use of its credit cards. Auditors tested a sample of the provider's purchases of food, shelter, clothing, and travel and determined that the provider lacked receipts for several of these purchases. Specifically:

- The provider did not have receipts for 29 (12 percent) of 233 purchases for food, shelter, and clothing tested. Those 29 purchases totaled approximately \$9,578. In addition, nine (31 percent) of the 29 transactions identified were reimbursements to employees that totaled approximately \$1,330.
- The provider did not have receipts for 36 (35 percent) of 102 credit card transactions that totaled approximately \$6,926.
- The provider did not have receipts and documentation describing the purpose of the travel for 6 (17 percent) of 35 expenditures for travel to seminars and conferences that totaled approximately \$1,604.
- The provider did not have receipts and documentation describing the purpose of the travel for 7 (23 percent) of 31 expenditures for other administrative travel that totaled approximately \$571.

The provider's contract with the Department requires it to maintain adequate documentation for all purchases and uses of funds. Adequate documentation is necessary to determine whether a provider's costs are appropriate, reasonable, and necessary and whether those costs should be included in the Commission's rate setting process.

This provider should develop policies and procedures for use of its credit cards.

This provider does not have policies and procedures for how its employees use its credit cards. The provider paid \$428,964 for purchases made on its four credit cards in calendar year 2005. The credit cards are intended primarily for travel, but they also can be used for office and foster group home supplies, repairs, lunches, catering, and office equipment. The lack of policies and procedures exposes the provider to the risk that its credit cards could be used on inappropriate, unreasonable, or unnecessary purchases.

Recommendations

The provider should:

- Ensure that its direct care staff and executive management provide adequate documentation for the purchases they make.
- Develop and implement objective policies and procedures for purchases made with its credit cards. Those policies and procedures should include, but should not be limited to, the following:
 - ♦ Limits on the items that can be purchased with specific credit cards.
 - ♦ Documentation that employees must submit for credit card purchases.
 - ♦ Description of the actions the provider will consider when employees do not comply with its credit card policies and procedures.

Chapter 2-D

The Provider Should Strengthen Access to and Security Surrounding Its Automated Systems, Applications, and Data

This provider should correct weaknesses in its information system environment to improve the security over its automated systems, applications, and data. The weaknesses we identified increase the risk of inadvertent or deliberate alteration or deletion of data, which could affect the provider's ability to ensure the integrity of its data. We identified opportunities for improvement in the following areas:

- Information system policies and procedures.
- Access and security controls.
- Backup and storage of data.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the provider.

Recommendation

The provider should review recommendations auditors provided and consider which recommendations are most appropriate for improving the security over its automated systems, applications and data.

See Provider A's responses in Appendix 4, page 46.

Audit of Provider B: Youth and Family Enrichment Centers, Incorporated

Provider B Background Information Calendar Year 2005	
Contract services audited	Residential treatment Center
Number of children served	77
Average length of a child's stay	354 days
Total payments received from DFPS	\$1,390,860
Total revenue	\$1,914,339
Federal tax filing status	Non-profit
Ending cash balance on December 31, 2005	\$149,229
Approximate number of program staff	20
Program staff turnover rate	250.0%

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

Provider B used the payments it received from the Department to pay costs it incurred for providing 24-hour residential child care services. These services were necessary to ensure the mental and physical well-being of the children placed in this provider's care and included items such as direct care, food, shelter, and clothing. However, auditors identified the following:

- **Potentially Unallowable costs.** Auditors identified potentially unallowable costs of \$23,578 that were paid to lease five vehicles, a tractor, and tractor equipment from a company owned by former members of its board of directors. This lease agreement is considered a less-than-arm's-length transaction.
- **Non-compliance with criminal background check and direct care staff training requirements.** This provider did not perform in a timely fashion the contractually required criminal background checks for two direct care staff. In addition, two direct care staff did not have required first aid or cardio-pulmonary resuscitation (CPR) training.
- **Weaknesses in documentation for purchases, lease documents, and personnel files.** This provider did not consistently maintain documentation to support its purchases of food, shelter, and clothing. It also did not ensure that its lease agreement for building, vehicles, and other items was up to date and that its personnel files contained adequate documentation of its staff's qualifications.
- **Weaknesses in access to and the security environment surrounding automated systems, applications, and data.** This provider should make improvements to address weaknesses in the security over its automated systems, applications, and data. The weaknesses auditors identified increase the risk of inadvertent or deliberate alteration or deletion of data.

The Provider Paid Potentially Unallowable Costs to Lease Vehicles and Equipment

This provider paid an estimated \$23,578 in potentially unallowable costs to lease vehicles, a tractor, and tractor equipment from a company owned by former members of its board of directors.⁷ Auditors identified this lease agreement as a less-than-arm's-length transaction because:

Less-than-arm's-length Lease

A less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other.

Source: Office of Management and Budget Circular A-122.

- The land and buildings the provider uses to maintain its operations and deliver services to foster care children are leased from the company owned by the former members of its board of directors.
- The former board members appointed the provider's current chief financial officer (who also is the current board president) in 2001.

Title 40, Texas Administrative Code, Section 732.250, states that rental costs under less-than-arm's-length leases are allowed only up to the amount that would be allowed if the provider held the title to the property.

Table 7 summarizes the potentially unallowable costs the provider paid to lease vehicles, a tractor, and tractor equipment in 2005. The amounts the provider paid could have been used to provide additional services or enhance the quality of services provided to the children in its care.

⁷ The former board members served on the board of directors from 1985 through 2002.

Table 7

Comparison of the Costs Paid by Provider in 2005 with Costs Based on Straight Line Depreciation (With No Salvage Value)							
Item	Date Lease Obtained	Self- reported Purchase Price ^a	Estimated Useful Life	Estimated Annual Depreciation Cost	Estimated 2005 Depreciation Cost	Reported Lease Costs Paid in 2005	2005 Potentially Unallowable Costs (Reported lease costs less estimated 2005 depreciation costs)
1998 Vehicle	March 2000	\$18,144	5 years	\$ 3,629	\$ 604 ^d	\$ 6,300	\$ 5,696
1999 Vehicle	March 2000	18,144 ^b	5 years	3,629	604 ^d	4,725	4,121
2001 Vehicle	November 2002	18,244	5 years	3,649	3,649	6,600	2,951
2003 Vehicle A	January 2005	21,582	5 years	4,316	4,316	6,396	2,080
2003 Vehicle B	January 2005	21,582	5 years	4,316	4,316	6,396	2,080
2005 Vehicle	July 2005	18,959	5 years	3,792	1,896 ^c	2,664	768
Tractor	March 2000	6,800	5 years	1,360	226 ^d	4,956	4,730
Tractor Equipment	March 2000	3,250	5 years	650	108 ^d	1,260	1,152
Totals				\$25,341	\$15,719	\$39,297	\$23,578
<p>^a Self-reported actual purchase costs from the company.</p> <p>^b The purchase price shown is an estimated cost based on the cost of the 1998 vehicle. The purchase cost was not provided on this vehicle.</p> <p>^c The reported 2005 depreciation cost of \$1,896 is for the period of July through December 2005.</p> <p>^d The reported 2005 depreciation cost is for the period of January through February 2005. The item was completely depreciated by March 2005.</p>							

In July 2002, the Department determined that this provider was paying unallowable costs on the lease agreement during fiscal years 2001 and 2002.⁸ At the time, the transaction was treated as a related party transaction because the owners of the company in which the items were leased were current members of the board of directors. In October 2002, the Department requested a repayment of approximately \$92,884 for the unallowable related party costs.⁹ As a result of the Department's findings, the board members resigned from the provider's board of directors to terminate the related party relationship. In addition, to ensure the reasonableness of the lease costs, the company owned by the former board members reassessed the lease agreement's costs. This resulted in a new lease with reduced rental rates.

⁸ The lease agreement for these vehicles and equipment also includes land and buildings.

⁹ The Department reports that it is still in negotiations to resolve the recoupment of \$92,884. The provider reported the \$92,884 as a contingent liability in its 2004 audited financial statements.

In addition, the lease agreement does not transfer ownership of the vehicles, tractor, and tractor equipment to the provider at the end of the lease. The provider has paid total costs that exceed the purchase price of these items, as Table 8 shows.

Table 8

Comparison of the Total Lease Costs Paid by Provider with Reported Purchase Price				
Item	Date Lease Obtained	Self-reported Purchase Price ^a	Total Estimated Payments Provider Has Made as of December 2005	Estimated Potentially Unallowable Costs
1998 Vehicle	March 2000	\$18,144	\$ 38,510	\$ 20,366
1999 Vehicle	March 2000	18,144 ^b	41,351	23,207
2001 Vehicle	November 2002	18,244	20,900	2,656
Tractor	March 2000	6,800	28,910	22,110
Tractor equipment	March 2000	3,250	7,350	4,100
Totals		\$64,582	\$137,021	\$72,439
^a Self-reported actual purchase costs from the company. ^b The purchase price shown is an estimated cost based on the cost of the 1998 vehicle, the purchase cost was not provided on this vehicle.				

The provider could have purchased the vehicles, tractor and tractor equipment at lower costs. The federal and state funds it spent on potentially unallowable costs could have been spent on additional or enhanced services for the children in its care.

Recommendations

The provider should:

- Change the cost it pays to lease vehicles from the company owned by former members of its board of directors to an amount that is based on the annual depreciation of the vehicles or terminate its lease agreement and purchase replacement vehicles.
- Determine whether it is cost-effective to continue leasing the tractor and tractor equipment. If it is not cost-effective, the provider should renegotiate the cost it pays to lease these items to an amount that is based on annual depreciation or terminate its lease agreement and purchase a tractor and tractor equipment.

- Amend the current lease agreement for vehicles and equipment to transfer ownership to the provider after the costs of the vehicles and equipment have been paid.
- Revise its purchasing policies and procedures to include:
 - ♦ Assessing and documenting the cost-effectiveness of leasing property and equipment from related parties.
 - ♦ Document its board of directors' approval of related party transactions.

Chapter 3-B

The Provider Should Conduct Criminal Background Checks in a Timely Fashion and Ensure Its Direct Care Staff Meet First Aid and CPR Training Requirements

Auditors reviewed the personnel files of 35 direct care staff that were either currently employed or employed during calendar year 2005. The provider had not performed the criminal background check (as required by the Department) for one of these individuals. For another of these individuals, the provider had not performed an updated criminal background check (as required the Department). Auditors performed criminal background checks for these individuals and the results of those criminal background checks indicated these individuals had no reported offenses that would violate the Department's requirements.

Auditors also reviewed the personnel files for certifications required by the Department and determined that:

- One direct care staff member did not have current first aid and CPR certifications.
- One direct care staff member did not have current CPR certification.

The Department requires that staff maintain their CPR certifications on an annual basis.

Recommendations

The provider should:

- Conduct criminal background checks for direct care staff before they are hired and perform updated criminal backgrounds as required by the Department.
- Provide first aid and CPR training at times that will ensure direct care staff are maintaining current certifications.

The Provider Should Strengthen Support for Purchases, Lease Documentation, and Personnel Files

The provider should ensure it has supporting documentation for all purchases.

Although this provider has policies and procedures for purchases, those policies and procedures should be enhanced to reinforce the need for staff to submit supporting documentation for all purchases. Auditors reviewed 91 purchases of food (35 transactions), building maintenance and repairs (35 transactions), and clothing (21 transactions) made in calendar year 2005. The provider lacked adequate documentation to support:

- Four (19 percent) of 21 clothing purchases totaling approximately \$558. The provider did not have receipts for two purchases, one purchase was supported with a petty cash receipt, and another purchase was supported with a credit card charge slip.
- Two (6 percent) of 35 food purchases totaling approximately \$197. The provider did not have a receipt for one purchase, and the other purchase was supported by a petty cash receipt.

The provider should ensure its lease agreement is up to date.

The provider should ensure the terms and conditions of its lease agreement for the use of land, 11 buildings, 5 vehicles, a tractor, and tractor equipment are complete and accurate (this is the same lease agreement discussed in Chapter 3-A). The lease expired on December 31, 2003, but it was not formally renewed or extended. The provider stated that revised payment schedules served as amendments to the lease agreement; however, the revised payment schedules were only lists of the items being leased and their associated costs.

In addition, the monthly payment amounts described in the lease agreement did not equal the monthly payments actually paid by the provider. Although the lease agreement states that the lease amounts will total \$14,261 each month, according to the documents provided by the provider, it paid three different amounts in 2005:

- From January through June 2005, the monthly payments increased to \$14,842 a month as the result of adding two vehicles to the lease schedule and removing a vehicle that was previously listed.
- From July through September 2005, the monthly payments increased to \$15,286 a month as the result of adding a new vehicle to the lease schedule.
- For October through December 2005, the monthly payments decreased to \$14,761 a month as the result of removing a vehicle from the payment schedule that was listed on the original lease agreement.

The provider paid a total of \$179,718 on the lease agreement in 2005.

The provider should ensure its personnel files are complete.

We reviewed 35 personnel files of 18 current and 17 previously employed direct care personnel and identified the following:

- One personnel file did not include the employee's application for employment.
- Seven personnel files lacked documentation demonstrating that the provider verified the employees' work history and experience before hiring them.
- Three personnel files for professionally licensed staff lacked documentation of current professional licenses. However, auditors determined that all three individuals had current licenses.

Recommendations

The provider should:

- Develop and implement policies and procedures that require staff to submit documentation for all purchases they make. These policies and procedures should include descriptions of the types of personnel actions that can be taken for non-compliance with purchasing policies.
- Amend its lease agreement for the use of land, buildings, vehicles, a tractor, and tractor equipment to recognize any agreed-upon changes made to the original terms and conditions. It also should ensure that amendments to lease agreements are appropriately documented, dated and signed by all contracting parties.
- Develop and implement policies and procedures that identify the types of documents that should be maintained in the personnel files for direct care staff. It should ensure these policies and procedures address which documents (for example, criminal background checks and professional licenses) should be kept up to date.

Chapter 3-D

The Provider Should Strengthen Access to and Security Surrounding Its Automated Systems, Applications, and Data

This provider should correct weaknesses in its information system environment to improve the security over its automated systems, applications, and data. The weaknesses we identified increase the risk of inadvertent or deliberate alteration or deletion of data, which could affect the provider's

ability to ensure the integrity of its data. We identified opportunities for improvement in the following areas:

- Information system policies and procedures.
- Access and security controls.
- Backup and storage of data.
- Audit trails.
- Physical security controls.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the provider.

Recommendation

The provider should review recommendations auditors provided and consider which recommendations are most appropriate for improving the security over its automated systems, applications, and data.

See Provider B's responses in Appendix 4, page 51.

Audit of Provider C: The Burke Foundation, Incorporated (doing business as Pathfinders Camp)

Provider C Background Information Calendar Year 2005	
Contract services audited	Therapeutic camp
Number of children Served	42
Average length of a child's stay	228 days
Total payments received from DFPS	\$764,834
Total revenue	\$1,060,409
Federal tax filing status	Non-profit
Ending cash balance on December 31, 2005 ^a	\$75,195
Approximate number of program staff	42
Program staff turnover rate	85.7 %
^a The ending cash balance reported includes the cash balance for other foster care services offered by the provider.	

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

Provider C used the payments it received from the Department to pay costs it incurred for providing 24-hour residential child care services. These services were necessary to ensure the mental and physical well-being of children placed in this provider's care and included items such as direct care, food, shelter, and clothing. However, auditors identified the following:

- **Non-compliance with criminal background check requirements.** This provider did not perform criminal background checks for two direct care staff prior to hiring these individuals. It also hired another direct care staff who had criminal offenses that violated the Department's requirements (it terminated this individual's employment after learning about the individual's criminal background).
- **Weaknesses in the documentation of purchases and financial processes.** This provider does not always have support for purchases. It should also strengthen the segregation of financial duties and ensure that its payroll is consistently supported with timesheets that supervisors approve and sign.
- **Weaknesses in access to and security environment surrounding automated systems, applications, and data.** This provider should make improvements to address weaknesses in the security over its automated systems, applications and data. The weaknesses auditors identified increase the risk of inadvertent or deliberate alteration or deletion of data.

Chapter 4-A

The Provider Should Conduct Criminal Background Checks for All Direct Care Staff Before It Hires These Individuals

Auditors reviewed the personnel files of 35 direct care staff that were either employed currently or during calendar year 2005 and identified the following:

- The provider did not perform a criminal background check for one direct care staff person before it hired this individual. The provider hired the individual in July 2005 and terminated the individual's employment in August 2005. It did not perform the criminal background check until May

2006. The criminal background check identified that this person may have a criminal offense that was dismissed.

- The provider hired another direct care staff person who had a criminal history that included offenses that violated the Department's minimum standards. The provider hired this individual in February 2006 and terminated employment in March 2006 after it received notification from the Department that the individual had criminal offenses that violated minimum standards.
- The provider did not perform criminal background checks for two other direct care staff prior to rehiring them. The provider had previously employed these individuals. It did not perform a background check because it rehired these individuals within two years of their first criminal background check. Auditors performed criminal background checks for these individuals and determined that there were no reported offenses that would violate the Department's minimum standards.

The Department's licensing rules require providers to perform criminal background checks for all employees who have direct contact with children within two business days of the employees being hired.

Recommendation

The provider should develop and implement objective policies and procedures that require the documented review of criminal background checks prior to the hiring of new or former direct care staff.

Chapter 4-B

The Provider Should Strengthen Certain Financial Processes

The provider should ensure it has supporting documentation for all purchases.

Auditors tested a sample of 104 purchases of clothing (34 transactions), food (35 transactions), and building maintenance and repairs (35 transactions) made in calendar year 2005. The provider lacked adequate documentation to support:

- Four (12 percent) of 34 clothing purchases totaling approximately \$470. The provider did not have receipts for two purchases, and two purchases were supported with "Affidavit of Lost Receipt" forms.¹⁰

¹⁰ This provider requires its direct care staff to use an "Affidavit of Lost Receipt" to document that a purchase was made but the receipt was lost or misplaced.

- Eight (23 percent) of 35 food purchases totaling \$1,807. The provider did not have receipts for two purchases, and six purchases were supported with “Affidavit of Lost Receipt” forms.
- Five (14 percent) of 35 building maintenance and repair payments totaling \$1,988. The provider did not have a receipt for two payments, and three payments were supported with “Affidavit of Lost Receipt” forms.

The provider should segregate certain financial duties.

A single employee is responsible for reviewing, entering, and approving transactions in the provider’s financial system and reconciling the provider’s accounts payable and accounts receivable. This weakness in segregation of duties increases the risk that inaccurate and inappropriate financial transactions could be processed without detection.

The provider should improve certain controls over its payroll process.

Auditors reviewed 144 timesheets for 39 employees and determined that 56 timesheets (39 percent) were not signed by a supervisor to indicate the supervisor had reviewed and approved the time charged.

Recommendations

The provider should:

- Develop and implement policies and procedures that require staff to submit documentation for all purchases they make. These policies and procedures should include descriptions of the types of personnel actions that can be taken for non-compliance with purchasing policies.
- Hire additional personnel or delegate duties to existing personnel so that it can ensure that financial duties are properly segregated.
- Revise its policies and procedures to ensure that timesheets are processed for payroll only if they have been reviewed, approved, and signed by the appropriate individual.
- Develop and implement a process to ensure that it maintains all timesheets to support its payroll records.

Chapter 4-C

The Provider Should Strengthen Access to and Security Surrounding Its Automated Systems, Applications, and Data

The provider should correct weaknesses in its information system environment to improve the security over its automated systems, applications,

and data. The weaknesses we identified increase the risk of inadvertent or deliberate alteration or deletion of data, which could affect the provider's ability to ensure the integrity of its data. We identified opportunities for improvement in the following areas:

- Information system policies and procedures.
- Access controls.
- Backup and storage of data.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the provider.

Recommendation

The provider should review recommendations auditors provided and consider which recommendations are most appropriate for improving the security of its automated systems, applications and data.

See Provider C's responses in Appendix 4, page 54.

Audit of Provider D: Baptist Child and Family Services (doing business as Baptist Children’s Home Ministries)

Provider D Background Information Calendar Year 2005	
Contract services audited	Child placing agency
Number of children served	116
Average length of a child’s stay	371 days
Total payments received from DFPS	\$1,378,998
Total revenue	\$1,471,961
Federal tax filing status	Non-profit
Ending cash balance on December 31, 2005	\$ (9,313)
Approximate number of program staff	9
Program staff turnover rate	30.0%

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

Provider D used the payments it received from the Department to pay the foster care families with whom it placed children. The payments families receive are intended to ensure the mental and physical well-being of foster care children placed in their care and are used for items such as food, shelter, and clothing.

However, auditors identified the following:

- Non-compliance with foster care family reimbursement payment requirements and foster care parent training requirements. This provider paid a foster care family with whom it placed children less than the minimum amount the Department requires. In addition, auditors identified foster care parents that did not have current cardio-pulmonary resuscitation (CPR) certifications.
- Weaknesses in the provider’s contract with one foster care family. This provider’s contract with one foster care family was incomplete (this was the same family to which the contract paid the reduced rate discussed above). A contract agreement between the provider and the foster care family was not in place for a five-month period during which the foster care family cared for children.
- Weaknesses in access to and the security environment surrounding automated systems, applications, and data. This provider should make improvements to address weaknesses in the security over its automated systems, applications, and data. The weaknesses auditors identified increase the risk of inadvertent or deliberate alteration or deletion of data.

Chapter 5-A

The Provider Should Pay Foster Care Families in Accordance with the Department’s Requirements

This provider paid one of its foster care families at payment rates that were below the minimum payment rates set by the Department. From January through September 2005, the provider underpaid the foster care family by \$5,262. Table 9 shows the difference between the minimum payment rates required by the Department and the payment rates the provider paid to this family.

Table 9

Daily Rates Paid to One Foster Care Family Calendar Year 2005			
Level of Care	Minimum Daily Payment Rates Required by the Department	Daily Payment Rates Paid by the Provider	Difference
Basic	\$20.00	\$17.00	\$3.00
Moderate	\$35.00	\$31.50	\$3.50
Specialized	\$45.00	\$41.00	\$4.00

In March 2003, the provider entered into a unique contractual arrangement with the foster care family that resulted in the payment rates paid to that family being lower than the minimum payment rate set by the Department. The provider agreed to pay the foster care family \$1,400 per month in rental assistance in addition to the reimbursements the family received from the Department. This would have resulted in the foster care family's total payments significantly exceeding the reimbursements the provider paid to other foster care families. For this reason, the provider decided to reduce the payment rates to this foster care family. The foster care family ended its contract with the provider in September 2005.

Although the Department's program monitoring staff identified concerns with the payment rate reduction in 2004, the program monitoring staff at that time accepted the provider's reasons for reducing the payment rates. However, after auditors brought the issue of the payment rate reduction to the attention of Department management in May 2006, the Department's program monitoring staff cited the provider in June 2006 for contractual non-compliance for paying the foster care family at rates that were below the minimum.

Recommendation

The provider should ensure that any supplemental payments made to foster care families do not result in lowering the minimum payment rates set by the Department.

The Provider Should Ensure Its Foster Care Parents Maintain Current CPR Certification Requirements

Auditors reviewed the training files of 30 foster care families with which the provider placed children during calendar year 2005 and determined that four (13 percent) of those families did not have current CPR certifications.

The Department requires providers to ensure that foster care families obtain and maintain CPR certifications.

Recommendations

The provider should provide notifications to foster care families prior to the expiration date of CPR certifications. It should consider sanctioning foster care families that fail to renew their certifications in a timely manner, in ways such as:

- Immediately transferring the children to another foster care family.
- Denying the renewal of contracts or new contracts with the foster care families.
- Terminating contracts with the foster care families.

The Provider Should Ensure That Its Has Complete Contract Agreements with Foster Care Families

This provider did not have a documented contract agreement with the foster care family discussed in Chapter 5-A for a four-month period in 2005; however, the foster care family did care for children and received payments from the provider during that period.

The Department requires providers to have written agreements with foster care families that specify both (1) the rights and obligations of each party and (2) the financial terms.

Recommendation

The provider should periodically review its contracts with foster care families to ensure that all of its contracts are complete and current.

The Provider Should Strengthen Access to and Security Surrounding Its Automated Systems, Applications, and Data

This provider should correct weaknesses in its information system environment to improve the security over its automated systems, applications, and data. The weaknesses we identified increase the risk of inadvertent or deliberate alteration or deletion of data, which could affect the provider's ability to ensure the integrity of its data. We identified opportunities for improvement in the following areas:

- Information system policies and procedures.
- Access and security controls.
- Backup and storage of data.
- Physical security controls.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the provider.

Recommendation

The provider should review recommendations auditors provided and consider which recommendations are most appropriate for improving the security over its automated systems, applications and data.

See Provider D's responses in Appendix 4, page 55.

Audit of Provider E: El Paso Center for Children, Incorporated

Provider E Background Information Calendar Year 2005	
Contract services audited	Child placing agency
Number of children served	150
Average length of a child's stay	381 days
Total payments received from DFPS	\$1,817,308
Total revenue	\$4,067,396
Federal tax filing status	Non-profit
Ending cash balance on December 31, 2005	\$470,925
Approximate number of program staff	12
Program staff turnover rate ^a	67.6%
^a Turnover rate includes program staff for emergency shelter services. Emergency shelter services were not audited.	

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

Provider E appropriately used the payments it received from the Department to pay the foster care families with whom it placed children. The payments families receive are intended to ensure the mental and physical well-being of foster care children placed in their care on items such as food, shelter, and clothing.

However, this provider should make improvements to address weaknesses in its information system environment to improve the security over its automated systems, applications, and data. The weaknesses we identified raise the risk of inadvertent or deliberate alteration or deletion of data, which could affect the provider's ability to ensure the integrity of its data. We identified opportunities for improvement in the following areas:

- Information system policies and procedures.
- Access controls.
- Backup and storage of data.

To minimize the risks associated with public disclosure, auditors communicated details regarding those issues directly to the provider.

Recommendation

The provider should review recommendations auditors provided and consider which recommendations are most appropriate for improving the security over its automated systems, applications, and data.

See Provider E's responses in Appendix 4, page 56.

Appendices

Appendix 1 - Objective, Scope, and Methodology	Page 35
Appendix 2 - Types of Residential Child Care Providers (24-hour Providers)	Page 38
Appendix 3 - Responses from the Health and Human Services Commission and the Department of Family and Protective Services	Page 40
Appendix 4 - Responses from the Residential Child Care Providers Audited	Page 46

Objective, Scope, and Methodology

Objective

The objective of this audit was to verify that residential child care providers (24-hour providers) are spending federal and state funds for contractually required services that promote the well-being of the foster care children placed in their care.

Scope

The audit scope included assessing the appropriateness, reasonableness, and necessity of costs paid by providers that delivered foster care services to the Department of Family and Protective Services (Department) during calendar year 2005. In addition, the scope included verifying whether providers ensured that professionally licensed staff and direct care staff met the Department's requirements for qualifications and training.

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) risk factors the Health and Human Services Commission's Rate Analysis Division proposed for selecting residential child care providers for cost report audits. Additionally, the audit methodology included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of tests; and interviewing management and staff at the Department, the Health and Human Services Commission's Office of Inspector General, and providers.

Information collected and reviewed included the following:

- Information from interviews with the Department's foster care program management and staff, and interviews with the Health and Human Services Commission's rate analysis division and Office of Inspector General's Cost Report Review Unit management and staff.
- Contracts between the Department and providers.
- Providers' costs reports.
- Providers' financial records.
- Providers' independent audit reports.
- Providers' personnel files for direct care staff, professionally licensed personnel, and subcontract therapists.

- Providers' tax filings.
- Providers' payment records for foster care parents.
- Department program monitoring reports.
- Providers' policies and procedures.
- Providers' subcontracts.

Procedures and tests conducted included the following:

- Review of criminal background checks performed on direct care, professionally licensed, subcontract therapist, and administrative staff.
- Test of internal controls.
- Test of food, shelter, and clothing costs related to the services provided to children.
- Test of related-party costs and contract agreements.
- Test of payroll records.
- Test of personnel files.
- Test of payments made to foster care parents.

Criteria used included the following:

- U.S. Office of Management and Budget circulars.
- Texas statutes and Texas Administrative Code.
- Contracts between the Department and providers.
- The Department's Contract, Licensing and Child Placing Agency Minimum Standard Handbooks.

Project Information

Audit fieldwork was conducted from April 2006 through August 2006. This audit was conducted in accordance with generally accepted government auditing standards.

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

- Willie J. Hicks, MBA (Project Manager)
- Jim Yerich, CPA (Ohio), CGFM (Assistant Project Manager)

- Annette Banks
- Michael Boehme
- Darrell Edgar
- Toscha Lee, MPA
- Joseph Mungai, CIA, CISA
- Anthony Patrick, MBA
- Rachel Snell, MPA
- Dorvin Handrick, CISA, CDP (Information Systems Audit Team)
- Gary Leach, MBA, CISA, CQA (Information Systems Audit Team)
- Leslie Ashton, CPA (Quality Control Reviewer)
- John Young, MPAff, CGAP (Audit Manager)

Types of Residential Child Care Providers (24-hour Providers)

The Department of Family and Protective Services contracts with the following six types of residential child care providers (24-hour providers):

- **Child Placing Agency:** A person, agency, or organization other than a parent who places or plans for the placement of a child in an adoptive home or other residential care setting.

Approximate number of Child Placing Agency contracts

Fiscal year 2005: 97

Fiscal year 2006: 102

- **Emergency Shelter:** An operation that provides short-term care (less than 30 days), for 13 or more children up to the age of 18 years.

Approximate number of Emergency Shelter contracts

Fiscal year 2005: 54

Fiscal year 2006: 54

- **Foster Family Home (Independent):** An operation that provides care for six or fewer children up to the age of 18 years.
- **Foster Group Home (Independent):** An operation that personally provides care for seven to twelve children up to the age of 18 years.

Approximate number of Foster Family and Group Home contracts

Fiscal year 2005: 20

Fiscal year 2006: 14

- **Operation Providing Basic Child Care:** An operation that provides care for 13 or more children up to the age of 18 years. The care does not include specialized care programs.

Approximate number of Operation Providing Basic Child Care contracts

Fiscal year 2005: 39

Fiscal year 2006: 38

- **Residential Treatment Center:** An operation that provides care and treatment for 13 or more emotionally disturbed children up to the age of 18.

Approximate number of Residential Treatment Center contracts

Fiscal year 2005: 73

Fiscal year 2006: 69

- **Therapeutic Camp:** An operation that provides a camping program for 13 or more children ages 13 to 18. It is designed to provide an experiential therapeutic environment for children who cannot function in their home school or community.

Approximate number of Therapeutic Camp contracts

Fiscal year 2005: 4

Fiscal year 2006: 3

**Responses from the Health and Human Services Commission and the
Department of Family and Protective Services**



TEXAS HEALTH AND HUMAN SERVICES COMMISSION

ALBERT HAWKINS
EXECUTIVE COMMISSIONER

September 25, 2006

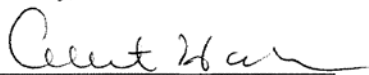
John Keel, CPA
State Auditor
1501 North Congress Avenue, Suite 4.224
Austin, Texas 78701

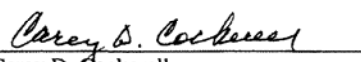
Dear Mr. Keel:

Attached please find the Health and Human Services Commission and Department of Family and Protective Services management response to the State Auditor's Office (SAO) draft audit report on "On-Site Audits of Residential Child Care Providers."

We have carefully reviewed the information contained in the draft report, and appreciate the opportunity to provide our response to SAO's findings and recommendations.

Sincerely,


Albert Hawkins
Executive Commissioner
Health and Human Services Commission


Carey D. Gockerell
Commissioner
Department of Family and Protective Services

cc: Tom Suehs, HHSC Deputy Executive Commissioner for Financial Services
David Griffith, HHSC Internal Audit Director
Dianne Skinnell, DFPS Internal Audit Director

P. O. Box 13247 • Austin, Texas 78711 • 4900 North Lamar, Fourth Floor, Austin, Texas 78751

**HEALTH AND HUMAN SERVICES COMMISSION
DEPARTMENT OF FAMILY AND PROTECTIVE SERVICES**

Management Response
to the State Auditor's Office Audit Report on:

On-Site Audits of Residential Child Care Providers

Summary of Management Response:

The Department of Family and Protective Services (DFPS) and the Health and Human Services Commission (HHSC) are committed to the maintenance of appropriate cost reimbursement and rate setting methodologies and to the effective contract oversight of residential child care providers in Texas. The methodology used by HHSC for reimbursing providers for the services delivered by residential child care providers is referred to as a prospective daily unit rate.

Under this approach, a provider, in return for delivering care to foster children, is paid a daily unit rate determined by HHSC. By accepting this arrangement, the provider agrees to deliver care to foster children at a level of quality defined in the contract. DFPS staff monitor providers to determine whether the required level of care is delivered, and take immediate corrective action if those requirements are not met. In return for delivering those services, the provider receives payment, determined by the daily unit rate, and accepts this amount as the full payment for those services.

When the provider controls its costs and delivers the services efficiently, it may be able to deliver services at less than the unit rate. If it does not, and costs exceed the amount the state pays, the provider will experience a loss. Under the prospective daily unit rate methodology, the provider assumes any risk associated with cost overruns, not the state. From the state's perspective, this approach helps control costs while ensuring the required levels of quality are met. From the provider's perspective, this approach provides an opportunity to be rewarded through increased savings when operations are efficient and meet DFPS' quality requirements.

Daily unit rates are determined by the HHSC Rate Analysis Department. The process begins when providers submit their actual costs to HHSC each year through completion of a formal cost report schedule. When completing this schedule, or cost report, the provider is required to identify and remove any unallowable costs, including amounts paid to related parties that exceed the actual cost to the related party.

The HHSC Office of Inspector General (OIG) Audit Section examines each cost report submitted by a residential care provider. It performs either a desk review or an on-site field audit to ensure that unallowable costs are appropriately removed from the cost report. Once the OIG Audit Section validates the information contained in the cost report, and adjusts the report if necessary to remove unallowable costs, OIG forwards the report to the Rate Analysis Department. This combination of provider self-reporting and OIG Audit Section validation

HHSC and DFPS Management Response
On-Site Audits of Residential Child Care Providers
September 25, 2006

ensures that the Rate Analysis Department considers only allowable costs when determining daily unit rates.

Unit rates are not determined for individual providers based on their actual costs, but instead are developed collectively based on an average of the actual costs of all contracted residential child care providers, resulting in a state-wide daily rate. The rate determination process removes unallowable costs, including related party markups, ensuring that the resulting unit rate is based on allowable costs.

The unit rate does not guarantee that all allowable costs will be covered by the unit rate. Consequently, the provider incurs the full risk of possible losses. Similarly, as the provider agrees to incur this risk and manages expenses to contain costs at or below the unit rate, the state benefits from these actions in future rate determination.

Once the funds are paid to the provider for services properly provided, DFPS does not control how they are expended, as long as the provider expends them legally and accounts for them accurately in its cost report which is verified and adjusted if necessary through the OIG audit process. What is most critical to this methodology is not how the providers spend the funds it receives for the services it performs, but rather how it reports its costs. In addition, under this methodology, there are no retrospective settlements. If amounts were to be recouped for related party transactions or other distributions of profits earned, then the amounts paid to providers would no longer be based on unit rates, but instead would represent a cost reimbursement contract methodology¹.

Providers receive reimbursements based on state-wide daily unit rates which, as described above, are developed from audited cost reports only after unallowable costs, such as amounts paid to related parties that exceed the actual cost to the related party, have been removed from those reports. Because of this process, providers receive the same reimbursement amount whether or not they have unallowable expenses of any kind, including those attributable to related party transactions.

The rules at Title 40, Texas Administrative Code §732.240 and §732.250, apply to both HHSC cost reporting and DFPS cost reimbursed contracts. While these rule sections serve to identify what is an unallowable related party cost, they do not in themselves indicate how unallowable costs are to be addressed. For unit rate contracts, unallowable costs are addressed by ensuring that these costs are not included in the amounts used to develop daily unit rates. This is accomplished through the cost reporting and validation process described above. HHSC rules will be clarified to reflect this position for unit rate contracts, and DFPS rules will be clarified to address unallowable costs for cost reimbursement contracts.

¹ In cost reimbursed contracts, providers are reimbursed for allowable costs. The reimbursement is based on actual cost experience and not an average cost of all cost reimbursed contracts. The cost reimbursed contracts guarantee that all allowable costs are reimbursed under the terms of the contract and, therefore, the provider incurs no risk of loss.

HHSC and DFPS Management Response
On-Site Audits of Residential Child Care Providers
September 25, 2006

DFPS and HHSC are confident that the payment methodology used for residential child care providers is consistent with their rules, well conceived, and properly implemented to control costs while offering an opportunity for a fair return to providers. HHSC is also confident that adequate controls are in place and working effectively to ensure that only allowable costs are considered in the development of daily unit rates and to ensure that providers do not have an opportunity to use unallowable costs, including any unallowable costs that result from related party transactions.

In regard to criminal background checks, all residential child care providers in Texas are required to comply with the minimum standards established by the DFPS Residential Child Care Licensing (RCCL) Division. These standards require that providers submit the identifying information of owners, administrators, employees and anyone who will have regular and frequent contact with children for background checks. RCCL staff monitor compliance with this standard during routine visits to providers and any violation is noted as a standard deficiency. DFPS providers for residential child care are required to meet minimum standards as a part of their contract terms and conditions.

Chapter 1-A

SAO Recommendation: *The Department should clearly specify in its rules and contracts whether its rules concerning related party transactions and less-than-arm's-length transactions apply to (1) how providers actually spend funds or (2) how providers report their costs on their annual cost reports. The Department should correct inconsistencies between its rules and contracts.*

Management Response: DFPS and HHSC agree that currently there is no clear separation of the rules as they apply to unit rate contracts and to cost reimbursed contracts. To clarify any ambiguity this may cause, HHSC will develop separate cost reporting rules in the rule base for HHSC so that it will be clear which rules apply to cost reporting and rate determination. As a result, the rules that remain in DFPS rule base will apply to the DFPS cost reimbursed contracts only.

The separation of these rules into two distinct rule bases at each agency should clarify that HHSC intends to apply the related party allowable cost rules to cost reporting and unit rate determination and does not intend to limit or recoup the expenditure of payments made from the unit rate. Likewise this separation of rules will clarify that DFPS intends to apply the related party allowable cost rules to limit payments made under the cost reimbursed contracts. In addition, HHSC will explore the development of rules to limit related party salary costs to specified maximum amounts for cost reporting and rate determination.

HHSC and DFPS Management Response
On-Site Audits of Residential Child Care Providers
September 25, 2006

Estimated Completion Date:

November 2007

Title of Responsible Person:

DFPS Residential Contracts Director
DFPS Contract Oversight and Support Director
DFPS General Counsel
HHSC Director, Rate Analysis for Long-Term Care

Chapter 1-B

SAO Recommendation: *The Department should consider strengthening practices to (1) ensure that providers' cost reports continue to identify payments of unallowable costs made with federal and state funds through related party transactions and less-than-arm's-length transactions and (2) ensure that unallowable costs are not authorized or used in the rate setting analysis. In addition, the Department should consider requiring providers to annually submit adequate documentation of all related party and less-than-arm's length transactions and associated costs. The Department should consider establishing a formal annual review of its providers' related party transactions and less-than-arm's length transactions by its internal audit department to determine the appropriateness, reasonableness, and necessity of the good or services being provided.*

Management Response: HHSC requires providers, when completing their cost reports, to identify and remove any unallowable costs, including amounts paid to related parties that exceed the actual cost to the related party. The HHSC Office of Inspector General (OIG) Audit Section examines each cost report submitted by a residential care provider. It performs either a desk review or an on-site field audit to ensure that unallowable costs are appropriately removed from the cost report. This combination of provider self-reporting and OIG Audit Section validation and, if necessary, removal of unallowable costs, ensures that the Rate Analysis Department considers only allowable costs when determining daily unit rates.

SAO Recommendation: *The Department should consider requesting that the Health and Human Services Commission's Office of Inspector General conduct field audits of cost reports from providers that are considered to be higher risk because they engage in related party transactions and less-than-arm's-length transactions.*

Management Response: The current methodology removes amounts that exceed the allowable costs of a related party or less-than-arm's-length transition during the cost reporting, cost report auditing, and rate development processes.

HHSC and DFPS Management Response
On-Site Audits of Residential Child Care Providers
September 25, 2006

SAO Recommendation: *The Department should consider ensuring that its program staff conducts reviews to verify providers that engage in related party transactions and less-than-arm's-length transactions are meeting the required standard of care.*

Management Response: DFPS conducts contract monitoring, annual contract assessment and ad-hoc visits to all residential contractors throughout each fiscal year to ensure the quality of services provided to children as well as assess compliance with contract terms and conditions. All providers are expected to meet the required standard of care regardless of whether they have related party transactions or not.

The contract monitoring schedule, called the Statewide Monitoring Plan, is developed by Contract Oversight and Support and is based on a risk assessment for all DFPS contractors, including residential contractors. Related party transactions have been included in the risk assessment since it's inception and will continue to be a factor.

SAO Recommendation: *The Department should consider ensuring that results of cost report audits are coordinated and communicated between its program staff and the Commission.*

Management Response: HHSC OIG will communicate the results of cost report audits with DFPS Residential Contracts beginning with the 2005 cost reports. DFPS will use this information to complete the risk assessment and in contract monitoring as appropriate.

Estimated Completion Date:

November 2006

Title of Responsible Person:

DFPS Residential Contracts Director
HHSC OIG Director of Audit

Responses from the Residential Child Care Providers Audited

Responses from Provider A: Life Support Counseling and Research, Incorporated (doing business as Therapeutic Family Life)

Chapter 2-A

- *Ensure that the salary of one of its foster group home supervisors is reasonable.*

The salary at issue was established after careful consideration of the employee's duties and responsibilities and review of Compensation in Non-Profit Organizations 16th Edition – 2003 (CNPO). This publication reflects a nationwide survey and compilation of non-profit pay rates and is commonly relied upon by non-profit organizations in establishing salary or wage rates for employees. Unlike the publication reviewed by the SAO, a 2006 copy of which has been obtained by our agency and is a single volume, forty-one page document compiling information from only 288 participations and containing no job descriptions, CNPO is a three volume, 700 page compilation of responses from 1688 organizations nationwide which contains job descriptions. Because of its comprehensive nature, we believe CNPO better enables its users to compare compensation rates. Although its job descriptions are necessarily general, straightforward comparisons can be made.

Among other things, the employee referenced in the SAO report is responsible for managing two agency foster group homes, each with a capacity of twelve males ranging in age from 9-18 years. Average occupancy is near capacity and almost all the residents are adjudicated sex offenders or otherwise troubled children. Twenty-four hour supervision is provided which necessitates the retention and supervision of staff and the employee is on call 24 hours per day. In addition to the coordination and provision of food, clothing, medical and dental care, therapy, transportation and recreation, the duties and responsibilities of the position include liaison with schools, case managers and referring agencies. According to CNPO, a Residential Supervisor manages a single site and 2003 compensation ranges from \$25,741 to \$36,134. In view of the facts that the employee involved has exceptional tenure for this type of position and historical positive results at the homes he manages exceed expectations and because he performs other functions including but not limited to marketing, facility maintenance, repair and construction management, his salary has been set near but within the maximum of the CNPO range.

Nevertheless, in order to further address the recommendation that the position be properly classified and compensated, our agency is compiling information regarding potential alternatives and will make appropriate changes, if any, depending on the availability of a more cost effective alternative which will meet agency needs. The reevaluation will be completed and any appropriate adjustments implemented by November 1, 2006.

- *Revise its policies and procedures for procuring goods or services to require bids for goods or service(s) to be provided by a related party. In addition, it should ensure the costs it pays for goods provided by related parties do not exceed the actual purchase cost paid by the related parties. These policies and procedures should include maintaining adequate documentation of the price quotes, cost analyses that were performed, the data used in those cost analyses, and the board of directors' approval.*

It is undisputed that this agency was founded and continues to be operated by its executive director and his spouse and that several members of their family have been involved. This is a relatively common situation in this field of endeavor. Agency management recognizes the need to insure the propriety of related party transactions given the agency's status as a provider to the Texas Department of Family and Protective Services and a 501(c) (3) entity. Accordingly, we have worked hard to interpret and conform to applicable requirements including 40 TAC 732.240 (f) upon which some of your audit findings are based. Although we understand that applicable circulars and rules in this area are complex, we respectfully submit that this portion of your report does not reflect an accurate reading of the rule upon which you rely, especially when its context is considered.

At page 12, in the first sentence of the second paragraph, the report and footnote 4 paraphrases the rule as follows:

"Title 40 Texas Administrative Code, Section 732.240(f), states that costs incurred through a related party transaction should not exceed the actual costs incurred by the related party to provide the good or service.⁴"

"4. The related Party's actual costs also may not exceed the fair market value for the good or service.

However, a close examination of the actual language shows that, rather than stating that payments to related parties may not be made, the first sentence of the rule actually simply categorizes such payments as "allowable" only up to the cost to the related party. Thus, under OMB Circular A-122 payments above such costs may not be used to

formulate residential contract rates. But, under section 28 (B) of the current residential child care contract and 40 TAC 732.241 (b) they are neither unexpected nor prohibited. On the other hand, and consistent with federal regulations pertaining to non-profit organizations, the second sentence of 40 TAC 732.240 (f) clearly prohibits costs incurred by a provider in a related party transaction from exceeding fair market value. Of course, all related party transactions must be disclosed and detailed in the annual cost report.

The foregoing response is presented solely to outline our agency's historical understanding of the applicable requirements pertaining to related party transactions: that properly reported transactions which do not exceed fair market value are not prohibited.

Our agency is concerned about any requirement that a related party lease to it real estate at a rate far below fair market value, which can be the case in situations where the property has been paid for and depreciated. This is because facilities for providing group care to significant numbers of troubled children can be difficult, if not impossible, to locate because of the community resistance. A requirement which provides a disincentive for related parties to lease such real estate to the agency limits our ability to provide services.

The agency has procedures that address procurement of goods and services including those with related parties. The agency will continue to maintain bid files for each of its purchases which are in accordance with these policies. Our agency will adhere to its procedure of seeking Board approval on all related party leases and purchase of goods. We have re-bid the related party service contracts noted in the SAO Audit report. All bids were presented to the Board of Directors for approval on August 7, 2006.

- *Ensure that all lease agreements for property and equipment have a specific contract term and do not continue indefinitely.*

The agency has no leases agreements that have an indefinite term. We will ensure that all future contracts have a term limit.

- *Terminate its lease agreement for the use of the training and recreational facility and enter into a per use contract that is approved by the board of directors. This per use contract should:*
 - ♦ *Ensure that the related party charges only a per use fee for the number of employees that attend training at the facility or the number of families that visit the facility for recreational purposes.*

The agency will terminate its monthly lease for the use of the recreational area effective October 1, 2006. The agency will convert

to a per use agreement and will continue to maintain a log of attendees of each training and staff meeting to validate its use. Historically, the agency has utilized the facility far more than was stated in the SAO audit. Staff and foster children used the recreational facility at least 15 days during the first 3 quarters of 2005 then for a 6 week period (24 hours/day) for an emergency evacuee home for 24 foster children and staff.

- *Recoup the funds that were paid for the care of the horses unless adequate documentation of use can be established.*

The horses owned by the executive director are used solely by children and families for recreation. It is well documented that relating and caring for animals, particularly horses, is therapeutic for children and contributes to emotional healing and well being. The horse are kept primarily in Orange, Texas on the premises of one foster group home and near another, and ridden and cared for to a large extent by adolescent boys. The horses have been kept in Austin full time since the Hurricane Rita damaged the facilities in Orange. We acknowledge that records of equine activities should be appropriately maintained and have implemented a system for doing so. In the future, the agency will pay fair market value for the actual use of the horses rather than pay for their care. In addition, we will establish the minimum numbers of hours the horses were used by children and/or families in 2005, assign the rate charged by local stables and recoup the difference between the fair market value of their use and the \$16, 740 paid for their care during that year. The funds will be recouped in equal quarterly installments commencing April 1, 2007 and ending no later than December 31, 2008.

Chapter 2-B

Our agency is cognizant of its responsibility regarding criminal background checks for any subcontractors that will have direct contact with children and even the one instance noted during the audit (out of thirty seven files reviewed) is unacceptable to us. We have enhanced the training and experience of staff involved and for redundancy and quality assurance all file(s) are then routed to our HR department to verify that all required documentation has been received prior to our executing contract(s).

Chapter 2-C

- *Ensure that its direct care staff and executive management provide adequate documentation for the purchases they make.*

The agency has a policy for requiring and maintaining receipts. By December 31, 2006 the agency will retrain foster parents and staff on the

necessity and logistics of providing receipts for all purchases in a timely manner.

- *Develop and implement objective policies and procedures for purchases made with its credit cards. Those policies and procedures should include, but should not be limited to, the following:*
 - ♦ *Limits on the items that can be purchased with specific credit cards.*

The agency has developed and implemented a procedure for the use of company credit cards. This procedure, which is available for review, outlines the approved usage of agency credit cards, references procurement policies that set bidding and purchasing limits and outlines requirements for receipt submission.

Although the agency has documentation that clearly describes the purposes of each conference and seminar to which it sends representatives, we will attach a more detailed agenda directly to each receipt to comply with this recommendation)

Chapter 2-D

The agency has a working procedure for administrator access, password and user authentication, intrusion protection, firewalls, and antivirus protection. However, we will ensure that a written policy that is tailored to our agency's specific set of security needs is complete. Our agency has created comprehensive policies for administrator and special access accounts, including rules for the creation, use, monitoring, control, and removal of accounts, password and user authentication, intrusion protection and intrusion detections systems, and antivirus maintenance.

Responses from Provider B: Youth and Family Enrichment Centers, Incorporated

Chapter 3-A

This provider disagrees with the opinion that this lease is less than arms length. The SAO's sidebar omits the details of the relevant paragraphs from OMB A-122. It states "For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of a non-profit organization; (ii) non-profit organizations under common control through common officers, directors, or members; and (iii) a non-profit organization and a director, trustee, officer, or key employee of the non-profit organization or his immediate family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest." Since neither this provider's relationship nor the provider President/CFO's relationship with lessor falls within the OMB definition, the SAO has, evidently, relied on the 1985-2002 relationship to substantiate its opinion. It appears that the SAO has assumed that, because the provider's Board of Directors that hired the current President/CFO in 2001 was made up of lessor's partners, lessor's partners hold undue influence over the President/CFO. After the first draft of this report, this relationship was explained to the SAO in writing and verbally. Since the SAO appears to prefer its opinion over fact, this provider will restate the facts for the record. In actuality, the CFO was hired because of his experience in turning around financially distressed non-profits, not because of any relationship with members of lessor. The only relationship that exists between the provider's President/CFO and the lessor is the business relationship between the provider and the lessor. Other than to conduct lessor/lessee business, the provider's President/CFO has not had any contact with the partners of the lessor since July 2002. The provider's President/CFO has already retired three times and is not dependent on his position with the provider except as an opportunity to serve the children of the State of Texas. There are no other personal, social or business relationships with the lessor or its partners. The apparent basis for the SAO's opinion of "substantial influence" is incorrect, and, therefore, the opinion is incorrect.

Also, it appears that the SAO has assumed that it must be more advantageous to substitute a new lease for an old lease. This is not always true. As long as the vehicles are in good working order and are safe to operate, it is less expensive to continue the lease using the old lease rates and lower insurance costs than it is to lease a newer vehicle with attendant increased lease rates and insurance costs. The determination to continue a lease beyond the date that the vehicle is fully depreciated is not based on the lessor's desires or profit margins, but rather on the best financial arrangement for the lessee. When the CFO inquired about purchasing vehicles in 2002, the Residential Contract Manager stated that the TDPRS (now TDFPS) would not approve

the purchase of vehicles and, therefore, the costs would be unallowable. If that policy has changed, and TDFPS and HHSC are willing to stipulate in writing that the purchase price, interest and associated fees are allowable costs, then the provider will most certainly investigate that option.

While the SAO correctly states that the Department requested a repayment for the unallowable related party costs in October 2002, the SAO fails to mention that it has been the Department, not the provider that has pursued this issue only sporadically for the past four years. The provider has responded to every step of the process within the Department's required deadlines.

Specific Recommendations:

1. The provider disagrees with this recommendation. No entity, person or business, would lease anything for the value of the depreciation. The provider agrees that it appears to be a better use of funds to purchase rather than lease vehicles. However, when the CFO inquired about purchasing vehicles in 2002, the Residential Contract Manager stated that the TDPRS (now TDFPS) would not approve the purchase of vehicles and, therefore, the costs would be unallowable. If that policy has changed, and TDFPS and HHSC are willing to stipulate in writing that the purchase price, interest and associated fees are allowable costs, then the provider will most certainly investigate that option. The provider does not intend to implement this recommendation.

2. The provider will implement the portion of this recommendation that states "determine whether it is cost-effective to continue leasing the tractor and tractor equipment." The CFO will make this determination not later than November 30, 2006. The provider will make a determination on the second part of the recommendation based on the answer to the question about TDFPS and HHSC policy regarding the allowable costs of purchasing this type of equipment.

3. The provider disagrees with this recommendation. The CFO has investigated this idea with two commercial rental companies. Neither one will transfer title to a lessee at the end of the lease period unless the lease is structured as a lease-to-own. Also, the payments for a lease-to-own are higher than a standard lease. The provider does not intend to implement this recommendation.

4. This provider does not lease any buildings, vehicles or equipment from related parties. This provider will implement this recommendation based on the TDFPS response to the allowability of purchasing this type of equipment. The CFO will revise the provider's policies to maintain the documentation supporting the choice of lessor's not later than November 30, 2006.

Chapter 3-B

In the summer of 2005, the provider instituted a new procedure to ensure that each prospective new hire had all the documentation required by Minimum Standards and company policy prior to beginning work. Even before the TDFPS required that background checks be completed prior to hire, the provider had already made it company policy. Minimum Standards Section I, 2600 does not require that all staff have CPR training. It only requires that staff with CPR training be available.

Specific Recommendations:

- 1. The provider agrees with the recommendation. It was implemented in the summer of 2005.*
- 2. The provider agrees with the recommendation. It was implemented in the summer of 2005.*

Chapter 3-C

This provider did in fact keep the lease up to date and has provided that documentation to the SAO. The terms of the lease do not require it to be “formally renewed or extended.” Paragraph 15 states “services of all notices under this Lease shall be sufficient if given personally or mailed...” The SAO states that the lease expired in December 2003. In the understanding between the lessor and the lessee, the lease does not expire until one party to the lease notifies the other party to the lease of its intention to cancel or not renew. By providing amended exhibits to reflect the addition/deletion of a building, vehicle or item of equipment lessor and lessee have kept this lease up to date and current.

The SAO states that “the lease amounts will total \$14261 each month” and then quotes three different amounts that were paid during the course of 2005. The SAO neglected to reference the term “(see exhibit)” at the bottom of paragraph 2 of the lease. It is the exhibit that sets the actual lease amount to be paid each month. It is the exhibit that adds or removes buildings, vehicles and equipment from the lease. These items are not specified within the boiler plate verbiage of the lease. They are specified in the exhibit.

Specific Recommendations:

- 1. The provider agrees with the recommendation. The CFO will implement this change not later than November 30, 2006.*
- 2. The provider agrees with this recommendation. The CFO will contact the lessor and revise the methodology for affecting a revised exhibit not later than November 30, 2006.*

3. *The provider agrees with this recommendation. It was implemented in the summer of 2005.*

Chapter 3-D

The provider agrees with this recommendation. The CFO will work with the provider's IT consultants to implement the most appropriate recommendations not later than December 31, 2006.

Responses from Provider C: The Burke Foundation, Incorporated (doing business as Pathfinders Camp)

Chapter 4-A

This provider has always had the appropriate policies in place which require that the Program Director get the criminal background checks prior to the hiring of any direct care staff. These policies and procedures are outlined in the Personnel Policy and in the Program Director's Job Description. In May 2006, upon learning of the failure of the Program Director to follow these policies, the Executive Director implemented an additional procedure that requires that the results of the criminal background check be signed by the Executive Director prior to the hiring of any direct care staff. The Program Director that previously failed to follow the original policies is no longer with the provider. The disciplinary action was taken as a direct result of the failure to follow the original policy.

Chapter 4-B

This provider agrees with the recommendation to develop and implement additional policies which give the provider the ability to take personnel actions against employees who neglect to turn in receipts for purchases made. Implementation of these policies is the responsibility of the Program Director and Executive Director. The time line for implementation is by September 30, 2006.

This provider agrees with the recommendation to segregate certain financial duties. In fact, in April 2006, this provider contracted with an independent bookkeeper to perform the monthly reconciliations of this provider's accounts payable and accounts receivable thus providing segregation of duties on an on-going basis.

This provider agrees with the recommendation to implement its procedures to ensure that timesheets are processed for payroll only if they have been reviewed, approved, and signed by the appropriate individual. The Administrative Assistant has been overseeing the implementation of these procedures since June 2006.

Chapter 4-C

This provider agrees with the recommendations related to the creation and implementation of new policies that are more comprehensive in terms of our information system. New policies will be created by the Executive Director by October 1, 2006. Implementation will begin at that time and will be overseen by both the Executive Director and the Assistant to the Director.

This provider agrees with the recommendations related to access controls. Some policies already exist related to access controls but additional policies which clarify more specific protocols will be implemented by the Executive Director and Assistant to the Director by October 1, 2006. Some of the specific items mentioned in the recommendations were addressed and corrected in June 2006 when brought to the provider's attention by the SAO team. One recommendation made by the SAO team is not possible at this time because of the limitations of the provider's current hardware. The provider, when upgrading equipment, will implement the additional protocol. The Executive Director will oversee that the new protocol is implemented by September 1, 2008 with all provider computers being upgraded by that time.

This provider agrees with the recommendations related to back up and storage of data. New policies and procedures related to such will be implemented by October 1, 2006 by the Executive Director and Assistant to the Director.

Responses from Provider D: Baptist Child and Family Services (doing business as Baptist Children's Home Ministries)

Chapter 5-A

Currently we do not have any foster families who are paid less than the minimum amount the Department requires. We do not have any foster families who are paid rental assistance. We will not pay foster families rental assistance in the future. Our practice is and will continue to be in line with the terms of Contract 19 (E).)

Chapter 5-B

All foster parents receive notices the month prior to their training expiration date. Foster parents receive agency citations for training non-compliances along with a corrective action plan. Those families that demonstrate a pattern of training deficiencies are issued a 30-day notice of our intent to terminate their contract, and children placed with them are moved to a subsequent placement. [Please note that 2 of the 4 CPR deficient foster parents referenced in your findings were expired for less than 30 days; the other two were expired for less than 60 days].

Chapter 5-C

In order to ensure that all foster care contract agreements are complete and current, BCHM will reissue contract agreements to all of its foster families with an open-ended contract date. Contract terms will be evaluated/reviewed verbally on a quarterly basis to ensure that the rights and obligations of each party and the financial terms are properly maintained.

Chapter 5-D

Modified and Added as of October 23, 2006

Information system policies and procedures: Baptist Children's Home Ministries (BCHM) has no Information Systems or Technology Department of its own. All IT services are provided by Baptist Child & Family Services (BCHM's parent corporation). We agree that with the general intent of the recommendations and have either addressed or will be actively addressing them in a way that provides reasonable levels of safeguarding and security taking into consideration the balance of fiscal/economic and the impact of the policy or procedure.

Executive management works closely with the IT department in setting priorities, direction and expectations. We are currently in the process of more clearly setting up and documenting priorities as that department has expanded from one individual to three. This will be an ongoing process.

Access and security controls: BCHM responded that it either corrected or determined that it had established practices and controls to address the access and security controls concerns identified by auditors.

Backup and storage of data: BCHM responded that it is evaluating other methods in maintaining the backup and storage of data.

Physical security controls: BCHM responded that it will evaluate the concerns identified by auditors.

Responses from Provider E: El Paso Center for Children, Incorporated

Chapter 6

Information System Policies and Procedures

SAO Recommendation: Management should develop and implement objective policies and procedures to protect its automated resources and data with regard to: 1) Administrator and Special-access accounts; 2) Password and user authentication; 3) Intrusion Protection; and 4) Antivirus maintenance.

Management Response: We agree with this recommendation. A formal policy and procedure document has been created covering each of the above items. The applicable policies and procedures are now being implemented.

Access and Security Controls

SAO Recommendation: Management should use Microsoft or other industry recommendations for password and account lockout setting in Active Directory.

Management Response: We agree with this recommendation. Microsoft standards are being adopted with slight modifications.

SAO Recommendation: Management should formalize and document the user access assignment process.

Management Response: We agree with this recommendation. An Add/Change/Delete form has been developed for the Personnel office that will be filled out and become a part of an employee's personnel record.

SAO Recommendation: Management should consider hiring a third-party vendor to perform an annual information technology and security audit.

Management Response: We agree with this recommendation. We have contacted an independent business computer consultant to conduct an annual review of our systems.

SAO Recommendation: Management should consider separating the duties of the data entry and posting for accounts payable transactions.

Management Response: We believe there is only minimal risk that the Center's AP procedure "could enable the individual in this position to sign the checks, with no other person's having interaction in the process." Moreover, the Center's administrative staff is small, and we believe that assigning either the AP data entry or posting responsibility to another staff member would create other more serious internal control risks.

We believe the following policies and procedures minimize the risk cited. The checks are number controlled by someone other than the AP Coordinator; and we offer the review of the AP listing (together with number control of checks) to insure that all checks are seen by an authorized signer. All Center checks require two signatures, and the position in question (AP Coordinator) is not an authorized check signer for printed checks, nor is she authorized to post check batches for direct deposit. There is a signature card kept on file at Chase Bank, making it difficult for anyone to forge two signatures on a printed check. When checks need to be voided, the Controller is involved in that process. The Controller also receives all original cancelled checks and bank statements from the bank and reviews them to ensure there are no

irregularities prior to passing them on to the AP Coordinator for preparation of bank reconciliations.

Backup and Storage of Data

SAO Recommendation: Management should maintain three sets of backups; discontinue storing offsite backups at the homes of employees; and strengthen security for its on-site storage of backups.

Management Response: We agree with these recommendations. We are currently maintaining three sets of backups; and we have purchased two fireproof safes to store backup sets, including one at another off-site location.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Health and Human Services Commission

Mr. Albert Hawkins, Executive Commissioner

Department of Family and Protective Services

Mr. Carey Cockerell, Commissioner

Board Members and Executive Directors of the Following Providers Audited

Baptist Child and Family Services (doing business as Baptist Children’s
Home Ministries)
The Burke Foundation, Incorporated (doing business as Pathfinders
Camp)
El Paso Center for Children, Incorporated
Life Support Counseling and Research, Incorporated (doing business as
Therapeutic Family Life)
Youth and Family Enrichment Centers, Incorporated



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