

Department of Developmental Services

A More Uniform and Transparent Procurement and Rate-Setting Process Would Improve the Cost-Effectiveness of Regional Centers

REPORT NUMBER 2009-118, AUGUST 2010

Department of Developmental Services' response as of October 2010

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits (bureau) to examine the Department of Developmental Services' (Developmental Services) oversight responsibilities for the regional centers and to determine the extent to which Developmental Services performs oversight at a sample of regional centers selected for review.

Finding #1: Developmental Services completed almost all fiscal audits within the required time frame.

The Lanterman Act requires Developmental Services to audit state funds provided to the regional centers, and Developmental Services generally accomplishes this responsibility through the fiscal audits it conducts every two years as a condition of participating in a federal reimbursement program called the Medicaid Waiver. During our review of its files, we found that Developmental Services completed 18 of the 21 fiscal audits required in fiscal years 2007–08 and 2008–09. According to the chief of Developmental Services' Regional Center Audit Section (audit chief), the remaining three audits were completed in fiscal year 2009–10 and did not meet the required two-year period. The audit chief explained that Developmental Services did not complete these audits within two years because it did not have staff available to perform the reviews and because the lack of a timely budget resulted in no funds being available for travel.

To ensure that it is providing oversight in accordance with state law and Medicaid Waiver requirements, we recommended that Developmental Services ensure it performs audits of each regional center every two years as required.

Developmental Services' Action: Pending.

Developmental Services reports that it is on schedule to complete all its biennial fiscal audits by December 2010.

Finding #2: Although expenditures were generally allowable, the regional centers could improve their documentation and written procedures for purchase of services.

Based on our review of a sample of 40 expenditures at each of the six regional centers we visited, we determined that the regional centers generally have controls in place to ensure that they purchase only allowable services for consumers. Even so, we noted a few areas in which improvements could be made in the documentation of expenditures and in the written description of important control

Audit Highlights . . .

Our review of the Department of Developmental Services (Developmental Services), as well as six of the nonprofit regional centers coordinating services and supports for Californians with developmental disabilities (consumers), revealed the following:

» *Developmental Services systematically audits and reviews whether services purchased for consumers are allowable but, at the time of our fieldwork, generally did not examine how regional centers establish rates or select particular vendors for services.*

» *Although the regional centers could improve their documentation of procedures in a few areas, most of the expenditures we reviewed for the purchase of services appeared allowable and were properly supported by vendor invoices.*

» *Regional centers, however, do not always document how rates are set, why particular vendors are selected, or how contracts are procured; thus, in some cases, the ways in which regional centers established payment rates and selected vendors had the appearance of favoritism or fiscal irresponsibility. For example, we found the following:*

- *A regional center procured \$950,000 in services from a transportation provider under a so-called "negotiated rate" that appears to have been calculated to incur a specific level of spending before the end of the fiscal year rather than to obtain the best value for the consumers the regional center serves.*

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- *A different regional center negotiated a rate that was considerably higher than the rate of an existing vendor performing the same type of services and the vendor owner receiving the higher rate was the sister of the regional center's assistant director who approved the rate.*
- *Responses to a survey we conducted of regional center employees of locations we visited indicated that half of the roughly 400 employees who responded do not feel safe reporting suspected improprieties to their management.*
- *We could not systematically evaluate Developmental Services' process for responding to complaints from regional center employees, because, at the time of our fieldwork, it did not centrally log or track employees' complaints or have a written process for handling such complaints.*

processes. Specifically, because some have moved to electronic processes, two of the six regional centers we reviewed could not provide the authorizations for expenditures for purchase of services required by regulation.

Additionally, two regional centers could not provide up-to-date documentation of their procedures for approving and processing invoices for services. At San Andreas, the regional center's purchase-of-services manual was 20 years old, and the financial manager acknowledged that it needs to be updated. Although Valley Mountain Regional Center's (Valley Mountain) usual process for purchasing services is well documented, its method of processing transportation invoices relies on one person's expertise, and no written guidance exists for vital steps in the process. This lack of an established process for invoice reviews appears to be one of the factors that allowed Valley Mountain to pay a vendor based on insufficiently supported invoices. Although this issue did not necessarily result in inaccurate payments to the vendor, it called attention to a pattern of errors in its invoicing process that Valley Mountain agreed it needed to address.

We recommended that Developmental Services require the regional centers to prepare and follow written procedures for their purchase of services that detail what documents will be retained for payment of invoices. Additionally, we recommended that, if regional centers move to an electronic authorization process, Developmental Services should determine whether it needs to revise its regulations. Finally, we recommended that Developmental Services ensure that the system Valley Mountain implements to correct its transportation invoicing process collects individual consumer data as necessary to ensure compliance with Medicaid Waiver requirements.

Developmental Services' Action: Partial corrective action taken.

Developmental Services issued a directive dated August 16, 2010, to regional centers requiring them to update their administrative policies and procedures related to purchasing consumer services and to retain required documentation when paying invoices. Developmental Services also stated that it is developing regulations related to electronic authorizations. It plans to report its progress toward implementation in its six-month report to the bureau. Finally, Developmental Services indicated in its October 2010 response that audit fieldwork is in progress at Valley Mountain.

Finding #3: Left to their own discretion, regional centers often established rates that were not supported by an appropriate level of analysis.

State law and regulations allow regional centers to establish the payment rates for many types of vendor services through negotiation with the vendor but do not prescribe how regional centers are to accomplish or document completion of this responsibility. Also, Developmental Services provided little direct oversight through existing monitoring efforts of how regional centers establish rates. Within this framework, we found—based on our review of a sample

of regional-center-established rates—that regional centers often do not retain support demonstrating that they established rates using an appropriate level of analysis. When documentation was available, however, a cost statement from the vendor—such as used by Far Northern Regional Center (Far Northern)—was the most frequently used support for rate determination, and one we considered a best practice. We also found that regional centers sometimes established rates using inappropriate processes that gave the appearance of favoritism toward certain vendors or fiscal irresponsibility.

For example, we found that a regional center procured \$950,000 in services from a transportation provider under a so-called “negotiated rate” that appears to have been calculated to incur a specific level of spending before the end of the fiscal year rather than to obtain the best value for the consumers the regional center serves. In another example, a different regional center negotiated a rate with a new vendor under circumstances giving the appearance of favoritism. The resulting rate was considerably higher than the rate of an existing vendor performing the same type of service and the vendor owner receiving the higher rate was the sister of the regional center’s assistant director who approved the rate.

To ensure that negotiated rates are cost-effective, we recommended that Developmental Services:

- Require regional centers to document how they determine that the rates they negotiate or otherwise establish are reasonable for the services to be provided.
- Encourage regional centers to use, when applicable, the cost-statement approach exemplified by Far Northern.
- Follow and refine, as necessary, its newly established fiscal audit procedures requiring a review of a representative sample of negotiated rates as part of its biennial fiscal audit of each regional center.

We also recommended that, if Developmental Services believes it needs statutory or regulatory changes to provide effective oversight of the regional centers’ rate-setting practices, the department should seek these changes.

Developmental Services’ Action: Partial corrective action taken.

Developmental Services issued a directive dated August 16, 2010, to regional centers requiring them to maintain documentation on the process they use to determine, and the rationale for granting, any negotiated rate. Developmental Services also expanded its fiscal audit protocols to include a review of negotiated rates during its biennial fiscal audits of regional centers to ensure adequate documentation exists. However, we could not confirm whether Developmental Services is using these protocols because it had not—as of November 2010—completed fieldwork related to any fiscal audits it is conducting using the new protocols. Finally, Developmental Services indicated that it believes the statutory and administrative actions taken in recent years set parameters for rate negotiations and establish clear mechanisms for accountability.

Finding #4: The regional centers did not always comply with the requirements of the July 2008 rate freeze.

We found that the regional centers did not always conform to the requirements of legislation requiring them to freeze their negotiated rates for existing vendors or, for new vendors, to establish rates at or below the lesser of the regional center or statewide median rate for the pertinent service codes. These provisions, which were enacted in February 2008, specified that beginning on July 1, 2008, increases in payment rates for existing vendors were allowed only if required in contracts in effect on June 30, 2008, or authorized by Developmental Services in writing. In our review of 61 rates, we found four instances in which regional centers did not appear to follow the law requiring this rate freeze. As a result, these regional centers expended resources that the Legislature, in enacting the rate freeze, intended to preserve. We also found an additional instance of noncompliance with rate-freeze provisions in our review of regional center contracts.

We asked Developmental Services whether it reviews compliance with the rate freeze in its fiscal audits of the regional centers. The audit chief showed us that Developmental Services has procedures built into its fiscal audit process for reviewing compliance with the rate freeze within certain service codes. The audit chief stated that the scope of the fiscal audits includes transportation, day programs, and residential programs but did not generally involve other service codes for which regional centers establish rates. Therefore, other than for the services just mentioned, Developmental Services' audits division did not ordinarily review most regional-center-established rates for compliance with the rate freeze. In fact, four of the five rate-freeze violations we found are in service codes not typically reviewed during the fiscal audits.

In July 2010 Developmental Services provided us with revised fiscal audit procedures. These new procedures include a review of compliance with rate-freeze requirements for a sample of rates established by regional centers. Because these additions were provided to us after the end of our fieldwork, we could not evaluate their efficacy or the degree to which they had been implemented at that time.

We recommended that Developmental Services carry out its newly developed fiscal audit procedures for ensuring compliance with provisions of the Legislature's July 2008 rate freeze, unless these provisions were rescinded by the Legislature. We also recommended that, if Developmental Services needs to streamline its current fiscal audit program to enable it to incorporate this review of rate-freeze compliance and still adhere to mandated deadlines, it should do so. Finally, we recommended that Developmental Services review the five instances of noncompliance with the rate freeze that we identified and require corrective action by the respective regional centers, stating this corrective action should include remedies for future rate payments to these vendors as well as repayment by the regional centers of any state funds awarded in a manner not in compliance with state law.

Developmental Services' Action: Partial corrective action taken.

Developmental Services expanded its fiscal audit protocols to include testing for compliance with the July 2008 rate freeze. However, we could not confirm whether Developmental Services is using these protocols because it had not—as of November 2010—completed fieldwork related to any fiscal audits it is conducting using the new protocols. Additionally, in its October response, Developmental Services indicated that audit fieldwork is underway for one of the four regional centers that the bureau reported may have violated the rate-freeze provisions and it plans to begin the remaining reviews within 60 days. According to Developmental Services, it will report findings and the corrective actions it determines are appropriate when the audits are completed.

Finding #5: Developmental Services generally does not regulate or examine the regional centers' selection of vendors.

State law places the responsibility for securing needed services for consumers on regional centers and has traditionally imposed few restrictions on how the regional centers select vendors to provide these services. Although a recent amendment to the law now requires regional centers to select the least costly available provider of comparable services, Developmental Services has not adopted regulations or other requirements describing how regional centers are to demonstrate compliance with this amendment.

When we attempted to review documentation at the six regional centers we visited, we found that they do not maintain information showing how they chose from among the available providers. Because they do not document why a consumer's planning team selected particular vendors for a consumer's Individual Program Plan (IPP), oversight entities—Developmental Services in particular—cannot currently ensure that planning teams select the least costly providers of comparable services as required by the Lanterman Act, nor can they examine whether the regional centers mitigate, as much as feasible, the appearance of favoritism towards certain vendors.

To ensure that consumers receive high-quality, cost-effective services that meet the goals of their IPPs consistent with state law, we recommended that Developmental Services do the following:

- Require the regional centers to document the basis of any IPP-related vendor selection and specify which comparable vendors (when available) were evaluated.
- Review a representative sample of this documentation as part of its biennial waiver reviews or fiscal audits to ensure that regional centers are complying with state law—and particularly with the July 2009 amendment requiring selection of the least costly available provider of comparable service.

Developmental Services' Action: None.

Developmental Services does not believe it has the legal authority to implement this recommendation, as it states that it places the department in a role inconsistent with the intent of the Lanterman Act. Developmental Services asserts that to require documentation of all vendors considered and an explanation of why the vendor selected constitutes the least costly vendor, and presumably all other factors required by law, could delay needed services to consumers and their families. According to Developmental Services, by design it does not have a direct role in the IPP development. Developmental Services asserts that if it required extensive documentation of one factor and not all factors considered in the IPP process, the likely response would be litigation claiming that Developmental Services overstepped its authority. As outlined in the Comments section of our August 2010 audit report (notes 2 and 3), the bureau does not agree with Developmental Services' response to this recommendation.

Finding #6: Regional centers have not established protocols for determining when a contract is prudent and do not consistently require or advertise competitive bidding for contracts.

Although state law requires the regional centers to submit to Developmental Services their policies for purchasing services for consumers, the Lanterman Act—and the Title 17 regulations designed to carry it out—does not require the regional centers to define when or how they will use contracts to procure services with vendors. Also, Developmental Services does not examine how particular vendors were selected for regional center contracts.

More specifically, except when awarding startup funds to develop new community resources, none of the regional centers we visited have policies indicating when a contract is required or when they would allow a vendor to operate under the more common vendorization and rate process. Without protocols establishing when to use a contract for special instances, regional centers risk paying for specialized services that are ill-defined. For example, Inland Regional Center (Inland) entered into a rate agreement with a startup transportation company to assess consumer transportation needs. Inland paid this company a total of \$950,000 in July and August 2008 to perform this service under a service code used for transportation broker services. The regulatory description of this service code would not be sufficient to hold this vendor accountable for a specific level of services. The only definition of the service the vendor was to perform was contained in the June 2008 rate agreement, which stated, "Contractor will assess, develop, implement and manage routing and time schedules to meet consumer transportation needs." The rate agreement contained no description of when or how the services would be performed, how the vendor would communicate the results of individual consumer assessments, or what form any end summary of results would take.

We asked Inland to provide us with the deliverables the vendor produced as a result of the rate agreement, and all it could provide was a six-page, high-level report that lacked the details necessary to identify how it could create a more efficient transportation system. Of particular concern was that a purpose of the assessment was to make transportation routing more efficient for individual consumers, but after repeated requests, Inland could not provide us a single example of a consumer rerouted as a result of the assessment. Furthermore, Inland's rate agreement was so general that we are not sure that it could have held the vendor to any specific level of performance.

Just as the regional centers did not establish a procedure for determining when to enter into a contract, some also did not have written policies specifying a competitive procurement process. The lack of established procurement requirements resulted in inconsistent documentation among and within regional centers. Additionally, we found that when entering into contracts, the regional centers missed opportunities to contain costs or attract the highest-quality service providers because they did not advertise the contracting opportunity or evaluate bids competitively. Specifically, the regional centers we visited issued Requests for Proposal (RFPs) or otherwise notified vendors about contracting opportunities for only nine of the 33 contracts we evaluated. In the nine instances when the regional centers issued RFPs, they evaluated some of the proposals competitively but, in two of these instances, one regional center—Westside Regional Center—did not retain documentation of its reviewers' analysis of the proposals. The lack of a consistent contracting process across the regional centers reduces transparency and can create the appearance of vendor favoritism.

To ensure that the regional centers achieve the greatest level of cost-effectiveness and avoid the appearance of favoritism when they award purchase-of-service contracts, we recommended that Developmental Services require regional centers to adopt a written procurement process that:

- Specifies the situations and dollar thresholds for which contracts, RFPs, and evaluation of competing proposals will be implemented.
- When applicable, requires the regional centers to notify the vendor community of contracting opportunities and to document the competitive evaluation of vendor proposals, including the reasons for the final vendor-selection decision.

To ensure that the regional centers adhere to their procurement process, we recommended that Developmental Services review the documentation for a representative sample of purchase-of-service contracts during its biennial fiscal audits. Finally, to deter unsupported and potentially wasteful spending of state resources by the regional centers, we recommended that Developmental Services determine the extent to which Inland needs to repay state funds it provided to a transportation vendor for an assessment of Inland's transportation conditions.

Developmental Services' Action: Partial corrective action taken.

Developmental Services states that it and the Association of Regional Center Agencies representing the 21 regional centers have agreed to language amending the contracts between Developmental Services and the regional centers. Developmental Services indicated that the contract amendments will require the regional centers to develop procurement policies and processes approved by their respective board of directors. According to Developmental Services, the policies and processes will address circumstances under which RFPs will be issued, the applicable dollar thresholds, and how the submitted proposals will be evaluated. Additionally, Developmental Services developed fiscal audit protocols for testing whether regional centers are complying with the newly developed procurement policies and processes. Finally, in its October 2010 response, Developmental Services indicated that an audit of Inland is underway and it has scheduled an audit of the transportation vendor to begin November 1, 2010.

Finding #7: Developmental Services' processing of allegations from regional center employees was only recently defined.

Employees at six locations we visited identified several problems in the working environment at the regional centers. Responses to a survey we conducted of these six regional centers' employees indicated that almost half of the roughly 400 employees who responded to the questions concerning this topic do not feel safe reporting suspected improprieties to their management. Consequently, we asked Developmental Services about its process for receiving regional center employees' complaints, concerns, or allegations and its procedures for reviewing this information. Although Developmental Services indicated that it has a process for receiving and reviewing allegations from regional center

employees, it had not documented this process, nor had it shared this process with regional center employees, until we brought our concern about this issue to its attention. Similarly, Developmental Services only recently began centrally logging allegations and tracking the status of its follow-up efforts and ultimate disposition of such allegations.

To ensure that regional center employees have a safe avenue for reporting suspected improprieties at the regional centers, we recommended that Developmental Services follow its newly documented process for receiving and investigating these types of allegations it put into writing in July 2010 and should continue to notify all regional centers that such an alternative is available. To ensure that appropriate action is taken in response to allegations submitted by regional center employees, we also recommended that Developmental Services centrally log these allegations and track follow-up actions and the ultimate resolution of allegations, as required by its new procedures.

Developmental Services' Action: Corrective action taken.

As we stated in our report, in July 2010 Developmental Services formally documented procedures that describe how it accepts, tracks, and resolves complaints from regional center employees, and it also informed the regional centers of this process. Developmental Services included information about its process on its Web site and instructed regional centers to do the same on their Web sites. Additionally, Developmental Services instructed regional centers to provide notification to employees, board members, consumers and their families, and the vendor community of the complaint process and their right to make reports of improper activity to Developmental Services. Finally, in July 2010, Developmental Services created and began using a log that summarizes allegations it has received and follow up it has taken.

