



PERFORMANCE AUDIT REPORT

**Foster Care: Reviewing Selected Issues Related to
State Contracts for Foster Care and Family
Preservation Services**

Executive Summary ***with Conclusions and Recommendations***

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
April 2008**

Legislative Post Audit Committee

Legislative Division of Post Audit

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April 1, 2008

To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency responses, from our completed performance audit, *Foster Care: Reviewing Selected Issues Related to State Contracts for Foster Care and Family Preservation*.

The report also contains appendices showing the history of SRS payments to family preservation and foster care contractors, the contractors' family preservation and foster care outcomes for fiscal years 2006 and 2007, and organizational charts for four child welfare contractors with affiliate companies.

This report includes several recommendations for The Farm, Inc., SRS, and the Division of Purchases. We would be happy to discuss these recommendations or any other items in the report with you at your convenience.

If you would like a copy of the full audit report, please call our office and we will send you one right away.

A handwritten signature in black ink that reads "Barbara J. Hinton". The signature is written in a cursive, flowing style.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY
LEGISLATIVE DIVISION OF POST AUDIT

Overview of Family Preservation and Foster Care in Kansas

Several contractors provide family preservation and foster care services in five regions of the State, at a total cost of about \$151 million in fiscal year 2007. page 3
Beginning in fiscal year 2006, family preservation services were split into in-home and out-of-home services, and foster care was also expanded to include case management for adoption services. Payments for out-of home services within the foster care and family preservation contracts have increased from about \$69 million to about \$141 million over the past seven years, while in-home services have decreased from about \$12 million to almost \$10 million.

Question 1: Were Appropriate Procedures Followed in Awarding Contracts to The Farm for Foster Care and Family Preservation Services in 2005?

In May 2004, SRS began soliciting bids for family preservation and foster care services for fiscal years 2006 through 2009. page 7
The new contracts differed from the previous ones in that they created two categories of family preservation services, and introduced a more complex pricing structure for foster care services. SRS used a negotiated procurement process designed to provide the State with the best value, which may not result in the lowest cost.

During the process, an SRS employee appears to have inadvertently disclosed information that The Farm subsequently used to increase its bids. page 9
When conducting the financial phase of the contracting process, SRS officials realized that four of five contractors' bid proposals were significantly higher than SRS' target, while The Farm submitted bids that were lower than SRS had projected. In an attempt to treat all contractors uniformly, SRS officials shared the basic framework for a "risk mitigation" plan with all finalists to resolve issues that had stalled discussions, but withheld certain details from The Farm.

While discussing its risk mitigation plan with Farm officials during the third and final negotiations, an SRS employee disclosed financial information that initially had been withheld, which led to The Farm increasing its bids. Consequently, the State paid an additional \$2.9 million to The Farm during the first two contract years. To avoid this situation, SRS officials could have finalized negotiations with The Farm before working with the other contractors on the risk-mitigation plan.

We also found three minor instances where officials from SRS or the Division of Purchases deviated from best practices and requirements, including the absence of a procedure to check SRS staff involved in evaluating the bids for potential conflicts of interest.

Recently, SRS modified the contracts to resolve issues related to Medicaid payments to contractors. Contractors were going to lose an estimated \$7 million in Medicaid payments during fiscal year 2008 due to reimbursements they couldn't claim anymore. SRS agreed to cover the majority of those losses with State General Fund moneys. The balance was to be covered by other federal revenue sources. For fiscal years 2008 and 2009, SRS also modified the existing contracts to return to a flat monthly payment per child plus an administrative fee to alleviate contractors' concerns about uncertain payments. page 13

Question 1 Conclusion. Before it rebids the foster care and family preservation contracts for fiscal year 2010 and beyond, SRS needs to take a number of steps to improve its bid evaluation and procurement negotiation process. Some of those improvements relate to procedural issues, but others are more substantive. It appeared to us that SRS and the Division of Purchases erred in trying to treat all contractors the same during the final price negotiations. The Farm had submitted a reasonable bid that was in-line with SRS' projections, and that had much lower costs than the bids submitted by the contractors for the four other regions. It would have been in the State's best interest to finalize price negotiations with The Farm before proceeding with a "risk-mitigation" plan to limit payments to the four other contractors. Involving The Farm in discussions about this plan—and inadvertently disclosing financial details of that plan to The Farm—led The Farm to raise its bid and ended up costing the State almost \$3 million more over two years than it would have had to pay. We saw no indication in any of the documents we reviewed that there were concerns about The Farm's financial viability page 14

Question 1 Recommendations. We recommended that SRS secure services for foster care and family preservation contracts at the best price for the State by providing uniform information to contractors, providing written guidance to employees on how to evaluate bids, ensuring enough time is allotted to make sure proposals are reasonable, and developing an agency strategy for dealing with each bidder during the price negotiation process. We also recommended that SRS create a process to ensure that its employees involved in reviewing and awarding major contracts are free from bias with regard to those contracts. Lastly, we recommended that when applicable, the Division of Purchases should follow the law and include in its reports to the Legislature an explanation about why the lowest-cost bidders aren't selected for a contract. page 15

Question 2: Have Moneys from the Contracts Awarded to The Farm Been Used Only for Appropriate Purposes Related to the Contracts?

During fiscal year 2007, The Farm spent \$21.3 million on its family preservation and foster care contracts with SRS. page 17
The majority of the money The Farm spent from its foster care and family preservation contracts with SRS in 2007 was on foster care placements (\$7.3 million) and staff compensation (\$5.8 million).

The contracts focus on outcomes rather than how the money can be spent, and The Farm's results were similar to other contractors. page 18
None of the contractors have met all outcomes for family preservation and foster care, but The Farm's results generally are in-line with the other contractors' results. Family preservation contractors have met 58% to 77% of the specified outcomes, while foster care contractors have met about half of the specified outcomes during fiscal years 2006 and 2007.

We saw no spending by The Farm that was contrary to best practices, but we identified independence issues related to one board member. page 19
The Farm's management compensation in 2006 was in-line with other foster care and family preservation contractors, and board members received no compensation. The Farm's travel expenditures also didn't appear to be out-of-line. However, we noted two potential conflict-of-interest situations that exist because one of The Farm's board members is married to its Chief Executive Officer.

The Farm hasn't used affiliated businesses to increase management compensation. page 22
The Farm has created a total of seven affiliates, but only three of them are currently active. All three active affiliates are non-profit organizations, while two of the inactive affiliates are for-profit organizations. According to experts, creating for-profit or non-profit affiliate companies is both common and acceptable. Three of the four other foster care and family preservation contractors in Kansas also have affiliates. We saw no evidence that The Farm has used affiliates to increase fiscal year 2007 management salaries to unreasonable levels.

In fiscal year 2007, The Farm donated \$500,000 to an affiliate, but reported it to SRS as an expense. page 24
The donation to its Foundation is an acceptable practice according to non-profit experts. However, The Farm showed the \$500,000 donation as an expense on reports it submitted to SRS, which understated its net revenues and financial health. Because both organizations share the same board of directors and many of the key management staff, we think the transaction shouldn't have been categorized as an expense, but as a transfer of funds.

Since fiscal year 2005, The Farm has improved its financial position significantly. *The Farm has increased its net assets from \$7.6 million to almost \$12.1 million—an increase of about \$4.5 million (or 59%) since the new contract began. The Farm’s current assets for fiscal year 2007 totaled \$13.4 million which was enough to cover about five months’ worth of expenditures that year.* page 25

Question 2 Conclusion. *When the State contracts for services from an outside vendor, it typically doesn’t specify how that vendor can spend the money. Instead, the contractor agrees to provide a certain level of service for the price paid. The foster care and family preservation contracts are no different. The contractors are free to spend the money as they see fit, as long as they provide a level of service that is acceptable to SRS. The foster care and family preservation money The Farm spent during fiscal year 2007 generally went toward the types of expenditures we would expect to see under the contracts, and The Farm’s performance was in line with the other contractors.* page 25

There was no evidence that The Farm officials had used affiliated companies to boost management salaries or divert moneys from the contracts. However, because the marriage of one of its board members to The Farm’s chief executive officer creates a potential for conflicts of interest, officials need to take some additional steps to avoid those potential conflicts. Although it was allowable for The Farm officials to donate \$500,000 of its net revenues to its affiliated foundation, they need to do a better job of ensuring that net revenues transferred to affiliated organizations are clearly spelled out in the reports The Farm provides to SRS, and are not included as operating expenses for the organization.

Question 2 Recommendations. *We recommended The Farm accurately shows how it calculates net revenues by not including transfers to its affiliate as a donation expense as long as the two organizations share the same board members. Furthermore, we recommended The Farm revise the 6-month report to SRS containing the \$500,000 donation. Lastly, we recommended The Farm take further steps to mitigate the potential conflict of interest, and that board meeting minutes clearly indicate who abstains from votes.* page 26

The Division of Purchases and the Department of Social and Rehabilitation Services officials agreed with our report findings and indicated they will act on our recommendations accordingly. Officials from The Farm indicated they agreed in principle with most findings in our report and laid out reasonable steps to respond to our recommendations. However, Farm officials disagreed with our conclusion that the transfer of \$500,000 to one of their affiliates was reported inaccurately to SRS.

These appendices can be found in the full report.

APPENDIX A: <i>Scope Statement</i>	page 24
APPENDIX B: <i>History of SRS Payments to Family Preservation and Foster Care Contractors.</i>	page 29
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APPENDIX D: <i>Organizational Charts of Four Child Welfare Contractors with Affiliate Companies.</i>	page 36
APPENDIX E: <i>Agency Responses.</i>	page 38

This audit was conducted by Katrin Osterhaus, Nathan Ensz, Brad Hoff and Justin Stowe. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Katrin Osterhaus at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.