

PERFORMANCE AUDIT
OF THE
RESIDENTIAL SERVICES PROGRAM
OF WAYNE COMMUNITY LIVING SERVICES, INC.

AN AGENCY UNDER CONTRACT WITH THE
DETROIT-WAYNE COUNTY COMMUNITY MENTAL HEALTH AGENCY

November 1998

EXECUTIVE DIGEST

RESIDENTIAL SERVICES PROGRAM OF WAYNE COMMUNITY LIVING SERVICES, INC.

INTRODUCTION

This report, issued in November 1998, contains the results of our performance audit* of the Residential Services Program of Wayne Community Living Services, Inc. (WCLS), an agency under contract with the Detroit-Wayne County Community Mental Health Agency (DWCCMHA).

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

WCLS, located in Wayne, Michigan, is a nonprofit mental health agency under contract with DWCCMHA to provide mental health services to people with developmental disabilities* throughout Wayne County. WCLS provides direct clinical support services* and housing development services* to recipients* and it subcontracts for day program services* and residential services*.

WCLS is governed by a 13-member board of directors selected from Southeastern Michigan.

* See glossary on page 32 for definition.

WCLS's mission* is to enable persons with developmental disabilities to experience a full life with dignity, health, opportunity for personal growth, and self-esteem while residing in the community.

WCLS's operations are funded by State, federal, and local funds. As of September 30, 1997, WCLS had 324 authorized positions and was serving approximately 1,680 recipients. For fiscal year 1996-97, WCLS's revenues and expenditures totaled \$106,095,891 and \$114,055,410, respectively. In addition, WCLS's subcontractors received \$7,759,967 in Supplemental Security Income* on behalf of recipients that WCLS served for fiscal year 1996-97.

**AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS**

Audit Objective: To assess the effectiveness of WCLS's residential services contract administration process.

Conclusion: We concluded that WCLS's residential services contract administration process was generally effective. However, our assessment disclosed one material condition* :

- WCLS did not have an effective budgeting process for funding residential services contracts (Finding 1).

WCLS concurs with the finding and informed us that it has established policies and procedures to ensure cost effective budgeting based on historical cost and anticipated need, in keeping with both federal and State standards.

* See glossary on page 32 for definition.

Our assessment also disclosed reportable conditions* related to contract management and program management funding (Findings 2 and 3).

Audit Objective: To assess the effectiveness and efficiency of WCLS's home development and provider selection processes.

Conclusion: We concluded that WCLS's home development process was generally effective but not efficient. Our assessment disclosed one material condition:

- WCLS had not established sufficient control procedures to ensure the efficient purchase of home repairs and renovations (Finding 4).

WCLS concurs with the finding and informed us that it has implemented policies and procedures to ensure appropriate controls over the purchase of home repairs and renovations.

Our assessment also disclosed reportable conditions related to home development, home leasing, and Medicaid billing rates (Findings 5, 6, and 7). We concluded that WCLS's provider selection process was effective and efficient.

Audit Objective: To assess the effectiveness of WCLS's recipient residential placement practices.

Conclusion: We concluded that WCLS's recipient residential placement practices were generally effective.

* See glossary on page 32 for definition.

Audit Objective: To assess whether State funds were used effectively and efficiently in the purchase and delivery of residential services.

Conclusion: We concluded that WCLS generally used State funds effectively and efficiently when purchasing and delivering residential services.

Noteworthy Accomplishments: WCLS was selected as 1 of 3 sites in Michigan to receive a grant from the Robert Wood Johnson Foundation to participate in a demonstration project on Self-Determination*. This project is intended to increase recipient satisfaction rates and outcome levels while simultaneously reducing costs.

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Residential Services Program of Wayne Community Living Services, Inc. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

We examined WCLS's records and activities for the period October 1, 1994 through September 30, 1997.

To accomplish our objectives, we reviewed the Department of Community Health's (DCH's), DWCCMHA's, and WCLS's policies and procedures. We interviewed selected DCH, DWCCMHA, and WCLS personnel. We reviewed and evaluated WCLS's residential services budget development process; cost

* See glossary on page 32 for definition.

settlement and cost settlement appeals processes; and home, home investor, and provider selection processes. We evaluated the appropriateness of WCLS's lease terms, home repair, and renovation purchasing practices, and Medicaid rate calculation process. We assessed the effectiveness of selected WCLS residential placements. We reviewed and evaluated WCLS's efforts at preventing, detecting, and eliminating potential conflicts of interest. We tested for undisclosed conflicts of interest.

AGENCY RESPONSES

Our audit report includes 7 findings and 8 corresponding recommendations. WCLS's preliminary response indicated that it concurs with our findings and has taken steps to implement the recommendations.

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Ms. Marguerite Schervish, Chairperson
Wayne Community Living Services, Inc.
Metro Place Center
35425 Michigan Avenue West
Wayne, Michigan
and

Ms. Cynthia Taueg, Chairperson
Detroit-Wayne County Community Mental Health Agency
640 Temple, 8th Floor
Detroit, Michigan
and

Mr. James K. Haveman, Jr., Director
Department of Community Health
Lewis Cass Building
Lansing, Michigan

Dear Ms. Schervish, Ms. Taueg, and Mr. Haveman:

This is our report on the performance audit of the Residential Services Program of Wayne Community Living Services, Inc., an agency under contract with the Detroit-Wayne County Community Mental Health Agency.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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OF WAYNE COMMUNITY LIVING SERVICES, INC.
AN AGENCY UNDER CONTRACT WITH THE
DETROIT-WAYNE COUNTY COMMUNITY MENTAL HEALTH AGENCY**

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Description of Agency

Wayne Community Living Services, Inc. (WCLS), located in Wayne, Michigan, is a nonprofit mental health agency under contract with the Detroit-Wayne County Community Mental Health Agency to provide mental health services to people with developmental disabilities throughout Wayne County. WCLS provides direct clinical support and housing development services to recipients, and it subcontracts for recipient day program and residential services. WCLS is governed by a 13-member board of directors selected from Southeastern Michigan.

WCLS's mission is to enable persons with developmental disabilities to experience a full life with dignity, health, opportunity for personal growth, and self-esteem while residing in the community.

WCLS's operations are funded by State, federal, and local funds. As of September 30, 1997, WCLS had 324 authorized positions and was serving approximately 1,680 recipients. For fiscal year 1996-97, WCLS's revenues and expenditures totaled \$106,095,891 and \$114,055,410, respectively. In addition, WCLS's subcontractors received \$7,759,967 in Supplemental Security Income on behalf of recipients that WCLS served for fiscal year 1996-97.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit of the Residential Services Program of Wayne Community Living Services, Inc. (WCLS), an agency under contract with the Detroit-Wayne County Community Mental Health Agency (DWCCMHA), had the following objectives:

1. To assess the effectiveness of WCLS's residential services contract administration process.
2. To assess the effectiveness and efficiency of WCLS's home development and provider selection processes.
3. To assess the effectiveness of WCLS's recipient residential placement practices.
4. To assess whether State funds were used effectively and efficiently in the purchase and delivery of residential services.

Audit Scope

Our audit scope was to examine the program and other records of the Residential Services Program of Wayne Community Living Services, Inc. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit work was performed during the months of February through July 1998. We examined WCLS's records and activities for the period October 1, 1994 through September 30, 1997.

To accomplish our first objective, we evaluated WCLS's residential services budget development process. We evaluated WCLS's cost settlement and cost settlement appeals process. We visited selected residential services providers and reviewed their expenditure and revenue records. We reviewed the Department of Community Health's

(DCH), DWCCMHA's, and WCLS's policies and procedures related to residential services contract administration. We interviewed DCH, DWCCMHA, and WCLS personnel.

To accomplish our second objective, we reviewed and evaluated WCLS's home, home investor, and provider selection processes. We evaluated the appropriateness of the lease terms negotiated with home lessors. We reviewed and evaluated the propriety of selected home repairs and renovations. We evaluated WCLS's purchasing practices for home repairs and renovations. We reviewed WCLS's Medicaid rate calculation process to determine if WCLS included all applicable home development costs in the calculation. We reviewed DCH's, DWCCMHA's, and WCLS's policies and procedures related to home development and provider selection. We interviewed DCH, DWCCMHA, and WCLS personnel.

To accomplish our third objective, we reviewed selected residential placements to determine if they were made in accordance with clinical recommendations, the recipients and/or their guardians approved of these placements, and the length of these placements appeared reasonable. We reviewed WCLS's policies and procedures related to placement. We interviewed WCLS placement personnel.

To accomplish our fourth objective, we reviewed and evaluated WCLS's procedures for preventing, detecting, and eliminating conflicts of interest in vendor contracting. We obtained the articles of incorporation for selected WCLS vendors to identify any potential conflicts of interest. We reviewed selected employees' disclosure of interest forms.

Agency Responses

Our audit report contains 7 findings and 8 corresponding recommendations. WCLS's preliminary response indicated that it concurs with the findings and has taken steps to implement the recommendations.

The agency preliminary response which follows each recommendation in our audit report was taken from WCLS's written comments and oral discussion subsequent to our fieldwork.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

CONTRACT MANAGEMENT

COMMENT

Audit Objective: To assess the effectiveness of Wayne Community Living Services, Inc.'s (WCLS's) residential services contract administration process.

Conclusion: We concluded that WCLS's residential services contract administration process was generally effective. However, our assessment disclosed one material condition. WCLS did not have an effective budgeting process for funding residential services contracts.

Our assessment also disclosed reportable conditions related to contract management and program management funding.

FINDING

1. Budgeting

WCLS did not have an effective budgeting process for funding residential services contracts.

In fiscal year 1995-96, WCLS paid 64 residential services providers approximately \$80 million to deliver residential services in a total of 358 residential settings. WCLS funded these providers using a net cost or fee-for-service contract.

Residential services providers who are contracted on a net cost basis receive State and county funding based on their annual budget, less anticipated revenues from other sources. WCLS cost settled all expenditures, excluding administration, for these contracts.

Residential services providers who are contracted on a fee-for-service basis receive State and county funding based on a negotiated daily per diem rate equal

to their annual budgets less anticipated revenues, divided by budgeted days of occupancy. Generally, only staffing-related expenditures are cost settled.

Annual cost settlement allows WCLS to recover the amount of revenue received by providers that exceeds their expenditures. We reviewed selected residential services providers' budgets and noted:

- a. WCLS did not establish the budgets for the non-cost settled components of its fee-for-service contracts based on providers' recent expenditure history. Instead, WCLS generally established providers' budget for these items based on WCLS's estimates of the providers' expected costs. Accurate budgeting is essential to minimize the funding paid to providers in excess of their needs.
- b. WCLS did not use providers' current expenditure data to develop budgets for net cost contracts. Instead, WCLS established the budgets for its fiscal year 1994-95 through 1996-97 net cost contracts on the providers' fiscal year 1993-94 expenditure reports without verifying the accuracy of those reports. As a result, WCLS funded some residential services providers above its established budget limitations without determining the providers' need for this level of funding.

We reviewed the budgets of 10 homes funded on a net cost basis for fiscal years 1994-95 through 1996-97. In 4 instances, 1 or more budget components exceeded WCLS's established budget guidelines even though the residential services providers' expended substantially less than the budgeted amount for these homes in the preceding fiscal year. This inflated providers' administrative revenues and also tied up WCLS funds pending providers' payment of amounts due from cost settlement. For example, WCLS funded a residential services provider \$3,078 and \$18,038 to purchase activity materials and consumable supplies, respectively, in fiscal year 1995-96. This funding exceeded WCLS's budget guidelines for these items by \$2,558 and \$7,906, respectively, and the provider's fiscal year 1994-95 expenditures by \$3,012 and \$3,521, respectively. This inflated the provider's administrative revenue by \$1,002. In addition, because of the time required to

conduct the cost settlement and appeal, the provider had not begun repaying the amount it was overfunded for approximately two years after it received the funds.

DWCCMHA instructed WCLS to discontinue using net cost contracts in fiscal year 1997-98. As a result, WCLS's future residential services contracts (excluding staffing) are not subject to cost settlement. Consequently, it is important that residential services provider budgets closely reflect the providers' actual operating costs.

- c. WCLS did not sufficiently act to correct inflated home budgets disclosed in an independent review of 29 and 32 home budgets for fiscal years 1993-94 and 1994-95, respectively. The review concluded that WCLS contract managers authorized payments to providers that totaled \$450,000 above WCLS's budget guidelines without obtaining the approval of WCLS management. We examined the budgets for fiscal years 1995-96 and 1996-97 for 5 of the homes (3 funded on a fee-for-service basis and 2 funded on a net cost basis) included in the review:
 - (1) In fiscal years 1995-96 and 1996-97, WCLS funded 2 of the 3 homes contracted on a fee-for-service basis, above its established budget guidelines without obtaining required management approval. WCLS funded these homes \$5,762 and \$10,149, respectively, in each of fiscal years 1995-96 and 1996-97 for unspecified equipment. WCLS's budget development guidelines did not allow ongoing funding of equipment for homes funded on a fee-for-service basis. Instead, the guidelines required providers to submit special requests for specified equipment needs. WCLS paid administrative fees totaling \$1,484 over the last 3 fiscal years related to these equipment budgets.
 - (2) In fiscal years 1995-96 and 1996-97, WCLS funded 2 homes contracted on a net cost basis above its budget guidelines without documenting the need and management approval for this level of funding. For example, in fiscal year 1994-95, WCLS funded a provider a total of approximately \$58,000 more than specified by WCLS's budget guidelines for various items and \$42,800 more than the provider's actual expenditures for these

items. WCLS then funded this home at the same level in fiscal year 1995-96. This funding exceeded the home's actual fiscal year 1995-96 expenditures by approximately \$44,500. Pending cost settlement and appeal, this home's provider had not begun repayment of this overfunding as of October 21, 1997. WCLS paid the residential services provider approximately \$2,387 in administrative fees related to the \$44,500 in excessive funding.

In fiscal year 1996-97, WCLS funded the home cited in the preceding example at the home's fiscal year 1995-96 funding levels. However, effective March 28, 1997, WCLS assigned the home to another residential services provider and reduced the home's budget by approximately \$36,500. Notwithstanding this reduction, the home's budget for utilities, consumable supplies, and transportation continued to exceed WCLS's budget guidelines and also fiscal year 1995-96 actual expenditures by approximately \$9,800.

By strengthening its budgeting process, WCLS could reduce the operating cost of its residential program. WCLS could then use the savings to maintain and/or expand its residential services program. By expanding its residential services program, WCLS could provide services to some or all of the 68 individuals referred for placement from Southgate Center as of June 1998.

RECOMMENDATION

We recommend that WCLS improve its budgeting process for residential services contracts.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding and informed us that it has established policies and procedures to ensure cost effective budgeting based on historical cost and anticipated need, in keeping with both federal and State standards.

FINDING

2. Contract Management

WCLS's internal control structure over contract management was deficient regarding contract execution, cost settlement appeals, and State-owned equipment.

Because WCLS expends over \$80 million annually for residential services, sound controls are essential. Our review disclosed:

a. Executing Contracts

WCLS did not timely execute contracts for residential services for fiscal years 1996-97 and 1995-96. Contracts for these fiscal years were not executed until the respective fiscal years were over or nearly over. Also, WCLS did not timely execute contract addendums extending the terms of prior years contracts. WCLS did not execute the five fiscal year 1994-95 contract addendums that we reviewed until 4-6 months after fiscal year end.

The timely execution of contracts helps to ensure the protection of WCLS's recipient population and to safeguard the interests of the State.

b. Processing Cost Settlement Appeals

WCLS did not timely process at least 22 provider's appeals related to the fiscal year 1994-95 cost settlements that it completed for its 60 residential services providers. As of July 1, 1997, these 22 appeals, related to cost settlements completed between 7 and 15 months earlier, totaled approximately \$1 million.

Cost settlement, the reconciliation of provider revenue with provider costs, often results in providers owing WCLS for excess funding provided to them. WCLS policy prescribes a limit of approximately 60 business days to process provider's cost settlement appeals. WCLS partially attributed its delay in processing these appeals to personnel turnover.

The timely processing of cost settlement appeals helps to free resources needed to maintain existing and develop new mental health services.

c. Controlling State-Owned Equipment

WCLS did not maintain a comprehensive equipment inventory list that would allow it to account for equipment purchased by residential services providers with State funds.

DWCCMHA, in accordance with community mental health State financing guidelines, required WCLS to maintain an inventory of all equipment items purchased by its residential services providers that exceeded \$500. The State maintains an interest in this property proportionate to its share of funding, generally 90%.

RECOMMENDATION

We recommend that WCLS strengthen its internal control structure over contract management relative to contract execution, cost settlement appeals, and State-owned equipment.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding that contracts for residential services were not signed timely, but wishes to clarify that WCLS was directed by DWCCMHA not to enter into contracts until its own contract with DWCCMHA was executed. Also, since execution of this contract was not timely (and not under the control of WCLS), it was not possible for WCLS to execute its subcontractor agreements timely.

WCLS also concurs with the finding that it did not timely process cost settlement appeals. Significant turnover in the finance department of WCLS resulted in excessive processing delays. WCLS informed us that staffing has stabilized and procedures are now in place to assure timely processing of initial cost settlements and appeals.

In addition, WCLS concurs with the finding that it did not maintain a comprehensive list of equipment maintained by residential service providers. WCLS is currently in the process of compiling a comprehensive inventory list as required.

FINDING

3. Program Management Funding

WCLS supplemented the administrative compensation for some residential services providers, through program management funding, without substantiating the need for the supplement. In fiscal year 1995-96, this resulted in approximately \$1 million in supplemental administrative compensation for these residential services providers.

A WCLS residential services provider who cares for 30 or more recipients can receive \$2 per recipient day (\$4,380 annually for a six-bed residential setting) for program management in addition to the provider's administrative fee, which is equal to 9.9% of each residential setting's operating budget. However, the additional funding for program management does not increase a provider's responsibility to deliver program management. All residential services providers have this responsibility regardless of the number of recipients under their care.

WCLS required residential services providers to use the program management funds to employ one or more program managers for every 30 recipients they served. WCLS activated program management funding when a provider submitted a position description and the name(s) of its program managers.

In this audit, and in previous audits of residential services programs, we questioned the rationale for program management supplemental funding because the level of administrative responsibility per recipient is not increased when a residential services provider delivers services to 30 or more recipients. A WCLS residential services provider who cares for 30 recipients will receive an annual program management supplement of \$21,900 whereas a provider caring for 29 recipients will not receive any supplement.

The current administrative funding methodology of 9.9% of the operating budget, regardless of the number of residential settings a residential services provider operates, does not recognize and account for "economies of scale" efficiencies that providers with multiple residential settings should achieve. Under the economies of scale concept, a residential services provider's administrative cost per residential setting should proportionately decrease as the provider assumes

responsibility for additional settings. Instead, the program management supplement proportionately increases provider administration compensation as a provider assumes responsibility for more residential settings and recipients:

Provider	Number of Homes	Annual 9.9% Administrative Compensation	Annual Program Management Funding	Annual Provider Compensation		
				Total	Per Recipient	Per Home
A	1	\$ 24,750		\$ 24,750	\$4,125	\$24,750
B	2	\$ 49,500		\$ 49,500	\$4,125	\$24,750
C	3	\$ 74,250		\$ 74,250	\$4,125	\$24,750
D	4	\$ 99,000		\$ 99,000	\$4,125	\$24,750
E	5	\$123,750	\$21,900	\$145,650	\$4,855	\$29,130

Note: Residential settings (homes) are 6 bed settings with an operating budget of \$250,000 per setting.

RECOMMENDATION

We recommend that WCLS discontinue supplementing residential services providers' administrative compensation, through program management funding, without substantiating the need for the supplement.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding, but wishes to clarify that it followed State practice in supplementing administrative compensation through program management funding. However, we were informed that, effective October 1, 1997, WCLS no longer provides program management funding to its residential services providers.

HOME DEVELOPMENT

COMMENT

Background: WCLS develops licensed and nonlicensed homes to facilitate its mission of providing mental health services to individuals residing in the community. WCLS begins its home development process by identifying individuals requiring residential placement. After evaluating the needs of these individuals, WCLS staff work with local realtors to locate suitable home sites. Concurrently, WCLS staff identify and select a provider to deliver the residential services.

WCLS staff, recipients, and the selected residential services provider evaluate each potential home site. When a site is selected for development, WCLS selects an investor to purchase the property, contingent upon satisfactory inspection. WCLS enters into informal lease negotiations with the investor at this time. Given a satisfactory inspection and successful lease negotiations, the investor purchases the home. For licensed homes, WCLS executes a lease with the investor. For non-licensed homes, recipients and/or their guardians generally execute a lease with the investor.

After negotiating a lease, WCLS hires a contractor to prepare the specifications for the repairs and renovations needed to make the home suitable for recipients' use. Many recipients require wheelchairs to ambulate; therefore, some homes require renovations to make them barrier free. In addition, homes requiring licensure require features not generally available in the average home. For example, licensed homes require a smoke detection system on a dedicated circuit with a battery backup.

Audit Objective: To assess the effectiveness and efficiency of WCLS's home development and provider selection processes.

Conclusion: We concluded that WCLS's home development process was generally effective but not efficient. Our assessment disclosed one material condition. WCLS had not established sufficient control procedures to ensure the efficient purchase of home repairs and renovations. Our assessment also disclosed reportable conditions related to home development, home leasing, and Medicaid billing rates. We concluded that WCLS's provider selection process was effective and efficient.

FINDING

4. Home Repairs and Renovations

WCLS had not established sufficient control procedures to ensure the efficient purchase of home repairs and renovations.

During the period October 1, 1994 through August 19, 1997, WCLS expended approximately \$4 million to repair and renovate homes. Our review of 59 WCLS

expenditures, totaling approximately \$423,500, for repairs and renovations to 11 homes during this period disclosed:

- a. WCLS did not periodically advertise for contractors to bid on home repair and renovation projects. Instead, WCLS solicited bids for its major repair and renovation projects (excluding flooring) primarily from three contractors. From October 1, 1994 through August 19, 1997, WCLS paid these contractors approximately \$2.2 million for repairs and renovations. Periodically identifying additional contractors through advertisement is necessary for WCLS to ensure that it receives competitive pricing.
- b. Two of WCLS's primary contractors for major repair and renovation projects completed WCLS financed repairs and renovations on homes that they or a relative owned and leased to WCLS. Also, one of these two contractors prepared most of WCLS's bid specifications. We question whether these two contractors can be fair and objective in determining the extent of repairs and renovations needed and the related pricing when they have a proprietary interest in a home. For example, one of these contractors prepared the bid specifications for work on a home that he owned and leased to WCLS. WCLS then awarded him a contract for approximately \$18,200 to complete this work.

In the preceding example, we also noted that WCLS's independent appraiser factored the cost of some of the WCLS-financed repairs into the home's appraised value, which WCLS used in determining the annual rental payments for the property. As a result, WCLS paid for these repairs twice, once when the repairs were performed and again throughout the term of the lease.

- c. WCLS did not comply with its purchasing policy that requires at least 3 competitive bids for purchases exceeding \$2,000. Of the 20 repairs/renovations which exceeded \$2,000, 14 were not competitively bid. WCLS staff informed us that in some instances they did not obtain three bids because the work was completed on an emergency basis. However, in 13 of

the 14 instances, WCLS did not document an emergency condition or prepare a written justification for not obtaining at least 3 bids as required by WCLS policy. We also noted:

- (1) Three of the 13 repairs/renovations were for flooring related items (e.g., carpet and linoleum). In September 1996, WCLS solicited bids on a listing of frequently purchased flooring items (approximately \$500,000 was expended for these items during the period covered by our review) from 5 contractors. However, WCLS's bid request did not indicate its expected purchasing volume or its bid evaluation criteria. Of the 5 contractors, 3 had not conducted any business with WCLS during the period covered by our review. Thus, they had little or no basis for evaluating the potential business that WCLS represented to them. The three contractors did not respond to WCLS's bid solicitation.
 - (2) WCLS did not solicit competitive bids for preparation of repair/renovation bid specifications. WCLS utilized one contractor to prepare most of these bid specifications. Although the cost of preparing an individual bid specification was less than \$2,000 (the minimum amount when at least 3 competitive bids are required according to WCLS policy), during the period October 1, 1994 through September 30, 1997 WCLS paid the one contractor approximately \$60,000 for preparation of bid specifications. WCLS informed us that it used this contractor because of the contractor's construction expertise and ability to develop the needed specifications in a timely manner.
- d. WCLS did not require contractors to submit itemized bids. Itemized bids are helpful in evaluating the reasonableness of the bids, ensuring that contractors fully understand the scope of the work, and in establishing a basis for determining the appropriateness of change order credits.

We noted several instances in which WCLS deleted items included in original bid specifications subsequent to awarding a contract. In one instance, WCLS deleted approximately \$8,300 in work from the original bid specifications. However, neither we nor WCLS could ascertain whether the \$8,300 credit was reasonable. In another instance, WCLS requested a credit when it deleted a

whirlpool tub from the original bid specifications. However, the contractor refused to credit WCLS for this deletion, stating that it did not include the tub in its original bid. The tub was valued at approximately \$1,100. Also, we noted one instance in which a contractor requested an additional \$12,257 to complete a project that it originally agreed to complete for \$62,850. The contractor stated that it missed several items on the original specifications and misunderstood others when it submitted its original bid. WCLS honored the contractor's request for additional funds and increased the contract amount by \$12,049.

- e. WCLS did not seek competitive price quotes for repair and renovation projects costing less than \$2,000. WCLS's practice was to award these projects to the first contractor to submit a bid. One contractor often submitted a bid along with the related bid specifications which were prepared by the same contractor. The contractor awarded these projects had an advantage because WCLS primarily utilized this contractor to write bid specifications.

To ensure competitiveness in pricing, WCLS should periodically obtain multiple price quotes for projects costing less than \$2,000. For projects that WCLS does not obtain multiple price quotes, WCLS could document that it compared the bids to a construction pricing guidebook.

RECOMMENDATION

We recommend that WCLS establish sufficient control procedures to ensure the efficient purchase of home repairs and renovations.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding and informed us that it has implemented policies and procedures to ensure appropriate controls over the purchase of home repairs and renovations.

FINDING

5. Home Development

WCLS had not established sufficient control procedures to ensure proper home selection, limit its home development costs, plan its repair and renovation projects, and allow management to make informed decisions regarding the need for repair and renovation projects.

We reviewed WCLS's home development process for 16 of the 80 new homes opened during the period October 1, 1994 through September 30, 1997 and noted:

a. Home Selection

In all 16 of the home development projects that we reviewed, WCLS home developers failed to document their evaluation of homes considered for development or to obtain management approval to commence development.

In conjunction with a sound internal control structure, an evaluation of each home's suitability for its intended purpose is necessary for WCLS management to make informed decisions regarding program and financial issues related to home development.

b. Home Development Costs

WCLS did not attempt to limit its home development costs by soliciting individuals interested in leasing homes meeting its predetermined specifications. Also, the Center did not evaluate the cost effectiveness of funding major home repair and renovation projects that often increase the value of the home, versus requiring lessors to provide homes suitable for immediate placements. Instead of limiting its home development costs through these methods WCLS used realtors to locate homes for sale, arranged for investors to purchase desired homes, negotiated leases with home investors, and then renovated the homes to meet its specifications.

By leasing homes with features meeting its specifications, WCLS may be able to significantly reduce its home development time and related rental costs, which average 5 months and \$8,250, respectively. In addition, WCLS may be able to significantly reduce its initial repair and renovation costs. For example, WCLS expended approximately \$40,000 on renovations for a newly built

home that included various items, such as landscaping, decking, and additional paved parking.

When homes meeting its specifications are unavailable, WCLS's analysis of funding needed repairs and renovations should consider such things as the effect on the appraised value of the home, the funding available, and the estimated length of time that WCLS expects to lease the home.

c. Repair and Renovation Planning

WCLS home developers did not obtain or document that they obtained the input of recipients, their support team, and their residential services provider when planning the repairs and for renovations needed to open a new residential setting, as required by WCLS procedure.

In all 16 home development projects that we reviewed, WCLS's home developers maintained little or no documentation to show that they met with the required parties or that the required parties had appropriate input in the planning process. In one instance, a support team received the renovation specifications after the renovation contract was awarded and recommended changes that reduced the total project cost by approximately \$8,300.

d. Management Review of Home Repair and Renovation Documentation

WCLS did not sufficiently document the need for either all or part of 42 of the 59 repair and renovation projects that we reviewed. As a result, management could not have made informed decisions regarding the necessity and priority for completing the projects. For example, WCLS completed a project described as fire/safety, that included such things as interior painting, major bathroom renovations, and additional paved parking. Without the necessary documentation, we could not identify how these items related to fire/safety and, therefore, we could not evaluate the appropriateness of completing them. Also, documentation supporting the need for repair and renovation projects is useful in determining who should pay for the repairs and renovations.

Our review of 59 repair renovation projects disclosed numerous examples of individual project components that appear to have been the financial responsibility of the lessor. For example, WCLS paid an undeterminable

amount to contractors to replace a rotted deck and worn out carpeting, to secure a crumbling fireplace, and to repair sagging floors.

RECOMMENDATION

We recommend that WCLS establish sufficient control procedures to ensure proper home selection, limit its home development costs, plan its repair and renovation projects, and allow management to make informed decisions regarding the need for repair and renovation projects.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding. WCLS informed us that it has established policies and procedures designed to ensure proper home selection, limit home development costs, and appropriately plan repair and renovation projects with management approval.

FINDING

6. Home Leasing

WCLS demonstrated limited effectiveness in its home leasing process that related to selecting investors and obtaining management and guardian approvals.

In fiscal year 1995-96, WCLS expended approximately \$5 million to lease 358 homes for its Residential Services Program. WCLS's practice was to locate a home for sale, arrange for an investor to purchase the desired home, negotiate leases with home investors, and then renovate the home to meet its specifications. Our review disclosed deficiencies related to investor selection, management approvals, and guardian approvals:

a. Investor Selection

WCLS did not periodically advertise for home investors to participate in its Residential Services Program. Instead, WCLS relied primarily on repeat business with existing investors and located new investors through informal contacts. This process limited competition by not providing an opportunity for other interested investors to compete for WCLS leases.

b. Management Approvals

WCLS management did not review and approve the appropriateness of the lease terms negotiated by its home developers. Management review of lease terms is necessary to ensure, among other things, that lease payments are negotiated in accordance with WCLS's leasing guidelines.

We reviewed the annual lease payments negotiated by WCLS's home developers for 43 homes. In 2 instances the percentage of fair market value used in calculating the annual lease payment exceeded WCLS's guidelines. For example, WCLS guidelines limit the rent paid during the initial lease term (generally 5 years) and the first and second optional terms (generally 3 years each) to 12.0%, 13.0%, and 14.0% of the property's fair market value, respectively. The actual lease terms for the two leases were for 10.9%, 11.9%, and 14.7% for one lease and 13.0, 13.0%, and 13.0% for the other lease, respectively. This will result in increased rent payments totaling approximately \$10,000 over the life of these leases.

c. Guardian Approvals

WCLS arranged for recipients to execute long-term (11 years) home leases without including the recipients' guardians in the lease execution process.

We reviewed 8 lease files and noted 2 instances in which recipients' guardians did not sign the home leases. In addition, we could not determine if the guardians signed three other leases because WCLS did not maintain a copy of the leases.

WCLS negotiated leases with investors on behalf of its recipients for some nonlicensed residential settings. WCLS's recipients or their guardians, if applicable, were then responsible for executing these leases with the home investors. Because guardians by definition are legally responsible for the care and management of persons incompetent to manage their own affairs, it is incumbent upon WCLS to ensure that guardians sign the leases.

In addition, we question the enforceability of these leases without guardian approval. WCLS often spends thousands of dollars repairing and renovating

these homes for recipients' use. It is imperative that WCLS protect recipient's legal right to use these properties over the entire lease term.

RECOMMENDATION

We recommend that WCLS improve the effectiveness of its home leasing process that relates to selecting investors and obtaining management and guardian approvals.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding and informed us that it has established policies and procedures to ensure appropriate controls over vendor selection and management and guardian approvals.

FINDING

7. Medicaid Billing Rates

WCLS did not calculate and bill Medicaid for the actual cost to deliver covered services in fiscal year 1994-95. In addition, WCLS did not document the methodology it used to calculate its fiscal year 1995-96 and 1996-97 Medicaid billing rates.

In fiscal years 1995-96 and 1994-95, WCLS received approximately \$50 million and \$48 million, respectively, in Medicaid reimbursement that was related to residential services. Most of the funds were obtained through the Medicaid Habilitation Supports Waiver Program. To participate in this program, Medicaid required service providers to calculate, document, and bill it for their actual cost to deliver covered services.

WCLS management informed us that in fiscal year 1994-95, WCLS billed the Medicaid Habilitation Supports Waiver program at the program's maximum reimbursement rates. Also, WCLS management informed us that in fiscal year 1995-96 and 1996-97 WCLS calculated and billed Medicaid for WCLS's actual cost to deliver Medicaid covered services. However, WCLS could not locate documentation to support its rate calculations. Therefore, we could not substantiate the appropriateness of WCLS's Medicaid billings.

Failure to calculate, document, and bill Medicaid for the actual cost to provide covered services could jeopardize the continued Medicaid eligibility of WCLS's programs.

RECOMMENDATIONS

We recommend that WCLS calculate and bill Medicaid for its actual cost to deliver covered services.

We also recommend that WCLS document its methodology used to calculate Medicaid billing rates.

AGENCY PRELIMINARY RESPONSE

WCLS concurs with the finding and informed us that it has established policies and procedures for rate development in keeping with Medicaid guidelines.

RESIDENTIAL PLACEMENT

COMMENT

Audit Objective: To assess the effectiveness of WCLS's recipient residential placement practices.

Conclusion: We concluded that WCLS's recipient residential placement practices were generally effective.

PURCHASE AND DELIVERY OF RESIDENTIAL SERVICES

COMMENT

Audit Objective: To assess whether State funds were used effectively and efficiently in the purchase and delivery of residential services.

Conclusion: We concluded that WCLS generally used State funds effectively and efficiently when purchasing and delivering residential services.

Noteworthy Accomplishments: WCLS was selected as 1 of 3 sites in Michigan to receive a grant from the Robert Wood Johnson Foundation to participate in a demonstration project on Self-Determination. This project is intended to increase recipient satisfaction rates and outcome levels while simultaneously reducing costs.

Glossary of Acronyms and Terms

clinical support services	Mental health services that include case management; physical, speech, and occupational therapy; and nursing, psychological, and psychiatric services.
day program services	A program that provides planned and systematic sequences of training and therapy tailored to the recipient's needs, which are delivered in a setting other than residential or inpatient and with frequency and duration that will improve the recipient's functioning in the community.
DCH	Department of Community Health.
developmental disabilities	Disabilities that become evident in childhood; are expected to continue indefinitely; constitute a substantial handicap to the affected individual; and are attributed to mental retardation, cerebral palsy, epilepsy, or other neurological conditions.
DWCCMHA	Detroit-Wayne County Community Mental Health Agency.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
housing development services	The establishment of residential settings for the placement of recipients, which includes homes, condominiums, and apartments, for the placement of recipients.
material condition	A serious reportable condition which could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the opinion of an interested person concerning the effectiveness and efficiency of the program.

mission	The agency's main purpose or the reason the agency was established.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
recipients	Individuals receiving mental health services.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
residential services	Services provided in residential settings which may include room and board, 24-hour supervision and protection, and specialized mental health services in-home or out-of-home. These services are designed to enhance the health, welfare, and development of a recipient with developmental disabilities or mental illness.
Self-Determination	A new method of organizing and delivering support to individuals with developmental disabilities that emphasizes recipient freedom, authority, support, and responsibility.
Supplemental Security Income	Payments authorized under Title XVI of the Social Security Act to persons who have attained age 65 or who are blind or disabled.
WCLS	Wayne Community Living Services, Inc. (a service provider).