



**New Jersey State Legislature
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**Department of Human Services
Division of Family Development
Child Day Care Contract Administration**

July 1, 2001 to August 22, 2003

**Richard L. Fair
State Auditor**

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Enclosed is our report on the audit of the Department of Human Services, Division of Family Development, Child Day Care Contract Administration for the period July 1, 2001 to August 22, 2003. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair
State Auditor

January 9, 2004

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**Department of Human Services
Division of Family Development
Child Day Care Contract Administration**

Scope

We have completed an audit of the Department of Human Services, Division of Family Development for the period July 1, 2001 to August 22, 2003. The scope of this audit was limited to child day care contract administration. The child care expenditures during our audit period were approximately \$664 million and are accounted for in the state's General Fund.

Objectives

The objectives of our audit were to determine whether expenditure transactions were related to the program, were reasonable, and were recorded properly in the accounting systems.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of expenditure transactions. We also read the budget message, reviewed financial trends, and interviewed agency personnel to obtain an understanding of the program and the internal controls.

A nonstatistical sampling approach was used. Our samples of the expenditure transactions were designed to provide conclusions about the validity of

transactions as well as internal control and compliance attributes. Sample populations were sorted and transactions were judgmentally selected for testing.

Conclusions

We found that the expenditure transactions included in our testing were related to the program, were reasonable, and were recorded properly in the accounting systems. In making this determination, we noted certain internal control weaknesses and matters of compliance with laws and regulations meriting management's attention.

Background

The division administers approximately 460 child day care contracts, which include Unified Child Care Agencies (UCCA), Center Based Care (CBC) providers, and Abbott school district providers. The UCCAs are contract providers who serve recipient clients with counseling and referral services for their child day care needs. The CBCs are direct contract child care centers who provide day care services. The division also contracts with day care providers who are located in the Abbott school districts.

Unified Child Care Agency Contract Monitoring

The division contracts with Unified Child Care Agencies to administer the child care programs in each of the 21 counties. During our audit period, the division expended \$466 million for these contracts. Our review of the division's closeout process for these contracts disclosed the following:

Final expenditure reports were not submitted in a timely manner.

Contracts were not closed out timely.

Final quarterly payments were not adjusted.

- In accordance with the contract terms, final UCCA expenditure reports are due 120 days following the end of the contract period. The final reports for the contracts ending September 30, 2002 were due January 31, 2003. Eighteen of the 21 UCCAs had not submitted their final expenditure reports as of the due date and as a result, the closeout process was delayed.
- The Unified Child Care Service Delivery System - Fiscal Manual states contract closeout should occur as promptly as is feasible after the end of the contract period. The 1998, 1999, 2000, and 2001 UCCA contracts were not closed out until April 2003 and resulted in the division requesting \$11.8 million in net overpayments from 13 UCCAs in April 2003. The division had collected \$998,000 as of August 22, 2003.
- UCCAs receive equal quarterly advances. The division does not adjust the final quarterly payment based on actual expenditure for the first three quarters and projected fourth quarter expenditures. Such action could avoid overpayments.

Recommendation

We recommend that the division enforce the final reporting date deadline to facilitate the closeout process. We also recommend that the division analyze expenditures before the final payment and UCCAs that have not spent a certain percentage of

the funds advanced to them should have their final payment adjusted.

Auditee's Response

The Department concurs that the Unified Child Care Agencies (UCCAs) are having difficulty in meeting the reporting deadline for the final Report of Expenditures (ROE). The Division of Family Development (DFD) issued an instruction to the UCCAs on December 18, 2002 to remind the agencies of the Department contract close out procedures for the contracts that ended September 30, 2002. A similar letter was issued on December 9, 2003 relative to the contracts that ended September 30, 2003. The Division continues to stress to the UCCAs the importance of the timely submission of all expenditure reports, especially the final ROE. We anticipate that the UCCA's will meet the reporting timeframes for final expenditure reports for the 2003 contract period.

For contracts that ended September 30, 2002, final close out letters were issued by the Division of Family Development subsequent to receipt of the respective agency's final expenditure report. As of December 19, 2003 16 of the 21 UCCA's have returned funds owed. The delinquent UCCAs were sent follow-up letters in October 2003 stating that if funds were not returned, recoupment would occur by deducting the amount owed from January 2004 contract advances.

Regarding the adjustment of final advances, the UCCAs were formally advised in a June 2003 instruction that payments for the quarter beginning July 1, 2003 will be adjusted for each UCCA based on a comparison of funds advanced to date to actual and projected expenditures. This reconciliation process to reduce the amount of advance payments to the UCCA's has been fully implemented by the Division of Family Development.

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Emergency Payments

The division should develop and enforce procedures for emergency payments.

The division makes payments to Center Based Care providers for emergency repairs or purchases. During our audit period, the division made 14 emergency payments totaling \$148,000 to 11 centers. The division has no formal written procedures concerning the review, approval, and monitoring of these payments. Our review of emergency payments disclosed:

- The division does not verify that all emergency funds requested were spent. As a result, three centers were able to underspend \$6,000 of their requested funds without returning the unused funds to the division.
- The division does not verify the urgency of the request. As a result, emergency expenditures totaling \$29,300 were incurred by five centers from three to nine months following the division's payment. We further noted two emergencies totaling \$4,300 were not completely addressed nine months after the receipt of the division's funds.
- Due to an oversight by the division, a provider received \$22,750 for an emergency, even though the request was only for \$2,561. The provider did not return the \$20,189 overpayment. The division was unaware of the overpayment until it was disclosed by the audit and the division subsequently recovered the overpayment.

Recommendation

We recommend that the division develop formal written procedures for emergency payments that:

- Require providers submit invoices supporting their emergency payments and return any unused funds.

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- Verify the need for the emergency payment with a visit to the provider's facility.
 - Require a follow-up visit to verify that the work was completed or the goods were received in a timely manner following the receipt of the emergency funds.

Auditee's Response

The Division has implemented a revised instructional policy for Emergency Payments for Center Based Care Child care centers (CBC) effective July 1, 2003. The revised policy requires submission of documents by the CBCs as part of the application process, including licensing reports or citations from local fire or construction officials outlining the need for repairs. Other resources, such as insurance, must be explored first. If documentation from a third party is available to verify the emergency (e.g., a copy of a citation from the Fire Marshall), such field visits will not be necessary. All work must be completed within 60 days and receipts and unexpended funds must be submitted to the Division. Site visits will be performed by DFD staff to verify the work was completed. In addition, the Division is closing out or has closed out all previously approved emergency payments.



Waiver of Overpayments

At the conclusion of the annual contract period, Center Based Care (CBC) providers are required to submit their final level of service reports. These final level of service reports serve as the basis for determining whether the providers earned the monies received during the contract period. The provider is required to refund any unearned payment should their level of service drop below 80 percent.

The division should develop procedures for authorizing and maintaining control over waivers.

The following table is based on a reconstruction of the division's records as of the close of our field work.

Contract Year	Total Overpayment	Amount Recovered	Amount Unrecovered/Waived
1999	\$ 1,288,000	\$ 558,000	\$ 730,000
2000	2,995,000	1,681,000	1,314,000
2001	2,994,000	1,119,000	1,875,000
Totals	\$ 7,277,000	\$ 3,358,000	\$ 3,919,000

Amounts owed can be completely or partially waived by the Contract Administration Unit. The authority to approve waivers rests with one individual without further review. The division does not have written procedures authorizing the processing and/or approval of waivers. In addition, the division does not have adequate accounting records and reports that would enable management to monitor the waivers authorized and the reasons supporting the waivers. As a result, we could not identify how much of the \$3.9 million has been waived.

Recommendation

We recommend that the division:

- Develop written policies and procedures for waivers that included documenting and maintaining the calculation and the justification for the waiver.
- Add an additional level of approval for waivers.
- Identify and recover all current overpayments not waived.

Auditees Response

The Department has not yet been informed how the auditors determined the alleged unrecovered/waivered amount of \$3.9 million was calculated. Assuming this is an accurate amount, it

represents 0.6% of the \$668 million in payments to child care agencies during the stated audit period. However, since the \$3.9 million amount refers to payments since 1999, it represents 0.3% of the payments to child care agencies of \$1.4 billion over this period.

While the Division is very diligent concerning holding contracted agencies to a performance standard for level of service, we also recognize the legitimacy of statements by providers concerning situations beyond their control. This is particularly important as their fixed costs remain the same regardless of their level of performance. It should also be mentioned that the Abbott wraparound child care centers must rely on the respective school districts for sufficient referrals to fill their Abbott classrooms. This dependency further emphasized the necessity for the centers to have dependable sources for revenue in order for them to meet their financial obligations.

The Division has taken the following internal actions on agency waiver or overpayments:

- A revised Child Care Closeout Policy was promulgated by the Division. Included in the policy is the internal procedure and criteria for any consideration of waiving (reducing) the 80% Level of Service (LOS) requirement.
- The Director of the Division of Family Development will make the final decision regarding a request for waivers.
- Contracts are closed out on a consistent and timely schedule, with recoveries made for any overpayments. This is accomplished through

submission of checks from providers or contract payments reductions. Reports are now routinely prepared to Division management that identify the providers, contract overpayment and current recoupment amounts.

Summary reports are also provided to the Department each month.



Contract File Maintenance

Contract files should be maintained.

Contract files should be maintained for management to have information that is readily available to be used in their decision making process. A file should be maintained for each provider and contract year.

At a minimum, the file should contain the original signed contract, quarterly level of service reports, waiver documentation and other correspondence between the division and the provider. These items are necessary to document and measure the providers' performance. We tested 185 provider files for contract year 2001 and found 115 to be lacking level of service documentation.

Disposal of confidential information should be discontinued.

The Contract Administration Unit disposed of original contracts for the Center Based Care providers and ten provider contract files could not be found for audit review. In addition, recently received attendance reports and level of service reports were found by the auditors in a recycling bin for disposal on June 16, 2003. These attendance reports included confidential information, such as the parent's and child's name and their social security numbers, which could be subject to unauthorized use.

N.J.S.A. 47:3-17 states that no person shall destroy, sell or otherwise dispose of any public records without first having advised and obtained the consent of the Division of Records Management in the Department of State. The Division of Family Development's Contract Administration Unit did not establish a retention schedule nor advise the Division of Records Management of their intent to dispose of public records.

Recommendation

We recommend that the division's Contract Administration Unit maintain a complete contract file

for each provider and each contract year. Public records should be disposed of in accordance with N.J.S.A. 47:3-17.

Auditees Response

All contract material is now kept in a single file, with report information maintained in the CATS (Contract Administration Tracking System). All obsolete or duplicate reports are disposed of in the recycling bins where material are routinely shredded by a State contracted vendor. All officials records are maintained on a records retention schedule.



Segregation of Duties

Incompatible duties should be segregated.

The purpose of a system of internal control is to provide adequate checks and balances that ensure financial transactions are properly authorized and recorded, and to provide a means to safeguard the assets of the entity. In order for such a system to be effective, more than one person should be involved in carrying out various duties related to a specific operation. The failure to utilize more than one person increases the risk of unauthorized transactions, improper recordkeeping and the misappropriation of resources.

Our review of the child day care contracts noted a lack of segregation of duties between the request for recovery of contract overpayments and the receipt of these recoveries. We found that the same individual responsible for requesting the return of overpayments is also receiving the checks before they are recorded in the mail log.

Recommendation

We recommend that the division strengthen its internal controls by segregating the duties of individuals requesting and receiving checks.

Auditees Response

Instruction issued by the Division on October 1, 2003 requires close out letters to providers to indicate that overpayment checks are to be mailed directly to the Division's Accounting Unit and not the unit requesting payment.

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