

**Department of
Education:
Has Not Spent
Millions for Child Care
and Development
Services**

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***California State
Auditor's
Comments
on the Response
by the
California
Department of
Education***

Summary

✔ *Could neither tell us
Audit Highlights ...
services nor the
The department children
currently receiving
child care.*

✔ *Is not maximizing
delivery of child care
and development
services.*

✔ *Has not spent more
than \$84 million in
federal and state child
care funds.*

✔ *Did not ensure that its
process to review and
score applications is
free of potential bias.*

✔ *Did not consistently
handle appeals of
contract awards or
adverse actions.*

The California Department of Education (department) is responsible for administering both federal- and state-subsidized child care and development programs. To carry out this responsibility, the department contracts with various public and local agencies that in turn provide child care and development services to eligible families in California. Our review focused on the department's administration of child care and development program funds, its contracting policies and procedures, and the oversight of child care contractors during fiscal years 1991-92 through 1993-94. Specifically, we noted the following key concerns:

- The department could not tell us the demand for services offered by the child care and development programs it funded during fiscal years 1991-92 through 1993-94. Furthermore, the department could not tell us the actual number of children currently served by its programs. However, in July 1995, the department estimated that it served approximately 130,000 to 140,000 eligible children during each fiscal year from 1991-92 through 1993-94. Additionally, in April 1995, the department reported to the Legislature that California provides subsidized child care and development services to less than 20 percent of eligible low-income families.
- The department did not maximize the delivery of child care and development services because millions of dollars in state and federal funds remain unspent. For example, contractors providing child care and development services did not spend \$84.7 million that the department had allocated to them.

In addition, the department did not allocate all of the Federal Child Care and Development Block Grant (FBG) funds it received. In April 1995, the department estimated that, as of June 30, 1995, \$70 million of the FBG would remain available for allocation; however, this estimate does not include an additional \$28.6 million. Furthermore, the department's plan to spend the funds is flawed. Specifically, the plan calls for increasing funding allocations to existing contractors but fails to specify how these contractors will use the increased allocations. And finally, the plan does not

address the need to identify additional contractors that could provide child care and development services.

- Two department practices for reviewing and scoring applications increased the risk that biased scoring decisions were made.
- The department did not consistently process appeals of contract awards. It also did not consistently recommend adverse actions against contractors that submitted late audit reports. As a result, the department gave the impression that some contractors received special or preferential treatment.
- The department's process for reviewing annual audit reports submitted by contractors was deficient. Specifically, reviews of some audit reports were late, and other reviews were inadequate.

Recommendations

To maximize the provision of child care and development services, the department should take the following steps:

- Determine the level of unmet need for each child care and development program that it administers and the level of unmet need in each county;
- Periodically compare the allocations it provided to contractors with the amounts they actually spent to identify those not spending all of their allocations; and
- Identify options and implement solutions to assist the contractors so that they can provide more child care and development services to eligible families who need them.

Further, if the department identifies contractors whose allocations exceed need, it should identify other contractors that can use the excess funds to provide services to eligible families. If necessary, the department should issue a request for applications to identify additional contractors that wish to provide child care and development services.

To ensure that it consistently processes appeals of contract awards, the department should take the following steps:

- Develop written guidelines for use when considering whether an appeal issue should proceed to a hearing;
- Follow its procedures for hearing appeals of contract awards; and
- Develop and implement a system to track appeals of contract awards.

To improve its process for monitoring contractors, the department should ensure that the Office of External Audits assigns sufficient staff to review all the submitted audit reports between November and February of each fiscal year. In addition, the department should consistently recommend adverse actions against contractors who submit late audit reports.

Agency Comments

In its response to our audit report, the department stated that it did not agree with some of our findings, conclusions, and recommendations. For example, the department does not concur with our finding that its three-year plan is flawed, does not concur with our conclusion that it did not maximize its efforts to provide child care and development services, and does not plan to identify additional contractors. However, the department stated that it agreed with other findings, conclusions, and recommendations. For example, the department agreed that the risk of bias would have been reduced had application readers not been the assigned consultant for the county, that it was a good idea to include appeal provisions in requests for applications, and that it should periodically evaluate contractors' performance by reviewing their spending patterns.

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Introduction

With the enactment of the Child Care and Development Services Act in 1980, the California government recognized the need for the State to subsidize the provision of child care and development programs to families meeting certain eligibility requirements. The Child Development Division (division) within the California Department of Education (department) administers these programs. The programs are designed to assist families in becoming self-sufficient by providing a safe environment for the children of parents who work or receive training; enhance the physical, emotional, and developmental growth of children; and refer families in need of medical or family support services to the appropriate agencies. For fiscal years 1991-92 through 1993-94, the Legislature appropriated more than \$1.2 billion from the General Fund to the department for the provision of child care and development services.

Also recognizing the need to subsidize the provision of child care and development services, the federal government enacted the Omnibus Budget Reconciliation Act of 1990, which established the Federal Child Care and Development Block Grant (FBG). The purpose of the FBG is to increase the availability, affordability, and quality of child care. The federal government allocates FBG funds to states to provide financial assistance to low-income working families to help them find and afford good-quality child care services for their children. It also provides funds to the states to enhance the quality and increase the supply of child care services available to all parents. From the inception of the FBG in September 1991 through September 1994, the federal government allocated \$369 million to the department for the provision of child care and development services.

Scope and Methodology

The purpose of this audit was to evaluate the department's administration of child care and development program funds, its contracting policies and procedures, and its oversight of child care contractors during fiscal years 1991-92 through 1993-94.

To review the department's appropriations, federal allocations, and its budgeted and actual expenditures for fiscal years 1991-92 through 1993-94, we determined the amount of appropriations from the State's General Fund and FBG allocations from the federal government to the department. We also determined the amount that the department spent from these appropriations and allocations. Further, we identified the total amount of unspent funds and the sources of those unspent funds. Moreover, we determined whether the department submitted the reports required by the annual budget acts for fiscal years 1992-93 through 1994-95 concerning the amount of unspent moneys from the State's General Fund.

To review and assess the division's policies and procedures for awarding child care and development contracts and allocating funds to those contracts, we identified the number and dollar amount of contracts that the division issued for the provision of child care and development services. Moreover, we identified the methods that the division used to issue its contracts and whether the division awarded contracts in compliance with applicable laws and regulations. Additionally, we determined whether the division's practices for awarding contracts resulted in fair and open competition and limited, to the extent possible, subjective decisions by department personnel.

To review and assess the division's appeals process for contract awards, we attempted to establish the number and disposition of the appeals filed challenging contract awards issued during fiscal years 1991-92 through 1993-94. However, because the division did not maintain complete records, the information we report is limited to what we were able to verify through a review of existing records.

To further assess the appeals process, we determined whether the division's practices for resolving appeals of contract awards were in compliance with applicable laws and regulations. We also examined the division's appeals practices to determine whether they resulted in a fair and objective assessment of the applicant's appeal and whether the process limited, to the extent possible, subjective decisions by department personnel.

To review and assess the department's oversight function relative to child development programs, we identified applicable policies and procedures. We also identified how the department selected which contractors to review and determined whether the department followed up on identified deficiencies in an unbiased manner. In addition, we identified the organizations responsible for reviewing the audit reports submitted by contractors. We

focused our review on those audit reports submitted by privately operated contractors.¹ For these audit reports, we determined the total number of reports submitted, whether the department's Office of External Audits completed its reviews of the reports promptly, and whether the department acted on identified issues of noncompliance.

To review and assess the division's process for responding to appeals of adverse actions it took against contractors, we documented the number and disposition of appeals filed by contractors during fiscal years 1991-92 through 1993-94. We also determined whether the division consistently applied its appeal policies and procedures.

To complete our review, we determined whether the department submitted reports required by the annual budget acts to the Legislature promptly and whether these reports were accurate. We also reviewed an October 1992 report issued from a hearing of the Senate Select Committee on Infant and Child Care and Development concerning the department's implementation of the FBG. Those who testified at the hearing identified several concerns, one of which related to the issues within the scope of our audit. We address this concern in Chapter 2 of our report.

Appendix A describes the child care and development programs administered by the division during fiscal years 1991-92 through 1993-94. In Appendix B, we present information regarding practices the department used to administer child care and development programs in which we found no material problems.

¹ We did not review audit reports submitted by school districts or county superintendents of schools because they are submitted to the State Controller's Office, nor did we review the relatively small number of audit reports submitted by community colleges to the department's Education Finance Division.

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Chapter 1

The California Department of Education Can Do More To Maximize the Delivery of Child Care and Development Services

Chapter Summary

In our review of the California Department of Education's (department) use of state and federal funds for the provision of child care and development services during fiscal years 1991-92 through 1993-94, we observed two conditions that demonstrate that the department did not maximize the delivery of these services. First, contractors did not spend almost \$84.7 million that the department allocated to them to provide services. Some contractors did not spend all their funds because they perceived state rules and regulations as impediments to their providing services, while others stated that they met identified need with less funds than the department allocated to them. In addition, some contractors did not use the funds because they either received contracts too late in the fiscal year or they received late notification of increased funding.

Second, the department did not allocate all of the Federal Child Care and Development Block Grant (FBG) funds it received. In April 1995, the department submitted a revised three-year plan to the Legislature regarding the status of its FBG funds. In this plan, the department estimated that, as of June 30, 1995, \$70 million of the FBG would remain available for allocation. However, the department did not include an additional \$28.6 million in its estimate. Furthermore, the plan to spend the funds is flawed. The department stated that it intends to increase the amount it allocates to existing contractors; however, it does not specify how these contractors are going to provide additional services with these funds. Moreover, the department's plan does not address the need to identify more contractors that could provide additional child care and development services.

Because the department has not maximized its efforts to provide child care and development services, it is not meeting the needs of more low-income families. In addition, when funds remain unspent

for long periods of time, the department risks losing its authority to use those funds because it may be required to return them to their original source.

Demands for Services Are Significant

Child care and development programs offer services to children and their families for a variety of purposes, including supporting family self-sufficiency; enabling parents to complete education or training programs; reducing the threat of abuse, neglect, or exploitation of children; and providing comprehensive developmental services to children. As with all public programs, resources to support child care and development programs are limited, and accurate information about the characteristics and location of the population eligible for services is needed to ensure that these resources are used properly.

—◆—
Less than 20 percent of eligible low-income families receive services.
—◆—

The department could not tell us the actual demand for services offered by the child care and development programs it funded during fiscal years 1991-92 through 1993-94. Furthermore, the department could not tell us the actual number of children served by its programs. However, in July 1995, the department estimated that it served approximately 130,000 to 140,000 eligible children during fiscal years 1991-92 through 1993-94. Furthermore, in April 1995, the department reported to the Legislature that California provides subsidized child care and development services to less than 20 percent of eligible low-income families. The department further stated that there remains a tremendous unmet need for such services, especially for infants, toddlers, and school-age children.

Contractors Are Not Spending All Their Allocations

—◆—
\$84.7 million of funds allocated to contractors left unspent.
—◆—

During our review of expenditures for the various child care and development programs, we noted that contractors did not spend all the funds that the Child Development Division (division) had allocated to them. As Table 1 shows, during fiscal years 1991-92 through 1993-94, contractors left unspent \$84.7 million. We determined that nearly \$61 million (72 percent) of the unspent funds related to four programs: State Preschool, Child Care Services, Early Childhood Education/Before-and-After-School Care, and Resource and Referral. The State Preschool program was funded with appropriations from the State's General Fund, whereas the remaining three programs were supported with federal funds.

Table 1

**Amount of Funds
Contractors Did Not Spend
Fiscal Years 1991-92 Through 1993-94**

	Fiscal Year 1991-92	Fiscal Year 1992-93	Fiscal Year 1993-94	Total
Federal Block Grant	\$ 2,823,193	\$22,590,451	\$12,383,464	\$37,797,108
State General Fund	10,017,849	15,646,449	21,265,242	46,929,540
Total	\$12,841,042	\$38,236,900	\$33,648,706	\$84,726,648

Contractors that provided services through these four programs spent less than 95 percent of the funds allocated to them. For example, contractors that provided services through the State Preschool program spent only \$203 million (90 percent) of the \$226 million allocated to them during fiscal years 1991-92 through 1993-94. Similarly, contractors that provided services through the Child Care Services program spent only \$97.6 million (75 percent) of the \$130 million allocated to them.

**Reasons Contractors Did Not
Spend All Funds Allocated to Them**

◆
*Contractors perceive state
rules and regulations as
impediments to providing
services.*

We identified two principal reasons why contractors did not spend all the funds the division allocated to them. First, some contractors perceived state rules and regulations as impediments to their ability to provide more services. We contacted five State Preschool contractors to ascertain why they had not spent all the funds allocated to them. Three contractors told us that meeting the licensing requirements was either cumbersome, difficult, or expensive. One of these contractors stated that, to meet additional licensing requirements, she needed to add a capital improvement, but staff of the division told her that she could not use grant funds to add it. Four contractors also told us that the rates that the department paid them were too low. As a result, the program is subsidized with funds from other areas. When the funds from other areas are low, they have to limit the number of children in the program even though they may not have spent all their allocations.

Two contractors mentioned that department rules prohibited them from admitting children from different income levels into the program.



Some contractors received more funds than they needed.



The second reason why contractors did not spend all the allocated funds is that the division allocated more funds than necessary to some contractors. Section 8289 of the Education Code requires the department to develop a formula that it can use to allocate increases in child development funds to each of California's 58 counties. This section also states that, to develop this formula, it should use indirect indicators of the need for child care (e.g., the number of children aged zero to five receiving Aid to Families with Dependent Children in the county). The intent of Section 8289 is to promote equal access to child development services throughout the State. The department calculates the amount of funds to allocate to each county, then the division allocates those funds to contractors within that county.

Generally, the division renews contracts from one fiscal year to the next and allocates the same amount of funds to each contractor regardless of whether the funds from the previous year have been exhausted. If additional funds are available, the department will again apply the formula to determine how much it will allocate to each county, and then the division apportions the additional amounts to contractors in the county, regardless of whether the contractors need the funds.



Other contractors were issued their contracts or notified of funding increases too late to implement.




We asked ten Child Care Services contractors that spent less than 95 percent of the funds the division allocated to them why they did not spend all their allocations. Six of the ten contractors cited either late issuance of contracts or late notification of funding increases as the reason why they were not spending more of their allocations. Two contractors told us that they were meeting identified need with less than their full allocations. During fiscal years 1991-92 through 1993-94, these two contractors used only \$1.2 million (63 percent) of the \$1.9 million the division had allocated to them. Rather than reduce the allocations to these contractors for fiscal year 1994-95, the division increased the allocations by \$201,000 (17 percent). Moreover, the department was aware that one contractor was able to meet identified need without using the entire allocation of funds in fiscal year 1993-94.

Department's Plan To Use Unallocated Child Care and Development Block Grant Funds Is Flawed

From the inception of the FBG in September 1991, through September 1994, the federal government awarded four grants to the department totaling \$369 million. Delays in issuing FBG contracts during fiscal year 1991-92, lower than expected costs for resolving a court case, and inaccurate estimates of the amount of funds that contractors would spend all resulted in the department having more federal funds available than expected. Because of concerns regarding the department's plan to use the unallocated federal funds, the Legislative Analyst recommended in its "*Analysis of the 1995-96 Budget Bill*" that the department submit a revised three-year expenditure plan for the FBG to the Legislature in April 1995. The Legislative Analyst further recommended that the revised plan include the department's proposal for spending the unallocated federal funds in conjunction with the amount of funding expected to be available during the next two years.

In this plan, the department estimated that as of June 30, 1995, it would have \$70 million of unallocated federal funds available. The department described how it intends to spend these funds during fiscal years 1995-96 and 1996-97. We reviewed the plan and found it to be flawed. First, after reviewing supporting documentation for the department's estimate of \$70 million in unallocated funds, we concluded that the department should have reported that it planned to spend \$98.6 million. We determined that the estimate did not include approximately \$28.6 million in additional federal funds. This amount is mainly comprised of \$25.5 million (25 percent) from the \$102 million grant that the department received in September 1994. Apparently, the department excluded the \$25.5 million from its plan because it has earmarked these funds for use from July through September 1995.² However, we believe that the department should have included the \$25.5 million amount in the three-year plan because those funds are available for expenditure during fiscal years 1995-96 and 1996-97. The other \$3.1 million is abatements. Abatements are reimbursements that the department receives from contractors for disallowed costs.


Department's plan to spend \$70 million in unallocated funds is flawed.

² According to the department, when it receives an FBG award in September, it earmarks one-fourth of the award to be used in the first quarter of the following state fiscal year.

Second, the department's plan does not adequately address how it will use these funds. For example, of its \$70 million estimate of unallocated funds, the department stated that it intends to use \$58 million (83 percent) to increase the level of funding for contractors in fiscal years 1995-96 and 1996-97 and \$5 million (7 percent) for a data automation project. However, the department did not specify how it was going to use the remaining \$7 million (10 percent). Although the department stated that it intends to allocate \$58 million to existing contractors, it did not specify how these contractors were going to be able to provide additional services using the increases in their allocations. As previously discussed, contractors have not spent \$84.7 million of the funds that the division allocated to them for fiscal years 1991-92 through 1993-94. The plan did not address the need to identify more contractors who could provide additional child care and development services.

Impact of Not Spending

Because the department has not maximized its efforts to provide child care and development services, the needs of more low-income families are not being met. In addition, when funds remain unspent too long, the department loses the opportunity to use those funds to provide services. Generally, the department has one fiscal year to encumber moneys allocated from the State's General Fund and two additional fiscal years to spend it. Any amounts not encumbered by the end of the first fiscal year or not spent by the end of the third fiscal year typically return to the General Fund. However, if contractors do not spend all the annual funding the division allocated to them, Section 8278 of the Education Code allows the department to re-encumber the unspent amounts during the second and third fiscal years. This section also gives the department an additional two years to spend the re-encumbered funds. Therefore, the department has up to five years to spend some appropriated amounts.

—◆—
*\$7 million in unused funds
may revert to the State's
General Fund.*
—◆—

During our review, we noted that the department had not re-encumbered all of the \$10.2 million in unspent funds from fiscal year 1991-92. As explained above, to ensure the availability of these funds for an additional two fiscal years, the department should have re-encumbered the unspent funds by June 30, 1994. Because the department re-encumbered only \$3.2 million of those funds, the remaining \$7.0 million will revert to the State's General Fund on July 1, 1996. As of July 10, 1995, accounting records indicated that the department had not re-encumbered \$9.4 million from fiscal year

1992-93. Unless the department provides support that it encumbered these funds before July 1, 1995, these funds will revert to the General Fund on July 1, 1997.

The federal government also places encumbrance and spending requirements on the FBG funds it provides the department. The department may spend FBG funds in the year awarded and in the following three fiscal years. Normally, the federal government has awarded the grant on the last day of the federal fiscal year. In effect, the department has three years and one day to spend FBG funds. To date, the department has not reverted any FBG allocations to the federal government. However, as noted earlier, department records reveal that, as of June 30, 1995, an estimated \$98.6 million of FBG funds remain unspent. The department has until September 30, 1997, to spend these funds, but if it does not improve its efforts to quickly and effectively allocate these funds, the State may lose resources necessary to provide child care and development services.

Efforts the Department Should Have Taken To Maximize Delivery of Services

The department should have taken four proactive steps to maximize child care and development services.

We believe that the department should have taken four proactive steps to maximize the provision of child care and development services. First, the department should have periodically compared the amounts it allocated to contractors over a three-year period with the amounts they actually spent over the same period. The department's Education Finance Division has the capability of performing this procedure but has not done so since fiscal year 1991-92.

Second, the department should have identified those contractors having differences of greater than 5 percent between the amounts allocated and the amounts actually spent. Differences exceeding 5 percent may be a symptom of a larger problem. We believe that underspending by contractors indicates either the contractors had difficulty providing needed services or the division awarded them more funds than they needed.

As a third step, the department should have identified the reasons why differences of greater than 5 percent occurred. The division employs staff members identified as "consultants." In part, consultants are responsible for providing technical assistance to contractors. If, for example, a consultant is notified that a contractor left unspent at least 5 percent of an allocation,

indicating a difficulty in providing services, the consultant can determine the reason for underspending.

Finally, the department should have developed options for resolving any identified problems and implemented the option that best solved, within available resources, each problem. For example, if contractors within the State Preschool program could not spend all their allocations because they had insufficient funds from other sources necessary to operate the program, the department could have identified what it costs a contractor to operate a State Preschool program, determined whether the rate it paid the contractors was sufficient to operate the program, and, if necessary, raised the rates. If a contractor within a program could not spend all allocations because there was no additional unmet need in the area, the division could reduce this contractor's allocation in subsequent years and transfer these excess amounts to other contractors in other areas whose allocations are insufficient to meet identified need.

Conclusion

Because the department is not maximizing its efforts to ensure the delivery of child care and development services, it is not meeting the needs of more low-income families. For example, we determined that contractors had not spent nearly \$84.7 million that the division had allocated to them during fiscal years 1991-92 through 1993-94. Some contractors did not use all the funds allocated to them because they perceived state rules and regulations as impediments. Other contractors stated that they were able to meet the needs of eligible families in their service area without using all the funds that the division allocated to them. Finally, some contractors received the contract late in the fiscal year or they received late notice of funding increases.

In addition to the \$84.7 million of unspent funds, the division had not allocated an estimated \$98.6 million of FBG funds. Moreover, the department's plan to use these FBG funds is flawed. Specifically, the department's plan included only \$70 million in unallocated FBG funds and did not include an additional \$28.6 million. In addition, the department stated that it intends to increase the amount it allocates to existing contractors; however, it did not specify how the contractors would use the additional funds. Furthermore, the

department did not indicate whether it plans to identify more contractors that could provide child care and development services in those areas where the need is not being met.

Recommendations

To maximize the provision of child care and development services, the department should take the following actions:

- Determine the level of unmet need for each child care and development program that it administers and the level of unmet need in each county;
- Periodically compare the allocations it provided to contractors with the amounts actually spent to identify those contractors that do not spend all of their allocations;
- Determine the reasons these contractors are not spending all their allocations; and
- Identify options and implement solutions to assist the contractors to provide more child care services to eligible families who need them.

Further, if the department identifies contractors whose allocations exceed need, the division should identify other contractors that can use the excess funds to provide services to eligible families. If necessary, the division should issue a request for applications to identify additional contractors that can provide child care and development services to eligible families that do not currently receive them.

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Chapter 2

The Department Needs To Improve Certain Administrative Processes

Chapter Summary

The California Department of Education's (department) processes for awarding contracts, resolving appeals of contract awards, and monitoring contractors need improvement. Although we found no direct evidence of bias in the selection of contractors, two practices followed by the department's Child Development Division (division) for reviewing and scoring applications increased the risk of biased scoring decisions. Furthermore, the division cannot ensure that the contract award process was fair because it did not always include provisions in its requests for applications (RFA) to allow unsuccessful applicants to appeal the award of a contract. Additionally, the division did not consistently follow established procedures when applicants appealed contract awards, giving the impression that some contractors received special or preferential treatment.

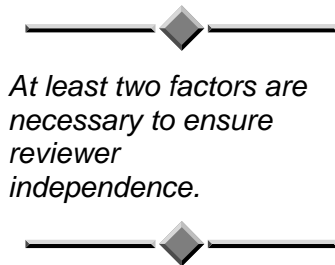
In addition, the processes that the department's Office of External Audits (office) used for reviewing annual audit reports submitted by contractors were deficient. Specifically, the office failed to promptly complete its reviews, and it inadequately reviewed some audit reports; therefore, it could not provide the division with the accurate information necessary to evaluate the contractors' status during the contract renewal process. Finally, the department did not always meet its statutory obligations to submit to the Legislature reports describing the status of unspent appropriations.

Processes for Awarding Contracts Can Be Improved

One method that the division uses to select providers of child development services is to choose from among those who applied in response to an RFA. An RFA is an announcement for the competitive award of a contract. For example, when the division issued its RFA for the Federal Child Care and Development Block Grant (FBG), it

used teams of three people to read and score the applications. After all the applications are scored, the division awards contracts to those applicants that receive the highest scores.

Independence Reduces Risk of Biased Decisions



Independence is one of the elements necessary to ensure that reviewers develop unbiased scores for applications received in response to an RFA. We believe that at least two factors are necessary to ensure reviewer independence. First, reviewers must not have current affiliations with any of the applicants they are reviewing. For example, a reviewer should not be a former employee of an applicant. Current affiliations with an applicant increases the risk that biased scores will result because the reviewer may use information from the affiliation in addition to information contained in the application when determining scores.


Division policy states that reviewers cannot read and score applications received from applicants located in counties for which they have been the assigned “consultant” for the last three years. Consultants are division staff members assigned to monitor contractors within a specific geographic region. The responsibilities of a consultant include ensuring that contractors comply with applicable requirements, providing technical assistance to contractors, and making recommendations to division management regarding contract funding amounts and amendments.

A second factor that we believe is necessary to ensure independence is that reviewers develop their scores exclusive of the other members of the same review team. This process would prevent one or more members of a review team from unduly influencing the scores determined by other members. It also reduces the risk of collusion between reviewers when developing scores. Because total scores determine which applicant will be offered a contract, biased scores may affect the outcome of the contract award process.


Two Division Practices Increase Risk of Biased Decisions

Although we found no direct evidence of bias in the selection of contractors, two division practices for reading and scoring applications increased the risk of biased scoring decisions. First,

application reviewers did not always meet the division's own independence requirements. Of the 40 teams that read and scored applications received in response to the RFA for the FBG, 5 teams inappropriately contained a member who reviewed applications from contractors located in the counties for which they were the assigned consultants. The 5 review teams scored 45 (7 percent) of the 652 applications received in response to the RFA. Of the 45 applications, 25 applicants received contract awards totaling \$3.2 million.



The division overrode its own independence requirements for reviewing and scoring applications, thus increasing the risk of biased scoring decisions.



According to the chief deputy superintendent for instructional services, the division disregarded its own independence requirements because it had limited staff resources to score the 652 applications and the reviews had to be completed in a relatively short period. Furthermore, she stated that the consultants signed statements that they did not have any conflicts of interest with the organizations whose applications they read.

The second practice that increased the risk that biased scores could be developed was that reviewers were in the same room at the same time when they read the applications and developed their scores. According to the department, to provide space for the 40 teams to review the applications for the FBG, the division rented a conference room at a Sacramento hotel. During a six-week period, the division had from 6 to 13 teams reading and scoring applications in the conference room at the same time. While the teams were in the conference room, members of each team sat at the same table to read and score the applications. Although the reviewers were directed to read and score the applications separately, the department stated that group discussions were required to promote scoring reliability and to ensure that scoring criteria were equitably applied.


Because the division increased the risk that biased scoring decisions were made, it reduced its assurance that it issued contracts to the most qualified contractors and it may not have provided all applicants a fair opportunity to compete for the contracts.

Some RFAs Did Not Include Provisions for Appeals of Contract Awards

Section 8445 of the Education Code requires the department to develop a grievance procedure for resolving disputes arising from the award of direct service contracts. Title 5, Section 18003, of the California Code of Regulations describes the appeal process that the

division uses to resolve contract award disputes. Specifically, Section 18003 states that unsuccessful applicants may appeal the procedures used to score the applications.

During fiscal years 1991-92 through 1993-94, the division did not include provisions that allowed unsuccessful applicants to appeal the contract awards for seven RFAs. Of the seven contract awards, one was for direct care services totaling \$92,000, and the remaining six were for nondirect care services. Of the six awards for nondirect service contracts, five ranged from \$150,000 to \$250,000. The purpose of these contracts was to develop and implement training projects for staff in child development centers as well as family day care home providers. The purpose of the remaining contract, which included renewal provisions and was worth up to \$800,000 in the first year, was to establish a child development mentor teacher project. The intent of this project is to train selected child development teachers to become mentors to train teachers in their centers.


The department did not always provide an administrative appeal process for resolving grievances arising from the contract award process.

Although state law does not require the department to develop a procedure for resolving disputes arising from awards of nondirect service contracts, we believe that, because of the large dollar amounts associated with these contracts, the division should have included such provisions in its RFAs. Furthermore, the division awarded these contracts using a competitive process similar to that outlined in the Public Contract Code. The Public Contract Code requires state departments using this competitive process to include provisions for an administrative process for resolving protests of proposed contract awards.

Because the division did not include provisions for appealing contract awards for seven RFAs, it did not provide applicants an administrative process for resolving grievances arising from the award process or for expressing concerns regarding errors, favoritism, or lack of integrity in the contract award process. Without such an administrative process, an applicant's only avenue of dispute resolution is through the court system, which can be costly for both the State and the applicant. As a result, applicants may perceive the contract award process as unfair because it does not provide an administrative appeal process. Furthermore, the division reduces its assurances that the contract award process was error-free and that it awarded contracts to the most qualified applicants.

***Processing of Notices of Appeal
Can Be Made More Consistent***

The department should ensure the fair and impartial appeals of contract awards.

An equally important factor in preventing biased decisions is consistency in reviewing appeals. The California Code of Regulations, Title 5, Section 18003(a), states that an unsuccessful applicant may appeal the procedures used in scoring applications. This section requires the unsuccessful applicant to file a notice of appeal with the division either in writing or by telephone. After a notice of appeal is filed, the manager of the division's Oversight and Information Services Unit reviews the notice of appeal and determines whether the issue described relates to the procedures used for scoring applications. If the manager determines that the issue relates to the scoring procedures, the appeal is allowed to proceed to a hearing before an appeal panel consisting of department staff. When possible, the division attempts to include a staff member of the department's legal office on the appeal panel. It is the applicant's responsibility to demonstrate that there was an inconsistent application of scoring criteria. If the appeal panel agrees with the applicant, it can adjust the scores. The outcome of adjusting the scores may change the rank order of the applications, and a different contractor may receive the award.

Division's Process for Reviewing Appeals of Contract Awards Is Inconsistent

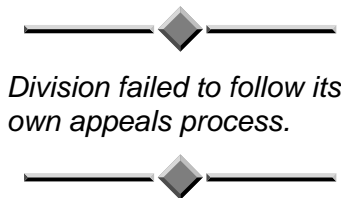
We identified several types of inconsistencies in the division's processing of appeals of contract awards. First, the division did not always consistently allow applicants that filed notices of appeal concerning similar issues to proceed to a hearing. For example, one applicant filed a notice of appeal challenging the division's determination that it did not have headquarters in the area in which the services were to be provided, and two others challenged the division's determination that the winning applicant had its headquarters in the service delivery area.³ Although the division told two of the three applicants that their issue was not appealable, it

³ According to state regulations, applications from applicants whose headquarters are outside the area in which the services are to be provided will be read only if no qualified applications are received from organizations with headquarters in the service delivery area.

allowed the remaining applicant to proceed to a hearing. This applicant won the appeal and received a contract award totaling \$124,316.

In another instance, four applicants filed notices of appeal regarding the small amount of funding the division awarded them. The division allowed two of the four applicants to proceed to a hearing, and those applicants won their appeals and received increases in their contract award amounts totaling \$117,375. The division determined that the remaining two applicants' appeals did not relate to scoring and therefore would not be heard by an appeals panel; however, the division later approved one applicant's appeal without a hearing and increased that applicant's award amount by \$100,000.

We also noted an instance in which three applicants filed notices of appeal regarding the division's failure to fund their applications because the applications did not state that they were to provide services within a particular set of zip codes. The division initially told all three applicants that their appeals would not be considered. However, the division later approved two of the three appeals without a hearing. These two applicants received contract awards totaling \$281,304.




Division failed to follow its own appeals process.


A second type of inconsistency resulted when the division failed to follow its established appeals process and gave one applicant an “informal” appeal hearing. In this instance, the applicant did not file a notice of appeal with the current appeals coordinator. Rather, the applicant called a former appeals coordinator and complained that the division failed to fund it, although it received a tie score with the winning applicant. Instead of referring the applicant to the current appeals coordinator and following the established appeals process, the former appeals coordinator contacted a division administrator and scheduled a conference call. As a result of the conference call, the former appeals coordinator and the administrator agreed that the applications should be reread and rescored. Despite the rescoring, the division still awarded the contract to the original winner.

The final inconsistency concerned an applicant who filed a notice of appeal on which the division did not take sufficient action. Telephone message slips in the division's files indicated that an applicant wanted to file an appeal and that the division called the applicant back. Because we found no other records that indicated what additional actions the division took in response to the applicant's request, we contacted the applicant. She stated that she did not withdraw her appeal and that she did not recall any telephone messages from the division regarding her appeal.

The division did not consistently process appeals filed by applicants challenging contract awards for several reasons. First, the division has no written guidelines for identifying which issues should proceed to an appeal hearing and which should not. According to the department, the manager of the division's Oversight and Information Services Unit determines whether an appeal should proceed to a hearing based on a review of the notice of appeal. Second, the division did not always comply with the manager's decision concerning the appealability of the issues. Specifically, the division changed award decisions for three applicants without a hearing even though the manager denied their appeal notices. Third, the division did not follow its procedures for hearing appeals of contract awards. For example, the division reviewed and rescored applications even though no applicant had filed a formal appeal. Finally, the division did not have a system to monitor or track appeals to ensure that all appeals were processed adequately.



Some applicants were allowed appeal hearings while others with similar appeal issues were not.





Because some applicants proceeded to an appeal hearing while other applicants with similar appeal issues did not, the division either inappropriately denied applicants their right to an appeal hearing or inappropriately allowed appeals to proceed to a hearing even though the issues were not appealable. When the division does not consistently process appeals of contract awards, it does not treat applicants equally and gives the impression that some contractors receive special or preferential treatment.

Department's Oversight of Contractors Through the Review of Audits Can Be Improved

Section 8448 of the Education Code requires contractors receiving more than \$25,000 in state funds to submit an annual audit report to the department.⁴ Audit reports provide the department with information regarding deficiencies in the contractor's administration of state programs, as well as the contractor's financial position. Audit reports submitted by private contractors are reviewed by the department's Office of External Audits (office). When the office identifies deficiencies cited in an audit report, it notifies the division so that it can take adverse action to ensure that the contractor corrects the deficiencies.

⁴ Contractors that receive less than \$25,000 during a year may submit a biennial audit report.


Review of reports submitted by contractors provide the division information to determine the status of contracts and to take appropriate actions.


Generally, contractors must submit their audit reports to the office by November 15, 4.5 months after the close of the State's fiscal year. However, the office may grant a contractor that is on a "clear" status a one-time-only 30-day extension if the contractor failed to submit the audit report on time for a reason beyond its control.⁵ According to a manager in the office, to ensure that sufficient time exists for the division to make determinations about the contract status of contractors by April 1, the office should complete the reviews of the audit reports by February 28 of each year.

Section 18303(a) of Title 5 of the California Code of Regulations states that division staff must determine by April 1 of each year whether to offer a contractor continued funding on a clear contract, offer continued funding under a conditional contract, or make no offer of continued funding. Section 18303(b) states that if the staff recommends conditional contract status or no offer of continued funding, the contractor must be notified in writing of the reasons for the proposed change in contract status by April 7.

Reviews of Audit Reports Are Late

As shown in Table 2, the office did not complete its reviews of all audit reports by the February 28 deadline. For fiscal years 1991-92 through 1993-94, the office failed to complete its reviews by the end of February for 525 (64 percent) of the 818 audit reports it received by December 15⁶. The office completed these reviews from one to 387 days late. For example, although the office received one audit report on October 22, 1992, it did not complete its review until August 26, 1993, 179 days after February 28. The office received another audit report on November 15, 1993, but did not complete its review until September 19, 1994, 203 days late.

⁵ See page 36 in Appendix B for a description of the types of contract status.

⁶ Because the office did not maintain records concerning which contractors it granted one-time-only 30-day extensions, we used December 15 as the due date.


Table 2

**Audit Reports Received By
December 15 but Not Reviewed by February 28
Fiscal Years 1991-92 Through 1993-94**

Fiscal Year of Audit	Audit Reports Received By December 15	Reviews Not Completed by February 28
1991-92	277	65 (24%)
1992-93	242	177 (73%)
1993-94	299	283 (95%)
Total	818	525 (64%)

Of the 242 late reviews for fiscal years 1991-92 and 1992-93, the office completed 171 after June 30. As a result, the division renewed contracts without information related to either the contractors' administration of state programs or their financial condition. When the office fails to complete its reviews of audit reports by the end of February, it cannot provide the division with information necessary when considering whether to change the contract status of a contractor.

The office did not complete its reviews of the audit reports by the end of February because it did not assign a sufficient number of audit staff members to this task. Our review of office records indicated that for fiscal years 1991-92 through 1993-94, the office assigned an average of only three staff members per month from November through February of each fiscal year to review the audit reports even though the division provided the office with funding for five positions and the office had a minimum of five positions available. The remaining audit positions were either vacant or were assigned to other responsibilities, such as investigations. Based on the office's estimate of an average of 12 hours to complete the review of an audit report, we estimate that the office needs 3,600 hours to complete the reviews of approximately 300 annual audit reports. To complete the reviews within the 3.5 months from November 15 through February 28, the office needs to assign an average of 7.5 staff members per month to this task during this time.



The office did not complete reviews on time because too few staff were assigned to the task.

According to the department, it is considering various alternatives for handling the workload of the office. These alternatives include evaluating different ways to obtain assistance for reviewing audit reports, including the possibility of contracting with the Department of Finance; identifying additional funding sources for audit staff and, if funds are

available, establishing new auditor positions; and establishing a work group to review the audit resolution process to determine if it can be modified to provide additional time to complete reviews of audit reports.

Reviews of Some Audit Reports Were Inadequate

Office staff did not adequately review some audit reports submitted for fiscal year 1991-92. We received an allegation that, to meet the February 28 deadline for completing the reviews of audit reports, staff did not review some audit reports for fiscal year 1991-92. Because the persons making the allegation could not tell us how many of the audit reports received were not reviewed, we selected six contractors whose audit reports for fiscal year 1992-93 cited deficiencies that likely would have also occurred during fiscal year 1991-92. Of the six audit reports, two contained significant deficiencies. However, we found no evidence that the office identified these cited deficiencies.


The office did not identify deficiencies that could affect contract status.

Because the office failed to adequately review some audit reports submitted for fiscal year 1991-92, it failed to identify deficiencies that may have affected the contract status of contractors. For the two instances identified during our limited review, the deficiencies were severe enough for the office to have recommended placing the contractors on conditional contract status. The auditor for one contractor reported the same problem for fiscal year 1992-93 that the office had missed in the audit report for fiscal year 1991-92. Because the office did identify the deficiencies in the audit reports for fiscal year 1992-93, the division placed both contractors on conditional contract status. The audit reports for fiscal year 1993-94 for these two contractors did not cite the same deficiencies, indicating that the contractors had corrected them.

Recommendations for Adverse Actions Are Inconsistent

The California Code of Regulations, Title 5, Section 18071, requires contractors to submit annual audit reports to the department by at least December 15, 5.5 months after the close of the State's fiscal year. For those who submit audit reports late, the office can propose an adverse action to place these contractors on conditional contract status for the next fiscal year. The proposed action is reviewed by a case conference committee, and if the committee agrees that an adverse action is warranted,

the division will send a notice of proposed action (NOPA) to the contractor.

Division did not consistently recommend adverse actions for late reporting.

During our review of the practices that the office used to notify the division about deficiencies in audit reports, we noted that it did not consistently recommend adverse actions against contractors that submitted their audit reports late. As shown in Table 3, for fiscal years 1991-92 and 1992-93, contractors submitted 166 audit reports after December 15. Even though contractors submitted these 166 audit reports late, the division issued only eight NOPAs to contractors. Records maintained by the office and interviews with staff members failed to disclose why the office did not recommend adverse actions against the remaining 158 contractors.

Table 3


Number of Late Audit Reports and Number of Notices of Proposed Actions as a Result of Late Reports Fiscal Years 1991-92 and 1992-93

	Received 12/16 Through 1/31	Received 2/1 Through 2/28	Received 3/1 Through 3/31	Received After 4/1	Total
Audit Reports	120	24	11	11	166
Notices of Proposed Action	3	2	0	3	8

By not consistently recommending adverse actions against contractors who submit late audit reports, the office gives the impression that some contractors receive special or preferential treatment. By allowing contractors to submit audit reports late, the office will continue to have difficulty completing its reviews by February 28, which, as discussed previously, is necessary to provide information to the division for its consideration when it renews contracts.

The Department Did Not Fulfill Its Reporting Obligations

The Budget Act of 1991, and succeeding annual budget acts require the department to submit reports in September and March to the Joint Legislative Budget Committee describing the status of unspent appropriations from the State's General Fund.


Department's report of unspent funds for fiscal year 1991-92 understated by \$4.8 million.

The department, however, did not always submit these required reports, and when it did, it did not always submit them by the due date, nor were they always accurate. Of the six reports pertaining to unspent appropriations during fiscal years 1991-92 through 1993-94, the department provided us with five. The department submitted three of the six reports to the Legislature from two weeks to more than three months late. In its April 1995 report, the department stated that the amount of unspent funds from fiscal year 1991-92 was \$2.2 million; however, our analysis of department accounting records indicated that the amount of unspent funds was actually \$7 million, a difference of \$4.8 million.

The department did not tell us why the reports were late nor why the information was inaccurate. Because the department did not fulfill its reporting obligations, it did not provide the Joint Legislative Budget Committee with prompt and accurate information.

Conclusions

The department needs to improve its processes for awarding contracts, resolving appeals of contract awards, and monitoring contractors. Although we found no direct evidence of bias in the selection of contractors, two division practices for reviewing and scoring applications increased the risk that biased scoring decisions were made. Additionally, division practices reduced assurances that the contract award process was fair. Because the division did not always include provisions to allow unsuccessful applicants to appeal the award of a contract, it eliminated the only administrative procedure for hearing grievances arising from the contract award process. When applicants challenged contract awards, the division did not always follow established procedures. Inconsistent processing of appeals gives the impression that some contractors receive special or preferential treatment.

Additionally, the Office of External Audits' process for reviewing annual audit reports submitted by contractors was deficient. Specifically, the office did not provide the division with prompt or accurate information necessary to evaluate a contractor's status during the contract renewal process because the office failed to complete its reviews by the end of February and inadequately reviewed some audit reports it received for fiscal year 1991-92.

Finally, the department did not always provide prompt, accurate reports to the Legislature regarding the amount of unspent appropriations from the State's General Fund. As a result, the department did not meet its statutory responsibility and may have hindered the Legislature's ability to make informed decisions regarding child care and development programs in California.

Recommendations

To improve its process for awarding contracts, the division should take the following actions:

- To reduce the risk of biased decisions during the scoring of applications received in response to RFAs, the division should follow its policy that application reviewers not include the assigned consultant for the county from which the application came and have reviewers score each application separately from other reviewers; and
- To provide applicants with an administrative procedure for airing grievances, the division should include provisions in its RFAs that allow unsuccessful applicants to appeal all contract awards exceeding a reasonable dollar amount or any contract that is renewable.

To improve its process for resolving appeals of contract awards, the division should take steps to avoid giving the appearance that some applicants received preferential or special treatment. Specifically, the division should:

- Develop written guidelines for use when considering whether an appeal issue should proceed to a hearing;
- Follow its procedures for hearing appeals of contract awards; and

- Develop and implement a tracking system to ensure that it properly processes all notices of appeal.

To improve its process for monitoring contractors, the department should ensure that the staff of the Office of External Audits assigned to review audit reports from November through February of each fiscal year is large enough to complete the review on time. Assignment of a sufficiently-sized staff also should prevent inadequate review of the audit reports.

To avoid giving the appearance that some contractors receive special or preferential treatment, the department should consistently recommend adverse actions against contractors that submit late audit reports.

Finally, the department should ensure that it submits required reports to the Legislature on time and that the information presented in these reports is accurate.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: August 2, 1995

Staff: Elaine M. Howle, CPA
Dale A. Carlson
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Appendix A

Description of Child Care and Development Programs Administered by the California Department of Education's Child Development Division

During the period covered by our review, the California Department of Education's Child Development Division (division) administered the following programs:

- The **Alternative Payment** program reimburses private agencies for an array of child care and development arrangements, including in-home and exempt care, licensed family child care homes, and center-based care, and issues payments to parents for their purchase of child care and development services. Contractors for this program also issue child care certificates to eligible parents.
- The **Campus** program provides child development services primarily for children of low-income student parents enrolled in college.

- The **Child Protective Services** program provides child care and development services to assist families whose children are being neglected, abused, or exploited or are at risk of being so.
- Under the **County Welfare Department** program, county welfare departments provide child care and development services through local providers.
- The **Exceptional Needs** program assists agencies in providing child care and development services for children with exceptional needs, such as those who are blind or deaf, or those with mental retardation, emotional problems, or certain other disabilities.
- The **Family Child Care Home** program assists care providers that provide care for children in a family setting.
- The **General Child Care** program provides comprehensive child development services for low-income parents who are either working, looking for work, in training, or homeless; or in which the parent or child is physically and mentally incapacitated. This program also provides child development services to children who are neglected, abused, or exploited or are at-risk of being so.
- The **Migrant** program provides child development and related services to children of migrant families working in fishing, agriculture, or related industries.
- The **Resource and Referral** program provides information to parents regarding child care and development placement, as well as referrals to social and community services.
- The **School-Age Community Child Care Services (Latchkey)** program provides child care for school-age children before and after school and during school vacations.
- The **School-Age Parenting and Infant Development** program provides supervised infant and child development services to allow eligible adolescent parents to complete high school and provides training of students in parenting skills.
- The **Severely Handicapped** program provides child development services to assist families with severely handicapped children.
- The **State Preschool** program provides educational and related experiences and services to pre-kindergarten children from low-income families, as well as education and training for their parents.

In addition to the above service programs, the division administered the following:

- The **Child Care and Development Block Grant** comprised of two separate programs:
 - Child Care Services** is similar to the Alternative Payment program except for eligibility and need limitations imposed by the federal government and locally established priorities.
 - Early Childhood Education/Before-and After-School Care** is similar to the General Child Care program except for eligibility and need limitations imposed by the federal government and locally established priorities.
- The **Title IV-A, At-Risk** program is a joint federal- and state-funded program that provides comprehensive child development services for low-income working parents who do not receive Aid to Families with Dependent Children.

Appendix B

Other Pertinent Information Related to the Administration of Child Care and Development Programs

In addition to the practices discussed in Chapters 1 and 2, we reviewed other practices that the California Department of Education (department) used to administer child care and development programs and found no material problems. These practices included the Child Development Division's (division) reviews of contractors to ensure compliance with statutes, regulations, and contract terms and the adverse action process. Details are provided in this appendix. We also provide information concerning categories of division programs and contractor selection methods in this appendix.

Categories of Division Programs

To provide child care and development services, the division issues contracts to public agencies such as school districts, county superintendents of schools, and community college districts, and to private service providers. We grouped contracts into one of three categories: center based, alternative payment, or resource and referral. Center-based contractors provide child care and development services in day care centers or family day care homes. Alternative payment contractors provide parents with certificates redeemable for child care and development services or reimburse other child care agencies for the provision of such services. Resource and referral contractors provide parents with general information regarding existing child care and development services and provide referrals for services to the general public. Table 4 summarizes the number and dollar amount of contracts issued by the department for fiscal years 1991-92 through 1993-94 for each category.

Table 4

**Number and Dollar Amount of Child Care and Development Services Contracts by Category
Fiscal Years 1991-92 Through 1993-94
(dollar amounts in millions)**

Fiscal Year	Center Based	Alternative Payment	Resource and Referral	Totals
1991-92	927 \$ 337.0	225 \$ 42.4	131 \$ 9.2	1,283 \$ 388.6
1992-93	1,171 \$ 406.7	394 \$ 81.0	132 \$11.0	1,697 \$ 498.7
1993-94	1,154 \$ 409.8	310 \$128.6	125 \$10.3	1,589 \$ 548.7
Totals	3,252 \$1,153.5	929 \$252.0	388 \$30.5	4,569 \$1,436.0

Contractor Selection Methods

A service provider can obtain a contract to provide child care and development services through one of three methods. First, the division can select the provider from among those who applied to the division in response to a request for applications (RFA). When the division issues an RFA, it reviews and scores the applications it receives and offers a contract to the eligible applicant who receives the highest score. The division also can assign a contract to an existing contractor. According to the department's chief deputy superintendent for instructional services, when a contractor voluntarily relinquishes a contract or the division terminates a contractor, the division generally will issue an RFA to identify a replacement contractor. However, if services will be discontinued before the division has time to issue an RFA and select a replacement contractor, the division will assign the contract to an existing contractor to prevent an interruption in services. The division will then issue an RFA for the permanent contract during the next fiscal year.

Finally, the division can renew a contract from one fiscal year to the next. Title 5, Section 18303 of the California Code of Regulations requires the division to determine by April 1 of each year whether to

offer continued funding to existing contractors. Table 5 summarizes the number and dollar amount of contracts issued during fiscal years 1991-92 through 1993-94 for each contractor selection method.

Table 5

Number and Dollar Amount of Child Care and Development Services Contracts by Contractor Selection Method Fiscal Years 1991-92 Through 1993-94 (dollar amounts in millions)

Fiscal Year	RFA Contracts	Assigned Contracts	Renewed Contracts	Totals
1991-92	273 \$ 12.1	13 \$4.0	997 \$ 372.5	1,283 \$ 388.6
1992-93	369 \$101.0	9 \$1.2	1,319 \$ 396.5	1,697 \$ 498.7
1993-94	41 \$ 6.2	32 \$4.7	1,516 \$ 537.8	1,589 \$ 548.7
Totals	683 \$119.3	54 \$9.9	3,832 \$1,306.8	4,569 \$1,436.0

During fiscal years 1991-92 through 1993-94, the division assigned 54 contracts to service providers. For 40 of these contracts, the division selected the permanent contractor by issuing an RFA. Through the RFA process, a new service provider became the permanent contractor in 25 instances and the assigned contractor became the permanent contractor in 15.

For 5 of the remaining 14 contracts, the division named the assigned service provider as the permanent contractor because, according to department records, the provider was the only existing contractor in the area eligible to provide the requested services. In eight other instances, the contract was reassigned to the service provider during the next fiscal year because the division did not select a permanent contractor. However, by June 30, 1994, the division selected permanent contractors for each of these 8 contracts. Finally, as of July 1995, the division had not selected a permanent contractor for one of the assigned contracts. Based on our review, we believe the division's assignment of contracts was reasonable.

Monitoring of Contractors

To monitor the activities of contractors, the department conducts several routine and nonroutine types of oversight. One method used on a routine basis is reviewing periodic fiscal reports and annual or biennial audit reports submitted by the contractors. We present the results of our analyses of the department's reviews of audit reports in Chapter 2. All contractors are required to submit these reports. If they do not, the department may withhold the contractor's next payment.

Another type of routine oversight is a compliance review. Section 18023(a) of Title 5 of the California Code of Regulations requires the department to, at least once every three years and as resources permit, conduct compliance reviews of contractors. The department conducts compliance reviews to ascertain whether contractors are complying with the regulations and rules governing the operation of the programs. Areas reviewed include the eligibility of children receiving the services of the contractor, staff qualifications, and ratios of staff members to children. During fiscal years 1991-92 through 1993-94, the department did not conduct compliance reviews of all contractors. Although we found evidence that the department reviewed contractors that were school districts, superintendents of schools, or community college districts during these years, we found no evidence that the department reviewed privately operated contractors during fiscal years 1991-92 and 1992-93. During fiscal year 1993-94, however, the department conducted compliance reviews of 42 privately operated contractors. The department did not provide reasons why it did not conduct the reviews during the two years nor did it provide the criteria it used to select contractors for review.

The final type of routine oversight is a program quality review. Program quality reviews assess the quality of care and services provided by contractors. Contractors receive these reviews once every three years. Program quality reviews are conducted by department staff and teams of other contractors. Reviewers will provide advice and recommendations for improving quality when necessary.

Oversight methods that the department does not conduct on a routine basis include special reviews conducted in response to allegations of wrongdoing by a contractor, field audits conducted by the department's Office of External Audits (office), "build-upon" audits conducted by the office when it determines it needs more financial information than an audit report provides, and management reviews conducted by staff of the office and the division's Compliance and Monitoring Unit when other types of oversight indicate that a contractor has serious program or fiscal compliance problems. Table 6 summarizes the number of each type of review conducted during fiscal years 1991-92 through 1993-94.

Table 6

***The Department's Oversight of
Contractors by Method
Fiscal Years 1991-92 Through 1993-94***

Reviews of Audit

Fiscal Year	Reports by the Office of External Audits	Compliance Reviews	Program Quality Reviews	Nonroutine Oversight Types
1991-92	345	46	133	2
1992-93	354	34	126	7
1993-94	22	96	99	4
Totals	721	176	358	13

Types of Adverse Actions

When the department identifies deficiencies through its oversight of contractors, the division can initiate one of two adverse actions against the contractor. First, the division can place a contractor on “conditional” status.⁷ Contractors on conditional status must take several additional actions that contractors on “clear” status do not. These actions include submitting the annual audit report by October 15 (rather than November 15), submitting monthly cost reports (rather than quarterly cost reports), and submitting an inventory of all equipment acquired in whole or part with funds provided by the division.

Second, if the division determines that a contractor on conditional status has continuing or more severe deficiencies, it may decide not to renew the contract. For example, the division placed one contractor on conditional status because the audit report for fiscal

⁷ Normally, a contractor operates with a “clear” status. A clear status indicates that the department has not identified deficiencies severe enough to warrant adverse action against a contractor.

year 1991-92 was submitted late. When the contractor failed to submit required documents, including its audit report for fiscal year 1992-93, the division decided not to renew the contract.

A final action the division can take is to terminate the contractor's contract. The division does this when the contractor commits a violation constituting a breach of the contract or when the health or safety of children is in danger. During fiscal years 1991-92 through 1993-94, the division terminated only one contractor.

The Administrative Review Process

To initiate an adverse action against a contractor, the organizational unit that identified the deficiency recommends a proposed action.⁸ To review the recommendation and any supporting documentation, the division forms a Case Conference Staff Review Committee (review committee), consisting of staff members from the division and other pertinent divisions within the department. The review committee can uphold, overturn, or modify the recommendation.

When the review committee determines that an adverse action is warranted, the division will send the contractor a notice of proposed action (NOPA). The NOPA identifies the proposed action to be taken, the reasons for the proposed action, the deadline for submitting additional information, and the deadline for the contractor to request an appeal of the adverse action.

The review committee will review the contractor's written response and any other information the contractor provides regarding the proposed action. The review committee can uphold the original recommendation, amend the recommendation to another type of adverse action, or return the contract to a clear status. If the contractor does not submit any information, the review committee will uphold the original recommendation. Table 7 summarizes the number of each type of adverse action the division took during fiscal years 1991-92 through 1993-94.

⁸ Deficiencies may be identified by the division, the office, the department's Education Finance Division, or the Contracts Office.

Table 7

**Adverse Actions
Taken Against Contractors
Fiscal Years 1991-92 Through 1993-94**

Fiscal Year	Conditional Status	Contracts Not Renewed	Contracts Terminated	Totals
1991-92	10	0	1	11
1992-93	24	6	0	30
1993-94	28	12	0	40
Totals	62	18	1	81

If the review committee proposes to place the contractor on conditional status or to not renew its contract and the contractor appeals the proposed action, the case is referred to the division's Oversight and Information Services Unit (unit). The unit will convene an administrative review panel (review panel) consisting of staff members from the division; the office; and the department's Education Finance Division, legal office, and contract office. The review panel also will include a representative from one of the division's contractors.⁹ The review panel examines the case prepared by the review committee and the written response provided by the contractor and issues a decision to uphold or modify the recommended action. However, if the contractor specifies in its written response to the proposed action that it intends to make an oral presentation, the review panel will schedule and conduct a hearing. At the conclusion of the hearing, the review panel will render a final decision. Table 8 summarizes the number of hearings and the resulting decisions by the review panel.

⁹ As of December 1994, no member of the review committee can be a member of the review panel for the same case.

Table 8

**Number of Hearings and the
Resulting Decisions Made
by the Review Panel
Fiscal Years 1991-92 Through 1993-94**

Fiscal Year	Hearings Held	Decisions Upheld	Decisions Amended	Decisions Overturned
1991-92	8	0	1	7
1992-93	31	14	6	11
1993-94	33	16	12	5
Totals	72	30	19	23

Comments

Comments of the California State Auditor on the Response from the Department of Education

To provide clarity and perspective, we are commenting on the Department of Education's response to our audit report. The numbers correspond to the numbers we have placed in the response.

- 1 Our report accurately and fairly describes the conditions we identified during our review; namely, contractors did not spend millions of state and federal funds while the need for subsidized child care and development services remained high. Furthermore, if the department had taken a more proactive approach to determining why contractors were not spending their allocations, more services could have been provided. Finally, we believe the implementation of our recommendations will enable the department to maximize the provision of child care and development services.
- 2 The department did not provide evidence that it prepared and monitored more than 2,100 contracts per year. As we show in Table 4 on page 34, the department issued 1,283 child care and development contracts during fiscal year 1991-92, 1,697 contracts during fiscal year 1992-93, and 1,589 contracts during fiscal year 1993-94.
- 3 The department provided no evidence to support its statement indicating that funding for administration has decreased. It should be noted

that the amount the department allocated for administration during fiscal year 1990-91, before the division received the Federal Child Care and Development Block Grant, implemented the Title IV-A grant, and received the increase in appropriations for the State Preschool program, was \$5.1 million. However, during each of the next four fiscal years, the department allocated \$9 million for administration, nearly doubling the division's administrative funding.

○ We do not consider ⁴ almost \$85 million in unspent allocations to be immaterial, especially since these funds could have been used to provide additional child care and development services. Furthermore, we do not conclude, as the department implies, that contractors' failure to spend allocations reflects a lack of need for child care and development services. We clearly state on page 6 of our report that the department estimated that less than 20 percent of eligible low-income families received services. Contractors' failure to spend allocations, we conclude, may be a symptom of a larger problem. For example, we believe that understanding indicates either the contractors had difficulty providing needed services or the division awarded them more funds than they needed. We also state that the department should have identified those contractors that did not spend their allocations, determined the reasons why they did not spend their allocations, developed options for resolving problems, and implemented the option that best solved, within available resources, each problem.

○ The department's ⁵ statement that the new programs represented a 24 percent increase in the number of contracts is misleading. The 1,589 contracts the department issued during fiscal year 1993-94 represent an increase of 306 (24 percent) from the 1,283 contracts it issued during fiscal year 1991-92, two years earlier. However, the 1,589 contracts also represent a decrease of 108 from the 1,697 contracts the department issued during fiscal year 1992-93.

Furthermore, the department neglects to mention that the amount allocated for administration increased from \$5.1 million in fiscal year 1990-91 to \$9 million during each of the next four fiscal years.

○ The department's ⁶ statement that it utilized "all on-going state and federal funds" during fiscal year 1994-95 is misleading. Although it may have allocated available state and federal funds, it does not currently know whether contractors have spent their allocations to provide child care and development services. Further, the department will not know this until its Office of External Audits completes its reviews of the audit reports submitted by contractors. These audit reports are not due until November 1995.

○ We disagree with the ⁷ department's contention that funding new contractors with unspent contractor allocations will result in the discontinuation of services to currently enrolled families. Contractors are not using these unspent funds in the year originally allocated. Therefore, if the department monitors the spending of its contractors

and reallocates funds from those that do not spend their allocations to new contractors that can provide the services, services to currently enrolled families should not be affected.

- The department 8 knows that we have never advocated identifying new alternative payment providers. Instead, during several meetings with department staff, we indicated that the department needed to identify additional center-based contractors.
- The department is 9 incorrect when it states that we report it did not identify \$25 million. We state on page 9 of our report that the department excluded \$25.5 million from its plan because it earmarked these funds for future spending. The department is also incorrect when it asserts that the purpose of the three-year plan is to identify encumbered, but “unearned,” federal funds available for one-time expenditure purposes. In its reports, the Legislative Analyst states:

“We recommend the state Department of Education provide by April 1, 1995, specific information to the budget subcommittees on the status of the three-year plan for the use of federal child care carryover funds. We further recommend the department submit to the fiscal committees its proposal for revising the plan in line with the amount of funding expected to be available during the next two years.”

As we stated on page 9, the department should have included the \$25.5 million with the \$70 million in its three-year plan because these funds are available during fiscal years 1995-96 and 1996-97.

- The department is 10 incorrect when it implies that we object to its process of allocating one-fourth of its annual Federal Child Care and Development Block Grant for expenditure during the first quarter of the next state fiscal year. This process is described on page 9 of our report. We object to the department excluding the \$25.5 million from its estimate.
- The department’s 11 statement that the three-year plan includes information about how it will use \$7 million in unallocated federal funds is false. As stated on page 10 of our report, the department did not specify how it was to use the remaining \$7 million.

- The department's ¹² disagreement with our conclusion that it did not maximize the delivery of child care and development services demonstrates that the department fails to recognize that it needs to take a more proactive role in the delivery of child care and development services. For example, in its response, the department addresses its use of federal block grant funds for the provision of child care and development services; however, it does not address its use of State General Fund money. As we noted on page 7 of our report, \$47 million of the \$85 million that contractors did not spend represents funds allocated from the State's General Fund. Furthermore, the department failed to address any of the reasons cited in the report concerning contractors' not spending all of their allocations.
- During our audit, the ¹³ department did not provide documentation that it reencumbered the \$9.4 million from fiscal year 1992-93, effective June 1995. As we state on page 10 of our report, as of July 10, 1995, accounting records indicated that the department had not reencumbered these funds. However, we anticipate that the department will provide the necessary documentation for the reencumbered amount in its 60-day response to our report.
- We did not conclude ¹⁴ that we found no significant problems with the department's administration of the child care and development programs. Chapter 1 details our concerns about the department's failure to maximize the use of child care and development funds while Chapter 2 describes several weaknesses in the department's administrative processes.
- During our audit, the ¹⁵ department did not provide any evidence to support its use of a "nationally recognized practice of inter-rater reliability" nor its efforts to balance the review teams to control potential bias. We remain convinced that having teams review and score applications while seated at the same table increases the risk that biased scoring decisions will result.
- The department's ¹⁶ conclusion, "...this process for reviewing applications is consistent with the procedures outlined in the Public Contract Code for review of requests for proposals is misleading. The department implies that the Public Contract Code outlines procedures for reviewing responses to requests for proposals; our review showed that California statutes provide only general, high-level guidance, not specific procedures.

During our audit, the ⑰ department provided no evidence that justified its approval of an applicant's appeal for reasons other than scoring.

During our review of ⑱ its processing of appeal requests, the division provided us no documentation that staff tried on three occasions to return the applicant's calls. However, we are pleased that the department is taking steps to improve the tracking of appeal requests.

- The department's ¹⁹ response does not address our concern regarding inaccurate information provided to the Legislature. On page 26, we report that accounting records indicated the amount of unspent funds from fiscal year 1991-92 was actually \$7 million, a difference of \$4.8 million from the \$2.2 million the department reported to the Legislature in April 1995. Records also show that the department knew of the entire \$7 million amount in August 1994, eight months before its April 1995 report. The department's response fails to explain why it did not report these additional funds to the Legislature.

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