

DEPARTMENT OF DEVELOPMENTAL SERVICES

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September 16, 2011

TO: REGIONAL CENTER EXECUTIVE DIRECTORS

**SUBJECT: ADDITIONAL CLARIFICATION ON IMPLEMENTATION OF
STATUTORY REQUIREMENTS IN SB 74, CHAPTER 9,
STATUTES OF 2011**

This letter provides additional clarification on implementation of the statutory requirement for an independent review or audit of vendors who receive regional center funding in excess of \$250,000 and \$500,000, respectively (Welfare and Institutions Code¹ section 4652.5), and the 15 percent administrative cap requirement for provider contracts and agreements (section 4629.7). Initial information was provided to regional centers on these statutory provisions (and others contained in SB 74, Chapter 9, Statutes of 2011) in correspondence dated June 16, 2011.

PROVIDER (VENDOR) AUDIT REQUIREMENTS (section 4652.5)

Background and excerpt from the Department of Developmental Services' (Department) June 16, 2011, letter to regional centers:

Section 4652.5 was added to the Code, requiring any entity receiving payments from one or more regional centers to contract with an independent accounting firm for an audit or review of its financial statements subject to all of the following:

- When the amount received from the regional center(s) during the entity's fiscal year is more than or equal to two hundred fifty thousand dollars (\$250,000) but less than five hundred thousand dollars (\$500,000), the entity must obtain an independent audit or independent review report of its financial statements for the period. Consistent with Subchapter 21 (commencing with Section 58800) of Title 17, this also applies to work activity program providers receiving less than two hundred fifty thousand dollars (\$250,000).
- When the amount received from the regional center(s) during the entity's fiscal year is equal to or more than five hundred thousand dollars (\$500,000), the entity must obtain an independent audit of its financial statements for the period. This does not apply to payments made using usual and customary rates, as defined by Title 17, for services provided by regional centers, nor to state and local governmental agencies, the University of California, or the California State University.

¹ All citations are to the Welfare and Institutions Code unless otherwise stated.

An entity subject to the above must provide copies of the independent audit or independent review report and accompanying management letters, to the vendoring regional center within 30 days after completion of the audit or review. Regional centers receiving the audit or review reports must review and require resolution by the entity for issues identified in the report that have an impact on regional center services. Regional centers must also take appropriate action, up to termination of vendorization, for lack of adequate resolution of issues. Regional centers must notify the Department of all qualified opinion reports or reports noting significant issues that directly or indirectly impact regional center services within 30 days after receipt. The notification must include a plan for resolution of issues.

An independent review of financial statements must be performed by an independent accounting firm and must cover, at a minimum:

- An inquiry as to the entity's accounting principles and practices and methods used in applying them.
- An inquiry as to the entity's procedures for recording, classifying, and summarizing transactions and accumulating information.
- Analytical procedures designed to identify relationships or items that appear to be unusual.
- An inquiry about budgetary actions taken at meetings of the board of directors or other comparable meetings.
- An inquiry about whether the financial statements have been properly prepared in conformity with generally accepted accounting principles and whether any events subsequent to the date of the financial statements would have a material effect on the statements under review; and,
- Working papers prepared in connection with a review of financial statements describing the items covered as well as any unusual items, including their disposition.

An independent review report must cover, at a minimum:

- Certification that the review was performed in accordance with standards established by the American Institute of Certified Public Accountants.
- Certification that the statements are the representations of management.
- Certification that the review consisted of inquiries and analytical procedures that are lesser in scope than those of an audit; and,
- Certification that the accountant is not aware of any material modifications that need to be made to the statements for them to be in conformity with generally accepted accounting principles.

This new section also prohibits the Department from considering a request for adjustments to rates submitted in accordance with Title 17 by an entity receiving payments from one or more regional centers solely to fund either anticipated or unanticipated changes required to comply with the above requirements.

Implementation: The Department will be sending a letter to vendored entities/providers, based on a Uniform Fiscal System (UFS) data run, that are subject to this law. This letter will be posted on the Department's homepage and regional centers are encouraged to either post the letter on their Internet Websites, or link to it. Regional centers may have other communication avenues with service providers through which they will additionally want to disseminate this information.

Vendor (and regional center) compliance with these requirements will be monitored through audits. Revisions are being made to the Department's vendor audit protocols for the monitoring of compliance with this statute. Corresponding revisions to the DDS-ARCA Regional Center Vendor Audit Protocol, will be discussed for incorporation and regional center use in monitoring providers of residential services receiving funding from regional centers at the qualifying thresholds, or monitoring other vendors with the Department's approval pursuant to audit thresholds in regional centers' contract with the Department.

Lastly, to assist regional centers, the Department will send to regional centers an annual UFS data run identifying vendors/entities, subject to these statutory provisions. This run will be based on the prior State fiscal year expenditures in UFS although the statutory requirements and dollar thresholds for a fiscal review or audit, are based on the "entity's fiscal year". Given the Department does not have information on each impacted vendor's established fiscal year, the run to be sent to regional centers is simply to be a tool for indentifying an impacted vendor when conducting audits.

Additional clarification on implementation:

The statute requires applicable entities to contract for an audit/review and to provide copies of the audit/review and accompanying management letters to the vendoring regional center within 30 days of completion. Therefore, application of the audit/review requirement would be as follows:

- *For all entities, whether they already obtain an audit/review of their organization or whether this is the first audit/review, the requirement applies to the entity's fiscal year at the time of the statute enactment (March 24, 2011).*

- *For an entity with a July through June Fiscal Year, the requirement would apply to the audit/review performed of the July 2010 to June 2011 expenditures, which would be performed in 2011-12.*
- *For an entity with a January through December Fiscal Year, the requirement would apply to the audit/review performed of the January 2011 to December 2011 expenditures, which would be performed in 2012.*
- *For an entity with an October through September Fiscal Year, the requirement would apply to the audit/review performed of the October 2010 to September 2011 expenditures, which would likely be performed in 2011-12.*
- *For an entity with an April through March Fiscal Year, the requirement would apply to the audit/review performed of the April 2010 to March 2011 expenditures, which would likely be performed in 2011-12.*

15 PERCENT ADMINISTRATIVE CAP (section 4629.7)

Background and excerpt from the Department's June 16, 2011, letter to regional centers:

Trailer Bill Language (SB 74, effective March 24, 2011) added Section 4629.7 to the Welfare and Institutions Code requiring that all regional center contracts or agreements with service providers in which rates are determined through negotiations between the regional center and the service provider expressly require that not more than 15 percent of regional center funds be spent on administrative costs. Direct service expenditures are those costs immediately associated with the services to consumers being offered by the provider. Administrative costs include, but are not limited to, any of the following:

- Salaries, wages, and employee benefits for managerial personnel whose primary purpose is the administrative management of the entity, including, but not limited to, directors and chief executive officers.
- Salaries, wages, and benefits of employees who perform administrative functions, including, but not limited to, payroll management, personnel functions, accounting, budgeting, and facility management.
- Facility and occupancy costs, directly associated with administrative functions.
- Maintenance and repair.
- Data processing and computer support services.
- Contract and procurement activities, except those provided by a direct service employee.
- Training directly associated with administrative functions.
- Travel directly associated with administrative functions.
- Licenses directly associated with administrative functions.
- Taxes.
- Interest.
- Property insurance.

- Personal liability insurance directly associated with administrative functions.
- Depreciation.
- General expenses, including, but not limited to, communication costs and supplies directly associated with administrative functions.

Implementation: All contracts or agreements with vendors with a negotiated rate must be amended to expressly require that not more than 15 percent of regional center funds be spent on administrative costs. This law is applicable to all negotiated rates and providers of such services, not just prospectively. Should it be determined that the negotiated rate is comprised of more than 15 percent administrative costs, adjustments must be made to comport with law.

With regard to the question of classifying profit, profit is revenue above cost and the statute only applies to cost. Typically, profit translates into a cost (i.e., wage/salary increase, bonus, etc.).”

Additional clarification on implementation:

Questions have been raised regarding the treatment of “indirect costs” and whether they are considered administrative costs. Indirect costs represent expenditures not initially categorized as direct or administrative costs but later allocated to direct and administrative cost centers using formulas established by the entity to fairly and appropriately distribute these costs. Therefore, a portion of indirect costs are allocated to administrative activity and a portion to direct activity.

We were also asked if “direct costs” were limited to expenditures solely associated with “face to face consumer time” or “billable time”. Direct costs can include expenditures beyond those directly related to consumer face to face or billable time (e.g. salary, benefits, travel, etc.). For example, costs associated with drafting consumer notes or report writing by direct service providers can be considered direct costs, as they directly relate to the service being provided. As explained above, a portion of indirect costs are allocated to, and therefore considered, direct costs even though they are not directly related to consumer face to face or billable time.

To ensure appropriate application of the administrative cost cap, the phrase “directly associated with administrative functions” was added in the statute to some cost categories. These cost categories often have expenditures that can be directly associated with an administrative or direct activity. For example, training received by an organization’s fiscal staff on accounting procedures would be considered administrative costs. However, training received by a therapist on new service techniques would be considered direct costs. Although the maintenance and repair cost category does not

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include the specific phrase, repair and maintenance of vehicles for a transportation provider would be considered a direct cost as it relates specifically to the service being provided. However, repair and maintenance of the office heating and air conditioning system would be considered administrative.

Clarification was also requested regarding the application of the statute to supported living services. When a provider of supported living services receives regional center funding through both service code 894 and 896 in the delivery of consumer services, these rates (and their cost elements) must be looked at in tandem when applying the statutory cap on administrative costs.

The Department was also asked if the requirement applies to only new contracts and agreements. The statute clearly states "notwithstanding any other provision of law, all (emphasis added) contracts and agreements with service providers in which rates are determined through negotiations between the regional center and the service provider shall expressly require that not more than 15 percent of regional center funds be spent on administrative costs." Therefore, the provision is not limited to new contracts or agreements, but applies to all negotiated contracts and agreements.

The complete text of each of the sections discussed in this letter is enclosed. The Department will post this correspondence on its Internet homepage so that this clarifying information is also available to service providers, consumers and families, and other interested parties. If you have any questions, please contact Brian Winfield, Manager, Regional Center Operations Section, at (916) 654-1569.

Sincerely,

Original Signed By

RITA WALKER
Deputy Director
Community Operations Division

Enclosure

cc: Mark Hutchinson, DDS
Karyn Meyreles, DDS
Ed Yan, DDS
ARCA
Regional Center Administrators

Excerpt from SB 74, Chapter 9, Statutes of 2011

SEC. 13. Section 4652.5 is added to the Welfare and Institutions Code, to read:

4652.5. (a) (1) An entity receiving payments from one or more regional centers shall contract with an independent accounting firm for an audit or review of its financial statements subject to all of the following:

(A) When the amount received from the regional center or regional centers during the entity's fiscal year is more than or equal to two hundred fifty thousand dollars (\$250,000) but less than five hundred thousand dollars (\$500,000), the entity shall obtain an independent audit or independent review report of its financial statements for the period. Consistent with Subchapter 21 (commencing with Section 58800) of Title 17 of the California Code of Regulations, this subdivision shall also apply to work activity program providers receiving less than two hundred fifty thousand dollars (\$250,000).

(B) When the amount received from the regional center or regional centers during the entity's fiscal year is equal to or more than five hundred thousand dollars (\$500,000), the entity shall obtain an independent audit of its financial statements for the period.

(2) This requirement does not apply to payments made using usual and customary rates, as defined by Title 17 of the California Code of Regulations, for services provided by regional centers.

(3) This requirement does not apply to state and local governmental agencies, the University of California, or the California State University.

(b) An entity subject to subdivision (a) shall provide copies of the independent audit or independent review report required by subdivision (a), and accompanying management letters, to the vendoring regional center within 30 days after completion of the audit or review.

(c) Regional centers receiving the audit or review reports required by subdivision (b) shall review and require resolution by the entity for issues identified in the report that have an impact on regional center services. Regional centers shall take appropriate action, up to termination of vendorization, for lack of adequate resolution of issues.

(d) Regional centers shall notify the department of all qualified opinion reports or reports noting significant issues that directly or indirectly impact regional center services within 30 days after receipt. Notification shall include a plan for resolution of issues.

(e) For purposes of this section, an independent review of financial statements must be performed by an independent accounting firm and shall cover, at a minimum, all of the following:

(1) An inquiry as to the entity's accounting principles and practices and methods used in applying them.

(2) An inquiry as to the entity's procedures for recording, classifying, and summarizing transactions and accumulating information.

(3) Analytical procedures designed to identify relationships or items that appear to be unusual.

(4) An inquiry about budgetary actions taken at meetings of the board of directors or other comparable meetings.

(5) An inquiry about whether the financial statements have been properly prepared in conformity with generally accepted accounting principles and whether any events subsequent to the date of the financial statements would have a material effect on the statements under review.

(6) Working papers prepared in connection with a review of financial statements describing the items covered as well as any unusual items, including their disposition.

(f) For purposes of this section, an independent review report shall cover, at a minimum, all of the following:

(1) Certification that the review was performed in accordance with standards established by the American Institute of Certified Public Accountants.

(2) Certification that the statements are the representations of management.

(3) Certification that the review consisted of inquiries and analytical procedures that are lesser in scope than those of an audit.

(4) Certification that the accountant is not aware of any material modifications that need to be made to the statements for them to be in conformity with generally accepted accounting principles.

(g) The department shall not consider a request for adjustments to rates submitted in accordance with Title 17 of the California Code of Regulations by an entity receiving payments from one or more regional centers solely to fund either anticipated or unanticipated changes required to comply with this section.

SEC. 8. Section 4629.7 is added to the Welfare and Institutions Code, to read:

4629.7. (a) Notwithstanding any other provision of law, all regional center contracts or agreements with service providers in which rates are determined through negotiations between the regional center and the service provider shall expressly require that not more than 15 percent of regional center funds be spent on administrative costs. For purposes of this subdivision, direct service expenditures are those costs immediately associated with the services to consumers being offered by the provider. Funds spent on direct services shall not include any administrative costs. Administrative costs include, but are not limited to, any of the following:

(1) Salaries, wages, and employee benefits for managerial personnel whose primary purpose is the administrative management of the entity, including, but not limited to, directors and chief executive officers.

(2) Salaries, wages, and benefits of employees who perform administrative functions, including, but not limited to, payroll management, personnel functions, accounting, budgeting, and facility management.

(3) Facility and occupancy costs, directly associated with administrative functions.

(4) Maintenance and repair.

(5) Data processing and computer support services.

(6) Contract and procurement activities, except those provided by a direct service employee.

- (7) Training directly associated with administrative functions.
 - (8) Travel directly associated with administrative functions.
 - (9) Licenses directly associated with administrative functions.
 - (10) Taxes.
 - (11) Interest.
 - (12) Property insurance.
 - (13) Personal liability insurance directly associated with administrative functions.
 - (14) Depreciation.
 - (15) General expenses, including, but not limited to, communication costs and supplies directly associated with administrative functions.
- (b) Notwithstanding any other provision of law, all contracts between the department and the regional centers shall require that not more than 15 percent of all funds appropriated through the regional center's operations budget shall be spent on administrative costs. For purposes of this subdivision, "direct services" includes, but is not limited to, service coordination, assessment and diagnosis, monitoring of consumer services, quality assurance, and clinical services. Funds spent on direct services shall not include any administrative costs. For purposes of this subdivision, administrative costs include, but are not limited to, any of the following:
- (1) Salaries, wages, and employee benefits for managerial personnel whose primary purpose is the administrative management of the regional center, including, but not limited to, directors and chief executive officers.
 - (2) Salaries, wages, and benefits of employees who perform administrative functions, including, but not limited to, payroll management, personnel functions, accounting, budgeting, auditing, and facility management.
 - (3) Facility and occupancy costs, directly associated with administrative functions.
 - (4) Maintenance and repair.
 - (5) Data processing and computer support services.
 - (6) Contract and procurement activities, except those performed by direct service employees.
 - (7) Training directly associated with administrative functions.
 - (8) Travel directly associated with administrative functions.
 - (9) Licenses directly associated with administrative functions.
 - (10) Taxes.
 - (11) Interest.
 - (12) Property insurance.
 - (13) Personal liability insurance directly associated with administrative functions.
 - (14) Depreciation.
 - (15) General expenses, including, but not limited to, communication costs and supplies directly associated with administrative functions.
- (c) Consistent with subdivision (a), service providers and contractors, upon request, shall provide regional centers with access to any books, documents, papers, computerized data, source documents, consumer records, or other records pertaining to the service providers' and contractors' negotiated rates.