ARIZONA DEPARTMENT OF ECONOMIC SECURITY
1717 W. Jefferson • P.O. Box 6123 • Phoenix, AZ 85005

Janet Napolitano
Governor

Tracy L. Wareing
Director

APR 19 2007
OFFICE OF THE PRESIDENT

APR 18 2007

The Honorable Timothy S. Bee
President of the Senate
Arizona State Senate
1700 West Washington
Phoenix, Arizona 85007

Dear President Bee:

This is the fourth in a series of quarterly reports on child welfare case management privatization submitted by the Department of Economic Security (DES) to the Joint Legislative Budget Committee (JLBC) as required by the JLBC as a result of its February 28, 2006 meeting. In the January 5, 2006 report, DES informed the JLBC that a briefing document was being prepared defining risk in child welfare privatization, a synopsis of what proponents and critics say about the legalities of privatization, and the identification of financial risk associated with different structural designs and payment arrangements. The attached briefing paper, entitled "The Impact and Risk of Child Welfare Privatization", was prepared by Charlotte McCullough of McCullough & Associates, Inc. and Madelyn Freundlich of Excal Consulting.

Based upon the briefing paper's discussion of legal issues and risks beginning on page 4, DES requested the federal Department of Health and Human Services (DHHS), Region IX Office, to provide guidance on its interpretation of the public agency's "overall responsibility for child welfare services". In addition, DES requested clarification of the federal interpretation of The Child and Family Services Improvement Act of 2006 (Public Law 109-288) that was signed into law by President George W. Bush on September 28, 2006. The new law makes changes to Title IV-B, subparts 1 and 2, of the Social Security Act and requires states to describe in their state plans by October 1, 2007, standards for the content and frequency of caseworker visits for children in foster care. These new requirements for children under responsibility of the state must, at a minimum, be monthly and focus on case planning and service delivery. States are required to establish by June 30, 2008, an outline of steps to be taken to ensure that 90 percent of children in foster care are visited by their case managers on a monthly basis by October 1, 2011 and that the majority of these visits occur in the residence of the child. The outline must include target percentages to be reached each fiscal year. States not meeting their annual targets will be subject to an increase in the state matching requirement for Title IV-B, subpart 1 funds. These changes will impact any further privatization activities by DES.

Information about current DES initiatives and contracts that include privatized case management components is also attached for JLBC's information. Although these do not encompass the full range of case management services proposed by the Public/Private Partnership Oversight Committee, it is prudent for DES to evaluate these initiatives not only to learn about the Department's capacity to effectively monitor contracts but also to learn about the capacity of private agencies to improve outcomes for children and families. In addition to the evaluations of these initiatives, DES will have the opportunity to learn from DHHS' funding of two multi-year initiatives in other jurisdictions to better understand the privatization of child welfare services. It is anticipated that these projects will yield information that will result in clearer guidance from the federal government on the impact of privatizing child welfare services. Funding for these projects is from January 2007 through September 2010.

The Department of Economic Security will reconvene the Public/Private Partnership Oversight Committee prior to the next quarterly report to the JLBC to review and discuss the attached briefing paper, the anticipated response from DHHS regarding the federal interpretation of Public Law 109-288, and next steps.

If you have any questions, please contact me at (602) 542-5757.

Sincerely,

Tracy L. Wareing

Tracy L. Wareing
Director

Attachments

cc: Members of the Joint Legislative Budget Committee
Speaker James P. Weiers, Arizona State House of Representatives
Richard Stavneak, Director, Joint Legislative Budget Committee
James Apperson, Director, Office of Strategic Planning and Budgeting

<u>**Attachment**</u>

DEPARTMENT OF ECONOMIC SECURITY
DIVISION OF CHILDREN, YOUTH AND FAMILIES

Privatized Child Welfare Case Management Initiatives and Contracts

- In June 2005, Arizona was approved by the U.S. Department of Health and Human Services for a Title IV-E Demonstration Project, to seek to expedite reunification for children placed in congregate and licensed foster home settings through several innovative child welfare service strategies. Demonstration participants have access to intensive home-based interventions including individual and family therapy, family assessments, and intensive case management. Arizona's demonstration takes place in two project phases. Phase I was implemented in April 2006 for a 15-month period in randomly selected Child Protective Services (CPS) units in the Mesa, Thunderbird, and Tempe CPS offices in Maricopa County. Depending in part on initial evaluation findings from Phase I, the Department of Economic Security (DES) may expand the demonstration to other CPS offices in Maricopa and Pima Counties and to one or more rural Arizona counties. Service contracts were awarded in March 2006 to two community agencies to provide expedited reunification services.

  The Department of Economic Security contracted with the Center for Applied Behavioral Health Policy, Arizona State University, to evaluate its Title IV-E Demonstration Waiver. One of the evaluation components is an outcome evaluation that will compare the experimental and control groups for significant differences in program outcomes. The evaluation will also include a cost analysis that will examine the costs of key elements of the services received by persons in the experimental group and compare these costs with those of the usual services/placements received by the comparison group. The cost analysis will include an examination of the use of key funding sources, including all relevant Federal sources such as Titles IV-B, IV-E and XIX of the Social Security Act, as well as State and local funds. Where feasible, a cost-effectiveness analysis to identify the cost per successful outcome for the experimental and comparison groups will be performed.

- In January 2006, DES contracted with 10 community agencies to provide comprehensive in-home services statewide. Services are family-centered, comprehensive, coordinated, community based, accessible, and culturally responsive. The integrated services model includes two service levels based on the needs of the child and family, moderate and intensive. At a minimum, moderate-level services include case management and parent-aide services. Intensive-level services include crisis intervention, in addition to case management and parent aide services.

  DES is meeting with the contracted providers to evaluate whether appropriate cases are being referred, resolve any barriers, and monitor the quality of services provided. The contract specifies outcomes that the provider must achieve. Provider required program reports include an Annual Report of Performance based upon specified outcomes and a semi-annual statement of services including costs or percent of services provided by other funding sources such as Title XIX. The Office of the Auditor General issued an Information brief in November 2006, describing the In-Home Services Program and plans to complete a performance audit of this program during fiscal year 2008.

In addition to the above initiatives, the DES contracts with Casey Family Programs for a "Child Welfare Demonstration Project" and with Catholic Community Services of Southern Arizona, Inc. for Adoption Services:

- The Casey Family Programs contract began in October 2004 and is designed to assist DES and Casey Family Programs, Phoenix and Tucson Offices, in determining how best to serve children, youth and families while systemically identifying and advancing sustainable and scalable improvements to the Department's child welfare system. This contract serves children 12 through 17 years of age who are adjudicated dependent and are in the legal custody of DES. Services include case management, educational supports, job training, housing supports, and life skills training.

- The Catholic Community Services of Southern Arizona, Inc. contract began in December 2001 in Pima County and provides Adoption Services. Adoption Services include adoptive home recruitment, adoptive home studies, placement of children in adoptive homes, and supervision of children and their families until adoptions are finalized. In addition, this service provides secondary case management under supervision of CPS.

ARIZONA DEPARTMENT OF ECONOMIC SECURITY
Division of Children, Youth and Families

The Impact and Risk of Child Welfare Privatization

February 2007

A report prepared by Charlotte McCullough, McCullough & Associates
and Madelyn Freundlich, Excal Consulting

EXECUTIVE SUMMARY

Laws 2005, Chapter 286, Section 29 (SB 1513) required the Department of Economic Security (DES) to "submit for review by the joint legislative budget committee options for the privatization of portions of the case management duties for child protective services." DES procured the services of McCullough & Associates to complete the research, facilitation, data collection, and analysis necessary to identify options for privatization of certain case management functions of the Division of Children, Youth and Families (Division). The final report, submitted in December 2005, included a synopsis of research findings related to privatized child welfare services, including options for the privatization of case management; an assessment of Arizona's readiness to pursue a privatization effort; and a series of recommendations to guide DES in planning for any potential privatization initiative.

At its February 28, 2006 meeting, the Joint Legislative Budget Committee (JLBC) reviewed the final report and requested that the Department, among other requirements, "identify and report to the JLBC the potential legal, financial and other risk impacts of privatization." This briefing paper, prepared by Charlotte McCullough of McCullough & Associates, Inc. and Madelyn Freundlich of Excal Consulting, was prepared in response to this request.

This document focuses specifically on the impact and potential risks of privatizing case management and related case planning activities. This focus is based on four key factors. First, privatization of case management was the focus of SB 1513. Second, these services are increasingly being provided by private agencies in other States. Third, case management is at the heart of child welfare. A program's success in keeping children safe and achieving timely permanency is dependent on the case manager's ability to work with the child and family to identify problem areas and ensure that children and families receive appropriate services to meet their needs. By the nature of their jobs, case managers have considerable discretion in determining what is in the best interest of the child and in making decisions that may permanently affect the child's and family's life. Finally, it is the privatization of case management that is central to many of the critics' of child welfare privatization concerns and is the focus of current federally funded research studies.

This document is organized in five sections:

I. A brief summary of trends and options;

II. Federal efforts;

III. An examination of potential legal issues;

IV. A description of potential financial risks; and,

V. An assessment of how design and implementation decisions impact both financial and non-financial risks.

I. Summary of National Trends in Privatization

Any consideration of options for the privatization of child welfare case management requires an understanding of the historical and current context of child welfare privatization. Privatization, generally defined as "the provision of publicly funded services and activities by non-governmental entities," has been widely used by child welfare systems across the United States. Privatization of child welfare services is not a new concept. Even before the publicly funded child welfare safety net was developed, sectarian and non-sectarian agencies created and funded various services analogous to today's child protection, congregate care, and foster care services. Since the emergence of publicly funded child welfare in the 1880s, state and local governments have paid private, voluntary agencies to provide various in-home, community-based, and out-of-home care services.

In the current environment, contracting (also called "outsourcing") is the most common form of privatization in the areas of child welfare, behavior health and juvenile justice. However, unlike the former informal, noncompetitive arrangements between public agencies and nonprofit providers, today's contracts are typically awarded after a competitive procurement process.

The services that are privatized and the manner in which payment is made have also changed. Until the past decade, it was uniform practice that public agencies retained case management decisions and control over the types, amount, and duration of non-case management services that were delivered by the private sector. Under this traditional child welfare per diem, fee-for-service, or other cost-reimbursement contracting model, the private agency simply agreed to provide placement or non-placement services to a certain number of children in return for payment based on a pre-determined rate. The contractor was paid to deliver units of service and rarely was reimbursement linked to any measures of effectiveness of the services provided. Such a payment approach offered few incentives for service providers to control costs, to build a more suitable array of services as an alternative to placement, or to more quickly return children to their families. In fact, these contracts provided incentives to continue delivering more of the same service whether children needed these services or not. If case management were privatized under these same rules, the results for children and families would likely be not much different from today.

Three dynamics have characterized the great majority of recent efforts that have included the privatization of child welfare case management services: a focus on quality through the purchasing of results rather than services, the development of outcomes related to state and federal mandates, and financing mechanisms that link implicit or explicit incentives to performance. The specific features of these privatization initiatives, however, have varied considerably. Wide differences exist in the geographical reach of these efforts, the range of services privatized, the population served, the degree of public agency involvement in ongoing case management, the structural design of the initiatives, the funding approaches utilized, and the specific mechanisms used to align financing with desired results. As examples, some privatization efforts have been statewide, while others have been implemented in designated regions or counties. Some initiatives have privatized the full range of child welfare services (with the exception of child protective services), while others have focused on services to children with more intensive needs. The lead agency model is the most common structural design, but other approaches have been implemented. Financial methodologies have ranged from case rates to global budget transfers.

When privatized initiatives are well designed and administered and supported with adequate funds, promising practices and innovations may emerge. For example, independent evaluations have noted that in some initiatives, the privatized case management system introduced best practice strategies that were not apparent or widely used in the previous public system including: system of care designs that reflected wraparound values/principles, a more rigorous emphasis on family engagement and the use of family team conferencing for the development and revision of all case plans, the introduction of evidence-based practices and decision support tools, added supports for case managers and new standards that require frequent contact and continuity in care for children and families, requirements that agencies meet national accreditation requirements, expanded services created through community service networks, improved use of technology, and added training and supports for caregivers. Great variability, however, has been noted in the extent to which individual initiatives have successfully implemented and sustained these best practice strategies.

In spite of innovations in some initiatives, the privatization of case management services in child welfare has generally produced mixed results regarding both the effectiveness of these efforts in achieving improved outcomes for children and families and cost efficiency. Evaluations of existing privatization efforts demonstrate great variability in the extent to which these initiatives have succeeded in improving the safety, well-being, and permanency of children served by child welfare systems and the well-being of their families. When compared to non-privatized systems, the results have in some cases been far better and in some cases, poorer.

Research studies consistently describe a number of challenges that must be overcome in privatizing case management services in child welfare. In case studies, public child welfare agencies and private case management agencies most often cite difficulties in: developing an adequate data collection and analysis capacity, appropriately defining the roles of private agency case managers and public agency staff, developing needed service capacity, developing the "right" outcomes, appropriately aligning resources with expectations, crafting effective financing strategies, ensuring that private agencies have the requisite practice and business expertise, recruiting and retaining quality staff, and ensuring that private agencies have an understanding of legal issues and effective relationships with the courts. Researchers have also noted other barriers that appear to be correlated with the lack of success of some privatization efforts including: limited funding, rigidity in procedures, problematically drafted contracts, overdone or underdone monitoring, limited consumer involvement, and lack of attention to cultural and linguistic issues.

Based upon national research findings, key factors for success, across different designs, appear to relate to the sophistication of the purchaser in planning, procurement, and contract oversight; the alignment of resources with expectations; the adequacy of funding and contractor rates; the buy-in from stakeholders; the care with which system designs were developed; the clarity and appropriateness of the expected outcomes; and the infrastructure, leadership, and innovation of the contractor and the public purchaser.

In summary, although privatization of child welfare services has been widely used throughout the nation in the form of contracting out for services, the privatization of case management services specifically is a much more recent phenomena and has had mixed results - both with regard to its effectiveness in improving outcomes for children and families and in cost efficiency. Not surprisingly, many of the factors that are necessary for successful privatization are the same factors that characterize an effective public sector case management system. Although privatization of case management has in some instances improved results, privatization is not a panacea for an under-funded and understaffed delivery system with limited service capacity.

II. Federal Efforts

Given the growing interest in and use of child welfare privatization in recent years, both the Administration for Children and Families (ACF) and the Office of the Assistant Secretary for Planning and Evaluation (ASPE) within the U.S. Department of Health and Human Services (DHHS) are currently funding multi-year initiatives to better understand the privatization of child welfare services. It is possible that one or both of these projects will yield information that may result in clearer guidance from the federal government on which services, if any, cannot or should not be privatized and which types of privatized services appear to offer the greatest promise in improving results for children and families. These projects include:

- *The Quality Improvement Center on the Privatization of Child Welfare Services (QIC PCW) was established in 2005 by ACF* to better understand the range and scope of child welfare privatization efforts. Some states, such as Kansas and Florida, have undergone significant reform, moving large segments of their service array into the private domain, while others have taken a much more limited approach, implementing pilot initiatives, outsourcing small segments of the service array for particular groups of clients, or particular geographic areas. However, the extent to which states are implementing such efforts, what these partnerships look like, and best practices for managing these relationships are largely unknown. A key function of the QIC PCW is to assess the current status of privatization of child welfare services, and to pull together evolving information and make it widely accessible. Through a competitive application process, the QIC PCW and the Children's Bureau have selected the following projects for funding beginning January 1, 2007 through September 30, 2010. These projects will be testing models of *performance-based contracting and quality assurance systems*. Results are due towards the end of the grant period. Following are brief descriptions of the three grantees.
    - *Florida's Department of Children and Families (DCF) District 13* will implement *the Performance Based Contracting and Quality Assurance Systems Demonstration Project* which is a partnership between DCF / District 13 and Kids Central, Inc. They intend to demonstrate that a comprehensive planning process leading to the development of performance-based contracts and inclusion of performance measures in the quality assurance process leads to improved outcomes for children in out-of-home care. The local site evaluation will be conducted by Jean K. Elder & Associates.
    - *Illinois Department of Children and Family Services* will be partnering with the *Child Care Association of Illinois* to implement the *Striving for Excellence: Extending Performance Based Contracting to Residential and Independent Living Programs project*. Their partnership will design, implement and evaluate the extension of the state's existing performance based contracting and quality assurance system to residential, independent living and transitional living programs in order to improve outcomes for this population of out-of-home care youth. The local site evaluation will be conducted by the Child Welfare Institute.

- *Missouri's Children's Division* is partnering with seven consortiums to implement the *Maintenance Needs in Performance-Based Contracting Success: The Missouri Project on Privatization of Out-of-Home Care for Children.* This project will examine the long-term maintenance supports and quality assurance processes needed to successfully implement a performance based contracting system for case management services for out-of home care and adoption. An independent evaluation will be conducted by the University of Missouri-Columbia School of Social Work.

- *Recognizing the need for more information about privatization of TANF services, ASPE funded Mathematica Policy Research to conduct a study of privatization with a special emphasis on TANF case management.* This study was designed to inform policymakers, researchers, and states and localities that are either currently contracting out or considering doing so. Built around in-depth case studies of six states or localities that have privatized TANF case management, the study described how the sites privatized portions of case management and documented the lessons learned from those TANF experiments in privatization (McConnell, Burwick, Perez-Johnson, & Winston, 2003). Building on the TANF study, *ASPE has contracted with the Urban Institute and Planning and Leaning Technologies, Inc. to develop a series of Issue Briefs on the privatization of child welfare services.*

III. Legal Issues and Risks

While all children are dependent on others for their care and well-being, children in the custody of the state are uniquely dependent upon government agencies. The public system must ensure that all needs, including physical and behavioral health needs, are properly provided. Risk-based financing arrangements created by either the child welfare or behavioral health system must not create barriers to services that undermine the unique legal protections to which children in state custody are entitled.

Most children enrolled in public sector managed care plans are in the care of their families who make decisions for them; by contrast, the courts are actively involved in planning for children in the child welfare system. Judges have the final authority to make decisions about the need for placement of a child, and they are charged with approving plans for a child's care when the child is under protective supervision. This authority might extend to ordering or approving plans for behavioral health treatment services for the child or the child's parents. The courts also serve as the final decision-maker related to achievement of the permanency goal for the child: courts must approve plans to return children to their parents, place children permanently with relatives, or free children for adoption and place them with new families. Courts often also oversee plans related to youth's discharge from out-of-home care at the age of majority.

The issues related to the legal protections for the child and the ultimate authority of the courts are important considerations when designing risk-based contracts and balancing the level of risk with the degree of autonomy contractors will have in decisions that affect risk, including decisions related to placements, level of care, length of stay, and permanency. The federal Adoption and Safe Families Act (ASFA) and the Child and Family Services Review (CFSR) process reaffirms the need for the child welfare system to forge linkages with other systems of support for families, including public sector managed care systems, and with the courts. When restructuring fiscal systems, it is essential that the required mandates of ASFA and the outcome standards that form the basis for the CFSR process remain central to the planning and the risk arrangements that are designed.

Some have questioned whether privatization of case management is a viable legal option. Although the federal government has a policy indicating that inherently government functions should not be contracted out, federal law has not addressed the nature of state public agency/private agency child welfare contracts. Instead, child welfare public-private contracting has been governed by state law and regulation (Federal Register, 2005).

Three key areas should be considered in relationship to legal issues and risk: interpretation of the federal requirement that the state child welfare agency retain "overall responsibility" for child welfare; the allocation of responsibilities for court related matters; and the development of appropriate mechanisms to address professional liability issues.

Interpretation of "Overall Responsibility" for Child Welfare

Critics of privatization have raised numerous legal concerns regarding the respective roles of the public child welfare agency and private child welfare agencies. These concerns have focused on the extent to which the State agency must maintain "overall responsibility" for child welfare decision-making in order to remain in compliance with federal regulations and meet the State's obligations under its federally-approved Title IV-E plan. Central to this issue is the concern that privatization might jeopardize the State's ability to claim federal reimbursement under Title IV-E. An issue that frequently surfaces is whether a private agency case manager would be able to perform the same functions as a public agency worker; thereby, generating the same potential to claim federal reimbursement for allowable expenses.

Texas well exemplifies the struggle States face in attempting to understand the legalities of privatized case management in connection with their "overall responsibility" for child welfare and to apply federal law and policy to the design of their privatized case management system. In the process of developing an RFP for an Independent Administrator (IA), Texas sought the opinion of the Department of Family and Protective Services'(DFPS) Legal Division on the extent to which the Department, in implementing a privatized system, was required to retain oversight responsibility in relation to the care and placement of children in its managing conservatorship. The Legal Division recommended that DFPS utilize a proactive strategy and seek approval from or, at minimum, notify the federal Administration for Children and Family (ACF) regarding the State's plan to outsource. The Legal Department recommended that the DFPS describe its plan regarding the role of DFPS and the IA in case-specific oversight and decision-making. Texas found it challenging to obtain such guidance from the ACF regional office. Acting as a consultant to DFPS at that time, our team sought guidance from Dr. Crystal Collins-Camargo of the University of Kentucky who directs the federally funded Quality Improvement Center on Child Welfare Privatization (described previously). In our conversations with her about this issue, she verified that there is no written federal guidance on this issue. ACF has not, at this point, issued policies that specifically address the level of authority and decision-making that a public agency must retain when privatizing or outsourcing child welfare services, including case management. It is unlikely, according to Dr. Collins-Camargo, that ACF will do so in the near future. She noted that with the possible exception of ACF's current position that a public agency may not outsource the determination of Title IV-E eligibility, there is no current policy that precludes the outsourcing of other child welfare functions that many public agencies have traditionally performed.

Given the absence of written policy, Dr. Collins-Camargo urged that any State moving into a privatized or outsourced system work with the relevant federal ACF regional office and seek its guidance on the State's plans or, at minimum, alert the ACF regional office to the model that will be utilized.

As has occurred in other states, Texas sought a clear interpretation of the term "overall responsibility" for the care and placement of children in out of home care which is, in essence, the requirement placed on public child welfare agencies under their Title IV-E state plans. The DFPS Legal Division concluded that DFPS' "overall responsibility" would include, on a case-specific level, "the development and revision of the case plan" and "ensuring that the child is progressing toward permanency within state and federal mandates." Lacking federal guidance on this matter, it appeared that the Legal Division relied primarily on a 20-year-old Washington Department of Social and Health Services DAB which states that the public agency's role cannot "be carried out through a contractual or regulatory relationship with a private, non-profit agency." This Washington State policy likely reflected unique policies and practices of Washington State, as its position is contrary to the practice of child welfare jurisdictions across the country with long histories of contracting with private, non-profit agencies to perform in a range of roles that public agencies had performed in the past. The relevance of the Washington State DAB was further brought into question by recent changes in federal law that now allow not only not-for-profits but for-profits to do what the DAB says not-for-profits may not do.

The Texas legal opinion that concluded that the public agency's "overall responsibility" meant that the public agency had to exercise total control over each decision regarding the child's placement and care (i.e., they concluded that case level decisions were functions that were "most certainly" non-delegable) is not representative of other States' conclusions on this issue. Public agencies in other jurisdictions that have privatized their child welfare services have not interpreted "overall responsibility" as encompassing the decision-making authority over each decision in each child's case. Instead, these jurisdictions have viewed "overall responsibility" as encompassing the retention of responsibility for ensuring, through carefully designed monitoring and oversight systems, the safety, well being and permanency of children in the agency's legal custody.

The federal ACF Child Welfare Policy Manual (8.3A.12 TITLE IV-E, Foster Care Maintenance Payments Program, Eligibility, Responsibility for placement and care) states that the public child welfare agency has the "ultimate responsibility" for the "proper operation of the foster care program." The full text from this section of the Child Welfare Policy Manual reads:

> "However, the ultimate responsibility for ensuring that there is an appropriate plan of care, case review, and activities to improve the home of the child or identify and work toward a permanency plan for the child remains with the State agency identified in the State plan as having responsibility for the placement and care of the child. Thus, the State agency must actively supervise the various activities performed by the contractor or other agency. This supervision includes case plan assessment and case review functions and adherence to the requirements of the Act, Federal rules, regulations and policy interpretations in operation of the foster care maintenance program. The State is ultimately responsible for proper operation of the foster care program."

Most privatized systems have developed and implemented policies and procedures in a manner that is consistent with the ACF Manual requirement of retention of ultimate accountability for the outcomes of children in the legal custody of public agencies. Kansas, Florida, and other States that have privatized some or all of their case management functions have proceeded on an understanding of ultimate responsibility through oversight and monitoring. These states have undergone subsequent federal reviews of both programs and their Title IV-E eligibility determination practices. There is no evidence that these States have lost Title IV-E funds as a result of privatization. Nor is there evidence that the federal government has put these States on notice that their practices and policies fail to comply with Title IV-E regulations.

> "The State is *ultimately responsible f*or proper operation of the foster care program." ACF Child Welfare Policy Manual (8.3A.12)

In summary, Arizona would need to consult with its federal ACF Region IX office and that of the Arizona Office of the Assistant Attorneys General for further guidance on interpretation of "Overall Responsibility" for Child Welfare.

Court Related Matters

Another area of legal concern with which States have grappled in planning and implementing privatized system relates to the court-related activities inherent in child welfare practice. The most common issues that arise in this area are:

- Whether private agency case managers can (or should) be allowed to participate in processes involving the filing of petitions that seek decisions on the part of the court regarding children's continued stays in foster care, their return home or placement with relatives, or the termination of parental rights.
- Whether private agency caseworkers can (or should) appear in court in cases which they manage but for which the State agency has legal responsibility.
- Whether attorneys representing the State can (or should) represent private agencies.

As with the interpretation of "overall responsibility," there is no policy guidance from the federal government on these legal issues. In an effort to address these concerns, some States have developed systems within their privatization initiatives that designate roles for both the private and public agency caseworkers. In these systems, it is common to find that the private agency case managers develop case plans with families and prepare all court related documents; public agency caseworkers review these documents prior to or at the time they are presented to the State's attorneys for filing; and public agency caseworkers attend all court hearings, either in place of or with the private agency case managers. Although these systems involve costly duplication, they are not uncommon, particularly in the early stages of privatization. Kansas, as the first State to fully privatize all services with the exception of investigations, for example, maintained a public presence at all court hearings on foster care and adoption cases through the first years of the privatized contracts.

Other states, however, have delegated these functions to private agencies. Upon privatizing, Florida, for example, delegated all court related work to private agencies. Florida maintained legal representation in each jurisdiction as it was prior to privatization (in some sites, it is attorneys with the Attorney General's office; in others, it is attorneys within the Department of

Children and Families). In some Florida jurisdictions, private agencies have created legal liaison positions to ensure smooth working relationships with the courts. The liaisons track filing deadlines, review court documents prior to filing, and monitor the performance of the private agency's case managers in court duties.

A third approach that has been used in yet other jurisdictions has been the retention of legal liaison positions within the public child welfare agencies. These liaisons work directly with private agency case managers and the courts—providing technical assistance and consultation as needed to ensure that private agency staff are fully prepared to assume critical legal functions.

> Court liaisons, based in the private or public agency, can support effective partnerships with the court and ease the transition of responsibilities when services are privatized.

In summary, we are aware of no requirement that only public agency staff may prepare court documents or appear in court on behalf of the State; similarly, we are not aware of federal guidance that states unequivocally that these functions can be delegated. We have only the experiences of other jurisdictions on which to draw.

Mechanisms to Address Professional Liability

A third area involving legal issues and risks relates to the development of mechanisms that address the professional liability of private agencies that, under privatized systems, assume case management responsibility. Typically, private agencies do not enjoy the level of immunity from litigation that public agencies hold. In all states in which we have worked, private child welfare agencies are required to carry liability insurance and do so. The combined impact, however, of dramatically increasing premiums in the child welfare sector and the assumption of increased levels of responsibility for children and families under privatization has raised a number of questions as to how public and private child welfare agencies can address professional liability issues. In several states, the proposal has been made that states confer liability immunity to agencies under contract with the state for child welfare activities. Legislative language has been proposed, for example, in Illinois which provides:

> "If the Department contracts with a private child welfare agency to provide child welfare services or to provide the arrangement of child welfare services, then the private child welfare agency and its employees shall not, as a result of their acts or omissions, be liable for civil damages, unless the acts or omissions constitute willful and wanton misconduct."

This issue can have a significant impact on states' ability to attract agencies and retain agencies within privatized systems, particularly smaller, community based agencies that provide culturally competent services but which do not have the resources to respond to litigation should it arise.

> Discussions between the public and private agencies on issues of professional liability and immunity are essential.

IV. Financial Issues & Risks

Unlike traditional payment systems, the recent privatized initiatives often use sophisticated financing mechanisms adapted from the health and behavioral health field to stimulate improved results and to share some of the financial risks with private agencies. Risk provokes anxiety, but it also can be an opportunity for improved results if providers have the appropriate level of control over decisions that directly affect risks, if there are incentives to take reasonable risks, and if mechanisms are in place to prevent unreasonable loss. In successful systems, risk is *shared*, rather than shifted between the public purchaser and the private agency. The design of a risk-based system requires an understanding of all the factors that affect risk and a willingness of the public agency to relinquish control over key decisions that directly impact the contractor's ability to bear risk.

In this section, we take a closer look at what is meant by *risk* and we examine risk-sharing mechanisms and risk-mitigating strategies as they are currently applied in various child welfare initiatives. This section is primarily focused on financial forms of risk, although other, non-financial forms of risk can and do occur. Non-financial risks (the risk of a good or bad outcome, for example) must be considered during the design or implementation of risk-sharing arrangements. From the design stage through implementation, public purchasers must monitor closely to ensure that there are no unintended consequences of the model they develop.

Risk-Sharing Terms and Concepts

<u>Risk</u> - Risk is equivalent to *uncertainty* about an outcome or cost. Uncertainty is due to *variation* that can occur in some factor that affects cost and outcomes. For example, different cases will have different lengths of stay (LOS), so LOS is a variable that is uncertain—it will not be the same in each individual case. There are four major factors that impact risk: 1) the characteristic of the population from which cases emerge; 2) the rate of referral and size of the population; 3) the intensity/duration/level of services per case (the number and type of service units per unit of time); and 4) the cost per unit of service.

<u>Financial Risk</u> - *Financial risk* can be defined as the *total cost of providing a defined scope of services for a defined population over a defined time period.* The term "*total risk*" is equivalent to "*total cost*" (over population, time, and scope of services). Actual service use and actual costs will vary from child to child and month to month, and the greater the variation, the greater the risks. Public agencies have to consider each of the components of financial risk and the inter-relationship of factors since the combined effects may be larger than the effects of the individual factors.

- *Risk for utilization*: The number and amount of services each person in the target population uses. The broader the scope of services, the more difficult it becomes to estimate the probabilities of the many different service utilization patterns, or *combinations*.
- *Risk for cost or price*: It is often easier to estimate cost or price than utilization, since providers usually have better records about and more control over costs. *Note that cost and price are not the same thing*. The provider's cost describes actual cost (e.g., salary and other fixed and variable costs). The provider's charge (price) may or may not exceed the provider's cost.

There are a number of financial approaches that can be used by child welfare systems, each of which carries some level of financial risk. These approaches are:

- Cost reimbursement, fee for service (FFS), discounted FFS and bundled rates
- Capitation
- Capped allocations
- Global budget transfers
- Case rates
- Performance incentives and payment schedules

We discuss each of these below.

Cost Reimbursement, Fees For Service (FFS), Discounted FFS, and Bundled Rates: Cost reimbursement and various fee for service arrangements, historically the most common reimbursement arrangement for child welfare, present the lowest level of risk to a private agency and the greatest risk to the public purchaser. A more recent variation has been to "bundle" formerly small, discrete service units into larger bundled service units. For example, a residential treatment center may have traditionally billed at a fixed fee for each service received by a child each day in the RTC (e.g., group therapy, medication, individual counseling, room and board). Each day's charges would vary directly in proportion to each individual child's consumption of specific services. Under a bundled rate the provider receives a global per diem rate, based on the average of all individual services billed on a daily basis. This puts the RTC at risk for variations among children in the number and type of services they need each day as well as variations across days in the services needed by any single child. However, the RTC is not at risk for additional days of care, or for the child's total length of stay. The provider's risk is limited to managing the cost of services at a level below the negotiated fee. The state as a payer still bears the risk for the underlying use rate and the average units per user.

Under discounted FFS arrangements, providers are asked to give the state a *discount* off their normal fees for a given service unit or bundled rate. The unit may be a day of care or an hour of therapy or other child and family service. The provider is at risk for the cost incurred in the process of providing the unit of service. Success will depend on how much of the unit cost is made up of *fixed* vs. *variable* components (discussed below as determinants of risk) and how well the provider manages costs so that they do not exceed the negotiated fee.

Capitation - In the purest managed care financing model, a contractor is prepaid a fixed amount for all contracted services for a defined, enrolled population for the duration of the contract. This per member, per month, population-based payment arrangement is referred to as *capitation*. In this type of arrangement, the contractor is at risk both for the number of children who use services and for the level or amount of services used. The contractor receives the predetermined amount based on the number of enrolled children regardless of the number of children who actually use services or the level of services that enrolled children require during the month. If the contractor enrolls children who subsequently underutilize services, the contractor will make a profit. Conversely, the contractor is exposed to significant financial risks if the plan is not adequately priced or if the eligible enrolled children use more services or more costly services than projected.

The extent of capitation may vary, ranging from *partial to full*. In full capitation, the provider is at risk for *all* services defined by the scope of contracted services. Partial capitation refers to instances where the provider is at risk for only *some* services, such as outpatient, and is not liable for others, such as inpatient or residential. Sometimes, partial capitation refers to circumstances where only some special *subset of a population* is the responsibility of the provider. (These arrangements are also referred to as "carve out" models in behavioral health).

There are a number of reasons cited by child welfare administrators for not extensively using pure capitation models in child welfare. Part of the challenge has been the lack of accurate data that can be used to project for the general population, what percent will require services from the child welfare system, at what level, for what period of time, and at what cost. Another serious challenge is the relatively small number of children who will be enrolled as compared, for example, to covered lives under a public sector managed health care plan, making capitation for child welfare very risky.

Capped Allocations - Several public agency child welfare initiatives include reimbursement methods that resemble capitation. For example, in many of the county-administered initiatives (Colorado and Ohio, for example), the state provides the county a capped allocation, and the county assumes responsibility for managing and delivering (or purchasing) child welfare services under this block grant arrangement. Under such arrangements, the county agency is often also given increased flexibility and control over resources and the ability to retain savings. The county agency may decide to share risks and case management responsibilities with individual service providers or lead agencies.

Global Budget Transfers - In Florida, nonprofit lead agencies operate under a *global budget transfer*. Each Lead Agency is given a predetermined percentage of the state's annual operating budget and is asked to provide all services, in whatever amount needed, regardless of how many children and families in their geographic area may require services. The allocation is based in part on historic caseload size and previous spending for the geographic area covered and in part on assumptions of how the new privatized community-based care systems will affect future utilization patterns and outcomes. The actual payment system is a cost-reimbursement within the parameters of the fixed budget. The private agency is at risk for the utilization of services, the volume (number of children referred), and the costs.

Case Rates - Under this arrangement, a service provider, private lead agency, or other managed care entity (MCE) is paid a predetermined amount for each child referred. The contractor is not at risk for the number of children who will use services but is at risk for the amount or level of services used. For the contractor, if the case rate amount is adequate, it is a *less risky* financing arrangement than capitation.

> The most common risk-based model in child welfare is a case rate.

In child welfare contracts, the case rate could be *episodic* or *annual*. An *episodic rate* means the contractor must provide all the services from initial entry into the plan until the episode ends. The point at which payments stop and risk ends varies from one initiative to another. However, it is common for the contractor to bear some risk until specified goals are achieved, whether it takes days, weeks, or years. For example, a typical case rate contract for foster care services might extend financial risks for up to 12 months after a child leaves the foster care system. If a child reenters care during that time, the contractor may be responsible for a portion (or all) of the cost of placement services.

Under an *annual case rate*, the provider receives the case rate amount each year the child is in the child welfare system and the contract is in effect. In both annual and episodic case rate arrangements, the payment schedule could be a monthly per child amount or it could be divided into lump sum payments that could be linked to attainment of various outcomes. An episode of care case rate is far riskier for the contractor than an annual case rate due to the many factors outside of the contractor's control that may extend the time it takes for the episode to end.

Another variation on a case rate payment is the difference between a "blended" case rate, which means a rate set at the average cost per case blended over all cases, and stratified case rates, where the rate varies by the type of case. Since there is always the risk of "adverse selection" – most of the more difficult and costly-to-serve cases going to one provider and easier cases going to the other, the payer ties a differentially lower or higher rate to different cases so amount of payment per case is correlated to the likely cost of serving that case. Stratified rates have some advantages (protecting the contractor from the risk of case-mix severity increases) as well as some disadvantages (more administrative complexity). One major disadvantage is the increased possibility of disputes, and grievances related to the proper assignment of a case to payment strata. If rates are tied to subjective factors, (e.g. severity ratings, level of functioning test scores, etc.) there is a high probability that the contractor will claim the low strata case needs to be reassigned to a higher level, and the payer will have a bias to operate in such a fashion (giving tests to score functioning) so as to place cases in the lower paying strata.

The State as payer can reduce its risk for the high degree of variation resulting from the use of many high cost services provided to children if it can establish a reasonable case rate over a sufficiently large number of children. A provider with a case rate, a sufficient volume, the authority to make decisions that impact risk, and a multi-year contract has an incentive to find the lowest cost service that will achieve the desired outcomes (Broskowski, 1997).

<u>Performance Incentives (Bonuses/Penalties) & Payment Schedules</u>- Pure pay-for-performance contracts while uncommon for child welfare have been found in a study of TANF contracts to offer the most financial incentives for contractors to meet performance goals (McConnell, Burwick, Perez-Johnson, & Winston, 2003). These contracts allow the public agency to place emphasis on specific goals by varying the dollar amounts attached to attaining each goal. In the organizations with pay-for-performance contracts visited as part of the TANF study, all staff members, from the top management to the front line, were aware of the performance goals and their importance.

While not adhering to a strict pay for performance model, public child welfare agencies are increasingly aligning payment schedules and/or bonuses or penalties to outcomes or results. Child welfare contracts differ in the events that trigger payments and in the assumptions underlying the fiscal model. Some contracts require the public agency to make regular fixed payments or payments to cover some of the costs incurred while some of the payments are contingent on contractors meeting performance goals. Some contracts also include advance payments to help providers cover upfront costs. Others provide direct financial bonus payments if expectations are met or exceeded, while still others include financial penalties if performance falls below some stated threshold. Initiatives differ widely in the selection of performance measures and in the incentives or penalties that are linked to the performance indicator. Some initiatives include only bonuses; in others, only penalties; and in yet others, both bonuses and penalties.

Risk-Mitigating Mechanisms

> The majority of child welfare contracts that include financial risks for private child welfare agencies also have some mechanisms to limit risks.

Before examining the mechanisms used to limit risks, it is necessary to understand what the risks are. Every fiscal strategy, even a traditional cost-reimbursement arrangement, has risks—the potential for revenues and expenditures to vary in unexpected ways. When revenues exceed expenditures, there is a surplus, which can be taken as profit or reinvested in the system. When expenditures exceed revenues, there is a loss. The risks can be found in the number of children who use services, the unit costs, the case mix, the volume, and the duration. *Risk-sharing* is a function of determining who is responsible for each type of risk. There are different inherent risks associated with each of the previously described risk-based financing options. Because of the newness of risk-based contracting, the uncertainty in calculating the rates, and the likelihood that the contractor will be a nonprofit agency with limited capital reserves, most child welfare risk-based contracts also include mechanisms to ensure that contractors remain solvent and stable (McCullough, 2003).

Child welfare purchasers have used various methods to limit a contractor's risk. For example, some child welfare case rates cover certain services typically reimbursed under Title IV-E funds, but the contractor is expected to bill Medicaid under fee-for- service arrangements to supplement the case rate. Or, as described previously, in an attempt to better match level of risk to level of need, purchasers might propose risk- adjusted or stratified rates for children with different levels of service needs. Using a similar logic, in a few initiatives, the purchaser allows the contractor to be reimbursed outside the risk arrangement on a fee-for-service basis for a certain number of children.

The following are among the most common risk-mitigating strategies used by child welfare purchasers:

- <u>Risk-Reward Corridor</u> - The most common risk-mitigating mechanism in child welfare initiatives is a risk-reward corridor. Risk-reward corridors limit contractors' losses to a percentage of total losses, but do not necessarily protect contractors against catastrophic losses.

- <u>Catastrophic Stop-Loss</u> - In some instances, the contract includes aggregate or individual catastrophic stop-loss provisions that limit the contractor's losses when expenditures exceed a certain amount for an individual child or for the entire covered population.

- <u>Risk Pools</u> - Funding is set aside and accessed to cover unexpected costs under specified circumstances. Various types of risk pools can be created to spread risk for low-incident, high-cost conditions, or to buffer a risk-bearing provider from a catastrophic cost that is outside the provider's control. The pool can also be used as a *bonus* fund to reward providers who achieve certain performance goals. A risk pool may be indicated when multiple providers serve a limited number of enrollees, so that no one provider may have a sufficiently large pool of covered lives.

  Funds for the pool may be *withheld* from each provider's monthly payment and set aside; contractors may contribute a percent of retained savings to the pool; and in still other instances, the public agency may fully fund the pool each year of the contract. If funds are left over at the end of the year, they may be retained or distributed to the providers according to some established allocation formula.

Is Risk-Sharing Necessary?

The cost and effectiveness of providing child welfare services is uncertain. The ease with which children and their families can be moved toward safety, permanency, and well-being is unknown and difficult to forecast accurately. The payment structure in contracts affects how the risk associated with this uncertainty is distributed between the public agency and contractors. Under traditional child welfare contracts, the public agency bore all of the risks and retained all of the responsibilities for managing its resources to meet State and federal requirements. As more public agencies began to contract for some case management services, they saw an opportunity to also share financial risks with their private contract agencies with the goals of stimulating innovation and improving results.

On the other hand, there is no requirement that a privatized child welfare initiative has to share financial risks. It may not be in the best interests of the public agency to design contracts that introduce financial risks to contractors, for two reasons. First, some private agencies do not have the capacity to manage risks and, as a result, the public agency would run the risk of having a contractor cut costs to avoid insolvency or terminate the contract, both of which would likely be detrimental to children and families served by the contractor. Second, smaller organizations with limited financial resources may be less likely to bid for risky contracts, reducing the diversity of service providers and the extent of competition. For this reason, public agencies may use cost-reimbursement contracts in order to cultivate community-based providers that have experience serving distinct client populations. (McConnell, Burwick, Perez-Johnson, & Winston, 2003). The decision about whether and how to share risks must take into account the capacity of the provider community, and the willingness of the public agency to relinquish control over decisions that directly impact the contractor's ability to succeed.

The distribution of risk varies with each type of payment model. When depicted as the rungs of a ladder it is clear that the public agency assumes the majority of risk under FFS and cost reimbursement models while the contractor assumes increasing risk under case rates, capitation, and global budgets (Broskowski, 1997).

There are pros and cons to each fiscal model depending on your viewpoint. Under full FFS and cost-reimbursement contracts, most of the risk is borne by the public agency. These contracts require payments to be made even if services are of poor quality or ineffective. The public agency also bears the risk of changes in referral flows, paying more if caseloads rise, and sometimes paying for the increase in the cost per client as caseloads fall. Cost-reimbursement contracts usually include a cap on total payments to the contractor to limit the financial obligations of the public agency.

Under fixed-price contracts, the public agency and contractor share the risk. These contracts are risky for the public agency because they require payments to be made irrespective of the quality and effectiveness of the services. But because the amount paid is fixed, the contractor bears the risks of higher than anticipated costs because of referral increases, higher service costs, or increased client needs.

The following examples of contract options illustrate the risks to the State and to the Contractor (Broskowski, 1997):

- If the State were to pay for all allowable costs, the Contractor would not be at risk (other than spending money on unallowable expenses). Nor would the Contractor have any opportunity for gain beyond the "profit margin" it negotiates with the State.
- If the State were to reimburse on a fixed price schedule for services it purchased through its contracts with providers, the providers would be at a risk for losses if the services cost more than the State's price schedule would allow. The provider's opportunity for gain would be based on the degree to which it could keep costs below the fixed level.
- If the State paid a case rate or fixed payment per time period for each enrolled child or family, then the contractor holds the risk for price as well as the number of units of service consumed by each case. If more cases are served, the contractor's cost would go up but so would its revenue. The contractor's opportunity for gain is proportional to the degree it can reduce the cost per case relative to the rate being paid by the State. It can do that by reducing the intensity (frequency per unit of time) and mix of services.
- If the State paid a premium per month for <u>all</u> cases in the child protective or foster care system that is based on some estimate of utilization for all children in the population (capitation) and the contractor had to pay for all of the costs of serving those children and families, then the contractor bears the risk for the prevalence rate of child abuse and neglect, the rate of removal from the home (a surrogate for severity) as well as the risks associated with use and with price. The contractor has opportunity for gain if it can undertake activities that reduce the rate of removal among the base number of cases, reduce the length of stay over historical averages on which the premium is based, or reduce the intensity or price of services. If the population (rate of referral) were to grow, the costs would rise, but so would the revenue.
- If the State paid a fixed global budget, then the contractor holds all the risk. The State holds none, but the Contractor would expect full control of all available actions (within limits of the statutes and regulations) and expect to gain a specified amount of all the savings it can achieve.
- Hybrid models that include some pay for performance elements offer incentives for both the purchaser and the Contractor. Some of the payments will only occur if contractors are successful at meeting the performance goals. The amount to be paid that is not attached to performance is usually capped, limiting the financial risk to the public agency. The contractor stands to gain only if it is successful in meeting performance goals. The risk for the contractor is that success depends at least partly on factors that may fall outside of the contractor's control, such as judicial actions and the availability of services.

Risk-Based Financing Trends & Challenges in Child Welfare

The Child Welfare League of America (CWLA) 2001-2002 50-state survey of management, finance, and contracting trends revealed significant variations in financing arrangements among the child welfare privatization initiatives. The arrangements may vary within the same initiative over time or between different county initiatives within the same state. The level of risk ranged from global budget transfers, to capped allocations or capitation, to case rates, to discounted Fee-For-Service or per diem arrangements that included bonuses and/or penalties based upon performance or case milestones. The degree of exposure to risk and the potential for reward often changed over time within the same initiative. (McCullough & Schmitt, 2003)

> Over 90% of the child welfare privatization initiatives described in the CWLA study (2003) include changes in financing or payment practices to create incentives for performance. Many initiatives include more than one mechanism to align payment with desired results.

There is little in the way of comparative analysis of initiatives to indicate that one financing model is superior to another or, for that matter, superior to traditional contract arrangements. It is important, however, that a public agency fully understand the pros and cons of each type of risk-based option and the potential opportunities afforded by different structural designs before making decisions. Some of the issues that must be considered are fairly straightforward; others require a full appreciation of how all the design pieces need to fit together to achieve results. It is also important to recognize that the ultimate success of an initiative may relate to many factors separate from the structural model and the risk option chosen.

Understanding Challenges and Avoiding Unintended Consequences

There is the potential for unintended consequences under all reimbursement models. The design of a contract's payment structure can affect both the public agency and the contractor.

There are at least four potential areas of impact: 1) the fiscal model may provide incentives to enhance performance but there may also be the potential for unintended consequences depending on the nature of the measures and incentives; 2) the design may achieve desired results but it may also impact federal funds and funding sources; 3) the model may affect the contractor's cash flow; and, 4) the model may present operational challenges for the public agency.

In the remainder of this section, we examine numerous issues relative to each of these areas.

> Privatization of child welfare case management under a performance-base or risk-sharing payment system offers the potential for improved results and overall system improvements but it also creates the potential for unintended consequences if the fiscal model is not designed or implemented with care.

- *Control over resources and the distribution of risk:* To the extent that the State wishes to have non-government agencies assume greater risk for costs, it must consider relinquishing some degree of control over the management of available resources. Assumption of control over resource management is generally correlated with assumption of risk and the concomitant opportunity for reward. Risk can be treated as a "whole pie", with 100% of total risk residing with the public agency or the private contractor. Or, more typically in child welfare contracts, risk is parsed out among the public agencies and one or more contractors. Risk-sharing or results-based contracts require providers to have the infrastructure, knowledge, skills, and authority to consistently assess and meet the needs of the children and families they serve while managing resources to achieve fiscal goals. Prior to determining whether risk-sharing options are desirable or which financing option to use, it is important for planners to assess current provider capacity and to carefully explore the pros and cons of different fiscal models with that capacity and interest in mind.

- *The high prevalence of serious and complex needs among the children and families served and the relatively small size of the population*: An important difference between Medicaid managed care reforms and child welfare initiatives relates to size and case mix. Children served by the child welfare system and their parents often need acute and extensive health and behavioral health services and if behavioral health needs are not identified and addressed, it will be more difficult to ensure safety, permanency, and well-being for children. Families who come to the attention of the child welfare system because of child abuse and neglect often have, in addition to clinical needs, needs for a range of services related to poverty, family and community vulnerability, homelessness, and a lack of basic supports. The types of services that must be mobilized to achieve positive outcomes often extend beyond traditional child welfare services and funding streams.

  Medicaid managed care reforms serve vast numbers of beneficiaries who are not involved in the child welfare system, thus child welfare is only one of many potential "customers." Children served by the child welfare system may be more likely than other children to have serious and complex needs, and therefore, have the potential to become high utilizers of deep-end services. The Medicaid managed care plan will have the ability to spread the financial risk across large numbers of low-, medium-, and high-need children and families. In contrast, child welfare initiatives typically target only the children and families involved with the child welfare system, who are, by definition, a high-risk population. Managing the risk in child welfare initiatives is increased by the relatively small numbers as compared with Medicaid managed care reforms and the likelihood that the majority of children served by child welfare initiatives will have higher-end needs.

- *Lack of data poses a significant challenge in fiscal restructuring efforts:* Planners may be seriously hampered by a lack of accurate data on costs, patterns of use, and outcomes in the current child welfare system. Since the child welfare system has difficulty providing detailed historic fiscal information, respondents to the CWLA surveys have often acknowledged that their initiatives were planned and priced with "guesstimates" instead of reliable data. The less that is known, the higher the risk that the restructuring will not meet the intended goals and that the rates will not accurately reflect true costs (McCullough and Schmitt, 2003).

> In child welfare contracts, initial rates have often been developed with inadequate data or risk modeling tools. It appears when rates change based on actual costs, the change is more likely to result in increased rates for providers.

- *Funding sources and the impact of "success" on federal revenue:* The bulk of federal child welfare funding is disproportionately directed toward out-of-home care—the very part of the system that many privatization initiatives are seeking to minimize. Given the complexity of child and family needs and the inadequacy of child welfare funds to support preventive, home-and community-based care, and therapeutic services, child welfare agencies have traditionally tapped other federal, state, or local funds that come from multiple agencies. Each funding source may come with different program eligibility and match requirements.

  As child welfare agencies strive to rearrange fiscal relationships, payment mechanisms, and introduce risk sharing into contracts, they have to also ensure that the proposed changes will not negatively affect their ability to maximize federal revenues. For example, under current prohibitions against the use of Title IV-E funds for services other than out-of-home care, when out-of-home care placements are reduced, so is federal reimbursement to the State. If the contractor reduces placements or shortens the length of stay in foster care, the state's portion of the contract rate will increase as the federal Title IV-E share decreases. When this happens, the state may realize savings in its out-of-home care costs; however, these savings may be more than offset by the state's obligation to pay for non-federally reimbursable services under the contract rate. To avoid this situation, in the past some States have sought and obtained Title IV-E waivers designed to allow the state to spend Title IV-E funds on a range of alternatives to foster care as long as the overall expenditures are cost-neutral to the federal government. Arizona was approved by the Department of Health and Human Services in June 2005 for a Title IV-E Demonstration Project, to seek to expedite reunification for children placed in congregate and licensed foster home settings through several innovative child welfare services strategies. Demonstration participants have access to intensive home-based interventions (e.g. individual and family therapy, family assessments, and intensive case management) and Child and Family Teams (CFTs) that support the family during the assessment, planning, intervention, and aftercare phases of the demonstration. In addition, flexible funds are available to participating families to address basic needs that cannot be met through other resources. This demonstration project was implemented in April 2006.

  Others have attempted to maximize federal revenue and gain greater flexibility over limited dollars by changing the funding mix—combining child welfare, TANF, Medicaid, and behavioral health block grant dollars in new ways to pay for services for children and families involved with the child welfare system and to create more flexibility over resources without reducing the level of federal revenue.

- *Cash flow:* Cash flow problems can become critical, especially for the nonprofit contractor. Contract design affects when payments are made to contractors, as well as how much they are paid. The timing of payments is important because it affects the financial resources needed for contractors to cover expenses before they are paid. Small organizations may not be able to bid on contracts that require them to have the financial resources to weather a period when expenses exceed income, even if it is relatively short. On an ongoing basis after award of a contract, contractors may face serious cash flow problems if they are not paid prospectively but are required to reimburse network subcontractors before receiving state payments.

  The question facing both public purchasers and providers is how the benefits of prospective payments—the best option for front-end flexibility—can be achieved with the retroactive cost reimbursement methodology required by Title IV-E and often by state statutes.

The more recent performance-based contracts that delay some portion of payments or incentives until case milestones or specified results are achieved may mean that contractors must wait many months after they have incurred the expenses of providing services for the client before they receive payment.

Pricing the system and adjusting the rates: Child welfare initiatives have varied in their approaches to pricing the overall system, establishing rates for contractors, timing the introduction of financial risk, and adjusting rates over time. Some child welfare initiatives introduced financial risk during the initial implementation; others phased-in risk after some period of time—often after the first year of cost and utilization data collection and analysis. In some initiatives, the public agency allowed the competitive bidding process to set the price and establish the rates. In other initiatives, the rate was specified in the RFP.

In most instances, the overall budget for the initiative was typically based upon estimates of what similar services cost under the traditional system. The risk-based rates were also typically calculated on the basis of rates paid under per diem and fee-for-service arrangements. Many respondents to the CWLA surveys, conducted periodically from 1998 to 2002, reported difficulty in accessing accurate historic data to guide them in pricing the system or establishing the rates. For example, few child welfare agencies have had the ability to estimate with confidence the costs of serving a child from entry to exit from the system as a foundation for developing an episode of care case rate. As a result of the initial guesswork, it has not been uncommon for states to err in pricing the overall initiative or in setting rates, with, at times, mid-course corrections being made (McCullough & Schmitt, 2003)

Anecdotal evidence suggests that at times, rates are adjusted based on state or county fiscal or political factors that do not necessarily reflect evidence of the sufficiency of the rates. In other instances, the changes are made in response to fiscal audits or independent evaluations. Some contracts include clauses that allow reconsideration of the payment structure if there are significant changes in the economy or referral flows. The triggers for the re-assessment and the frequency of such re-assessments have varied across child welfare initiatives.

Fiscal assumptions and actual performance: Although child welfare respondents have rarely indicated that containing or reducing overall child welfare costs is the principal goal of the initiative, most initiatives, however, have expected budget neutrality and the redirection of resources to provide more appropriate services to more people with the same dollars. In most initiatives, there were built-in assumptions about what effect the proposed change would have on costs. CWLA survey respondents were asked to compare actual fiscal performance data (if available) to fiscal assumptions that were made when initiatives were designed. No one-to-one relationship was found between fiscal assumptions and performance. Some initiatives were not designed explicitly or intended to save money, but they have (Illinois, for example), whereas others were intended to be cost neutral and have, in fact, cost more (Kansas, for example). Only three states expected the initiative to cost more than the previous system, but fiscal performance data indicate that 10 initiatives cost more than the previous system. In some instances, States reported they were pleased with results because funds had been re-directed, enabling more children and families to receive services at the same or slightly more costs (McCullough & Schmitt, 2003).

Section V: The Impact of Design Decisions & Contract Provisions

As noted in the previous sections, risk is affected by a variety of factors. *Client factors* include characteristics and service usage patterns of the population. *The scope of services* that the contractor is required to provide or procure for the target population affects risk. Contractual provisions can also influence risk. Examples include but are not limited to: the stated and implicit goals of the contract; the required performance measures and outcomes; whether or not the contract includes risk-sharing and the previously described risk mitigating factors and provisions for reassessing rates; contract duration; the size and geographic reach of the contract; and, the degree of flexibility/autonomy given to the contractor to manage risk.

For the privatized initiative to meet its objectives, there must be balance among the interrelated factors of quality, satisfaction, and cost. How to optimize or balance competing interests is still an imprecise art, but most would agree that successful implementation of a privatized child welfare initiative depends in large part on identifying potentially competing interests and realigning them so that all parties share the same interests. Too much risk can paralyze; too little risk can limit creativity, resourcefulness, and industry.

Estimating the potential impact or risk of a privatization effort requires that a variety of factors be explored and considered. Many of the decisions that are made in the design of the system might be expected to influence the provision or utilization of care, the costs, and the overall impact on the child welfare system. For example, the risks for the contractor and the State vary depending on which services are included and excluded, the current service capacity, how public and private roles are defined, and how payments are structured. In deciding which case management and planning functions and other services to privatize, consideration must be given to the relative strengths and abilities of the public and private agencies. Consideration must also be given to ensuring that *start-up* time and funding allow time for the public agency and/or the private contractor to expand services prior to the start of the privatized case management system. When funding and time for *start-up* are not built into the implementation, initiatives have encountered serious fiscal and programmatic challenges.

Design and Implement a Contract Monitoring System

Contract monitoring, to the degree that it existed under traditional contracting arrangements, focused almost exclusively on whether or not the contractor was in compliance with contract requirements related to process, i.e., were certain tasks performed in the manner and quantity specified. The newer privatization initiatives are part of a broader quality improvement trend that seeks to follow client outcomes in addition to or instead of process indicators. Most current privatization initiatives specify performance standards, improved functioning indicators, child and family outcomes, and client satisfaction requirements in their Requests for Proposals (RFPs) and their contracts. Specific outcome measures vary according to the target population served by the initiative but initiatives are most likely to include indicators related to child safety, recidivism/reentry, and achievement of permanency within the timeframes required by the ASFA.

- In spite of the focus on outcomes and accountability, numerous research studies also have revealed an inconsistent, inadequate or inappropriate approach to monitoring across privatization initiatives. While States and counties use multiple methods to collect and manage data on their privatization initiatives, many plans appear to rely heavily on reports generated by the contractor or from the State's automated management information system. However, both the findings of the independent evaluators and the responses to the CWLA surveys indicate that data collection and management remain challenges for public and private agencies across the county. Independent auditors have highlighted deficiencies in the monitoring conducted by many public agencies, and noted the lack of fiscal support to support an adequate infrastructure.

Balance the Benefit and Burden of Monitoring

Privatizing a child welfare service does not relieve the public child welfare agency of its responsibilities to the children and families served and to the taxpayers. In addition to developing and implementing policy, the public agency continues to be accountable for high-quality and effective services, complying with program rules, and using public funds efficiently. Private contractors that provide services on behalf of a public agency must, therefore, be held to similar standards (McConnell, Burwick, Perez-Johnson, & Winston, 2003). Consistent and thorough monitoring is vital to make certain that contractors meet their obligations. However, public agencies must weigh the benefits of their approach to monitoring for quality, outcomes and contract compliance against the costs.

When initiatives across the country have worked to establish an effective monitoring system, disagreement commonly has arisen around the definition of results and the means of ensuring the validity of data that indicate whether results were or were not achieved. Public agencies must monitor performance in three areas: 1) service quality and effectiveness to determine whether contractors fulfill program goals and achieve specified outcomes; 2) compliance with required policy or procedure, including Title IV-E rules; and, 3) financial integrity. Agencies use a myriad of methods to assess performance in each of these areas, including desk reviews, case record reviews, site visits, fiscal audits, customer satisfaction surveys, and independent evaluations.

> Monitoring standards and quality assurance/ monitoring processes should promote contract compliance and the private agencies' achievement of defined results without stifling the provider's ability to innovate.

Contracts that link reimbursement amounts or payment schedules to performance may present additional operational challenges for the public agency. First, accurately assessing performance requires clarity in the measures used and faith in the integrity of the data collection system. Although this is a requirement for all contracts with performance measures, its importance is magnified when payment is linked to performance.

What is required is a balanced approach that allows the public purchaser to monitor for results while also granting the provider the flexibility to innovate.

Planners need to carefully think through the monitoring process, drawing on the "lessons learned" from other communities that have struggled with finding the right balance between oversight and innovation.

Address Data Collection and Communication, and Technology Issues

Most researchers have noted that privatized initiatives have placed a premium on access to real time information to guide case-level decisions, contract monitoring, and system planning. However, there is abundant evidence that many initiatives have lacked the technology or staff resources to collect or manage data as intended. Issues that must be resolved in planning relate to the degree to which data systems are shared between the public payer and contractors; the mechanisms used to translate and communicate data into useful reports; and an assessment of the information needed by contractors operating under various risk-sharing contracts.

Data Systems

Contractors in many child welfare privatization efforts have at least limited viewing privileges to the data systems used by their public agency counterparts. In most initiatives, contractors' access to data systems is notably more extensive. In Florida, for example, private agencies with case management responsibilities are required to use the State's data system to manage eligibility determinations and ongoing case management. Shared access to information systems facilitates coordination among private and public agency staff in a number of ways, not the least of which is ensuring that the State is able to meet federal reporting requirements. Theoretically, a shared data system would also facilitate the resolution of communication problems and make it possible for contractor(s) and public agency staff to directly access information from or identify discrepancies in their counterparts' systems.

Use of a common data system is not without challenges, however. The State may need to modify its automated system to ensure contractor's ability to meet federal data reporting requirements.

At the case level, when private agencies assume case management responsibilities they are often allowed or required to enter data directly into the State's automated child welfare information system (SACWIS). When private agencies have this requirement, they have often had to develop complex and dual entry mechanisms—running their own management information systems to manage their business processes and separately entering data into State systems to meet contract requirements—hardly an ideal or cost-effective solution.

> Private agencies often find that the public agency's data system is cumbersome to navigate since it was designed for public rather than private agency work flow.
>
> Furthermore, State systems rarely support all of the functions that may be privatized under an initiative.

The necessity for dual data systems arises in part because few State systems are equipped for utilization management, provider network management, or claims/billing/ reconciliation/and payments—all core functions required in some private agency contracts.

Reporting Requirements

The ability to collect raw data, while essential, is not sufficient to ensure that data are translated into useful reports needed by the private agency and the public agency to fulfill their responsibilities under the contract.

Both public agencies and providers need data for operational decisions and successful contract management. The MIS must be able to track performance from a variety of different perspectives—client status, service utilization, service/episode costs linked with case plan goals, treatment, and outcomes. The system must be need-driven, flexible, user-friendly, and capable of generating useful reports for all users.

Child welfare privatization initiatives have varied in the reporting requirements imposed on private contractors but many research studies have documented a tendency for over- or under-reporting and a lack of clarity in the purpose of various reports. There has been a trend to broadly share findings from performance reports. For example, in more recent initiatives, public agencies have posted performance data on the State's website, allowing a comparison between private agencies and between the public and private agencies on key performance indicators or outcome measures.

Information Needed to Manage Risk Under Different Fiscal Models

As the level of potential financial risk for the private contractor increases, the extent and level of complexity in the information needed also increases.

As illustrated in Table 1, under three reimbursement methods commonly used in child welfare, the contractor needs sophisticated data systems capable of tracking and reporting a myriad of factors that impact fiscal risks. While not an exhaustive list of either payment methods or risks, the table illustrates that data challenges increase with risk.

> The data challenges increase with the inclusion of risk-sharing contracts, particularly if payment amounts or schedules are linked directly to performance.

Table 1: Method of Payment and Type of Information Needed

Payment Method	Nature of Risk	Type of Information
FFS and cost reimbursement	• Operating costs • Volume	• Management reports including fixed and variable costs • Staff productivity • Caseloads
Discounted FFS or performance bonus/penalty	All of above plus: • Are costs greater than the fee? • Will volume offset discount? • Can the outcomes be met? • Is the "incentive" high enough to offset increased cost?	All of the above plus • Incremental volume • Performance and outcome data
Per episode of care or per level of care	All of above plus: • Amount of case rate • Severity of each case • Intensity of services • Duration of episode	All of above plus: • Case mix • Length of stay • Level of care • Service utilization by type

Procurement documents should define all of the details the State would expect of the contractor's information system (i.e. the information systems functional specifications). At a minimum, depending on the type of reimbursement and the scope of work, the contractor must be able to continuously monitor cases by placement and associated cost, outcomes, and functional status, as well as the utilization and cost of supportive services. The contractor should also have the ability to plot trends in various indices (performance/cost ratios, averages, distributions) and take decisive action when key indicators go outside acceptable upper or lower limits.

> In determining which fiscal model offers the greatest potential to improve performance, it is important for planners to assess whether potential private contractors have the functional capacity to collect and use data to manage the risk associated with the proposed model.

Communication

In addition to defining how information on system and client performance will be shared, planners also need to ensure the smooth and timely sharing of information about policy or procedural changes that occur at either the public or private agency. Both public and private agency staff should not first learn about policy or procedural changes through informal communication with their counterparts at the other agency. Many public agencies now have "data dashboards" accessible through the state website. It is also not uncommon to maintain online policy and procedure manuals and have mechanisms in place to alert stakeholders to any changes.

Develop the Fiscal Reimbursement Model & Identify Challenges

As noted in the previous section, at least half of the states are now testing new reimbursement methods for their child welfare contracts. Most have introduced some elements of financial risk. In the best-case scenario, these reforms have increased flexibility and more closely aligned fiscal incentives with programmatic goals, resulting in better outcomes for children and families. Best-case scenarios, however, do not happen automatically.

During any planning phase it is essential to identify the major challenges for the public agency in implementing a new fiscal or reimbursement model. The following examples illustrate some but by no means all of the difficulties commonly described by public administrators:

- *Aligning and allocating funds to support the goals and other design elements of the initiative*: Perhaps the most important question is whether or not all of the design elements are consistent with the intended fiscal model. As an example, it may be determined that children in need of therapeutic levels of care are to be included in the target population, and outcomes will include measures of a reduction in the numbers of children placed in restrictive levels of care and the length of time they remain in restrictive levels of care. In that case, the question is whether the fiscal model provides sufficient incentives and control over the resources to enable the contractor to succeed in building alternate placement or community capacity to meet the specified goals.
- *Coordinating care across systems and avoiding cost shifting:* In many states, the child welfare system, Medicaid, and the behavioral health care system "share responsibility" for providing both acute and long-term behavioral health care services. In Arizona, the children

in the child welfare system will likely receive some services from the Regional Behavioral Health Authority (RBHA) Medicaid managed care plan and others through the child welfare system. As a result, it is incumbent on those planning a new approach to child welfare financing to fully understand the parallel systems and how child welfare, mental health, Medicaid, and other dollars will be used by each system. This understanding is critical to avoid cost shifting and other inherent problems that may occur with fragmentation of funding between systems. When the boundaries are less than clear and coordination is lacking, there is a great potential for duplication of effort, fragmentation, service gaps, cost-shifting, and disagreement about payment responsibilities.

- *Estimating and appropriately allocating risk:* There are two basic approaches to developing estimates of risk, the actuarial approach which uses historical data to predict what will happen in the future, and the prospective approach which includes simulation of future scenarios. The actuarial/historical model relies on retrospective analysis of such factors as patterns of service utilization and cost of units of service. This approach is flawed in that the historical data may not be complete and credible and the future service system is almost certain to differ from the one used in the past.

  Because of the limitations of historical data, or because significant changes in the delivery system or reimbursement method are being planned, planners often use prospective simulation techniques to estimate risk. Statistical modeling, or simulation, is a method of planning and forecasting that allows system designers to be explicit with regard to the probabilities of given values that can influence various outcomes. Using computer software, decision makers can enter any number of critical "input" variables, "output" variables, and formulas that define the relationships among and between inputs and outputs. The program will provide a model of possible outcomes and the probability that each will occur. By changing the size or content of a variable or formula, the decision-maker can simulate the probable effects of making such a change. There are many benefits of modeling and simulation, not the least of which is that they provide the public agency with the capacity to turn an estimating model into a tracking and trending model that supports comparisons of the assumptions and predictions made when the system was planned and implemented, with the actual results shown in utilization and cost reports (Broskowski, 2003).

  Given the benefits of statistical modeling, it is recommended that planners use this approach to price the new system and set parameters for any risk-sharing contracts.

- *Addressing financial risks associated with legal liability.* As discussed earlier, private agencies may face heightened legal exposure for decision making upon assuming case management responsibilities. Issues regarding professional liability insurance and immunity from lawsuits should be addressed in connection with other fiscal risk issues.

- *Achieving flexibility:* It is important to note that the introduction of risk into contracts does not necessarily equate with increased flexibility over resources. It is critical for the public agency to determine the degree to which funding flexibility can be introduced. This decision will be driven in part by the decisions about funding sources and limited by rigid eligibility and other rules associated with different federal and State fund sources.

  The single most important set of factors that can affect the total level of risk is the *contractor's ability to influence and change the historical pattern* of utilization and administrative processes that have produced the current high level of costs. Within child welfare, there are several ways that funds can be manipulated to achieve improved results and contain costs:

> Depending on the target population and the scope of services, it will be important for the public agency to maximize the contractor's ability to use resources flexibly and provide services that can impact historical patterns of use. The trick of course, is to achieve increased flexibility within the restrictions of federal and State law and without reducing quality and expected outcomes.

  1) There can be an emphasis on prevention to reduce the number of children who enter out-of-home care. The barriers to prevention include inadequate funds to implement prevention programs and the difficulty in demonstrating effectiveness in the short-term.

  2) There can be an emphasis on more appropriately managing the child's care once a child enters the system to reduce the length of stay, ensure a match between child and family needs, and ensure that appropriate levels of care and services are provided throughout an episode of care.

  3) There can be an emphasis on timely and lasting permanency with a focus on providing services to support reunification, adoption, and guardianship —including the provision of a wide array of supportive services to prevent re-abuse and re-entry.

- All efforts to change historical patterns of use depend on the availability of effective additional or alternative services – which, in turn, requires access to funds that can be flexibly used to stimulate these needed services.

- *Ensuring financial integrity:* Public agencies monitor contractors' finances to determine whether they bill for appropriate services and properly administer funding for subcontractors or client services. Scrutiny is necessary not only to confirm that contractors are spending public funds on allowable expenses, but also to alert public agencies about possible weaknesses in the management of provider operations. Financial audits are the main way that public agencies verify contractors' fiscal integrity. Some child welfare agencies also provide specific guidelines for financial management and use monitoring visits to confirm that required procedures are in place. Ongoing financial control also occurs as public agencies review invoices submitted by contractors.

  Child welfare privatization evaluations point to the importance of providing clear and comprehensive guidelines on financial management, and using multiple approaches for monitoring as doing so increases the likelihood of identifying problems early.

- *Ensuring adequate funding and periodically assessing the risk-sharing methodology and the sufficiency of the rates:* Given the current state of knowledge about risk-based financing in child welfare, it is important to have mechanisms in place to periodically assess the adequacy of the overall funds for the initiative and to adjust rates when needed. As States gain more experience and learn from their programmatic and fiscal audits, it is likely that some changes in the original methodology may be made.

  When risk-based contracts are used, the private agencies should have viable protections against excessive losses due to factors beyond their control—such as changes in public policies that increase caseloads or backlogs in the judicial system that delay attainment of contract goals. As discussed earlier, there are several mechanisms that can be used to protect private agencies against excessive losses. Children and families will be at increased risk if contractors are not protected from insolvency.

- *Planning for sustainability in the face of economic downturns and leadership changes:* When state economies weaken and legislators and governors must make difficult budget decisions, there may be growing pressure on public child serving systems to manage with less. It is important for public administrators to demonstrate the value-added contribution the new contracts make to child and family safety, well-being, and successful permanency. Devising appropriate performance indicators that adequately measure the effectiveness of these approaches is essential. In addition to economic downturns, these initiatives must also survive the challenges that occur when the "creators" move on. Many initiatives have introduced a variety of strategies to ensure sustainability in the face of leadership changes or economic downturns. Regardless of the mechanism used, the goal is to build a broader base of community involvement and ownership of the project. Some states have legislatively mandated bodies to oversee the initiatives, to serve as a voice for the community, and to identify and access the resources needed to support the initiative. Florida's legislatively mandated Community Alliances is a good example.

Address Staffing and Training Issues

In the past several years, the nationwide staffing crisis for both public and private child welfare agencies has become a well-documented and difficult to remedy reality. For that reason alone, it is important to acknowledge that any move towards privatization of case management may negatively impact the ability of the Division to recruit and retain workers to fulfill the roles that the Division would need to play in a privatized system.

Staffing issues have become a major challenge for many of the private agency models. When privatization plans are put into place and downsizing of the public workforce is envisioned, the assumption is often made that any displaced workers will find their way to the private contractor. This has not always happened easily.

> No matter what reimbursement methodology is used, if the new initiative does not have adequate numbers of staff who are well-prepared and well-supported, it will fail.

Often, the overall funding for an initiative is based on historic costs that may reflect caseloads that far exceed national accreditation standards. The new initiatives may be required to maintain caseloads that meet national accreditation standards. Lowered caseloads will help to ensure a workforce capable of achieving the desired goals while also reducing high staff turnover. Mandating lower caseloads is reasonable if states also recognize that this added but essential cost should be included in the overall budget for the initiative.

Additionally, many of the child welfare initiatives propose new approaches to case management and other evidence-based practices that require new competencies and a fundamental shift in attitudes about working effectively with families. However, funds for pre-service or ongoing training to introduce and reinforce new skills are not always included in the overall budget.

Manage the Procurement/Contracting Process

Selecting contractors is one of the most important tasks for the public agencies charged with administering contracts. Public agencies administering contracts have three main objectives for the procurement: (1) to attract qualified, competitive bidders, (2) to award contracts to the most capable providers, and (3) to protect the integrity of the selection process. While all three goals are affected by the way the procurement process is conducted, an agency's ability to attract qualified, competitive bidders also depends on the size, scope, and structure of contracts (McConnell, Burwick, Perez-Johnson, & Winston, 2003).

Many of privatization's perceived benefits derive from competition among contractors. As noted earlier, proponents of privatization believe that competition drives contractors to be more flexible and innovative, leading to better services and more efficient service provision. Some analysts even argue that it is the degree of competition that is most important, rather than whether the provider is a public or private sector organization (Kettl, 1993; Donahue, 1989; Osborne & Gaebler, 1992; Nightingale & Pindus, 1997).

The degree of competition depends on whether bidders perceive that there are other organizations that can offer services of similar or higher quality at a similar or lower cost. Procurements are more competitive when bidders perceive a high probability that they may lose the bid, and they are less competitive when bidders perceive that other organizations are unlikely to be interested in securing a contract or that other bidders will be unlikely to offer services of higher quality or lower cost.

As it depends on bidders' perceptions, there is no single, quantifiable measure of competition. The number of bids for each contract, the frequency that service providers are changed, and assessments of competition from contractors and the procuring agency all indicate the degree of competition.

Planners will need to consider the following issues in developing their approach to procurement and contracting:

<u>Determine The Number and Type of Contractors</u>

All indicators suggest that there is wide variation in the degree of competition for child welfare case management contracts. There is no one "business model" or structural design for privatization that has been proven to be superior to another in attracting competent bidders or achieving improved results. There is also no "right" answer to how many contractors the public agency should seek to achieve the desired results. As illustrated by the following examples, there are advantages and disadvantages that must be weighed in planning a procurement.

- *CWLA reported that the majority of initiatives are using a lead agency model (51%) supported by a provider network or other collaborative service delivery arrangement.* The lead agency model is what is being used under Florida's Community-Based Care plan and the Kansas privatization model. Under this type of arrangement, the public agency contracts with one or a very limited number of agencies within a designated region to provide or purchase services for the target population from the time of referral until the obligation ends -- often at case closure. Some lead agencies provide most, if not all, services with few or no subcontracts. Others may procure most services from other community-based agencies and directly provide case management and/or limited services. Some contracts impose a cap on the services that the lead agency can deliver if it assumes case management. Some lead agencies are single agencies that have long histories as child welfare service providers, while others are newly formed corporations that were created by several private agencies for the sole purpose of responding to the contract opportunity. A few lead agencies were created through collaboration between nonprofit agencies and one or more for-profit organizations. Most, however, are non-profit agencies.

Advantages of a Limited Number of Contracts: Issuing a few large "lead agency-type" contracts has several inherent advantages. First, it limits the cost of contract administration and monitoring. Second, there may be economies of scale in providing services — the costs of the infrastructure and management can be spread across a larger number of clients. Third, it allows for greater coordination and service integration — if there are many contracts divided by function, rather than region, clients may "fall between the cracks." Finally, variability in performance may be reduced with fewer contractors (McConnell, Burwick, Perez-Johnson, & Winston, 2003).

Potential Disadvantages: With a lead agency model, the public agency is placing all eggs in one (or a few) baskets. This can create serious problems if the contractor fails to perform. Depending on the other design elements and the level of risk-sharing, it is more likely that small to mid-size agencies will not compete for the contract, fearing the level of risk and responsibility.

- *Performance-based contract arrangements between the public agency and numerous single providers are found in nearly a quarter of the initiatives.* In this model, contracts with individual service providers (non-profit or for-profit) include either payment amounts or payment schedules that are linked directly to performance measures or the achievement of specified case milestones. Performance-based contracts between the public agency and private providers are found in nearly a quarter of the CWLA initiatives. Illinois was among the first states to implement performance contracts for kinship and foster care providers. In FY 2000, slightly more than 21,000 children were served statewide using performance contracts. This shift was accomplished by redesigning how new children are referred to foster care agencies for placement. Performance contracting (initially implemented only in Cook County), required all agencies to accept an agreed upon number of new referrals each month with the expectation that a certain number of children in care would exit care to permanency each month. When an agency falls short of the target percent of children exiting care, the agency serves more children without additional funds. In Illinois, agencies must absorb the costs of any uncompensated care. If the number of children in excess of the payment level exceeds 20% of the number served, the agency risks the loss of the contract. By exceeding the benchmark in permanency expectations, an agency can reduce the number of children served without a loss in revenue. Agencies also receive $2,000 for each child moved to a permanent placement beyond the contract requirement.

Advantages of Numerous Contracts: Issuing more numerous, smaller performance-based contracts may also have advantages. First, it allows contractors to specialize by service or by population. Second, having more numerous, smaller contracts reduces the risk of contractor non-performance. If a contractor goes out of business or performs below standard, the public agency can more quickly replace the nonperforming contractor with another that is operating nearby. The third advantage is increased competition that may, in turn, lead to higher quality or cheaper services. The greater the number of contracts, the more incumbent contractors there will be. This increases competition because the fiercest competition at contract renewal usually comes from other incumbent contractors. In addition, a wider range — and, as a result, a greater number — of organizations can compete for smaller contracts.

- Potential Disadvantages: The added administrative costs, the challenge of designing and implementing effective monitoring systems, and the added variability across providers are all concerns with numerous contractors.

<u>Design Contracts That Work</u>

Designing effective contracts is one of the most challenging — and consequential — aspects of privatizing case management. Whether contractors provide services as intended depends largely on the specific provisions of the agreements they sign. Contracts must be written with clearly defined expectations regarding the services to be provided, to whom they will be provided, and with what results, if monitoring is to play a meaningful role.

The contracts of the six jurisdictions studied for the Children's Rights report largely failed to meet these standards. In fact, in several cases, the contracts were found to be extremely lengthy, unduly complicated, and overly focused on details that bore little relationship to the critical issues that needed to be addressed. In some cases, contractual expectations were framed in ambiguous terms, making it impossible to determine what the private agencies were expected to do, what clients were expected to receive, and what results were to be produced. Specifically, the contracts combined vague service obligations, poorly defined outcomes and performance measures, poorly specified roles and responsibilities and financial risk. In sum, the dynamic in many initiatives was one of an inexperienced purchasing agent attempting to develop at-risk contracts with inexperienced sellers (Freundlich & Gerstenzang, 2003).

> In order to design contracts that work, public agencies must identify and reduce barriers to flexibility and creativity

While many public purchasers appear willing to contract in new ways and share or pass risks to contract agencies, some have shown a reluctance or inability to adapt current day-to-day operating procedures in ways that allow contractors to succeed. For example, some risk-sharing contracts have required that the contractor follow all established public agency operating procedures—essentially requiring the contractor to conduct business exactly as the public agency did. Instead of structuring RFPs and contracts to focus on the desired results, some public purchasers prescribe the approach that must be taken, thereby stifling creativity and innovation. It is important to note that simply changing from a public agency to a private agency and keeping everything else constant will not result in improved outcomes or efficiencies. If it is not possible to adapt the rules or current practice to accommodate innovative new practices, it might be advisable to reevaluate the wisdom of pursuing contracts that share risks.

Determine the Duration of Contracts

> Public purchasers must balance the benefits of keeping competition alive and undergoing a re-bid process with the transition challenges that inevitably emerge. Careful attention is needed to ensure that services are not disrupted when new contractors take over existing contracts.

There are advantages and disadvantages for choosing short or longer contracts. Contracts covering longer periods reduce the potential frequency of contractor turnover and the disruption in service provision that may accompany it. Fewer and less frequent procurements can help conserve both agency and contractor staff time and other resources. Longer contracts also may give contractors more opportunity to establish a program model and improve service provision over time. (McConnell, Burwick, Perez-Johnson, & Winston, 2003).

Contracts of shorter duration, on the other hand, increase incentives for contractors to launch and establish programs quickly. Shorter contracts may contribute to increased competition as well by reducing the advantages of long-term incumbency. They also reduce risk by providing agencies more frequent opportunity to change performance targets or payments. Unsatisfactory providers can also be released more readily. Many contracts include provisions allowing the agency to terminate them before they expire, but doing so can be difficult. (McConnell, Burwick, Perez-Johnson, & Winston, 2003).

Finally, most risk calculations are based on annual utilization and cost information. However, relatively greater stability results from using a longer time frame. It is both intuitive and statistically true that patterns of random fluctuations will average out over longer time periods. As the time period is extended, the provider will be more likely to gain the experience and skills needed for consistently profitable operation.

Manage the Transition & Implementation

There is ample evidence to suggest that both public purchasers and private contractors underestimate the challenges and the resources needed to ensure a smooth transition to a new method of financing and delivering services.

Both public agencies and contractors have to build critical capacity in a number of areas. Public purchasers may need to institute different types of contract monitoring and quality assurance activities than they may have previously used. Under traditional contracts, public agencies typically monitor process, that is, quality assurance staff attempt to determine if the provider actually delivered the units of service required under the contract. There is no attempt to assess the effectiveness of the services delivered or whether certain outcomes were achieved. Under risk-or results-based contracts, monitoring the "what" and the "how" of service delivery may be less important than assessing the results and determining whether the contractor met fiscal and programmatic goals. This type of monitoring may require staff with very different skills.

Contractors should be aware that risk-or results-based contracts will require new clinical and management tools and technologies, different staffing patterns and skill sets, adequate financial resources to support start-up and manage ongoing cash flow, and aggressive and sustained outreach to the community to maintain support. Community support is more attainable and sustainable if the community has been involved from the outset in the planning or the initiative.

Successful implementation is likely to require the use of evidence-based pathways and protocols, level of care guidelines, and other tools commonly found in behavioral health managed care reforms but which may be in short supply in the current child welfare system. Many agencies have found it challenging to develop effective utilization and risk management procedures in the absence of tested tools. As previously noted, the lack of management information systems is a real challenge for both purchasers and contractors. Even when contractors build or buy quality systems, they may face the challenge of linking information with multiple state data systems in order to meet contract reporting requirements.

Many initiatives include a start-up phase to allow both the public and private sectors to pass a *readiness review* prior to implementation. Some initiatives have wisely built in startup costs to provide private agencies with the resources needed to meet all readiness criteria.

It is important for planners to clearly define the process for implementation and determine and allocate the funding necessary to ensure a smooth transition from the current system to the new one. Formal problem-solving mechanisms also are important to resolve the inevitable glitches that occur during implementation.

Conclusion

This report briefly summarizes privatization trends and options described in the December 2005 report. It examines three key legal issues: (1) the need to reach clarity on the "overall responsibility" that the State must retain; (2) the need to reach consensus on an approach to court related matters; and (3) the need to work with private providers on issues of professional liability and immunity. There are no clear answers to any of these issues, but we share the experiences of other jurisdictions in attempting to address these issues.

The report provides a discussion of financial risk including an outline of key issues. We define "risk" and "financial risk" and provide a description of the key financial approaches that child welfare privatization initiatives have used or considered. We also describe various risk mitigation strategies that planners may consider in developing a privatization initiative. We raise the question of whether it is necessary to share risk with private agencies and discuss the issues that the State should consider in this regard. Our overview of how risk sharing plays out in different financial models and our description of trends in risk-based financing and the challenges likely to be encountered are designed to provide planners with an outline of the issues that should be considered.

Finally, we provide an assessment of how design and implementation decisions impact both financial and non-financial risks. Our framework provides a planning process that will enable planners to identify potential risks and ensure that mechanisms are in place to avoid or mitigate unintended consequences. We provide the key steps in designing and implementing a new initiative and the potential impact of each decision on risk for the State, potential contractors, and the children and families served. Beginning with the creation of a consensus vision, we provide a series of planning steps which may be variously implemented, depending on the vision and broad goals for the initiative (as long as all steps are implemented). Through implementing each of these steps, planners will engage in a process that should enable them to understand risk, project unintended consequences, and make the strongest possible decisions.

REFERENCES

Blank, R.M. (2000). When can public policy makers rely on private markets? The effective provision of social services. *Economic Journal, 111*, 34-49.

Broskowski, A. The Role of Risk-Sharing Arrangements. In L. Scallet , C. Brach, E. Steel (*Eds.*) *Managed Care: Challenges for Children and Family Services*. Baltimore, MD: Annie E. Casey Foundation, 1997.

Federal Register. (2005, June 6). Department of Health and Human Services. Administration for Children and Families. Funding Opportunity: National Quality Improvement Centr on the Privatization of Child Welfare Services, Volume 70 (107), 32825- 32838.

Freundlich, M. & Gerstenzang, S. (2003). *An assessment of the privatization of child welfare services: Challenges and successes*. Washington, DC: Child Welfare League of America Press.

McConnell, S., Burwick, A., Perez-Johnson, I. & Winston, P. (2003). *Privatization in practice: Case studies of contracting for TANF case management*. Washington, DC: US Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation.

McCullough, C. (2003). Financing & Contracting Practices in Child Welfare Initiatives & Medicaid Managed Care: Similarities and Differences. Under a grant to CWLA from the Center for Healthcare Strategies. Available on the website:http://www.chcs.org.
McCullough, C., Schmitt, B. (2003). CWLA 2000-2001 Management Finance, and Contracting Survey Final report. Washington, DC: Child Welfare League of America Press

National Association of Child Advocates. (2000). *Fact sheet: Privatization of human services – Is it the best choice for children?* Washington, DC: Author.

Nightingale, D.S. & Pindus, N. (1997). *Privatization of public social services: A background paper.* Washington, DC: Urban Institute.

Smith, S.R. & Lipsky,M. (1992). Privatization in health and human services: A critique. *Journal of Health Politics, Policy and Law, 17*, 233-253.

ARIZONA DEPARTMENT OF ECONOMIC SECURITY
Division of Children, Youth and Families

The Impact and Risk of Child Welfare Privatization
Annotated Summary
February 2007

The following provides an annotated version of the briefing document prepared by Charlotte McCullough of McCullough & Associates, Inc. and Madelyn Freundlich of Excal Consulting, entitled "The Impact and Risk of Child Welfare Privatization."

I. A Brief Summary of Trends and Options

Privatization, generally defined as "the provision of publicly funded services and activities by non-governmental entities," has been widely used by child welfare systems across the United States. Privatization of child welfare services is not a new concept. Even before the publicly funded child welfare safety net was developed, sectarian and non-sectarian agencies created and funded various services now provided by child welfare. Since the emergence of publicly funded child welfare in the 1880s, state and local governments have contracted with private agencies to provide various in-home, community-based, and out-of-home care services.

The services that are privatized and the manner in which payment is made have also changed. Until the past decade, it was uniform practice that public agencies retained case management decisions and control over the types, amount, and duration of non-case management services that were delivered by the private sector. Under this traditional child welfare per diem, fee-for-service, or other cost-reimbursement contracting model, the private agency simply agreed to provide placement or non-placement services to a certain number of children in return for payment based on a pre-determined rate.

Three dynamics have characterized the great majority of recent efforts that have included the privatization of child welfare case management services: a focus on quality through the purchasing of results rather than services, the development of outcomes related to state and federal mandates, and financing mechanisms that link implicit or explicit incentives to performance. The specific features of these privatization initiatives, however, have varied considerably. Wide differences exist in the geographical reach of these efforts, the range of services privatized, the population served, the degree of public agency involvement in ongoing case management, the structural design of the initiatives, the funding approaches utilized, and the specific mechanisms used to align financing with desired results.

In spite of innovations in some initiatives, the privatization of case management services in child welfare has generally produced mixed results regarding both the effectiveness of these efforts in achieving improved outcomes for children and families and cost efficiency. Evaluations of existing privatization efforts demonstrate great variability in the extent to which these initiatives have succeeded in improving the safety, well-being, and permanency of children served by child welfare systems and the well-being of their families. When compared to non-privatized systems, the results have in some cases been far better and in some cases, poorer.

II. Federal Efforts

The Quality Improvement Center on the Privatization of Child Welfare Services (QIC PCW) was established in 2005 by the federal Administration for Children and Families (ACF) to better understand the range and scope of child welfare privatization efforts. A key function of the QIC PCW is to assess the current status of privatization of child welfare services, and to pull together evolving information and make it widely accessible. Through a competitive application process, the QIC PCW and the Children's Bureau have selected projects for funding beginning January 1, 2007 through September 30, 2010. These projects will be testing models of performance-based contracting and quality assurance systems.

III. Legal Issues and Risks

While all children are dependent on others for their care and well-being, children in the custody of the state are uniquely dependent upon government agencies. The public system must ensure that all needs, including physical and behavioral health needs, are properly provided. Risk-based financing arrangements created by either the child welfare or behavioral health system must not create barriers to services that undermine the unique legal protections to which children in state custody are entitled.

In addition, the courts are actively involved in planning for children in the child welfare system. Judges have the final authority to make decisions about the need for placement of a child, and they are charged with approving plans for a child's care when the child is under protective supervision. The courts serve as the final decision-maker related to achievement of the permanency goal for the child.

The issues related to the legal protections for the child and the ultimate authority of the courts are important considerations when designing risk-based contracts and balancing the level of risk with the degree of autonomy contractors will have in decisions that affect risk, including decisions related to placements, level of care, length of stay, and permanency. When restructuring fiscal systems, it is essential that the required federal mandates of the Adoption and Safe Families Act (ASFA) and the Child and Family Services Review (CFSR) outcome standards remain central to the planning and the risk arrangements that are designed. Three key areas should be considered in relationship to legal issues and risk:

Interpretation of "Overall Responsibility" for Child Welfare

Critics of privatization have raised numerous legal concerns regarding the respective roles of the public child welfare agency and private child welfare agencies. These concerns have focused on the extent to which the State agency must maintain "overall responsibility" for child welfare decision-making in order to remain in compliance with federal regulations and meet the State's obligations under its federally-approved Title IV-E plan. Central to this issue is the concern that privatization might jeopardize the State's ability to claim federal reimbursement under Title IV-E. An issue that frequently surfaces is whether a private agency case manager would be able to perform the same functions as a public agency worker; thereby, generating the same potential to claim federal reimbursement for allowable expenses.

The federal ACF Child Welfare Policy Manual (8.3A.12 TITLE IV-E, Foster Care Maintenance Payments Program, Eligibility, Responsibility for placement and care) states that the public child welfare agency has the "ultimate responsibility" for the "proper operation of the foster care program."

Many States have struggled with understanding the legalities of privatized case management in connection with their "overall responsibility" for child welfare and to apply federal law and policy to the design of their privatized case management system. Obtaining federal guidance has been challenging. Dr. Crystal Collins-Camargo of the University of Kentucky, who directs the federally funded Quality Improvement Center on Child Welfare Privatization, verified that there is no written federal guidance on this issue. ACF has not issued policies that preclude a public agency from privatizing or outsourcing child welfare case management services. Given the absence of written policy, Dr. Collins-Camargo urged that any State moving into a privatized or outsourced system work with their federal ACF regional office and seek its guidance on the State's plans or, at a minimum, alert the ACF regional office to the model that will be utilized.

As a result of this lack of federal guidance, States have developed their own interpretations. For example, the Texas Department of Family and Protective Services Legal Division's legal opinion was that the public agency's "overall responsibility" meant that the public agency had to exercise total control over each decision regarding the child's placement and care. Public agencies in other jurisdictions have viewed "overall responsibility" as encompassing the retention of responsibility for ensuring, through carefully designed monitoring and oversight systems, the safety, well being and permanency of children in the agency's legal custody.

Court Related Matters

Another area of legal concern with which States have struggled with in planning and implementing a privatized system relates to the court-related activities inherent in child welfare practice. The most common issues that arise in this area are: whether private agency case managers can (or should) be allowed to participate in processes involving the filing of petitions that seek decisions on the part of the court regarding children's continued stays in foster care, their return home or placement with relatives, or the termination of parental rights; whether private agency caseworkers can (or should) appear in court in cases which they manage but for which the State agency has legal responsibility; and whether attorneys representing the State can (or should) represent private agencies.

As with the interpretation of "overall responsibility," there is no policy guidance from the federal government on these legal issues. In an effort to address these concerns, some States have developed systems that designate roles for both the private and public agency caseworkers. In these systems, it is common to find that the private agency case managers develop case plans with families and prepare all court related documents; public agency caseworkers review these documents prior to or at the time they are presented to the State's attorneys for filing; and public agency caseworkers attend all court hearings, either in place of or with the private agency case managers. Other states have delegated these functions to private agencies. Upon privatizing, Florida, for example, delegated all court related work to private agencies. Florida maintained legal representation in each jurisdiction as it was prior to privatization. A third approach has been the retention of legal liaison positions within the public child welfare agencies. These liaisons work directly with private agency case managers and the courts—providing technical assistance and consultation as needed to ensure that private agency staff are fully prepared to assume critical legal functions.

Mechanisms to Address Professional Liability

A third area involving legal issues and risks relates to the development of mechanisms that address the professional liability of private agencies that, under privatized systems, assume case management responsibility. Typically, private agencies do not enjoy the level of immunity from litigation that public agencies hold. Private child welfare agencies are often required to carry liability insurance. The combined impact, however, of dramatically increasing premiums in the child welfare sector and the assumption of increased levels of responsibility for children and families under privatization has raised a number of questions as to how public and private child welfare agencies can address professional liability issues. In several states, the proposal has been made that states confer liability immunity to agencies under contract with the state for child welfare activities. Legislative language has been proposed, for example, in Illinois.

This issue can have a significant impact on states' ability to attract agencies and retain agencies within privatized systems, particularly smaller, community based agencies that provide culturally competent services but which do not have the resources to respond to litigation should it arise.

IV. Financial Issues & Risks

Unlike traditional payment systems, the recent privatized initiatives often use sophisticated financing mechanisms adapted from the health and behavioral health field to stimulate improved results and to share some of the financial risks with private agencies. In successful systems, risk is shared, rather than shifted between the public purchaser and the private agency. The design of a risk-based system requires an understanding of all the factors that affect risk and a willingness of the public agency to relinquish control over key decisions that directly impact the contractor's ability to bear risk.

Risk-Sharing Terms and Concepts

Risk - Risk is equivalent to uncertainty about an outcome or cost. Uncertainty is due to variation that can occur in some factors that affects cost and outcomes. There are four major factors that impact risk: 1) the characteristic of the population from which cases emerge; 2) the rate of referral and size of the population; 3) the intensity/duration/level of services per case (the number and type of service units per unit of time); and 4) the cost per unit of service.

Financial Risk - Financial risk can be defined as the *total cost of providing a defined scope of services for a defined population over a defined time period.* The term "total risk" is equivalent to "total cost" (over population, time, and scope of services). Actual service use and actual costs will vary from child to child and month to month, and the greater the variation, the greater the risks. Risk for utilization: The number and amount of services each person in the target population uses. The broader the scope of services, the more difficult it becomes to estimate the probabilities of the many different service utilization patterns, or combinations. Risk for cost or price: It is often easier to estimate cost or price than utilization, since providers usually have better records about and more control over costs.

There are a number of financial approaches that can be used by child welfare systems, each of which carries some level of financial risk. These approaches are:

Cost Reimbursement, Fees For Service (FFS), Discounted FFS, and Bundled Rates - Cost reimbursement and various fee for service arrangements, historically the most common reimbursement arrangement for child welfare, present the lowest level of risk to a private agency and the greatest risk to the public purchaser. A more recent variation has been to "bundle" formerly small, discrete service units into larger bundled service units. Under a bundled rate the provider receives a global per diem rate, based on the average of all individual services billed on a daily basis. This puts the provider at risk for variations among children in the number and type of services they need each day as well as variations across days in the services needed by any single child. However, the provider is not at risk for additional days of care, or for the child's total length of stay. The provider's risk is limited to managing the cost of services at a level below the negotiated fee. The state as a payer still bears the risk for the underlying use rate and the average units per user.

Under discounted FFS arrangements, providers are asked to give the state a discount off their normal fees for a given service unit or bundled rate. The unit may be a day of care or an hour of therapy or other child and family service. The provider is at risk for the cost incurred in the process of providing the unit of service. Success will depend on how much of the unit cost is made up of fixed vs. variable components (discussed below as determinants of risk) and how well the provider manages costs so that they do not exceed the negotiated fee.

Capitation - In the purest managed care financing model, a contractor is prepaid a fixed amount for all contracted services for a defined, enrolled population for the duration of the contract. This per member, per month, population-based payment arrangement is referred to as capitation. In this type of arrangement, the contractor is at risk both for the number of children who use services and for the level or amount of services used. The contractor receives the predetermined amount based on the number of enrolled children regardless of the number of children who actually use services or the level of services that enrolled children require during the month. If the contractor enrolls children who subsequently underutilize services, the contractor will make a profit. Conversely, the contractor is exposed to significant financial risks if the plan is not adequately priced or if the eligible enrolled children use more services or more costly services than projected.

The extent of capitation may vary, ranging from partial to full. In full capitation, the provider is at risk for all services defined by the scope of contracted services. Partial capitation refers to instances where the provider is at risk for only some services, such as outpatient, and is not liable for others, such as inpatient or residential. Sometimes, partial capitation refers to circumstances where only some special subset of a population is the responsibility of the provider. (These arrangements are also referred to as "carve out" models in behavioral health).

There are a number of reasons cited by child welfare administrators for not extensively using pure capitation models in child welfare. Part of the challenge has been the lack of accurate data that can be used to project for the general population, what percent will require services from the child welfare system, at what level, for what period of time, and at what cost. Another serious challenge is the relatively small number of children who will be enrolled as compared, for example, to covered lives under a public sector managed health care plan, making capitation for child welfare very risky.

Capped Allocations - Several public agency child welfare initiatives include reimbursement methods that resemble capitation. For example, in many of the county-administered initiatives (Colorado and Ohio, for example), the state provides the county a capped allocation, and the county assumes responsibility for managing and delivering (or purchasing) child welfare services under this block grant arrangement. Under such arrangements, the county agency is often also given increased flexibility and control over resources and the ability to retain savings.

Global Budget Transfers - In Florida, nonprofit lead agencies operate under a global budget transfer. Each lead agency is given a predetermined percentage of the state's annual operating budget and is asked to provide all services, in whatever amount needed, regardless of how many children and families in their geographic area may require services. The allocation is based in part on historic caseload size and previous spending for the geographic area covered and in part on assumptions of how the new privatized community-based care systems will affect future utilization patterns and outcomes. The actual payment system is a cost-reimbursement within the parameters of the fixed budget. The private agency is at risk for the utilization of services, the volume (number of children referred), and the costs.

Case Rates - Under this arrangement, a service provider, private lead agency, or other managed care entity (MCE) is paid a predetermined amount for each child referred. The contractor is not at risk for the number of children who will use services but is at risk for the amount or level of services used. For the contractor, if the case rate amount is adequate, it is a less risky financing arrangement than capitation.

In child welfare contracts, the case rate could be episodic or annual. An *episodic rate* means the contractor must provide all the services from initial entry into the plan until the episode ends. The point at which payments stop and risk ends varies from one initiative to another. However, it is common for the contractor to bear some risk until specified goals are achieved, whether it takes days, weeks, or years. For example, a typical case rate contract for foster care services might extend financial risks for up to 12 months after a child leaves the foster care system. If a child reenters care during that time, the contractor may be responsible for a portion (or all) of the cost of placement services. Under an *annual case rate*, the provider receives the case rate amount each year the child is in the child welfare system and the contract is in effect.

In both annual and episodic case rate arrangements, the payment schedule could be a monthly per child amount or it could be divided into lump sum payments that could be linked to attainment of various outcomes. An episode of care case rate is far riskier for the contractor than an annual case rate due to the many factors outside of the contractor's control that may extend the time it takes for the episode to end.

Another variation on a case rate payment is the difference between a "blended" case rate, which means a rate set at the average cost per case blended over all cases, and stratified case rates, where the rate varies by the type of case. Since there is always the risk of "adverse selection" – most of the more difficult and costly-to-serve cases going to one provider and easier cases going to the other, the payer ties a differentially lower or higher rate to different cases so amount of payment per case is correlated to the likely cost of serving that case. Stratified rates have some advantages (protecting the contractor from the risk of case-mix severity increases) as well as some disadvantages (more administrative complexity). One major disadvantage is the increased possibility of disputes, and grievances related to the proper assignment of a case to payment strata. If rates are tied to subjective factors, (e.g. severity ratings, level of functioning test scores, etc.) there is a high probability that the contractor will claim the low strata case needs to be reassigned to a higher level, and the payer will have a bias to operate in such a fashion (giving tests to score functioning) so as to place cases in the lower paying strata.

The State as payer can reduce its risk for the high degree of variation resulting from the use of many high cost services provided to children if it can establish a reasonable case rate over a sufficiently large number of children. A provider with a case rate, a sufficient volume, the authority to make decisions that impact risk, and a multi-year contract has an incentive to find the lowest cost service that will achieve the desired outcomes (Broskowski, 1997).

<u>Performance Incentives (Bonuses/Penalties) & Payment Schedules</u> - Pure pay-for-performance contracts while uncommon for child welfare have been found in a study of TANF contracts to offer the most financial incentives for contractors to meet performance goals (McConnell, Burwick, Perez-Johnson, & Winston, 2003). These contracts allow the public agency to place emphasis on specific goals by varying the dollar amounts attached to attaining each goal. In the organizations with pay-for-performance contracts visited as part of the TANF study, all staff members, from the top management to the front line, were aware of the performance goals and their importance.

While not adhering to a strict pay for performance model, public child welfare agencies are increasingly aligning payment schedules and/or bonuses or penalties to outcomes or results. Child welfare contracts differ in the events that trigger payments and in the assumptions underlying the fiscal model. Some contracts require the public agency to make regular fixed payments or payments to cover some of the costs incurred while some of the payments are contingent on contractors meeting performance goals. Some contracts also include advance payments to help providers cover upfront costs. Others provide direct financial bonus payments if expectations are met or exceeded, while still others include financial penalties if performance falls below some stated threshold. Initiatives differ widely in the selection of performance measures and in the incentives or penalties that are linked to the performance indicator. Some initiatives include only bonuses; in others, only penalties; and in yet others, both bonuses and penalties.

Risk-Mitigating Mechanisms

Every fiscal strategy, even a traditional cost-reimbursement arrangement, has risks—the potential for revenues and expenditures to vary in unexpected ways. The risks can be found in the number of children who use services, the unit costs, the case mix, the volume, and the duration. Risk-sharing is a function of determining who is responsible for each type of risk. There are different inherent risks associated with each of the previously described risk-based financing options. Because of the newness of risk-based contracting, the uncertainty in calculating the rates, and the likelihood that the contractor will be a nonprofit agency with limited capital reserves, most child welfare risk-based contracts also include mechanisms to ensure that contractors remain solvent and stable (McCullough, 2003).

Child welfare purchasers have used various methods to limit a contractor's risk. For example, some child welfare case rates cover certain services typically reimbursed under Title IV-E funds, but the contractor is expected to bill Medicaid under fee-for-service arrangements to supplement the case rate. Or, as described previously, in an attempt to better match level of risk to level of need, purchasers might propose risk-adjusted or stratified rates for children with different levels of service needs. Using a similar logic, in a few initiatives, the purchaser allows the contractor to be reimbursed outside the risk arrangement on a fee-for-service basis for a certain number of children.

Is Risk-Sharing Necessary?

The cost and effectiveness of providing child welfare services is uncertain. The ease with which children and their families can be moved toward safety, permanency, and well-being is unknown and difficult to forecast accurately. The payment structure in contracts affects how the risk associated with this uncertainty is distributed between the public agency and contractors. Under traditional child welfare contracts, the public agency bore all of the risks and retained all of the responsibilities for managing its resources to meet State and federal requirements. As more public agencies began to contract for some case management services, they saw an opportunity to also share financial risks with their private contract agencies with the goals of stimulating innovation and improving results.

On the other hand, there is no requirement that a privatized child welfare initiative has to share financial risks. It may not be in the best interests of the public agency to design contracts that introduce financial risks to contractors, for two reasons. First, some private agencies do not have the capacity to manage risks and, as a result, the public agency would run the risk of having a contractor cut costs to avoid insolvency or terminate the contract, both of which would likely be detrimental to children and families served by the contractor. Second, smaller organizations with limited financial resources may be less likely to bid for risky contracts, reducing the diversity of service providers and the extent of competition. For this reason, public agencies may use cost-reimbursement contracts in order to cultivate community-based providers that have experience serving distinct client populations. (McConnell, Burwick, Perez-Johnson, & Winston, 2003). The decision about whether and how to share risks must take into account the capacity of the provider community, and the willingness of the public agency to relinquish control over decisions that directly impact the contractor's ability to succeed.

The CWLA 2001-2002 50-state survey of management, finance, and contracting trends revealed significant variations in financing arrangements among the child welfare privatization initiatives. The arrangements may vary within the same initiative over time or between different county initiatives within the same state. The level of risk ranged from global budget transfers, to capped allocations or capitation, to case rates, to discounted Fee-For-Service or per diem arrangements that included bonuses and/or penalties based upon performance or case milestones. The degree of exposure to risk and the potential for reward often changed over time within the same initiative. (McCullough & Schmitt, 2003)

There is little in the way of comparative analysis of initiatives to indicate that one financing model is superior to another or, for that matter, superior to traditional contract arrangements. It is important, however, that a public agency fully understand the pros and cons of each type of risk-based option and the potential opportunities afforded by different structural designs before making decisions. It is also important to recognize that the ultimate success of an initiative may relate to many factors separate from the structural model and the risk option chosen.

<u>Understanding Challenges and Avoiding Unintended Consequences</u>

There is the potential for unintended consequences under all reimbursement models. The design of a contract's payment structure can affect both the public agency and the contractor. *Control over resources and the distribution of risk:* To the extent that the State wishes to have non-government agencies assume greater risk for costs, it must consider relinquishing some degree of control over the management of available resources. Assumption of control over resource management is generally correlated with assumption of risk and the concomitant opportunity for reward. Risk-sharing or results-based contracts require providers to have the infrastructure, knowledge, skills, and authority to consistently assess and meet the needs of the children and families they serve while managing resources to achieve fiscal goals. Prior to determining whether risk-sharing options are desirable or which financing option to use, it is important for planners to assess current provider capacity and to carefully explore the pros and cons of different fiscal models with that capacity and interest in mind.

The high prevalence of serious and complex needs among the children and families served and the relatively small size of the population: An important difference between Medicaid managed care reforms and child welfare initiatives relates to size and case mix. Children served by the child welfare system and their parents often need acute and extensive health and behavioral health services and if behavioral health needs are not identified and addressed, it will be more difficult to ensure safety, permanency, and well-being for children. Families, in addition to clinical needs, require a range of services related to poverty, family and community vulnerability, homelessness, and a lack of basic supports. As a result, children and families served by child welfare have the potential to become high utilizers of deep-end services.

Funding sources and the impact of "success" on federal revenue: The bulk of federal child welfare funding is disproportionately directed toward out-of-home care—the very part of the system that many privatization initiatives are seeking to minimize. Given the complexity of child and family needs and the inadequacy of child welfare funds to support preventive, home-and community-based care, and therapeutic services, child welfare agencies have traditionally tapped other federal, state, or local funds that come from multiple agencies. Each funding source may come with different program eligibility and match requirements.

As child welfare agencies strive to rearrange fiscal relationships, payment mechanisms, and introduce risk sharing into contracts, they have to also ensure that the proposed changes will not negatively affect their ability to maximize federal revenues. For example, under current prohibitions against the use of Title IV-E funds for services other than out-of-home care. As a result, when out-of-home care placements are reduced, so is federal reimbursement to the State. If the contractor reduces placements or shortens the length of stay in foster care, the state's portion of the contract rate will increase as the federal Title IV-E share decreases. When this happens, the state may realize savings in its out-of-home care costs; however, these savings may be more than offset by the state's obligation to pay for non-federally reimbursable services under the contract rate.

Cash flow: Cash flow problems can become critical, especially for the nonprofit contractor. Contract design affects when payments are made to contractors, as well as how much they are paid. The timing of payments is important because it affects the financial resources needed for contractors to cover expenses before they are paid. Small organizations may not be able to bid on contracts that require them to have the financial resources to weather a period when expenses exceed income, even if it is relatively short. On an ongoing basis after award of a contract, contractors may face serious cash flow problems if they are not paid prospectively but are required to reimburse network subcontractors before receiving state payments. The more recent performance-based contracts that delay some portion of payments or incentives until case milestones or specified results are achieved may mean that contractors must wait many months after they have incurred the expenses of providing services for the client before they receive payment.

Pricing the system and adjusting the rates: Child welfare initiatives have varied in their approaches to pricing the overall system, establishing rates for contractors, timing the introduction of financial risk, and adjusting rates over time. Some child welfare initiatives introduced financial risk during the initial implementation; others phased-in risk after some period of time—often after the first year of cost and utilization data collection and analysis. In some initiatives, the public agency allowed the competitive bidding process to set the price and establish the rates. In other initiatives, the rate was specified in the RFP.

In most instances, the overall budget for the initiative was typically based upon estimates of what similar services cost under the traditional system. The risk-based rates were also typically calculated on the basis of rates paid under per diem and fee-for-service arrangements. Many respondents to the CWLA surveys, conducted periodically from 1998 to 2002, reported difficulty in accessing accurate historic data to guide them in pricing the system or establishing the rates. As a result of the initial guesswork, it has not been uncommon for states to err in pricing the overall initiative or in setting rates, with, at times, mid-course corrections being made (McCullough & Schmitt, 2003)

Fiscal assumptions and actual performance: Although child welfare respondents have rarely indicated that containing or reducing overall child welfare costs is the principal goal of the initiative, most initiatives, however, have expected budget neutrality and the redirection of resources to provide more appropriate services to more people with the same dollars. In most initiatives, there were built-in assumptions about what effect the proposed change would have on costs. CWLA survey respondents were asked to compare actual fiscal performance data (if available) to fiscal assumptions that were made when initiatives were designed. No one-to-one relationship was found between fiscal assumptions and performance. Some initiatives were not designed explicitly or intended to save money, but they have (Illinois, for example), whereas others were intended to be cost neutral and have, in fact, cost more (Kansas, for example). Only three states expected the initiative to cost more than the previous system, but fiscal performance data indicate that 10 initiatives cost more than the previous system. In some instances, States reported they were pleased with results because funds had been re-directed, enabling more children and families to receive services at the same or slightly more costs (McCullough & Schmitt, 2003).

V: THE IMPACT OF DESIGN DECISIONS & CONTRACT PROVISIONS

Risk is affected by a variety of factors. Client factors include characteristics and service usage patterns of the population. The scope of services that the contractor is required to provide or procure for the target population affects risk. Contractual provisions can also influence risk. Examples include but not limited to: the stated and implicit goals of the contract; the required performance measures and outcomes; whether or not the contract includes risk-sharing and the previously described risk mitigating factors and provisions for reassessing rates; contract duration; the size and geographic reach of the contract; and, the degree of flexibility/autonomy given to the contractor to manage risk.

For the privatized initiative to meet its objectives, there must be balance among the interrelated factors of quality, satisfaction, and cost. How to optimize or balance competing interests is still an imprecise art, but most would agree that successful implementation of a privatized child welfare initiative depends in large part on identifying potentially competing interests and realigning them so that all parties share the same interests. Too much risk can paralyze; too little risk can limit creativity, resourcefulness, and industry.

Estimating the potential impact or risk of a privatization effort requires that a variety of factors be explored and considered. Many of decisions that are made in the design of the system might be expected to influence the provision or utilization of care, the costs, and the overall impact on the child welfare system. Consideration must be given to the relative strengths and abilities of the public and private agencies. Consideration must also be given to ensuring that start-up time and funding allow time for the public agency and/or the private contractor to expand services prior to the start of the privatized case management system.