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Members of the Arizona Legislature

The Honorable Jane Dee Hull, Governor

Mr. John Clayton, Director
Department of Economic Security

In response to the provisions of Laws 1999, Chapter 292 §1, the Office of the Auditor General has reviewed the status of the electronic benefit transfer pilot program of the Division of Developmental Disabilities (Division) in the Department of Economic Security.

Summary

In 1997, the Legislature established a requirement for the Division to implement an electronic benefit transfer (EBT) pilot program. The program's goals were to simplify the payment process and to reduce administrative costs associated with issuing checks in order to facilitate the Division's consumers' choice of service provider. However, the Division has been unsuccessful in its efforts to obtain bids to implement the program. The Division approached three vendors, all of which declined to submit proposals.

Although the Division was unable to implement the EBT program, it identified an alternative—a fiscal intermediary program. The Division believes this program would simplify the payment process, facilitate consumer choice, and help its consumers make income tax, Social Security, and other payments that are not currently being withheld for their service providers. However, because there is no funding available to pay for the additional costs of hiring fiscal intermediaries, the Division has indefinitely postponed the fiscal intermediary program.

Legislative History

The Legislature initially established the requirement for an electronic benefit transfer pilot program in Laws 1997, Chapter 299 §5. The program would change the way the Division pays for the services it provides to its clients, or consumers, as the Division refers to them. These consumers are persons who meet the statutory definition of developmental disability. They have mental or physical impairments that result in substantial functional limitations and require special services for extended or even lifelong durations. The Division pays for a wide

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variety of services for these consumers, including attendant care, habilitation, group home room and board, day treatment and training, nursing, physical therapy, transportation, and respite. Currently, the Division issues checks to the service providers who provide the services. EBT typically entails issuing a magnetic strip card, similar to a bank debit card, to enable consumers to pay for their benefits through point-of-sale devices and automatic teller machines. Division officials believe EBT was intended to facilitate its consumers' ability to choose service providers by simplifying payment and to save administrative costs associated with issuing checks.

The same legislation established the Joint Legislative Developmental Disabilities Oversight Committee and set implementation dates for the pilot program. It directed the Committee to monitor the pilot program's implementation, study the feasibility of redesigning the Division's service delivery system, and monitor the Division's strategies to reduce paperwork and market an expanded voucher system and other programs. The pilot program was to be established in two counties chosen based on total population, and to begin on April 1, 1998, and end on July 31, 2000. These dates were changed to July 1, 2000, and June 30, 2002, respectively, by Laws 1999, Chapter 292 §1.

Electronic Benefit Transfer

Initially, legislators and department administrators hoped to add the Division's consumers to the Department's existing EBT program. The Department uses EBT in its food stamp and cash assistance programs. In these programs, clients receive a magnetic strip card to use at stores and banks. Citicorp, the Department's contractor, processes the transactions. The federal government requires EBT for all food stamp programs under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (welfare reform). Arizona's existing EBT program implementation costs totaled approximately $21 million, and the Department continues to pay transaction fees and equipment costs for point-of-sale devices. All these costs, shared equally between the federal government and the State, are more than offset by savings in administrative expenses and reduction in food stamp losses, according to the Department's cost-benefit analysis report to the federal government at the time of implementation.

Despite the apparent success of the Department's EBT program for food stamps and cash assistance, three vendors that the Division approached declined to submit proposals for the EBT program. In early 1998, department officials met with Citicorp and its subcontractor to discuss adapting the contractors' technology to include the Division. The director reported to the Oversight Committee chair in a February 1998 letter that the initial meetings were positive, and Citicorp intended to submit a proposal after receiving and analyzing information about the Division's automation systems. Division officials believed Citicorp expected to include the Division at no additional cost. However, Citicorp determined it would not be cost-effective for it to include the Division unless the Division paid for point-of-sale devices, installation and wiring, and software. Subsequent approaches to two other vendors were also unsuccessful.

The vendors the Division approached identified two primary reasons why, despite the success of the Department's existing EBT program, they were not interested in pursuing the Division's program:

- The volume of transactions is much lower than in the food stamp and cash assistance programs. In June 2002, the Department had 151,327 food stamp households and 41,172 cash assistance recipients, compared to only 20,740 division consumers. According to the former assistant director of the Division, the potential vendors felt the volume was too small to make it cost-effective for the vendors to invest in equipment and software to provide EBT for the Division.

- The Division's consumers do not have point-of-sale devices in their homes where many division services are provided. For example, providers deliver attendant care, housekeeping, habilitation support, respite, and transportation to consumers who live in their own or their families' homes. The Department's existing EBT program for food stamps and cash assistance uses the point-of-sale devices located in retail grocery stores and banks.

Fiscal Intermediary Program

Division officials believe an alternative plan called a fiscal intermediary program could be used instead of an EBT program to simplify the payment process and facilitate consumer choice. However, such a program would not reduce administrative costs. Although division officials believe the program can eventually pay for itself, Division-endorsed studies indicate it will initially increase administrative costs.

Fiscal intermediaries act as agents for consumers and families who choose to employ individuals as service providers. The fiscal intermediary performs the accounting functions required of employers, including payroll, payroll taxes, workers' compensation, and unemployment insurance. For doing these tasks, the intermediary receives a fixed monthly fee for each participating consumer. Consumers who choose to obtain services from a service provider agency do not need fiscal intermediaries because the agency employs the people who actually perform the services, and the agency handles its own payroll, tax, and insurance duties.

Division officials believe intermediaries would give consumers increased control over their services by providing them more timely information about the amount of authorized services they have received, and by making it easier for consumers to employ persons to serve as individual providers. The consumers originally identify many individual providers, and the Division believes intermediaries could help these individual providers complete the processes necessary to receive payments.

Because of the start-up costs and monthly fees, the Division's plan will result in additional costs to the Division, although the exact costs cannot be determined until after the Division issues a Request for Proposals. However, the Division's management consultant estimates start-up costs, in addition to the consulting fees already expended, would be about $300,000.[1] These start-up costs would include the costs of implementing the necessary accounting and recordkeeping systems; preparing manuals, brochures, and other training materials; and providing training and technical assistance to the Division's consumers, the intermediaries, and the individual service providers. Fees that would be paid to the intermediaries could vary significantly depending on the bids the Division receives. Based on their knowledge of programs in other states, the Division's management consultant reported that payments for fiscal intermediaries are generally about $50 monthly per customer. However, the Division hopes that, based on the interest level that potential bidders have exhibited, there could be sufficient competition to produce rates as low as $30 monthly per customer. Therefore, depending on the payment levels, the estimated payments to fiscal intermediaries could range from $850,000 to over $1.4 million annually. However, based on preliminary communications with AHCCCS, the Division believes that Medicaid may pay for 65 percent of these costs.

Despite these costs, the Division believes the fiscal intermediary program can eventually pay for itself. A review of payment rates shows that depending on the service provided, rates paid to individual service providers can be 35-40 percent lower than rates paid to service provider agencies. The Division believes using fiscal intermediaries will result in more consumers switching to individual providers for services. The Division's management consultant prepared an estimate of the fiscal impact of the fiscal intermediary program that showed that the program could break even by 2005. However, this estimate assumed that the Division could hire intermediaries at the $30-per-month rate and that the number of consumers receiving services from independent providers would increase from 2,300 to 4,200 per year. The Division has not developed data to determine whether the assumptions about the $30-per-month payment rate or the increased use of individual providers can be relied upon. Further, the Division's consultant was unable to provide us any information to support the feasibility of a $30-per-month rate. Regardless, until the program could become self-sufficient, the Division would still need to either reduce services or receive increased funding to pay for the additional costs of using intermediaries.

Tax and Insurance for Individual Service Providers

The Division also sees fiscal intermediaries as a way of assisting their consumers to pay taxes and make other required payments for the individual services providers—payments that have not been made in the past. The Division has historically regarded the individual service providers as independent contractors. It pays them an hourly rate, but makes no provision for their withholding taxes and employee-related expenses. Our review found and the Division concurs that the individual service providers do not appear to meet the IRS' guidelines for in-

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1 The Division employs a management consultant, EP&P Consulting, to support its budgetary processes, policy analysis, and initiatives and projects. EP&P has conducted background research and developed a trend analysis for the program, prepared a concept paper, and developed the Request for Information and Request for Proposals. So far, the Division has paid EP&P $243,485 for its services related to the fiscal intermediary program.

dependent contractors. Instead, it appears the Division's consumers are responsible for seeing that payments are made for unemployment insurance, Medicare, Social Security, and income tax withholding for the individual service providers.

Division officials believe their consumers are generally unaware of this responsibility and that many do not have the knowledge and means to ensure the withholdings occur. The Division is concerned about the potential liability this is creating for their consumers. The Division is now considering educating its consumers on their responsibilities for ensuring that tax and other payments are withheld.

Status of the Fiscal Intermediary Program

Currently, the Division's plan for implementing the fiscal intermediary program is on hold. The Division went so far as to complete a draft Request for Proposals in March 2002 and held a Request for Information meeting with several potential contractors. However, costs involved with the program and the weakening position of the state budget prevented further development. The Division still intends to pursue the program, but given the State's fiscal condition, does not know when it may do so.

Recommendations:

1. The Division should develop additional information to test and support its assumptions that the fiscal intermediary program can be self-funding before it is implemented.

2. The Division should inform and educate its consumers about their status and responsibilities as the employers of individual service providers.

We have reviewed the results of this work with the Division of Developmental Disabilities in the Department of Economic Security, and their response is enclosed. My staff and I will be pleased to discuss or clarify items in this letter.

Sincerely,

Debbie Davenport
Auditor General

cc: Joint Legislative Audit Committee members
Senate Family Services Committee members
House Human Services Committee members