



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

EVALUATION REPORT

Child Care Reimbursement Rates



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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

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Legislative Audit Commission

Minnesota's Child Care Assistance Program pays a portion of child care expenses for certain low-income families to help them stay employed and reduce their dependence on public assistance. Legislators have been concerned about the growing costs of this program and the rates paid for child care. Consequently, the Legislature directed the Department of Human Services to recommend options for cost control. In addition, the Legislative Audit Commission directed the Office of the Legislative Auditor to examine the methods used by the Department of Human Services to set maximum reimbursement rates for subsidized care.

We found that the basic methods used by the department to set maximum rates are reasonable. But the department sometimes uses complicated rate conversion procedures that ignore some of the rate information reported by providers. As a result, some of the maximum rates may exceed the levels permitted under state law. Prior to July 2003, state program administrators clearly violated state law by not setting maximum rates for child care centers in 68 of the state's 87 counties. In addition, the department's subsequent implementation of "regional" and "statewide" rates in those counties seems inconsistent with legislative directives, although the department believes its administrative rules provide authority to implement such rates.

We also found that an unexpectedly high percentage of licensed family home providers in some counties charge the state the maximum rate for child care. There are several possible explanations. Because one possibility is that providers are charging a higher rate than they are entitled to, we have recommended that the Department of Human Services investigate whether improper billing is occurring.

This report was researched and written by John Yunker (project manager) and Dan Jacobson. During the study, we received the full cooperation of the Department of Human Services. However, we have concerns about the department's written response to our report and have provided comments following their letter.

Sincerely,

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

Table of Contents

	<u>Page</u>
SUMMARY	ix
INTRODUCTION	1
1. BACKGROUND	5
Eligibility	6
Governmental Roles	8
Program Statistics and Trends	11
Participant Costs	20
2. MAXIMUM REIMBURSEMENT RATES	23
Overview	24
Surveys	33
Calculation of Maximum Rates	37
Comparisons With Other States	53
3. OTHER ISSUES	55
Provider Incentives	56
Participant Choices	63
Access to Subsidized Child Care	68
Other Methods of Setting Maximums	70
LIST OF RECOMMENDATIONS	73
AGENCY RESPONSE	75
LEGISLATIVE AUDITOR'S COMMENTS	81
RECENT PROGRAM EVALUATIONS	85

List of Tables and Figures

<u>Tables</u>	<u>Page</u>
1.1 Activities of Families Receiving Child Care Assistance, September 2003	7
1.2 Income Eligibility for Child Care Assistance, May 2004	8
1.3 Examples of State and Participant Payments for Child Care Obtained Through the Child Care Assistance Program, FY 2005	10
1.4 Monthly Average Number of Children Served by the Child Care Assistance Program, FY 2000-05	12
1.5 Type of Care Used in the Child Care Assistance Program by Region and by Subprogram, Federal FY 2003	15
1.6 Actual and Estimated Expenditures for the Child Care Assistance Program, FY 2000-07	18
1.7 Changes in Participant Co-payments at Selected Income Levels for a Two-Person Household, FY 2003-04	20
2.1 Maximum Reimbursement Rates in Ramsey County, FY 2005	25
2.2 Key Events Affecting Maximum Reimbursement Rates for the Child Care Assistance Program, 2001-05	27
2.3 Type of Rates Used to Calculate Hourly, Daily, and Weekly Maximum Reimbursement Rates for Child Care Centers, FY 2003-05	30
2.4 Geographic Area Used to Calculate Maximum Reimbursement Rates for Licensed Providers, FY 2003-05	31
2.5 Type of Rates Used to Calculate Hourly, Daily, and Weekly Maximum Reimbursement Rates for Licensed Family Home Providers, FY 2003-05	32
2.6 Average Discount for Daily and Weekly Preschool Child Care Rates by Area of the State, 2001	38
2.7 Calculation of Maximum Toddler Reimbursement Rates in Region 2 (North Central Minnesota), 2001	39
2.8 Calculation of Maximum Infant Reimbursement Rates in Region 10 (Southeastern Minnesota), 2001	41
2.9 Calculation of Maximum Infant Reimbursement Rates in Chisago County, 2001	42
2.10 Calculation of Maximum School-Age Reimbursement Rates in McLeod County, 2001	44
2.11 Percentage of Maximum Reimbursement Rates That Were Inappropriately Calculated, FY 2003-05 ^a	45
2.12 State Methods for Calculating Maximum Reimbursement Rates, 2004	53
3.1 Provider Rates Compared With Current Maximum Rates, 2001-04	58
3.2 Comparison of Child Care Payments with Provider Rates for Selected Counties, 2004	59
3.3 Primary Child Care Arrangement Used by Subsidized and Unsubsidized Families, 1999	65

	<u>Page</u>
3.4 Type of Subsidized Child Care Used in Minnesota and Other States, Federal FY 2001	66
3.5 Trends in Access to Child Care Providers by Region, 2002-04	69

Figures

1.1 Age of Children Served by the Child Care Assistance Program, FY 2003	13
1.2 Type of Child Care Used in the Child Care Assistance Program, Federal FY 2003	14
1.3 Percentage of Child Care Assistance Program Participants Using Child Care Centers by County, Federal FY 2003	16
1.4 Child Care Assistance Expenditures by Source, FY 2003	17
1.5 Trends in the Number of Families Receiving Child Care Assistance and the Cost per Family, FY 2000-07	19
2.1 Regions Used in Setting Maximum Reimbursement Rates	29

Summary

The Department of Human Services should revise some of the procedures it has used to set maximum reimbursement rates for the Child Care Assistance Program.

Major Findings:

- The basic methods used by the Department of Human Services to set maximum reimbursement rates for the Child Care Assistance Program are reasonable (p. 37).
- However, the department sometimes uses complicated rate conversion procedures that ignore important information about market rates for child care. As a result, some maximum rates exceed the levels we think are allowed under state law (pp. 39, 44).
- We question whether the Department of Human Services complied with state laws in establishing regional and statewide maximum rates for child care centers in 68 counties in July 2003. The Department of Education's prior practice of paying a provider's rate without a maximum clearly violated state statutes (p. 47).
- In some parts of the state, an unexpectedly high percentage of licensed family home providers have billed the maximum rate for subsidized care. The reasons for this are unclear, but the department needs to examine whether some providers are inappropriately billing the Child Care Assistance Program (pp. 61-63).
- There is some evidence that subsidized families in Minnesota use child care centers—the most expensive type of care—more often than unsubsidized families.

However, the use of centers in Minnesota's Child Care Assistance Program is much lower than that for subsidized programs in most other states (pp. 64-66).

Key Recommendations:

- The Department of Human Services should revise the methods it uses to calculate maximum reimbursement rates, particularly the methods used to convert maximums from one time period to another (pp. 42-43).
- The Department of Human Services should seek changes in state laws that would clearly allow the department to implement maximum rates based on geographic areas larger than a single county (p. 49).
- The Department of Human Services should become more familiar with the information reported in rate surveys. Department staff should adequately review the work of the child care resource and referral agencies that collect rate data and the consultant that analyzes the data and calculates maximum rates (p. 53).
- The Department of Human Services should examine whether there is a problem in some counties with providers charging the Child Care Assistance Program a higher rate than they charge the general public (p. 63).

Report Summary

Minnesota's Child Care Assistance Program pays a portion of child care expenses for certain low-income families. Fueled in part by growing federal support, total spending on the program increased to \$243 million in fiscal year 2003. In response to state budget shortfalls, the 2003 Legislature froze maximum reimbursement rates paid for subsidized care at child care centers and licensed family home providers, reduced the maximum rates paid for legal non-licensed care, tightened program eligibility, increased participant co-payments, and reduced state appropriations.

Despite the budget cuts made in 2003, the Legislature was concerned about future growth in program costs once the rate freeze is removed in July 2005. As a result, the Legislature asked the Department of Human Services to make recommendations for future cost containment to the 2005 Legislature. In addition, the Legislative Audit Commission directed our office to review the methods used by the department to calculate maximum reimbursement rates for subsidized child care.

The Department of Human Services Uses Inappropriate Methods to Calculate Maximum Reimbursement Rates in Some Counties

Minnesota law requires the Department of Human Services to establish maximum reimbursement rates for subsidized child care no higher than the 75th percentile rate for similar care in each county. The department sets separate rates for child care centers and licensed family home providers based on their respective market rates. Rates for legal non-licensed care are based on a percentage of the maximum rates for licensed family home care. In each of Minnesota's 87 counties, the department

has 28 maximum rates, including 12 maximums each for child care centers and licensed family home providers. The 12 maximums include hourly, daily, and weekly rates for each of four age groups of children. For legal non-licensed care, there are hourly rates for each of the four age groups.

Generally, the department uses appropriate methods to survey providers about their rates and set maximum rates. But some of the department's complicated procedures for calculating maximum rates seem inappropriate and inconsistent with state law. The problems mainly occur when the department converts maximums for one time period to another time period. For example, about half of the weekly maximums for child care centers are based on conversions of hourly or daily maximums rather than simply on weekly rates. In those cases, the department's method ignores the weekly rates reported by providers and, at times, sets weekly maximums not only higher than the 75th percentile allowed by law, but far in excess of the reported rates. In one county, the department set a weekly maximum more than twice as high as the reported weekly rates.

We estimate that about 25 percent of the current maximum rates for child care centers and about 9 percent of the maximums for licensed family home care would be lower if more reasonable procedures were used to set maximum rates. In addition, 13 percent of the maximum rates for legal non-licensed care would be lower. About 3 percent of the maximums for child care centers would be higher. Most of the problems we found affect the maximum rates in counties outside the Twin Cities metropolitan area.

There are additional problems with the current maximum rates, particularly those for center-based care of school-age children. Because the size of child care centers varies significantly, the department uses information on licensed

The department's complicated rate conversion procedures have caused some maximum rates to be set higher than the 75th percentile allowed by state law.

capacity in calculating maximum rates for centers. But, about one-fourth of the child care centers that reported rates for the care of school-age children did not report their licensed capacity in the 2001 survey. As a result, some of the current maximum rates are based on faulty assumptions about the capacity of these centers. The amount of non-reporting has decreased in more recent surveys, but we are concerned that some providers may be misstating their capacity when surveyed. In future surveys, the Department of Human Services should obtain information on licensed capacity from its Licensing Division and supplement it, when necessary, with information from providers.

State Administrators of the Child Care Assistance Program Have Not Paid Sufficient Attention to State Laws Governing the Setting of Maximum Rates

Prior to March 2003, the Department of Education was responsible for administering the Child Care Assistance Program and setting maximum rates. The Department of Education used a “pay provider rate” system that did not have maximum rates for child care centers in 68 counties for one or more age groups. The department allowed child care centers in those counties to charge the program whatever rate they charged private customers and to increase the rate charged to the program during a fiscal year. We think the “pay provider rate” system clearly violated state statutes that require maximum rates to be set in each county based on the 75th percentile of market rates as surveyed by the department. To comply with state law, state program administrators should have set maximum rates in these counties and enforced those rates until new rates were set throughout the state based on a new rate survey.

Within months after the Department of Human Services assumed responsibility

for the program, the Legislature directed the department to continue using the Department of Education’s schedule of provider rates through June 2005. That schedule had been implemented in July 2002 and included the “pay provider rate” system for child care centers in 68 counties.

The Department of Human Services implemented some parts of the legislative directive but did not continue the “pay provider rate” system. Instead, the department established maximums for child care centers in each of the 68 counties based on rates from counties in the same region or other regions of the state. The department’s action caused the allowed payment rates for some child care centers to decline even though the legislation required that the department’s rate schedule remain unchanged.

In establishing “regional” and “statewide” maximums in these 68 counties, the Department of Human Services did not consider the statutory language that appears to require maximum rates to be set based on rates in each county, rather than rates in multiple counties. While the department believes that its rules give it authority to set maximum rates based on multi-county jurisdictions, we think that the department should seek clearer statutory authority to set regional or statewide rates.

It Is Difficult to Determine Whether Licensed Providers Raise Their Rates to Take Advantage of the State’s Maximum Rates

Some legislators have been concerned that some child care providers increase their rates to the state’s maximum reimbursement rate in order to charge the state more for subsidized care. Almost all legal non-licensed providers charge the maximum rate. This result is not surprising since such providers generally do not have regular rates. They only

The Department of Human Services should seek clearer statutory authority to set "regional" and "statewide" maximum rates.

provide care for children of relatives and no more than one unrelated family.

But available evidence suggests that most licensed providers do not respond in the same way to increases in the maximum rate. Most licensed providers have a large number of private-pay customers and would lose some of these customers if they set their rates too high. Only providers that primarily serve children from the Child Care Assistance Program have a strong incentive to increase their rates to the maximum rates.

It is unclear, however, how many licensed providers are highly dependent on the subsidy program and how they respond to increases in maximum rates. This issue cannot be directly examined due to a lack of information on individual providers. The Department of Human Services does not have information on the extent to which providers rely on the subsidy program. In addition, the department did not maintain data on the names of providers responding to the 2001 rate survey. As a result, it is not possible to identify how much individual providers—particularly those serving a large number of children in the state’s program—raised their rates in recent years.

Indirect evidence suggests that there is not a significant problem with child care centers. However, in some parts of the state, there is a greater tendency among licensed family home providers to charge the maximum rates than one would expect from the market rates of providers serving the general public. This finding may indicate that there are a significant number of licensed family home providers that mostly serve subsidized families in those parts of the state. Another possibility is that providers are billing the maximum rate to a county or the state even though they charge a lower rate to the general public and are not entitled to the maximum rate. Although providers are required to provide counties with the rates they

charge to the general public, some counties may not be checking that information before making payments.

Program Participants Seem to Use Child Care Centers More than Unsubsidized Families But Use Centers Less than Subsidized Families in Most Other States

There has been a concern among some legislators that the system of setting maximum rates provides program participants with an incentive to select child care centers, even though they are the most expensive type of care for the state’s assistance program. The best information currently available on this issue comes from a 1999 survey of Minnesota families. Data from that survey suggest that subsidized families choose child care centers almost twice as often as families not receiving child care subsidies. However, some of the results from this survey are contradicted by the findings from a 1997 Urban Institute study. Data from a 2004 survey of Minnesota families will be available in 2005 and could be used to provide more up-to-date results.

While participants in Minnesota’s Child Care Assistance Program may be more likely to use child care centers than the general public, the setting of maximum rates limits the costs paid by the program. Furthermore, the use of centers in Minnesota’s program is low compared with other states. In 2001, only 36 percent of program participants in Minnesota used child care centers, while 58 percent of subsidized families in other states used center-based care.

The Department of Human Services needs to examine whether some licensed family home providers are inappropriately charging the maximum rate.

Introduction

Like other states, Minnesota pays a portion of the child care expenses of certain low-income families. The primary purpose of Minnesota's Child Care Assistance Program is to help low-income families pursue employment or education leading to employment. By facilitating employment, the program attempts to reduce the reliance on other public assistance programs.

The program is funded largely with state and federal government funds. Due to state budget shortfalls, the 2003 Legislature implemented several measures to reduce state spending on child care assistance. The Legislature reduced the appropriation for the basic sliding fee component of the program and increased co-payments for all families receiving child care assistance. In addition, the 2003 Legislature instituted a two-year freeze on the maximum reimbursement rates paid for subsidized licensed child care and reduced the maximum rates for non-licensed care. Prior to this freeze on licensed reimbursement rates, the state was adjusting the maximums annually based on the rates charged to unsubsidized customers by child care providers.

Our evaluation focused on the maximum reimbursement rates used in the Child Care Assistance Program.

The 2003 Legislature required the Department of Human Services (DHS) to study the Child Care Assistance Program and report back by January 15, 2005 with recommendations for controlling the future growth in child care assistance costs. But, some legislators were concerned about the quality of information received from DHS regarding child care assistance during the 2004 legislative session and wanted an impartial, third-party review of selected aspects of the program. As a result, in April 2004, the Legislative Audit Commission directed the Office of the Legislative Auditor to conduct a study of the methods used by DHS to establish maximum reimbursement rates. In this report, we address the following issues:

- **Does the Department of Human Services use appropriate methods in conducting surveys of child care provider rates?**
- **Are the department's methods of calculating maximum reimbursement rates reasonable and consistent with state statutes?**
- **How do the rates charged for subsidized care compare with the maximum rates set by the state? Do most providers simply charge the maximum rates set by the state?**
- **Do subsidized families tend to select the most expensive care available in their area? What do available data suggest about how the type of child care used by subsidized families differs from that used by unsubsidized families?**
- **To what extent has the freeze on maximum reimbursement rates affected the access of program participants to child care?**

- **Could Minnesota set lower maximum reimbursement rates and still comply with federal laws and regulations? What would be the advantages and disadvantages of setting lower maximum rates?**

To conduct this evaluation, we reviewed applicable state and federal laws and regulations and national studies on child care assistance programs. In addition, we interviewed Department of Human Services staff and selected individuals involved with the Child Care Assistance Program including county government staff, child care providers, and representatives of interest groups.

We reviewed the methods used to survey child care providers about their rates, and we analyzed rate data from the last three surveys. We examined the rate information obtained during the 2001 survey in detail, since that survey was used to set the maximum reimbursement rates that are currently in effect and have been in effect in some parts of the state since July 2002. We also examined child care assistance payment data from Hennepin County and from those counties that use the state payment system called the Minnesota Electronic Child Care Information System (MEC²). Finally, we analyzed data from several sources on the use of different types of child care providers by subsidized and unsubsidized families.

Data limitations affected our ability to answer some questions asked by legislators.

While we were able to complete our study, there are a number of data limitations that affected the extent to which we could answer the questions raised by legislators. First, Minnesota does not yet have a statewide payment system. In recent years, the number of counties using the state's payment system has gradually increased. But, as of July 1, 2004, only 38 of the state's 87 counties had all of their child care assistance payments made by the state. As a result, we were unable to systematically examine the child care assistance payments in most counties. Second, the state does not have a statewide database that identifies which providers serve subsidized children and the percentage of a provider's enrollment or capacity that is accounted for by subsidized children. Consequently, we could not identify providers that are highly dependent on the Child Care Assistance Program and compare changes in their rates with those of other providers. Third, complete information on how the 2003 legislative changes affected program participation, program expenditures, the use of different types of child care, and the number of providers was not available during our study. That information may now or soon be available from the Department of Human Services. Fourth, the most recent data available on the use of various types of providers by subsidized and unsubsidized families and by families of various incomes was from a 1999 Wilder Foundation survey. Data from a 2004 survey will soon be available and could be used to provide a more up-to-date answer to some of the questions asked by legislators. Finally, due to a change in the software used to track providers and rates, the Department of Human Services could not provide us with the names of providers whose rates were included in the 2001 rate survey. That survey was the one used to set the maximum rates currently in effect. As a result, we could not fully answer some questions legislators had about maximum rates set in their counties or track how the rates of particular providers changed over time.

Chapter 1 of this report describes Minnesota's Child Care Assistance Program, including its funding, the number of participants, and the use of various types of child care. We also discuss the role of the Department of Human Services in establishing maximum reimbursement rates and the federal government's

requirements for the process of setting maximum rates. Chapter 2 evaluates the department's methods for surveying child care providers and using information about their rates to set maximum reimbursement rates. In particular, we examine whether the department has set maximum rates that are consistent with actual rates and statutory requirements. We also compare the basic methods used to set maximum rates in Minnesota with those used in other states.

Chapter 3 reviews the response of providers and participants to the availability of child care assistance and the setting of maximum reimbursement rates. We examine whether providers typically adjust their rates to the maximum rates allowed by the state. We also examine whether subsidized families tend to select higher-priced child care than non-subsidized families. Furthermore, we consider how the freeze on maximum rates has affected the access of program participants to child care. Finally, in Chapter 3, we discuss the advantages and disadvantages of using alternative methods for setting Minnesota's maximum rates that would produce lower maximums than have typically been set in the past.

SUMMARY

Like other states, Minnesota provides child care subsidies for certain low-income families to enable them to pursue employment or education leading to employment. By fiscal year 2003, participation in Minnesota's Child Care Assistance Program had increased to a monthly average of about 40,000 children. Program spending had grown to \$243 million, including \$128 million in state funds. In response to state budget shortfalls, the 2003 Legislature restricted program eligibility, reduced state funding, increased participant co-payments, froze maximum reimbursement rates for licensed child care, and reduced maximum rates for legal non-licensed care. The Department of Human Services expects participation and spending to decline during the current biennium. But spending is expected to grow during the 2006-07 biennium, since the freeze on the state's maximum reimbursement rates is due to expire. Current reimbursement rates are based on a survey of market rates conducted during the fall of 2001.

The Child Care Assistance Program helps low-income families afford child care.

Each of the 50 states and the District of Columbia operate child care assistance programs that are funded in part by the federal government. The primary purpose of these programs is to help low-income families, particularly those receiving public assistance, pursue employment or education leading to employment. Without child care subsidies, it may be difficult for these families—which are often single-parent families—to be employed or in training. The programs also serve low-income families leaving public assistance programs and other low-income working families. An additional goal of the programs is to provide quality child care that helps prepare children for school.

This chapter provides an overview of Minnesota's Child Care Assistance Program. In particular, we address the following questions:

- **What types of families are eligible for child care subsidies under Minnesota's Child Care Assistance Program?**
- **What are the responsibilities of state, local, and federal government agencies in administering the program? What is the state's responsibility for setting maximum reimbursement rates, and what restrictions does the federal government place on the state's methods for setting maximum rates?**

- **How many children and families participate in the Child Care Assistance Program? How does participation vary across the state?**
- **What types of child care do subsidized families select? How does the selection of child care vary across the state and for different subprograms?**
- **How have expenditures for the Child Care Assistance Program changed in recent years? How are changes in the program expected to affect future expenditures?**
- **What child care costs do participants pay? How have those costs changed in recent years?**

ELIGIBILITY

The program serves participants in the Minnesota Family Investment Program (MFIP) and other low-income families.

Minnesota’s Child Care Assistance Program serves several types of low-income families. First, the program provides child care subsidies for families participating in the Minnesota Family Investment Program (MFIP) or the Diversionary Work Program (DWP).¹ The families must be employed or pursuing employment, or participating in employment, training, or social services activities authorized in an approved employment services plan. MFIP recipients without an approved plan must be employed at least an average of 20 hours per week and earn at least the minimum wage. Up to 240 hours per year of child care may be authorized for job search efforts. Recipients with an approved employment plan are not subject to these employment and earnings requirements. They can use subsidized child care for work, training, social services, and other activities authorized in their employment plans.

Second, former MFIP or DWP recipients who are in their first year off these programs are eligible to receive child care assistance provided they received MFIP or DWP at least three of the last six months. These “transition year” participants are then eligible for up to 12 consecutive months of child care assistance for employment and job search purposes. They must be employed at least an average of 20 hours per week and earn at least the minimum wage. The information in Table 1.1 suggests that most families qualifying for child care assistance due to their current or past MFIP status are employed. The Department of Human Services estimated that fewer than 15 percent were engaged only in education, social services, or other non-employment activities during September 2003.

Third, the program pays child care expenses on a sliding fee basis for other low-income parents that are employed or are in an educational program leading to

1 The Minnesota Family Investment Program, or MFIP, is the state’s welfare reform program for low-income families with children. It includes both cash and food assistance. When most families first apply for cash assistance, they participate in the Diversionary Work Program, or DWP. This is a four-month program that helps parents go immediately to work rather than receive welfare. Some families may be referred to MFIP as soon as they apply for assistance, while others are referred to MFIP after they finish four months of DWP. Parents on MFIP are expected to work, and are supported in working. Most families can get cash assistance for only 60 months.

Table 1.1: Activities of Families Receiving Child Care Assistance, September 2003

Most families that receive child care assistance are employed.

MFIP Program	Percentage of Families	Basic Sliding Fee Program	Percentage of Families
Families with an Employment Plan ^a		Employment	90%
Employment	40%	Education	3
Education	11	Employment and Education	6
Employment and Education	12		
Subtotal	63%	Total	100%
Families without an Employment Plan (Employment only)	9		
Transition Year and Transition Year Extension (Employment only)	26		
Orientations and Appeals	2		
Social Services Only	<1		
Total	100%		

^aSome of these families are also receiving child care for social services that are part of their employment plan.

SOURCE: Minnesota Department of Human Services' calculation from September 2003 county reports excluding data from the state's MEC² payment system.

employment. Sliding fee assistance declines as family income increases.² If participants in the sliding fee portion of the program are employed, they must be working at least an average of 20 hours per week and earning at least the minimum wage. There is no limit to the length of time that a family can obtain basic sliding fee assistance. But a participant can pursue education without employment only as long as it takes to complete an associate or baccalaureate degree.³ Full-time students that work and request child care during their work hours must work at least an average of 10 hours per week and earn at least the minimum wage. Table 1.1 shows that most basic sliding fee participants are employed. For September 2003, the Department of Human Services estimated that 90 percent were employed. The other 10 percent were enrolled in educational programs, but two-thirds of those in educational programs were also employed.

The basic sliding fee portion of the Child Care Assistance Program is subject to a fixed appropriation, while there is an open, or unlimited, appropriation available to fund the MFIP and transition year components of the program. Each county is given a fixed allocation of funds to provide sliding fee assistance and may not be able to serve all county residents that qualify for sliding fee child care assistance. The state sets priorities for counties to use in deciding which eligible families will receive assistance. A county must give highest priority to parents without a GED or a high school diploma and those who need remedial or basic skills courses to pursue employment or education leading to employment. The youngest parents receive the greatest consideration within this group. The second priority is

² All participants in the Child Care Assistance Program, including those in MFIP or DWP, are assessed a co-payment that is calculated on a sliding fee basis, except those with an annual gross income less than 75 percent of the federal poverty level adjusted for household size.

³ There is no limit on the amount of time that may be needed for remedial education.

families completing child care assistance in their transition year from MFIP or DWP. The third priority is portability pool recipients, who are individuals who were receiving basic sliding fee assistance in other counties but have moved into a new county. If a county cannot provide basic sliding fee assistance for all eligible families, it establishes a waiting list.

The 2003 Legislature tightened eligibility for child care assistance to non-MFIP families.

The federal government provides funding for state child care assistance programs that limit eligibility to families earning less than or equal to 85 percent of the state's median income. Prior to July 1, 2003, Minnesota's Child Care Assistance Program provided subsidized child care to families with incomes less than or equal to 75 percent of the state's median income. The 2003 Legislature reduced the income eligibility limits for non-MFIP participants and changed the method for calculating eligibility. Since July 1, 2003, Minnesota's program has admitted non-MFIP families into the Child Care Assistance Program only if they have incomes less than or equal to 175 percent of the federal poverty level adjusted for family size. The program has also terminated assistance for non-MFIP families with incomes equal to or greater than 250 percent of the federal poverty level. The new entry and exit ceilings for eligibility were roughly equivalent to 44 and 63 percent of the state's median income, although they varied slightly depending on family size. The change in eligibility did not immediately affect the vast majority of program participants. The Department of Human Services estimated that in fiscal year 2003 only about 5 percent of the families receiving basic sliding fee assistance had incomes equal to or greater than 250 percent of the federal poverty level. Table 1.2 illustrates the changes in income eligibility that were the result of 2003 legislation.

GOVERNMENTAL ROLES

In this section, we provide a brief overview of the roles that various governmental bodies and agencies play in establishing, overseeing, and operating the Child Care

Table 1.2: Income Eligibility for Child Care Assistance, May 2004

Family Size	Entrance Limit			Exit Limit			Comparison to Law Prior to July 2003 ^a		
	Percent of Federal Poverty Level	Dollars	Equivalent as a Percent of State Median Income	Percent of Federal Poverty Level	Dollars	Equivalent as a Percent of State Median Income	Percent of State Median Income	Dollars	Equivalent as a Percent of Federal Poverty Level
2	175%	\$21,210	43%	250%	\$30,300	61%	75%	\$37,043	306%
3	175	26,705	44	250	38,150	63	75	45,760	300
4	175	32,200	44	250	46,000	63	75	54,476	296
5	175	37,695	45	250	53,850	64	75	63,193	293
6	175	43,190	45	250	61,700	64	75	71,909	291

^aPrior to July 1, 2003, families with incomes less than or equal to 75 percent of the state's median income were eligible for child care assistance. Starting in July 2003, separate entrance and exit limits were placed into effect and were based on the federal poverty level. This table shows the limits in effect as of May 2004 and compares them with the eligibility limit that would have been in effect if state law had not been changed.

Assistance Program. In particular, we discuss the establishment of maximum reimbursement rates by the Department of Human Services and the guidelines set by the federal government.

General Responsibilities

Federal, state, and county governments are involved in the administration and funding of Minnesota's Child Care Assistance Program. In Minnesota, like other states, the federal government provides significant funding for child care assistance, administration, and improvements to the child care system. In return, the federal government sets program regulations that must be followed by states. In addition, the federal government requires states to file plans for federally funded child care services every two years and obtain federal approval for those plans. At the state level, the Minnesota Legislature has the authority to establish a child care assistance program and set the eligibility, operational, and administrative standards for the program. The Department of Human Services (DHS) has the general responsibility of ensuring that the policy set forth by the Legislature is implemented.⁴ The department establishes state rules, prepares a state plan for submission to the federal government, allocates funds to the counties for the basic sliding fee portion of the program in accordance with legislative direction, and communicates with counties regarding the operation of the program. DHS also operates a computer system that, as of July 1, 2004, made all child care assistance payments in 38 of Minnesota's 87 counties and some of the payments in eight other counties. Counties are responsible for the operation of the Child Care Assistance Program in Minnesota. Counties must review the eligibility of applicants, authorize payments to providers, and report to DHS on certain aspects of their activity.

The Department of Human Services sets hourly, daily, and weekly maximum reimbursement rates for various types of subsidized child care.

Maximum Reimbursement Rates

In operating a child care assistance program, each state is required to set maximum reimbursement rates for child care. In Minnesota, the Department of Human Services sets hourly, daily, and weekly maximum rates for various types of child care in each of the state's 87 counties. Child care providers are free to establish rates at any level for their customers. But, for subsidized care, the state will not pay rates higher than the maximum rate. Providers must collect any additional charges in excess of the maximum rate from participants.

To be specific, the state accepts the provider's rate unless it exceeds the maximum rate. The state's payment to the provider is the smaller of the two amounts—the provider's rate and the maximum rate—minus the co-payment required of the program participant. In most counties, the participant pays the co-payment directly to the provider. If the provider's rate exceeds the maximum rate, the participant must pay the provider the difference between the provider's rate and the maximum rate, in addition to the co-payment. Table 1.3 provides several examples illustrating how payment of child care assistance works. The examples show that the cost to a participant may increase significantly if the participant

⁴ State oversight of the Child Care Assistance Program moved from the Department of Education in March 2003 as a result of a government reorganization undertaken by the Governor. An earlier version of the program began in the Department of Human Services, but was moved to the Department of Children, Families and Learning, which later became the Department of Education.

Table 1.3: Examples of State and Participant Payments for Child Care Obtained Through the Child Care Assistance Program, FY 2005

	Example 1	Example 2	Example 3
	Provider's Rate is \$150 per Week	Provider's Rate is \$200 per Week	Provider's Rate is \$250 per Week
Maximum Weekly Rate	\$ 200	\$ 200	\$ 200
State Payment per Week			
Rate Paid ^a	\$ 150	\$ 200	\$ 200
Less: Participant Co-payment ^b	<u>13</u>	<u>13</u>	<u>13</u>
Total State Payment	\$ 137	\$ 187	\$ 187
Participant Payment per Week			
Co-payment	\$ 13	\$ 13	\$ 13
Amount in Excess of Maximum ^c	<u>0</u>	<u>0</u>	<u>50</u>
Total Participant Payment	\$ 13	13	\$ 63
Amount Received by Provider per Week	\$ 150	\$ 200	\$ 250
Annual Participant Payments	\$ 676	\$ 676	\$ 3,276
Annual Participant Gross Income	\$15,000	\$15,000	\$15,000
Payments as a Percent of Income	4.5%	4.5%	21.8%

Program participants must pay a co-payment and any charges in excess of the maximum reimbursement rate.

^aThe rate paid is the provider's rate or the maximum rate, whichever is smaller.

^bThis is the FY 2005 co-payment for a two-person household with an annual gross income of \$15,000. Co-payments are generally lower for households of larger size at the same income level.

^cThe participant is responsible for paying the amount by which the provider's rate exceeds the maximum rate, as well as the required co-payment.

SOURCE: Office of the Legislative Auditor analysis using information from the Minnesota Department of Human Services.

selects a provider that has rates higher than the maximum. As a result, the payment system may serve to limit the extent to which participants select high-cost providers even though they are free to choose any provider and any type of care. The examples also indicate that a participant does not have a financial incentive to select a provider with a rate below the maximum rate. The participant's cost is the same for all providers with rates at or below the maximum. However, other factors such as convenience, transportation, and familiarity with various providers may outweigh any financial factors in a participant's selection of a provider.

Under federal laws and rules, each state is required to submit a plan to the federal government every two years. In its plan, a state must show that its payment rates "...are sufficient to ensure equal access, for eligible families ... to child care services comparable to those provided to families not eligible to receive CCDF assistance..."⁵ In particular, a state must show that its maximum rates provide the required "equal access." To demonstrate that equal access is provided, a state must show: 1) how a choice of the full range of providers is made available;

⁵ 45 CFR part 98, sec. 98.43, (October 1, 2003 edition).

A state's child care assistance program must receive periodic approval from the federal government.

- 2) that payment rates are adequate in comparison to a survey of market rates conducted no earlier than two years prior to the effective date of the plan; and
- 3) that co-payments are affordable.

It is not entirely clear what evidence is considered necessary or sufficient to demonstrate that equal access is provided. The federal government used to require states to set the maximum rate for each type of child care based on the 75th percentile of market rates for that type of care. Theoretically, that requirement allowed program participants to access at least three-fourths of the providers (or, for child care centers, at least three-fourths of the available child care slots) without paying more than the required co-payment.⁶ That requirement was eliminated in 1998, however, and states are permitted to set maximum rates at either a higher or lower percentile than the 75th percentile. The Administration for Children and Families (ACF) within the United States Department of Health and Human Services has indicated that following the previous requirement would be sufficient to demonstrate that payment rates are adequate. But the ACF has allowed states to set rates based on a lower percentile of market rates. The federal government has also permitted some states to use surveys that are more than two years old to set maximum rates. Although a state must generally conduct a market rate survey every two years, it may be able to get its plan approved even if its maximums are based on a survey that was conducted more than two years prior to the effective date of its state plan.

In Minnesota, state law requires that the maximum rate set by the Department of Human Services "...not exceed the 75th percentile rate for like-care arrangements in the county as surveyed by the commissioner."⁷ Until recently, the state annually conducted rate surveys of licensed providers and set rates based on the 75th percentile. In response to budget shortfalls, however, the 2003 Legislature froze the maximum rates that were placed in effect on July 1, 2002 until after June 30, 2005. Chapter 2 will discuss the manner in which the department sets maximum rates in detail.

PROGRAM STATISTICS AND TRENDS

In this section, we provide information on program participation by various age groups and parts of the state. We also examine the type of care selected by participants and the variation in the types of care used across the state. In addition, we provide data on the source of funding for the Child Care Assistance Program and review recent trends in program expenditures. We also discuss the changes made by the 2003 Legislature that are expected to affect program expenditures and participation.

⁶ Setting the maximum rate at the 75th percentile means that the maximum is set so that at least 75 percent of the providers (or, for child care centers, at least 75 percent of the child care slots) are at rates equal to or less than the maximum rate. However, rates may increase between the time of the rate survey and the implementation of the maximum rate. By the time new maximum rates are implemented, fewer than 75 percent of the rates may be less than the maximum rate.

⁷ *Minn. Stat.* (2004), §119b.13, subd. 1.

Program Participation

During fiscal year 2003, a monthly average of more than 40,100 children participated in the Child Care Assistance Program. As Table 1.4 indicates, participation in the program increased about 20 percent between fiscal years 2000 and 2003. The growth was probably due to increased funding for the basic sliding fee portion of the program and declining economic conditions that caused greater numbers of MFIP recipients to seek child care assistance. The growth rate in basic sliding fee care was twice the rate for MFIP care. The Department of Human Services is estimating a 13 percent decline in program participation from 2003 to 2005. The decline mostly reflects the policy changes and budget cuts adopted by the 2003 Legislature.

Program participation had been growing but declined following legislative changes made in 2003.

Table 1.4: Monthly Average Number of Children Served by the Child Care Assistance Program, FY 2000-05

<u>Year^a</u>	<u>MFIP and Transition Year</u>	<u>Basic Sliding Fee</u>	<u>Total</u>
2000	16,589	16,799	33,388
2001	15,573	19,310	34,883
2002	17,038	20,158	37,196
2003	18,826	21,328	40,154
2004	16,695	17,365	34,060
2005 (Projected)	16,601	18,345	34,946
Percent Change: 2000-03	13%	27%	20%
Percent Change: 2003-05	-12%	-14%	-13%
Overall Change: 2000-05	0%	9%	5%

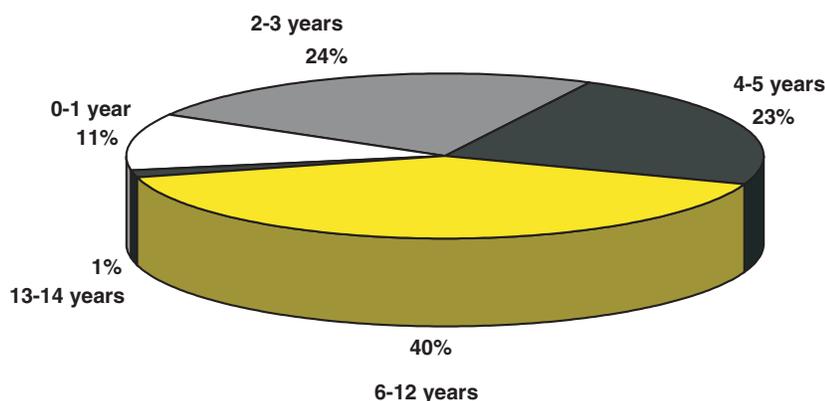
^aData for FY 2000 on MFIP and Transition Year participants were based on an estimate from the Minnesota Department of Human Services. All numbers for FY 2005 are projections.

SOURCE: Minnesota Department of Human Services.

State law restricts participation in the Child Care Assistance Program to children under age 13 except for persons of age 13 or 14 who are defined as having a disability and are eligible to receive special education services in schools. However, the Department of Human Services has estimated that only a little more than 1 percent of children served by the program in fiscal year 2003 were more than 12 years old. As Figure 1.1 shows, 40 percent of the children receiving subsidized care were school-age children between 6 and 12 years of age. About 47 percent of the children in the program were between 2 and 5 years old, while 11 percent were younger than 2 years old.

We examined more detailed data from federal fiscal year 2003 to analyze how participation varies across the state. These data—for the year ending September 30, 2003—indicated that participation in the Child Care Assistance Program was split about equally between the seven-county Twin Cities metropolitan area and the rest of the state. The Twin Cities area had about 51 percent of the program participants while 49 percent were from outstate Minnesota. For the MFIP and Transition Year portion of the program, the Twin Cities area accounted for

Figure 1.1: Age of Children Served by the Child Care Assistance Program, FY 2003



SOURCE: Minnesota Department of Human Services' estimate from case sample.

Per capita participation in the program appears to be higher outstate than in the seven-county Twin Cities area.

58 percent of the participants compared with 42 percent outstate. But, participation in the basic sliding fee portion of the program was greater in outstate Minnesota. The Twin Cities area had 44 percent of the basic sliding fee participants while 56 percent were from other parts of the state.

Per capita use of the Child Care Assistance Program in federal fiscal year 2003 was about 20 percent higher outstate than in the seven-county Twin Cities metropolitan area. The highest per capita usage was in north central and northeastern Minnesota, although per capita participation appeared to vary significantly among counties in those areas. There were also counties with relatively high per capita participation in other parts of the state.⁸

Type of Child Care

There are three main types of child care used by participants in the Child Care Assistance Program. Generally, the most expensive type of care is provided by child care centers. Centers are nonresidential facilities and may be operated by a for-profit company, a non-profit entity, a religious organization, or a governmental agency. Department of Human Services licenses most centers, but state law does not require all centers to be licensed. For example, school-based programs serving school-age children in a program approved by a school board do not need

⁸ Per capita participation was estimated by calculating the number of children served by the Child Care Assistance Program during federal fiscal year 2003 as a percentage of the population under age 13 as measured by the 2000 census. The data on program participation includes some double counting of children because children using more than one type of child care provider or receiving services in more than one county during the year would be counted more than once.

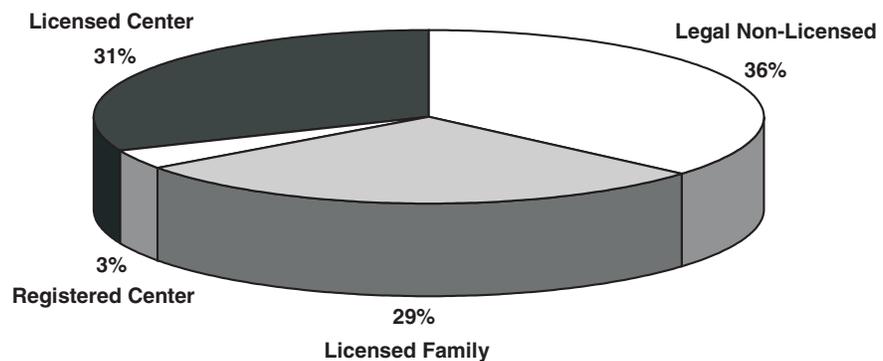
to be licensed. Centers not required to be licensed may apply for a license anyway. Those without a license are considered “registered centers.”

A second type of child care provider is the licensed family home provider. The licensed family home provider typically provides child care services in a private residence other than the child’s own home. This type of provider is permitted to care for non-relatives from more than one unrelated family.

The third type of child care provider is the legal non-licensed provider. This type of provider may care for relatives, as well as children from one unrelated family. The care may be provided in the child’s home or in the provider’s home. Legal non-licensed providers may include grandparents or other relatives, neighbors or friends, and nannies. The state requires legal non-licensed providers to register with counties if they intend to care for children participating in the Child Care Assistance Program.

As Figure 1.2 indicates, 36 percent of the children in the Child Care Assistance Program during federal fiscal year 2003 received care from legal non-licensed providers. About 31 percent received care from licensed child care centers, while 29 percent were served by licensed family home providers. Another 3 percent went to registered, or unlicensed, child care centers. The relative shares of children receiving care from the various types of providers changed only a little between 2000 and 2003. The share of children receiving care from legal non-licensed providers increased several percentage points, while the share of children receiving care from licensed family home providers declined.⁹

Figure 1.2: Type of Child Care Used in the Child Care Assistance Program, Federal FY 2003



In 2003, a slightly higher percentage of participants used legal non-licensed providers than child care centers.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

⁹ Changes made by the 2003 Legislature in program eligibility, co-payments, and maximum rates may have affected the type of child care selected by program participants in federal fiscal year 2004. However, 2004 data were not available during our study.

The type of child care used by participants varies across the state. As Table 1.5 shows, participants in the seven-county Twin Cities metropolitan area are more likely to use child care centers and less likely to use licensed family home providers than participants in outstate Minnesota. In federal fiscal year 2003, about 47 percent of the children participating in the Twin Cities area attended child care centers compared with only 22 percent in outstate Minnesota. In

Program participants are more likely to use licensed family home providers in outstate Minnesota than in the Twin Cities area.

Table 1.5: Type of Care Used in the Child Care Assistance Program by Region and by Subprogram, Federal FY 2003

Type of Care	Percentage of Children Served by Various Types of Providers			
	Twin Cities Metropolitan Area	Outstate Minnesota	MFIP and Transition Year	Basic Sliding Fee
Licensed Centers	43%	19%	31%	32%
Registered Centers	4	2	2	5
Licensed Family Homes	14	44	22	35
Legal Non-Licensed	39	34	45	28
Totals	100%	100%	100%	100%

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

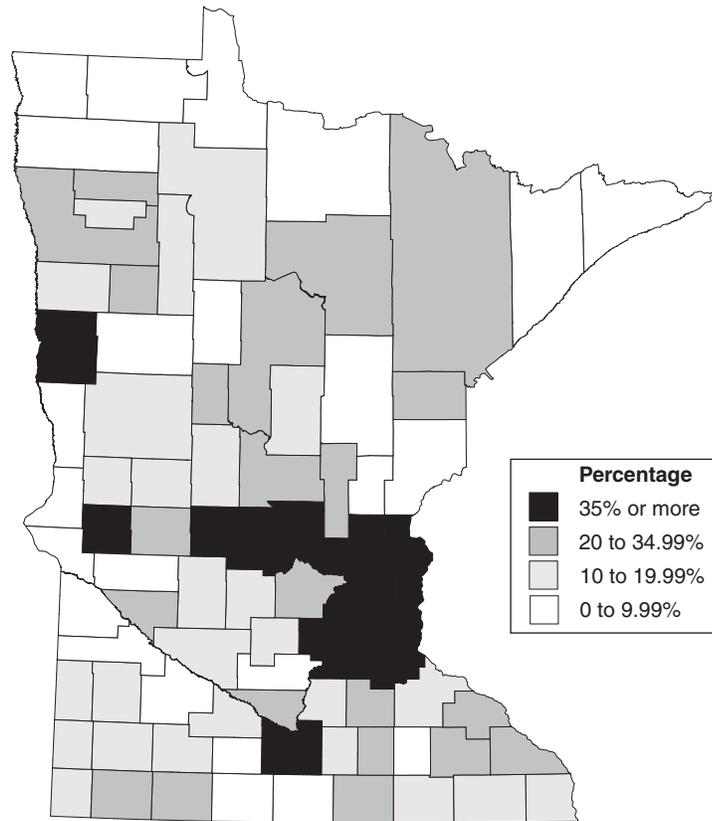
contrast, only 14 percent of the children in the Twin Cities area used licensed family home providers, while 44 percent of the children in outstate Minnesota used them for subsidized child care. These differences probably reflect in part the availability of child care centers, which are far less prevalent in outstate Minnesota than in the Twin Cities area. In 2003, there were 24 outstate counties in which fewer than 10 percent of program participants used child care centers. But, as Figure 1.3 indicates, the use of child care centers by participants in the Child Care Assistance Program varies significantly even within various parts of the state.

There are also significant differences in the choice of child care by MFIP participants compared with basic sliding fee participants. MFIP and Transition Year participants in the Child Care Assistance Program are more likely to use legal non-licensed care and less likely to use licensed family home providers than basic sliding fee participants. In federal fiscal year 2003, about 45 percent of the children in MFIP care used legal non-licensed providers compared with 28 percent of the children in basic sliding fee care. Only 22 percent of the MFIP children used licensed family home providers compared with 35 percent of the basic sliding fee children. These differences may reflect the higher incomes of families using basic sliding fee child care, as well as a cultural preference among certain MFIP participants to use legal non-licensed care, particularly by relatives.

Relatives provide a significant share of the legal non-licensed care given to program participants. In federal fiscal year 2003, about 41 percent of the subsidized children in legal non-licensed care were cared for by relatives. By comparison, only 5 percent of the subsidized children in licensed family homes were in the care of a relative. While the percentage of relative care varies from

Figure 1.3: Percentage of Child Care Assistance Program Participants Using Child Care Centers by County, Federal FY 2003

The use of child care centers varies significantly from county to county but is generally highest in the Twin Cities area.



SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

county to county, the Twin Cities metropolitan area did not differ much from outstate Minnesota on average.

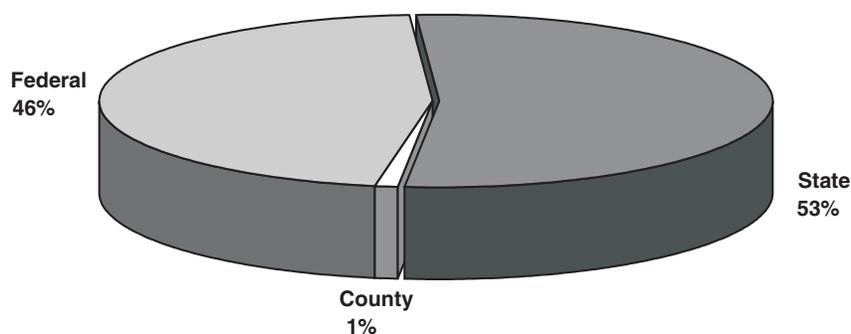
Statewide, about 38 percent of the legal non-licensed care for program participants was provided in the child's home, as opposed to the provider's home, in federal fiscal year 2003. The share of care in the child's home was much higher in the Twin Cities area. About 49 percent of the children using subsidized legal non-licensed care in the Twin Cities area were cared for in their own homes, compared with 25 percent in the rest of the state. This difference resulted largely because, in the Twin Cities area, subsidized care by non-relatives is much more likely to be in the child's home. In the Twin Cities area, 48 percent of the subsidized legal non-licensed care provided by non-relatives was provided in the child's home. Elsewhere in the state, only 13 percent of such care was in the child's home.

Program Expenditures

In state fiscal year 2003, government expenditures for Minnesota's Child Care Assistance Program were almost \$243 million. As Figure 1.4 shows, state government provided 53 percent of the program funds, while the federal government provided 46 percent and county government paid for 1 percent of the total expenditures. The vast majority (89 percent) of the expenditures were for child care assistance to MFIP and basic sliding fee participants. Less than 7 percent of the spending went for county and state administration. Another 5 percent—largely funded by the federal government—was for child care system development and quality improvement grants.

Spending for the Child Care Assistance Program is mostly supported by state and federal funds.

Figure 1.4: Child Care Assistance Expenditures by Source, FY 2003



SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

During the 1990s, spending on child care assistance programs grew significantly in states across the nation. In Minnesota, that growth continued even during the current decade. As Table 1.6 shows, spending on Minnesota's Child Care Assistance Program grew from \$171 million in 2000 to \$243 million in 2003, or 42 percent. The growth in the basic sliding fee portion of the program was slightly greater than the growth in the MFIP portion. Expenditures for basic sliding fee assistance rose 44 percent, while spending for MFIP child care assistance increased 40 percent. As Figure 1.5 indicates, the increased spending was due both to an increase in the cost per family and growth in the monthly average number of families receiving child care assistance. Costs per family rose 23 percent from 2000 to 2003, with higher increases for the MFIP portion of the program (33 percent) than the basic sliding fee portion (16 percent). The monthly average number of families receiving child care assistance grew 15 percent, with

Program spending declined in 2004 due to state budget cuts and program changes.

higher growth occurring in the number of basic sliding fee families (24 percent) than in the number of MFIP families receiving child care assistance (5 percent).

Spending for the Child Care Assistance Program is expected to decline by 19 percent to about \$197 million in fiscal year 2005. This reduction is largely the result of 2003 legislative actions that were part of the state's efforts to address budget shortfalls. The 2003 Legislature took a number of actions affecting the Child Care Assistance Program, including restricting eligibility, reducing the state appropriation for basic sliding fee assistance, increasing participant co-payments, freezing maximum reimbursement rates for licensed care for two years, and reducing the maximum reimbursement rates for legal non-licensed care.¹⁰ As a

Table 1.6: Actual and Estimated Expenditures for the Child Care Assistance Program, FY 2000-07

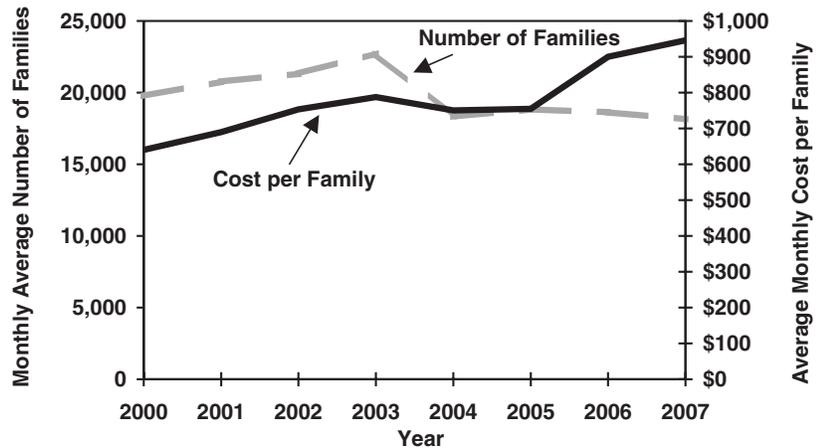
Type of Expenditure (in \$1,000s)	Fiscal Year								
	2000	2001	2002	2003	2004	Estimated 2005	Estimated 2006	Estimated 2007	
MFIP and Transition Year ^a									
Federal Funds	\$ 19,942	\$ 37,691	\$ 43,475	\$ 44,972	\$ 30,859	\$ 45,211	\$ 37,355	\$ 38,189	
State Funds	<u>63,356</u>	<u>49,863</u>	<u>57,101</u>	<u>71,536</u>	<u>64,700</u>	<u>51,093</u>	<u>82,125</u>	<u>89,086</u>	
Subtotal	\$ 83,298	\$ 87,554	\$100,576	\$116,507	\$ 95,559	\$ 96,303	\$ 119,480	\$127,275	
Basic Sliding Fee ^a									
Federal Funds	\$ 45,414	\$ 60,029	\$ 36,887	\$ 46,366	\$ 38,371	\$ 50,992	\$ 47,297	\$ 44,157	
State Funds	20,047	21,370	52,218	49,044	28,173	20,274	31,546	31,559	
County Match	<u>2,942</u>	<u>2,942</u>	<u>2,941</u>	<u>2,935</u>	<u>2,947</u>	<u>2,941</u>	<u>2,941</u>	<u>2,941</u>	
Subtotal	\$ 68,403	\$ 84,340	\$ 92,046	\$ 98,344	\$ 69,491	\$ 74,207	\$ 81,784	\$ 78,657	
Development and Quality									
Federal Funds	\$ 7,453	\$ 7,095	\$ 7,691	\$ 10,108	\$ 9,811	\$ 10,886	\$ 9,748	\$ 8,978	
State Funds	<u>1,853</u>	<u>1,874</u>	<u>1,824</u>	<u>1,360</u>	<u>1,067</u>	<u>1,164</u>	<u>1,365</u>	<u>1,365</u>	
Subtotal	\$ 9,306	\$ 8,969	\$ 9,515	\$ 11,468	\$ 10,878	\$ 12,050	\$ 11,113	\$ 10,343	
State Administration and Systems									
Federal Funds	\$ 2,468	\$ 4,686	\$ 5,245	\$ 5,692	\$ 5,652	\$ 5,876	\$ 5,543	\$ 5,601	
State Funds	<u>247</u>	<u>272</u>	<u>224</u>	<u>112</u>	<u>107</u>	<u>141</u>	<u>141</u>	<u>141</u>	
Subtotal	\$ 2,715	\$ 4,958	\$ 5,469	\$ 5,804	\$ 5,759	\$ 6,017	\$ 5,684	\$ 5,742	
County Administration									
MFIP: Federal Funds	\$ 997	\$ 1,885	\$ 2,174	\$ 2,249	\$ 1,543	\$ 2,261	\$ 1,868	\$ 1,909	
MFIP: State Funds	3,168	2,493	2,855	3,577	3,235	2,555	4,106	4,454	
BSF: Federal Funds	1,574	2,007	2,125	2,392	1,541	1,873	1,983	1,840	
BSF: State Funds	<u>1,574</u>	<u>2,007</u>	<u>2,125</u>	<u>2,392</u>	<u>1,541</u>	<u>1,837</u>	<u>2,106</u>	<u>2,093</u>	
Subtotal	\$ 7,313	\$ 8,392	\$ 9,278	\$ 10,610	\$ 7,860	\$ 8,526	\$ 10,063	\$ 10,297	
Total Expenditures	\$171,035	\$194,213	\$216,885	\$242,733	\$189,546	\$197,103	\$228,124	\$232,313	

^aFY 2005-07 expenditures are based on the November 2004 estimates from the Minnesota Department of Human Services.

SOURCE: Minnesota Department of Human Services.

¹⁰ Previously, state administrative rules set the maximum reimbursement rates for legal non-licensed care at 90 percent of the maximum rates for licensed family home providers. The 2003 Legislature reduced the maximums for legal non-licensed care to 80 percent of the maximums for licensed family home providers. The Legislature also required that payments for legal non-licensed care should be made on an hourly basis and that hourly maximum rates should not exceed the weekly maximum rates for licensed family home providers divided by 50. This latter provision reduced the rates significantly in the seven-county metropolitan area and a few outstate counties where weekly maximums were not based on hourly rates. In Ramsey County, where the maximum rates for licensed family providers are \$5 per hour and \$125 per week, the hourly rate for legal non-licensed care of preschool children was reduced from \$4.50 per hour to \$2.00 per hour.

Figure 1.5: Trends in the Number of Families Receiving Child Care Assistance and the Cost per Family, FY 2000-07



NOTE: Projections for FY 2005-07 are from the department's November 2004 estimates.

SOURCE: Minnesota Department of Human Services.

result, the monthly average number of families receiving child care assistance is expected to decline by 17 percent between 2003 and 2005. A greater decline is expected in the average number of families receiving basic sliding fee assistance (23 percent) due to the decreased state appropriation, restricted eligibility, and higher participant costs. The expected decline in the average number of families receiving MFIP child care assistance is only 10 percent, since the MFIP portion of the program is not limited by a fixed appropriation amount. The average government cost per participant is expected to decline by about 4 percent between 2003 and 2005 due to the freeze on maximum rates, the reduction in maximum rates for legal non-licensed care, and the higher participant co-payments.

Program spending is projected to increase during the 2006-07 biennium, since the freeze on maximum rates expires in July 2005.

Available projections for the next biennium show that expenditures for the Child Care Assistance Program are likely to increase again without additional cost controls. Between fiscal years 2005 and 2007, child care assistance payments are expected to increase by 21 percent, even though the monthly average number of families receiving child care assistance is expected to decline by 4 percent. The reason for the spending growth is an increase in the cost per family of 25 percent. The main source of this increase is the lifting of the freeze on maximum reimbursement rates, which will occur on July 1, 2005 under current law. With the lifting of the freeze, maximum rates could be based on the most recent survey of market rates, which was conducted in the spring of 2004, or a survey that could be conducted in the spring of 2005. Current maximum rates are based on a survey that was conducted in the fall of 2001.

PARTICIPANT COSTS

Participant costs increased in 2004.

As explained earlier in this chapter, a participant in the Child Care Assistance Programs may be responsible for two types of costs. First, a participant must make a co-payment for the care received if the participant's gross income is equal to or greater than 75 percent of the federal poverty level adjusted for family size. For example, in fiscal year 2005, the federal poverty level for a two-person household is \$12,490. A participating family whose adjusted gross household income is at least \$9,368 must make a co-payment. The amount of the co-payment is \$10 per month for incomes between 75 and 100 percent of the federal poverty level. Above 100 percent of the poverty level, the amount of the co-payment is based on a percentage of the participant's adjusted gross income. The percentage ranges from 3.85 percent at just under 105 percent of the poverty level to 22 percent at just under 250 percent of the poverty level. Individuals with incomes of 250 percent of the poverty level or higher are not eligible for child care assistance.¹¹

Due to state budget shortfalls, the 2003 Legislature increased co-payments significantly. Prior to the change, the co-payment for a family with an income between 75 and 100 percent of the federal poverty level was \$5 per month. After the legislative change, the co-payment increased to \$10 per month. As Table 1.7 indicates, co-payments at higher income levels increased even more.¹² Prior to

Table 1.7: Changes in Participant Co-payments at Selected Income Levels for a Two-Person Household, FY 2003-04

Gross Income as a Percentage of the Federal Poverty Level ^a	FY 2003				FY 2004			
	Gross Income	Monthly Co-payment	Annual Co-payment	Co-payment as a Percent of Income	Gross Income	Monthly Co-payment	Annual Co-payment	Co-payment as a Percent of Income
50%	\$ 5,970	\$ 0	\$ 0	0.0%	\$ 6,060	\$ 0	\$ 0	0.0%
75	8,955	5	60	0.7	9,090	10	120	1.3
100	11,940	5	60	0.5	12,120	41	492	4.1
125	14,925	31	372	2.5	15,150	61	732	4.8
150	17,910	45	540	3.0	18,180	74	888	4.9
175	20,895	70	840	4.0	21,210	135	1,620	7.6
200	23,880	110	1,320	5.5	24,240	260	3,120	12.9
225	26,865	193	2,316	8.6	27,270	398	4,776	17.5
250	29,850	312	3,744	12.5	30,300	Ineligible	Ineligible	Ineligible
275	32,835	441	5,292	16.1	33,330	Ineligible	Ineligible	Ineligible
300	35,820	600	7,200	20.1	36,360	Ineligible	Ineligible	Ineligible

^aThe Federal Poverty Level for a two-person household was \$11,940 in FY 2003 and \$12,120 in FY 2004.

SOURCE: Office of the Legislative Auditor analysis of information from the Minnesota Department of Human Services.

¹¹ *Laws of Minnesota* (1Sp2003), ch. 14, art. 9, sec. 36.

¹² Prior to the law change, co-payments at incomes higher than the federal poverty level were based on the family's income converted into a percentage of state median income and adjusted for family size. After the legislative change, co-payments were based on the family's income as a percentage of the federal poverty level as adjusted for family size. Table 1.7 converts all incomes into a percentage of the federal poverty level so that we can compare co-payments before and after the law change.

the law change, the co-payment required from a two-person household with an annual income of \$26,865, or 225 percent of the federal poverty level, was \$193 per month or \$2,316 per year. The 2003 co-payment represented 8.6 percent of the family's income. After the change, the co-payment required for a two-person household with an annual income of \$27,270, or 225 percent of the federal poverty level, was \$398 per month. This co-payment of \$4,776 per year represented 17.5 percent of the family's annual income.

Second, in addition to a co-payment, a family pays an additional charge for any child receiving care from a provider whose rate exceeds the maximum rate set by the state. An earlier table showed how the participating family has a financial disincentive to receive care from a provider with a rate higher than the maximum reimbursement rate. The freeze on maximum rates, along with continuing increases in the rates charged by providers, has likely increased the costs faced by some participants and may have caused them to select providers with lower rates or leave the program.

Some observers have speculated that rising participant costs, as well as tightened eligibility requirements for basic sliding fee assistance, may have caused some individuals to quit working and rely more on the state for basic assistance through the MFIP program. According to the Department of Human Services, however, there is no evidence suggesting that MFIP caseloads have grown as a result of the 2003 legislative changes in the Child Care Assistance Program. The department tracked the children receiving basic sliding fee assistance in June 2003 and found that only 4.6 percent of them became MFIP eligible in the six months following implementation of the legislative changes on July 1, 2003. The department considers this movement to be part of the normal trends experienced among low-income persons. A similar percentage (5.0 percent) of basic sliding fee recipients in June 2002 became MFIP eligible during the last six months of 2002, even though no significant changes were made in the Child Care Assistance Program that year.

Maximum Reimbursement Rates

SUMMARY

The basic methods used by the Department of Human Services to set maximum reimbursement rates for subsidized child care are reasonable. The maximums are generally based on the 75th percentile of market rates charged for child care, as measured in surveys of providers. However, the department sometimes uses complicated rate conversion procedures that ignore important information about market rates for child care. As a result, some maximum rates have been inappropriately set. In fact, in some counties or regions of the state, the converted maximum rates for child care centers have exceeded not only the 75th percentile of market rates but also the highest rate reported by centers in that area.

State administrators of the Child Care Assistance Program have not paid sufficient attention to other legal requirements regarding the setting of maximum rates. Prior to July 2003, the Department of Education used a “pay provider rate” system to reimburse child care centers in 68 of Minnesota’s 87 counties. That system failed to set maximum rates as required by state law. In July 2003, the Department of Human Services replaced the “pay provider rate” system in these 68 counties with regional and statewide maximum rates. We question whether the department had legal authority to implement maximum rates of this type. The use of multi-county jurisdictions—rather than individual counties—to set maximum rates appears to violate state statutes, although the department believes regional and statewide maximum rates are allowable under its rules. In addition, the department’s action is inconsistent with 2003 legislation that required the department to continue using the schedule of provider rates implemented in July 2002. The department’s action lowered reimbursement rates for some child care centers, even though the 2003 Legislature required provider reimbursement rates to remain the same through June 2005.

One of the important functions of the Department of Human Services in overseeing the Child Care Assistance Program is the setting of maximum reimbursement rates. The purpose of maximum rates is to provide some control over the program’s costs while still allowing participants reasonable access to the available child care providers. This chapter discusses in greater detail how the Department of Human Services sets maximum rates. In addition, we evaluate the department’s methods for establishing maximum rates and compare Minnesota’s

maximum reimbursement rates with those set by other states. In particular, we address the following questions:

- **How does the Department of Human Services set maximum reimbursement rates for the Child Care Assistance Program?**
- **Does the department use appropriate methods to conduct surveys of market rates? Is the response rate to department surveys adequate?**
- **Are the department's methods of calculating maximum reimbursement rates reasonable and consistent with state statutes?**
- **How do the maximum rates in Minnesota compare with those in other states? Do other states use similar methods in setting rates?**

OVERVIEW

In this section, we provide information on how the Department of Human Services sets maximum reimbursement rates. We first explain the general process used to set rates. We then discuss recent changes made in response to the two-year freeze imposed on maximum rates by the 2003 Legislature. Finally, we examine the department's methods for calculating maximum rates in greater detail.

The Department of Human Services has child care resource and referral agencies collect rate information from child care providers.

Process for Setting Maximums

Currently, the Department of Human Services sets 28 maximum rates in each of Minnesota's 87 counties. There are 12 maximum rates that apply to child care centers in each county. They include hourly, daily, and weekly maximums for each of the four different age levels of children in the program. The age levels include infants, toddlers, preschoolers, and school-age children.¹ Similarly, there are 12 maximum rates that apply to licensed family home providers in each county. For legal non-licensed care, there are four maximum rates in each county, including hourly rates for each of the four age groups. Table 2.1 provides an example of the types of maximum reimbursement rates established in each county.

The first step in establishing these maximum rates is to collect information from child care providers on their rates. The Department of Human Services contracts with child care resource and referral agencies across the state to collect rate and other relevant information from providers. Surveys are conducted of licensed child care centers and licensed family home providers. The department provides

¹ For centers, infants include children who are at least six weeks old but less than 16 months old. Toddlers range from 16 months to just less than 33 months of age. Preschoolers are at least 33 months old but are not yet old enough to be eligible to attend the first day of kindergarten within the next four months. School-age children are of sufficient age to attend school in the next four months and are generally less than 13 years old. The age groupings used for licensed family home care are somewhat different. Children are considered infants in licensed family care if they are less than 12 months of age, while toddlers range from 12 months to less than 24 months old. Preschoolers must be at least 24 months old but are not yet old enough to attend the first day of school within the next four months. School-age children at licensed family homes must be ten years of age or younger.

Table 2.1: Maximum Reimbursement Rates in Ramsey County, FY 2005

	Hourly	Daily	Weekly
Child Care Centers ^a			
Infants	\$9.50	\$70.00	\$236.00
Toddlers	8.50	57.00	195.00
Preschool	7.00	51.00	175.00
School Age	6.50	49.00	160.00
Licensed Family Home Providers ^b			
Infants	\$5.00	\$30.00	\$140.00
Toddlers	5.00	29.00	125.00
Preschool	5.00	25.00	125.00
School Age	4.50	25.00	118.50
Legal Non-Licensed Providers ^c			
Infants	\$2.24	N/A	N/A
Toddlers	2.00	N/A	N/A
Preschool	2.00	N/A	N/A
School Age	1.90	N/A	N/A

N/A = Not Applicable

^aThe maximum reimbursement rates are based on the 75th percentile of Fall 2001 market rates for center-based care in Ramsey County.

^bThe maximum reimbursement rates are based on the 75th percentile of Fall 2001 market rates for licensed family home providers in Ramsey County.

^cThe maximum reimbursement rates for legal non-licensed care are generally equal to 80 percent of the hourly maximums for licensed family home providers. But they cannot be greater than 80 percent of the weekly maximum for licensed family home providers divided by 50.

SOURCE: Minnesota Department of Human Services, *Bulletin #03-68-07* (St. Paul: June 23, 2003), Attachment A.

instructions to the child care resource and referral agencies on the content of the surveys and procedures for conducting the surveys. Targets are also set for the number of providers of each type to be surveyed in each county.

The Department of Human Services hires an out-of-state consulting firm to calculate maximum reimbursement rates.

Following the collection of rate information, the Department of Human Services utilizes an out-of-state consulting firm to analyze the results of the market rate surveys and determine maximum reimbursement rates. The department works with the consultant to determine how maximum rates should be set. The methods are fairly straightforward except in counties for which the number of providers responding with rates is smaller than the department deems desirable. For licensed family home providers, the department has generally required that the maximum rate be set at the lowest rate at which at least 75 percent of the providers have rates less than or equal to the maximum reimbursement rate at the time of the survey. This method is acceptable to the federal government and is consistent with state statutes that require the maximum rate to be no higher than the “75th percentile” of market rates.²

For child care centers, the department uses a slightly different method to obtain the 75th percentile of market rates. Because child care centers may vary significantly in the maximum number of children they are licensed to serve, the

² *Minn. Stat.* (2004) §119B.13, subd. 1.

department requires the child care resource and referral agencies to collect information from centers on their licensed capacity. The department then sets a maximum rate so that at least 75 percent of the licensed capacity at centers has rates that are less than or equal to the maximum rate. These maximum rates apply to both licensed centers and centers that are not required to be licensed.

Minnesota, like most other states, does not survey legal non-licensed providers about their rates. It is difficult to contact these providers since they do not need to register with a government agency unless they serve children in the Child Care Assistance Program. In addition, surveying legal non-licensed providers participating in the program would not be productive since they would have few clients that are not either program participants or relatives. As a result, Minnesota sets maximum rates for legal non-licensed care based on a percentage of the maximum rates for licensed family home providers.

Recent History

Prior to March 2003, the Department of Education was responsible for the Child Care Assistance Program.

There have been a number of changes in recent years affecting the establishment of maximum reimbursement rates. First, in March 2003, the Governor transferred responsibility for the Child Care Assistance Program from the Department of Education to the Department of Human Services. Second, the 2003 Legislature made significant changes in the program that affected the calculation of maximum rates. Finally, in July 2003, the Department of Human Services implemented maximum rates for some child centers that did not previously have maximum reimbursement rates. This section reviews these changes in detail, while Table 2.2 summarizes the key events that have occurred since 2001.

Until recently, rate surveys were conducted annually and the state implemented new maximums at the beginning of each fiscal year. For example, the fall 2001 survey was used by the Department of Education to set maximum reimbursement rates for fiscal year 2003. Those maximums were implemented on July 1, 2002 and were scheduled to remain in effect through June 30, 2003.

But the Department of Education did not establish maximum reimbursement rates for child care centers in 60 of Minnesota's 87 counties for fiscal year 2003. In addition, maximums were not set for certain age groups at child care centers in eight other counties. The Department of Education felt that there were too few child care centers responding to the survey in each of those counties to set maximum rates. For counties with fewer than three centers or with fewer than three centers providing rate information for an age group, the Department of Education authorized counties to "pay provider rates." Like centers elsewhere in the state, centers in these 68 counties were required to charge the same rates for children participating in the program that they charged for unsubsidized children. But, unlike others, centers in counties with "pay provider rates" were not subject to any maximum rate.

The Department of Education conducted another survey in the fall of 2002, which would have been used to establish new maximum rates for fiscal year 2004. But, because of state budget shortfalls, the 2003 Legislature chose to impose a two-year freeze on the maximum reimbursement rates. Specifically, the Legislature stipulated that the "...provider rates determined under Minnesota

Table 2.2: Key Events Affecting Maximum Reimbursement Rates for the Child Care Assistance Program, 2001-05

Month and Year	Event
October thru December 2001	The Department of Education conducts its annual surveys of rates for licensed child care centers and licensed family home providers.
June 2002	The Department of Education establishes maximum reimbursement rates for FY 2003 based on the Fall 2001 rate survey. New maximum rates are effective as of July 1, 2002. The department continues the “pay provider rate” system for child care centers in 68 counties. (Centers in these counties are not subject to a state-imposed maximum rate for subsidized care. They may charge subsidized families the same rate they charge private-pay customers.) ^a
October thru December 2002	The Department of Education conducts its annual surveys of licensed child care provider rates.
March 2003	The Governor transfers responsibility for the Child Care Assistance Program to the Department of Human Services.
May 2003	The 2003 Legislature requires the Department of Human Services to continue the schedule of maximum rates placed into effect on July 1, 2002 for child care centers and licensed family home providers through June 30, 2005. The Legislature requires that maximum rates for legal non-licensed care be reduced from 90 to 80 percent of the maximum rates for licensed family home providers. In addition, the Legislature requires that legal non-licensed care be billed on an hourly basis and that maximum rates for such care be subject to a limit equal to the maximum weekly rate for licensed family home care divided by 50. The Legislature makes other changes to the program, including increasing co-payments, tightening eligibility, and reducing the state appropriation for basic sliding fee assistance. The Legislature also directs the Department of Human Services to evaluate the costs of child care, examine the differences in costs across the state, review the county allocation formula for basic sliding fee assistance, study the relationship between child care assistance and tax incentives, and make recommendations for containing future cost increases in the Child Care Assistance Program by January 15, 2005.
June 2003	The Department of Human Services issues a bulletin containing maximum reimbursement rates for FY 2004 and 2005. The department continues to use the maximum rates for licensed providers that the Department of Education placed into effect on July 1, 2002. The department also revises the maximum rates for legal non-licensed care as required by the 2003 legislation. However, the Department of Human Services establishes new maximum rates to replace the “pay provider rate” system previously used for child care centers in 68 counties.
February thru April 2004	The Department of Human Services conducts another survey of licensed provider rates. The department intends to use information from this survey to help in preparing its January 2005 report to the Legislature. The survey could possibly be used in the future to establish new maximum reimbursement rates.
January 2005	The department’s report and recommendations to the Legislature for containing future cost increases are due by January 15.
July 2005	Current law allows new maximum reimbursement rates to be established effective on July 1, 2005.

^aThe “pay provider rate” system applied to child care centers serving all age groups in 60 counties. In eight counties, the system only applied to certain age groups.

SOURCE: Office of the Legislative Auditor summary of information from the Minnesota Department of Human Services.

Current maximum rates are based on a survey of market rates conducted in late 2001.

Statutes, section 119B.13, for fiscal year 2003 and implemented on July 1, 2002, are to be continued in effect through June 30, 2005.”³ The 2003 Legislature also required that only hourly rates be charged for legal non-licensed care and reduced maximum rates for legal non-licensed care from 90 to 80 percent of the maximum hourly rates for licensed family home providers.

As a result, the Department of Human Services, which assumed responsibility for the program in March 2003, did not use the 2002 survey to calculate new maximum rates. Instead, the department continued to use the maximum rates initially established for licensed family home providers on July 1, 2002 and reduced maximum rates for legal non-licensed providers in accordance with legislative directives. For child care centers, the department also continued the maximum rates that were placed into effect on July 1, 2002 but discontinued using “pay provider rates.” In those counties that previously did not have maximums for centers, the Department of Human Services implemented so-called “regional” or “statewide” maximum rates. These maximums were either based on rates from centers in the same region of the state or on rates from several regions of the state. For some centers, the new maximums reduced the amount that could be charged for the care of children participating in the Child Care Assistance Program.

In early 2004, the Department of Human Services conducted another rate survey of licensed providers. The primary purpose of this survey was to help the department respond to a legislative directive. The 2003 Legislature directed the department to examine the costs of child care and make recommendations to the 2005 Legislature on ways of containing future cost increases in the program.⁴ The 2004 survey provided the department with more up-to-date information on market rates. The survey can also be used to set maximum rates once the legislative freeze expires on June 30, 2005.

Details on Calculating Rates

Child Care Centers

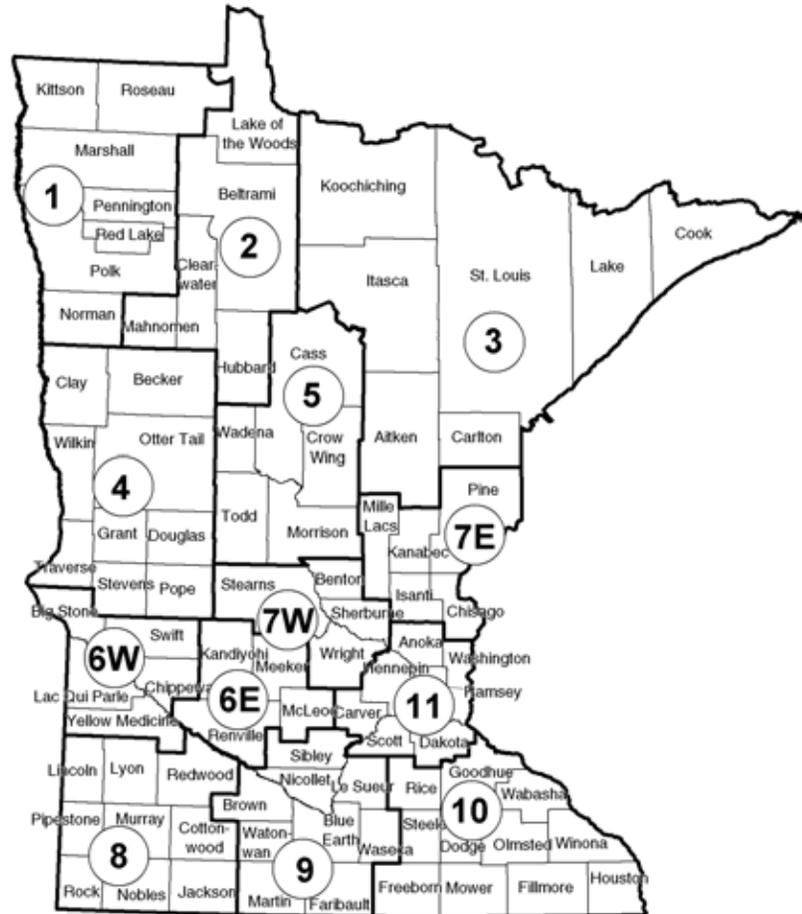
The Department of Human Services has a complicated protocol for determining maximum reimbursement rates, particularly for child care centers in counties with few centers. First of all, as Figure 2.1 indicates, the department divides the counties into regions.⁵ For each county within a region, the department first determines whether the county has sufficient rate information to establish a maximum rate at a particular age level. For centers, the department requires that there be at least three centers reporting rates for the same unit of service—hourly, daily, or weekly. In other words, for a particular age group, there must be at least three centers in the county reporting hourly rates, or at least three centers reporting daily rates, or at least three centers reporting weekly rates. In addition, if fewer than 60 percent of the centers reporting rates report their licensed capacity at that age level, the department requires at least four centers reporting a particular type of rate.

³ *Laws of Minnesota* (1Sp2003), ch. 14, art. 9, sec. 34.

⁴ *Laws of Minnesota* (1Sp2003), ch. 14, art. 9, sec. 34.

⁵ DHS uses the 13 economic development regions in the state. The seven-county Twin Cities metropolitan area is one of the 13 regions.

Figure 2.1: Regions Used in Setting Maximum Reimbursement Rates



SOURCE: Minnesota Department of Human Services.

Some of the procedures used to calculate maximum rates are very complicated.

If there are a sufficient number of centers reporting rates in a county, the Department of Human Services establishes a maximum reimbursement rate at the county level for that age group. The 75th percentile rate is based on the number of child care “slots,” or licensed capacity, of providers if at least 60 percent of the centers with rates report their licensed capacity. Those centers not reporting capacity are assumed to have the average capacity in the county or other geographic unit for which the department is calculating maximum rates. The average capacity is based on those centers reporting both rates and capacity information. But, if fewer than 60 percent of the centers with rates report their licensed capacity, the 75th percentile rate is based on the providers’ rates without any consideration of licensed capacity.

If there are enough rates reported to establish an hourly maximum rate for the county but not enough daily or weekly rates, the department converts the hourly maximum to a daily maximum by multiplying by 10 and converts it to a weekly maximum by multiplying by 50. Similarly, the department converts a weekly

maximum derived from weekly rates into hourly and daily maximums if an insufficient number of hourly and daily rates are reported in the county for that age group. The department also requires that, when calculating a converted hourly maximum, the hourly maximum must be set equal to the greater of the weekly maximum divided by 50 or the daily maximum divided by 10. A converted daily maximum must be set equal to the greater of the hourly maximum times 10 or the weekly maximum divided by 5. And, a converted weekly maximum must be set equal to the greater of the hourly maximum times 50 or the daily maximum times 5.

After converted maximums are calculated, a final comparison of maximum rates is made to see if maximum rates have a certain type of “proportionality.” If they are not proportional, the initial maximums can be overruled to ensure proportionality. For example, the final daily maximum must be at least as high as the weekly maximum divided by 5. This relationship must be maintained even though it might mean that an initial daily maximum based on a sufficient number of actual daily rates is adjusted upward. In fact, the initial daily maximum can be adjusted upward even if there were no weekly rates reported by providers and the adjustment uses a converted weekly maximum. Similarly, an hourly maximum must be at least as high as the daily maximum divided by 10. An initial hourly maximum, even if based on a sufficient number of hourly rates, is adjusted upward if it does not meet this final requirement.

A significant share of the maximum rates for child care centers are based on converted maximums. Table 2.3 shows that only about half of the maximums are based on rates of the same type. About 58 percent of the hourly maximums for child care centers are based on hourly rates, while 52 percent of the daily maximums are based on daily rates. About 48 percent of the weekly maximums are based on weekly rates.⁶

If the Department of Human Services cannot establish maximums in a county for a particular age group, it first looks to combine rates from that county with rates from other counties in the same region. Using only rates from those counties in

The department uses rate conversion procedures to calculate close to half of the maximum rates for child care centers.

Table 2.3: Type of Rates Used to Calculate Hourly, Daily, and Weekly Maximum Reimbursement Rates for Child Care Centers, FY 2003-05

<u>Rates Used to Calculate Maximums</u>	<u>Hourly Maximums</u>	<u>Daily Maximums</u>	<u>Weekly Maximums</u>
Hourly Rates	58%	37%	32%
Daily Rates	30	52	20
Weekly Rates	11	11	48
Totals	100%	100%	100%

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

⁶ Prior to July 2001, the state did not publish the converted maximums. Instead, the state provided conversion guidelines and allowed counties to calculate the converted maximums. Because counties interpreted the state’s guidelines inconsistently, the state began to publish the converted maximums beginning with fiscal year 2002.

the region for which a county maximum cannot be established, the department establishes a “regional” maximum for those counties, provided there are a sufficient number of rates reported from those counties.⁷ For the remaining counties, the department combines the rate information for all counties without either county or regional maximum rates along with rate data from counties with regional maximums and calculates a “statewide” maximum.⁸ As Table 2.4 indicates, only 27 percent of the maximums for child care centers are based on county rates. The majority (61 percent) are regional maximums, and another 13 percent are statewide maximums.

The department uses rates from more than one county to set almost three-fourths of the maximum rates for child care centers.

Table 2.4: Geographic Area Used to Calculate Maximum Reimbursement Rates for Licensed Providers, FY 2003-05

<u>Geographic Area</u>	<u>Child Care Centers</u>	<u>Licensed Family Home Providers</u>
Individual County	27%	100%
Individual Region ^a	61	0
Statewide ^b	13	0
Totals	100%	100%

^aRegional maximum rates are based on rates from a single region, but not from any county within that region that has a maximum based only on rates within that county.

^bStatewide maximum rates are based on rates from multiple regions of the state, but not from any county that has a maximum based only on rates within that county.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

Licensed Family Home Providers

For licensed family home providers, the Department of Human Services has different requirements regarding the number of rates needed in a county in order to calculate a county-based maximum reimbursement rate. The department requires a minimum of four rates in order to establish an hourly maximum in a county. For daily and weekly maximums, the department requires rate information from at least four providers in each Twin Cities metropolitan area county. For any other county in the state, the department requires rates from four providers if at least 50 percent of the providers responded with rate information and rates from 40 providers if between 30 and 49 percent responded. If an insufficient number of daily and weekly rates were reported in a county but a sufficient number of hourly rates were reported, the department calculates an hourly maximum and converts it to daily and weekly maximums using the same methods used for centers. Maximum rates for licensed family home providers are

⁷ A regional maximum rate may not apply to all counties in a region. One or more counties in the region may have maximums at a particular age level that are based only on rates in each county. The regional maximum only applies to those counties in the region for which a county maximum is not established.

⁸ In other words, center rates from counties in which neither a county maximum nor a regional maximum can be established are combined along with center rates from counties with regional rates to obtain the 75th percentiles for statewide maximums. The statewide maximums do not apply statewide but only in those counties for which county or regional maximums are not established.

subject to the same conversion rules and proportionality requirements as maximums for child care centers.

As Table 2.4 indicates, the department has not needed to calculate regional or statewide rates for licensed family providers. All of the maximum rates for these providers are based on rate information from individual counties. However, the department has many converted maximums because hourly rates are the standard for family home providers. Table 2.5 shows that 87 percent of the daily maximums are based on hourly rates. In addition, 81 percent of the weekly maximums are based on hourly rates, and 1 percent are based on daily rates.

Table 2.5: Type of Rates Used to Calculate Hourly, Daily, and Weekly Maximum Reimbursement Rates for Licensed Family Home Providers, FY 2003-05

<u>Rates Used to Calculate Maximums</u>	<u>Hourly Maximums</u>	<u>Daily Maximums</u>	<u>Weekly Maximums</u>
Hourly Rates	100%	87%	81%
Daily Rates	0	13	1
Weekly Rates	<u>0</u>	<u>0</u>	<u>18</u>
Totals	100%	100%	100%

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

Maximum rates for legal non-licensed providers are based on maximums for licensed family home providers.

Legal Non-Licensed Providers

The Department of Human Services does not have much discretion in setting maximum reimbursement rates for legal non-licensed providers. Rules adopted by the Department of Education when it administered the program set the maximum rates for legal non-licensed care equal to 90 percent of the maximum rates for licensed family home providers. But, the 2003 Legislature required that legal non-licensed care be billed only at hourly rates and set the maximum hourly rate for such care equal to 80 percent of the hourly maximum rate for licensed family home care.

In addition, the 2003 Legislature required that hourly maximum rates for legal non-licensed care reflect the discounts available for weekly licensed care in each county. Specifically, the Legislature required that the hourly maximum rate for legal non-licensed care not exceed 80 percent of the weekly maximum rates for licensed family home providers divided by 50. In most counties, this additional requirement did not affect the maximums for legal non-licensed care. In 71 of Minnesota's 87 counties, weekly maximums for licensed family home care are exactly equal to 50 times the hourly maximums for such care at each of the four age groups. However, in 16 counties, the weekly maximums for licensed family home care are less than 50 times the hourly maximums. Consequently, in those 16 counties, the maximum reimbursement rates for legal non-licensed care are less than 80 percent of the maximums for licensed family home care.

The counties affected by the requirement include all seven counties in the Twin Cities metropolitan area, as well as six counties immediately north and northwest of the Twin Cities area. In addition, three outstate counties (Clay, Crow Wing, and Olmsted) have lower maximums for legal non-licensed care as a result of the weekly discounts reflected in the maximum rates for licensed family home care.⁹ On average, the differences caused by this legislative requirement are larger in the Twin Cities area. Maximum rates for legal non-licensed care in the Twin Cities metropolitan area are an average of 40 percent lower as a result of the limit imposed by weekly maximums for licensed family home care. In the other nine counties, maximum rates for legal non-licensed care are about 21 percent lower due to the limit.

SURVEYS

We reviewed the procedures used in surveying providers regarding their rates for child care. We think that that the Department of Human Services generally provides adequate instructions to child care resource and referral agencies. The instructions provide sufficient guidance to these agencies to ensure that providers are randomly selected for inclusion in the survey when it is not appropriate to survey every provider in a county. In addition, the instructions are helpful in guiding the agencies in collecting rate and other information from providers. However, we identified a number of problems that the department needs to address. These problems are discussed below.

Response Rates

In 2001, the survey collected sufficient rate information in most counties.

We reviewed the rate surveys conducted by the Department of Education in 2001 and 2002, as well as the survey conducted by the Department of Human Services in 2004. Our primary focus was on the 2001 survey, since that survey has been the basis for the maximum rates in effect for fiscal years 2003 through 2005. We found that:

- **An adequate overall number of licensed child care centers and licensed family home providers were surveyed and responded with rate information in 2001, but response rates were unacceptably low in some counties.**

The 2001 rate survey gathered rate information from a high percentage of providers. Specifically, the survey collected rates from 81 percent of the child care centers and 68 percent of the licensed family home providers. Child care resource and referral agencies surveyed 89 percent of the 861 centers in their databases and received rate information from 91 percent of those surveyed. These agencies also surveyed 75 percent of the licensed family home providers and received rate information from 91 percent of those surveyed.

⁹ In Clay and Crow Wing counties, only three of the four age groups have lower maximum rates for legal non-licensed care due to the legislative limit involving weekly maximums. In the other 14 counties, the limit affects all four age groups.

But, rate information was received from an unacceptably small number of providers in some counties. For example, usable rate information was received from only 7 percent of the family home providers licensed to operate in Washington County. In addition, usable rate information was received from only 3 of the 20 child care centers located in four counties in Region 10 (southeastern Minnesota). It is not entirely clear why usable rate information was not available from most providers in these counties. But the problems may not have been due to a lack of cooperation from providers.

The survey conducted in the spring of 2004 has fewer of these problems than the 2001 survey. However, we think that the department needs to make sure that any survey used to set maximum rates in the future includes adequate information from providers in each county. The department or its consultant can accomplish this by checking the survey data to see how many providers actually reported rate information.

RECOMMENDATION

When conducting surveys of market rates for child care, the Department of Human Services should take steps to ensure that rate information is collected from an adequate number of providers in each county. The department and its consultant need to review the rate information to determine whether child care resource and referral agencies are adequately performing their duties.

Licensed Capacity of Centers

We also found problems with the collection of information on the licensed capacity of child care centers during the 2001 survey. Child care resource and referral agencies ask child care centers for their licensed capacities for each of the four age groups (infants, toddlers, preschoolers, and school-age children). This information is important because maximum reimbursement rates for child care centers are based on the number of slots of capacity at various rates. We found that:

- **In the 2001 survey, about one-fourth of the child care centers that reported rates for the care of school-age children did not report their licensed capacity.**

The problem of non-reporting is mostly concentrated in the centers serving school-age children. About 27 percent of the centers that reported rates for school-age care did not report their licensed capacity. Only 1 to 2 percent of the centers reporting rates for other age groups did not provide information on their licensed capacity. The problem with school-age capacity information is of particular concern in some parts of the state. In Region 7E (east central Minnesota), 92 percent of the centers reporting school-age rates did not provide information on their school-age capacity. Other regions with high percentages of non-reporting include Region 6E (55 percent), Region 6W (50 percent), and

There were problems in 2001 with non-reporting of licensed capacity by child care centers serving school-age children.

Region 7W (45 percent). In the Twin Cities metropolitan area, high percentages of non-reporting of school-age capacity occurred in Dakota County (73 percent), Scott County (50 percent), Carver County (42 percent), and Ramsey County (35 percent).

The lack of information on school-age capacity can significantly affect the calculation of maximum rates. Based on the percentage of centers with capacity information, the department either assigns an average capacity to those centers not reporting capacity or calculates a maximum rate without using capacity information. Assigning an average capacity could be misleading if the centers not reporting capacity have capacities that are quite different than the average in their county or region. The inability to use capacity information can also produce inappropriate maximum rates particularly if a small number of centers have a significant share of the capacity in the county or region.

We also think that:

- **There are problems with relying on centers to accurately report their licensed capacity.**

Some centers may be overrepresented in the calculation of maximum rates because those centers and the child care resource and referral agencies surveying them have not taken into account their overall capacity limits. Most centers have a licensed capacity for one or more age groups, and their total licensed capacity equals the sum of the individual capacities for each age group. But other centers have both licensed capacities applying to individual age groups and a licensed capacity that applies to several age groups combined. In addition, that combined capacity is less than the sum of the capacities for the individual age groups. For example, a center could have a capacity of 22 infants, 22 toddlers, and 20 preschoolers, but its overall capacity for all of these age groups combined could be 49. The department says that it instructs child care resource and referral agencies to ask the centers how they currently allocate their total capacity if they have an overall limit for two or more combined age groups. It appears to us, however, that the overall capacity of some centers reported in the 2004 survey exceeds their licensed capacity.

The Department of Human Services should use information from its Licensing Division to minimize problems with the non-reporting or misreporting of licensed capacity data.

We think that the solution to these problems of non-reporting or misreporting of capacity information could be addressed by using the licensed capacity information available from the department's Licensing Division. The department could provide this information to the child care resource and referral agencies. The agencies could record the capacity data along with the rate and other information collected during a rate survey. The agencies may need to ask new providers for capacity information if it is not yet available from the Licensing Division. In addition, the department may wish to have the agencies confirm the capacity information with each center and ask centers with the special capacity limitations described above to allocate that capacity among the relevant age groups based on recent enrollment.

RECOMMENDATION

When calculating maximum reimbursement rates for child care centers, the Department of Human Services should rely primarily on the licensed capacity data available from its Licensing Division. In some cases, the department may need to supplement these data with information gathered during the survey.

Different Types of Rates

Since the 2001 survey, the child care resource and referral agencies have been using a different software program to collect and report rates to the Department of Human Services. This rate information now being reported includes part-time, as well as full-time, rates. In addition, it includes rates based on other billing hours besides the standard 10-hour day and 50-hour week used by the department.¹⁰

Prior to the change in software, the agencies had to make decisions about what rates to record and transmit to the department. As a result, the rate information available from the 2001 survey includes only one type of hourly, daily, or weekly rate. But the 2002 and 2004 surveys include four different types of hourly, daily, and weekly rates. The rate information from the more recent surveys includes: 1) full-time rates based on 10-hour days and 50-hour weeks; 2) part-time rates based on 10-hour days and 50-hour weeks; 3) full-time rates based on billing hours other than 10-hour days and 50-hour weeks; and 4) part-time rates based on billing hours other than 10-hour days and 50-hour weeks.

In attempting to compare 2004 market rates with 2001 rates, we found that:

- **Child care resource and referral agencies across the state do not collect rate data in a consistent manner.**

For example, the reporting of part-time rates varies significantly across the state. In some counties and regions of the state, only part-time rates were reported in 2004. The extent of the differences in reporting suggest that agencies are not reporting actual market differences in the types of rates being charged by providers. Instead, the agencies are reporting data in inconsistent ways.

We also found that there are differences in the extent to which child care resource and referral agencies report rates in the category that is intended to represent rates based on billing hours other than the standard 10-hour day or 50-hour week. For example, one agency told us that they interpreted this category differently than the department. The agency entered rates for new providers in this category regardless of their billing hours. In addition, we found that:

¹⁰ For example, a provider could report rates for 8-hour days and 40-hour weeks. The information collected in the survey does not identify, however, the specific billing hours used by the provider. The information only indicates that the provider uses billing hours different from the standard 10-hour days and 50-hour weeks.

There were some problems with the inconsistent reporting of rate information in the 2004 survey.

- **The Department of Human Services does not have a clear understanding of how child care resource and referral agencies are reporting rate data in the current software system.**

The department was not aware of the inconsistent use by child care resource and referral agencies of the different types of rates collected during the survey. The department also does not have a clear understanding of what part-time rates represent. Program staff could not explain to us whether a part-time daily rate represents the rate for daily care several times a week or the rate for care throughout the week for parts of a full day.

Because of the freeze on maximum rates, the department has not used the rate data reported in 2002 or 2004 to set maximum rates. However, current law removes the freeze on maximum rates on July 1, 2005. If the department intends to use the 2004 survey to set maximum rates in the future, the department needs to gain a better understanding of how child care resource and referral agencies interpreted the various rate categories when collecting rate information in 2004. In addition, for any future survey, the department needs to make sure that child care resource and referral agencies have a common understanding about the type of rates being collected.

RECOMMENDATION

The Department of Human Services should become more familiar with the different types of rates reported in the 2004 survey and work with child care resource and referral agencies to ensure consistency in how rates are reported in future surveys.

CALCULATION OF MAXIMUM RATES

The Department of Human Services generally uses acceptable methods for calculating maximum rates.

We reviewed the procedures used by the Department of Human Services to calculate maximum rates. In general, we found that:

- **The basic methods used by the Department of Human Services to set maximum reimbursement rates for the Child Care Assistance Program are reasonable.**

Generally, the department sets the maximum rates for child care centers based on the 75th percentile of market rates for centers in a given area. In addition, the maximum rates for licensed family home providers are based on the 75th percentile of market rates for those providers in each county. Maximum rates for legal non-licensed providers are based on the maximum rates for licensed family home providers in each county and calculated in accordance with state law.

For the most part, the calculation of the 75th percentile of market rates is relatively straightforward. But we found problems with the methods the department uses to convert maximums from one time period to another. As we mentioned earlier, the department often calculates an hourly maximum and then converts that hourly

maximum to a daily or weekly maximum.¹¹ In the next section, we evaluate the department's rate conversion procedures and recommend alternative procedures.

Converted Maximums

While the Department of Human Services relies heavily on conversions of maximums, national experts generally discourage the practice of converting rates or maximums based on a standard number of hours in a day or week. The problem with conversions is that the market for child care generally provides a volume discount for daily and weekly care. Table 2.6 shows that, in Minnesota, there is a significant discount for daily or weekly care over the rates charged for hourly care. For example, in the seven-county Twin Cities metropolitan area, the

But the department relies on conversion procedures that do not recognize the discount available for daily or weekly child care.

Table 2.6: Average Discount for Daily and Weekly Preschool Child Care Rates by Area of the State, 2001

	Child Care Centers ^a			Licensed Family Home Providers		
	Hourly	Daily	Weekly	Hourly	Daily	Weekly
<u>Twin Cities Metro Area</u>						
Average Rates	\$6.60	\$45.72	\$166.72	\$3.75	\$25.63	\$112.69
Rates Proportional to Hourly Average ^b	NA	66.05	330.24	NA	37.53	187.66
Average Discount from Hourly Rates	NA	31%	50%	NA	32%	40%
<u>Outstate Minnesota</u>						
Average Rates	\$3.08	\$26.09	\$120.22	\$2.08	\$20.75	\$96.69
Rates Proportional to Hourly Average ^b	NA	30.82	154.08	NA	20.84	104.20
Average Discount from Hourly Rates	NA	15%	22%	NA	0%	7%

^aThe average rates for centers were calculated by weighting the rates for individual centers by their licensed capacity.

^bWe multiplied the average hourly rate by 10 to obtain the proportional daily rate and by 50 to obtain the proportional weekly rate. We did so because the daily and weekly rates collected in the survey represent 10-hour days and 50-hour weeks.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

average hourly rate for preschool care at a child care center was \$6.60 per hour in the Fall of 2001. If this hourly rate had been applied to daily or weekly care, it would have resulted in rates of about \$66 per day or \$330 per week. But, the average rates at Twin Cities area child care centers were \$45.72 per day and \$166.72 per week. The average daily rate represented a discount of about 31 percent over the hourly rate converted into a daily rate, while the average weekly rate represented a discount of 50 percent over the average hourly rate. Significant discounts are also the practice for licensed family home providers in the Twin Cities area. In outstate Minnesota, the market for child care provides

¹¹ The department converts an hourly maximum into a daily maximum by multiplying the hourly maximum by ten. Similarly, the department converts an hourly maximum into a weekly maximum by multiplying the hourly maximum by 50. The multipliers used by the department reflect the fact that it asks providers for their rates for 10-hour days and 50-hour weeks.

significant, though smaller, discounts at child care centers. Licensed family home providers in outstate Minnesota tend to charge only by the hour. As a result, their rates reflect only a small discount for weekly care.

Despite these concerns about conversions, the department needs to convert some rates in order to set hourly, daily, and weekly maximum rates. For example, in some counties, there are few providers that report a rate other than an hourly rate. So, it is important that the department use appropriate methods when converting rates. However, we found that:

- **The methods used by the Department of Human Services to convert maximum rates ignore important information about market rates for child care and have led to the setting of inappropriate maximum rates in some parts of the state.**

Table 2.7 shows the 2001 rate information used by the department to set maximum toddler reimbursement rates for child care centers in Region 2. The department set a \$4.00 hourly maximum based on the 75th percentile of the four hourly rates submitted by providers. Only two providers submitted weekly rates, so the department converted the hourly maximum to a weekly maximum of \$200. Three providers submitted their daily rates, which the department considers to be a sufficient number upon which to establish a maximum rate. But the department

Table 2.7: Calculation of Maximum Toddler Reimbursement Rates in Region 2 (North Central Minnesota), 2001

Provider	Licensed Capacity	Rates Reported by Providers			Converted Rates ^a	
		Hourly	Daily	Weekly	Daily	Weekly
#1	20	\$4.00	\$22.50	N/R	\$22.50	\$112.50
#2	14	3.00	N/R	N/R	30.00	150.00
#3	14	2.50	NR	\$112.50	25.00	112.50
#4	11	2.35	23.00	N/R	23.00	115.00
#5	21	N/R	19.00	N/R	19.00	95.00
#6	13	N/R	N/R	115.00	N/A	115.00
Department of Human Services' Maximums		\$4.00	\$40.00	\$200.00		
Office of the Legislative Auditor Calculation of Maximums		\$4.00	\$22.50	\$115.00		
Upper Limit on Maximums: 75th Percentile of Converted Rates					\$25.00	\$115.00

N/R = Not reported in 2001 survey; N/A = Not applicable.

^aA converted daily rate is a provider's actual daily rate or, if the provider did not report a daily rate, the provider's hourly rate times 10. A converted weekly rate is a provider's actual weekly rate or, if the provider did not report a weekly rate, the provider's daily rate times 5. If the provider did not report either a daily or weekly rate, the converted weekly rate is the provider's hourly rate times 50. These conversions reflect the department's practice of asking providers what their rates are for 10-hour days and 50-hour weeks. The Department of Human Services, however, does not calculate converted rates. We are using converted rates to show what would be the upper limit on each provider's daily and weekly rates.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

Some maximum rates for child care centers exceed any rate charged in a particular region.

ignored the 75th percentile for daily rates, which was \$22.50 per day, and set a daily maximum of \$40. The department's conversion rules require the daily maximum to be at least as high as the weekly maximum divided by five. This rule is applied even though there were enough daily rates to set a daily maximum and the weekly maximum was not based on actual weekly rates.

As Table 2.7 illustrates, the department's methods clearly ignore some of the rate information provided by child care centers. In particular, the methods ignore the discount available for daily or weekly care. The department's maximum rates were based solely on the highest hourly rate charged in Region 2. But the center with the highest hourly rate charged \$22.50 per day. Even though no other center charged more than \$23 per day, the department set a maximum daily rate of \$40. Similarly, the highest weekly rate charged in Region 2 was \$112.50, yet the department set a maximum weekly rate of \$200.

It was clearly inappropriate to convert the hourly maximum into daily and weekly maximums. We think it would be more appropriate to use "converted rates" than "converted maximums" to help determine maximum reimbursement rates. Table 2.7 indicates for each center what its daily and weekly rates would be if we converted them from either their hourly or daily rates. The table shows that no center had a converted daily rate of more than \$30, and none had a converted weekly rate of more than \$150. The center with an hourly rate of \$4.00 and a daily rate of \$22.50 would have a converted weekly rate of \$112.50. This converted weekly rate reflects its daily charge times the five days in a week.

An alternative rate conversion procedure would more accurately reflect the rates charged by providers.

As an alternative to the department's conversion procedures, we think that the 75th percentile of converted rates could be used to establish an upper limit on how high maximum rates should be set. In our example, the 75th percentile of converted daily rates was \$25, and the 75th percentile of converted weekly rates was \$115. Clearly, the use of every center's daily and weekly rates, as well as the converted rates from centers without those rates, would have resulted in lower maximums than the department set in this case. We think that the daily maximum should have been set, however, at \$22.50, since there were at least three centers providing daily rates. The 75th percentile of converted rates only provides a ceiling for the maximum rate, since it includes converted hourly rates for some centers and assumes that they do not offer a discount for daily care.

The value of using converted rates rather than converted maximums can perhaps be better illustrated using another example. For child care centers in Region 10, the Department of Human Services used daily rates to set a daily maximum and then converted the daily maximum into hourly and weekly maximums. As Table 2.8 indicates, ten centers reported hourly rates ranging from \$2.50 to \$3.50. Four centers reported daily rates ranging from \$26.70 to \$50. Only one center had a daily rate over \$30.20. Two centers reported weekly rates of \$135 and \$138. The department set a daily maximum of \$50 based on the 75th percentile of daily rates and used that maximum to set an hourly maximum of \$5 and a weekly maximum of \$250. The department overruled the use of the 75th percentile of hourly rates—which was \$3.25 per hour—on the premise that the hourly maximum had to be at least equal to one-tenth of the daily maximum.

Table 2.8: Calculation of Maximum Infant Reimbursement Rates in Region 10 (Southeastern Minnesota), 2001

Sometimes the department's procedures cause one provider's rate to determine maximum rates for an entire region.

Provider	Licensed Capacity ^b	Rates Reported by Providers			Converted Rates ^a	
		Hourly	Daily	Weekly	Daily	Weekly
#1	8	\$3.50	\$26.70	N/R	\$26.70	\$133.50
#2	N/R	3.25	N/R	N/R	32.50	162.50
#3	N/R	3.25	N/R	N/R	32.50	162.50
#4	10	3.00	N/R	\$138.00	30.00	138.00
#5	4	3.00	N/R	135.00	30.00	135.00
#6	8	2.85	N/R	N/R	28.50	142.50
#7	N/R	2.75	N/R	N/R	27.50	137.50
#8	8	2.70	N/R	N/R	27.00	135.00
#9	8	2.65	N/R	N/R	26.50	132.50
#10	N/R	2.50	N/R	N/R	25.00	125.00
#11	8	N/R	50.00	N/R	50.00	250.00
#12	7	N/R	30.20	N/R	30.20	151.00
#13	7	N/R	30.00	N/R	30.00	150.00

Another 14 providers reported licensed capacity for infants, but their rates were not collected. (None were recorded as having refused to provide rates.)

Department of Human Services' Maximums	\$5.00	\$50.00	\$250.00		
Office of the Legislative Auditor Calculation of Maximums	\$3.25	\$30.20	\$151.00		
Upper Limit on Maximums: 75th Percentile of Converted Rates		\$30.20	\$151.00		

N/R = Not reported in 2001 survey.

^aA converted daily rate is a provider's actual daily rate or, if the provider did not report a daily rate, the provider's hourly rate times 10. A converted weekly rate is a provider's actual weekly rate or, if the provider did not report a weekly rate, the provider's daily rate times 5. If the provider did not report either a daily or weekly rate, the converted weekly rate is the provider's hourly rate times 50. These conversions reflect the department's practice of asking providers what their rates are for 10-hour days and 50-hour weeks. The Department of Human Services, however, does not calculate converted rates. We are using converted rates to show what would be the upper limit on each provider's daily and weekly rates.

^bIn calculating the 75th percentile for hourly rates, DHS assigned a capacity of seven to each of the providers without a reported capacity. The capacity of seven was the average capacity of the six providers reporting both hourly rates and capacity.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

The department's methods were particularly inappropriate in this case, since there were many more centers that reported hourly rates than daily rates. In addition, the highest daily rate—which was well above any of the other daily rates—was used to set all three of the maximums for this region. The use of converted rates rather than converted maximums would have resulted in more reasonable maximum reimbursement rates. The hourly maximum would have been \$3.25 based on the 75th percentile of the rates provided by ten centers. The daily maximum would have been set at \$30.20, reflecting the 75th percentile of converted rates. Table 2.8 shows that only one of thirteen centers in the region had an actual daily rate or a daily rate converted from its hourly rate that was greater than \$32.50. The weekly maximum would have been set at \$151, which

was the 75th percentile of converted rates. Only one center had an actual or converted weekly rate that was greater than \$162.50.

RECOMMENDATION

The Department of Human Services should discontinue using converted maximums and related conversion rules to calculate maximum reimbursement rates. The department should instead consider using converted rates to set an upper limit on maximum rates.

For the most part, the use of converted maximums has resulted in maximums being set too high. But, in some counties, maximums have been set too low when compared with actual rates. For example, in Chisago County, weekly rates for infants were used to set hourly and daily maximum rates as well as weekly maximums. The department used weekly rates because all four centers responding to the 2001 survey provided weekly rate information. Hourly and daily rates were only provided by two centers. The department set the weekly maximum at \$172 based on the 75th percentile of weekly rates and then converted that maximum into a daily maximum of \$34.40 and an hourly maximum of \$3.44. As Table 2.9 shows, the hourly maximum was extremely low compared with the hourly rates of \$6.00 and \$8.50 reported by two of the four centers.¹² Clearly, the center with the \$8.50 hourly rate had more than 25 percent of the licensed capacity of centers responding to the survey. As a result, the 75th percentile of

Table 2.9: Calculation of Maximum Infant Reimbursement Rates in Chisago County, 2001

The department's rate conversion procedures can sometimes produce maximum rates that are considerably below market rates.

Provider	Licensed Capacity	Rates Reported by Providers			Reverse Converted Rates ^a	
		Hourly	Daily	Weekly	Hourly	Daily
#1	12	\$8.50	N/R	\$167.00	\$8.50	\$33.40
#2	12	6.00	\$40.00	150.00	6.00	40.00
#3	12	N/R	N/R	172.00	3.44	34.40
#4	8	N/R	28.00	140.00	2.80	28.00
Department of Human Services' Maximums		\$3.44	\$34.40	\$172.00		
Office of the Legislative Auditor Calculation of Maximums		\$8.50	\$40.00	\$172.00		
Lower Limit on Maximums: 75th Percentile of Reverse Converted Rates					\$8.50	\$40.00

N/R = Not reported in 2001 survey.

^aA reverse converted daily rate is a provider's actual daily rate or, if the provider did not report a daily rate, the provider's weekly rate divided by 5. A reverse converted hourly rate is a provider's actual hourly rate or, if the provider did not report an hourly rate, the provider's daily rate divided by 10. If the provider did not report either an hourly or daily rate, the reverse converted hourly rate is the provider's weekly rate divided by 50. These reverse conversions establish a lower limit on a provider's hourly and daily rates.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

¹² This problem also occurs in two other counties (Isanti and Mille Lacs) in the same region (Region 7E) and in several counties in Region 7W.

hourly rates, however calculated, was \$8.50, and the maximum hourly rate should have been set at \$8.50.

We think that the use of “reverse converted rates” in such cases would help establish more reasonable maximums. A reverse daily converted rate is calculated based on a provider’s weekly rate when the provider does not have a daily rate. Similarly, a reverse converted hourly rate is calculated from the provider’s daily rate or, if the provider does not have a daily rate, from the provider’s weekly rate. Reverse converted rates would thus use more of the rate information reported in the survey than the department currently uses when it converts maximums. The 75th percentile of reverse converted rates would set a floor below which the maximum rate should not be set. In this case, the 75th percentiles of the reverse converted rates were \$8.50 per hour and \$40 per day. The use of reverse converted rates sets a lower limit on the maximums because they convert rates down from longer time periods. If a provider has a weekly rate of \$172, we would expect that the provider’s hourly rate would be no lower than \$3.44 and the daily rate would be no lower than \$34.40. However, because of the discount generally offered on longer periods of care, the provider might have higher hourly and daily rates.

The problems with inappropriately low maximum rates can also be corrected with alternative conversion procedures.

RECOMMENDATION

Along with using converted rates to set an upper limit on maximum rates, the Department of Human Services should consider using reverse converted rates to set a lower limit on maximum rates.

As mentioned earlier in this chapter, one of the problems with the 2001 rate survey was the lack of adequate information on the licensed capacity of centers, particularly those serving school-age children. Table 2.10 illustrates some of the problems created by this lack of information. The Department of Human Services set maximum rates for school-age care in McLeod County even though only two of the six centers responding to the survey provided information on their licensed capacity to serve school-age children. In this case, the department set maximum rates without using licensed capacity. Since five centers provided hourly rates, the department used the rate from the second highest provider to set the maximum hourly rate. Two providers had hourly rates of \$4.25, so the department set the maximum hourly rate at \$4.25. The daily maximum was set at \$42.50, because none of the providers had a daily rate. In addition, the department set the weekly maximum at \$212.50—or 50 times the hourly rate—because the three providers with weekly rates did not provide capacity information. The department’s protocol requires at least four weekly rates in order to set a weekly maximum based on weekly rates when there is capacity information on less than 60 percent of those with rates.

The department’s use of a converted maximum, however, makes no sense in this case. The two child care centers with hourly rates of \$4.25 had weekly rates of \$105. The other center with a weekly rate charged \$95 per week. Regardless of the relative capacities of the three centers, the 75th percentile of their rates could be no higher than \$105. Using converted rates, we would set an upper limit on the maximum weekly rate of \$122.50 because we do not know the licensed

Table 2.10: Calculation of Maximum School-Age Reimbursement Rates in McLeod County, 2001

The non-reporting of licensed capacity information has also caused some maximum rates to be set at inappropriate levels.

Provider	Licensed Capacity	Rates Reported by Providers			Converted Rates ^a	
		Hourly	Daily	Weekly	Daily	Weekly
#1	N/R	\$4.25	N/R	\$105.00	\$42.50	\$105.00
#2	N/R	4.25	N/R	105.00	42.50	105.00
#3	45	2.50	N/R	N/R	25.00	125.00
#4	38	2.45	N/R	N/R	24.50	122.50
#5	N/R	2.25	N/R	N/R	22.50	112.50
#6	N/R	N/R	N/R	95.00	N/A	95.00
Department of Human Services' Maximums		\$4.25	\$42.50	\$212.50		
Office of the Legislative Auditor Calculation of Maximums		\$4.25	\$42.50	\$105.00 ^b		
Upper Limit on Maximums: 75th Percentile of Converted Rates					\$42.50	\$122.50

N/R = Not reported in 2001 survey; N/A = Not applicable.

^aA converted daily rate is a provider's actual daily rate or, if the provider did not report a daily rate, the provider's hourly rate times 10. A converted weekly rate is a provider's actual weekly rate or, if the provider did not report a weekly rate, the provider's daily rate times 5. If the provider did not report either a daily or weekly rate, the converted weekly rate is the provider's hourly rate times 50. These conversions reflect the department's practice of asking providers what their rates are for 10-hour days and 50-hour weeks. The Department of Human Services, however, does not calculate converted rates. We are using converted rates to show what would be the upper limit on each provider's daily and weekly rates.

^bThe 75th percentile of weekly rates could not be higher than \$105, regardless of the relative capacities of the three providers reporting weekly rates.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

capacities of four of the six centers in the county. But, clearly the weekly maximum should have been no greater than \$105.

These examples show that the department's methods for converting maximums produce results that are inconsistent with information from rate surveys. In addition, we think that:

- **The department's methods for converting maximums sometimes produce maximum rates that exceed the 75th percentile level allowed by state law, or at least exceed a reasonable interpretation of how that level should be calculated.**

In fact, the examples highlight cases in which the maximums are not only higher than the 75th percentile of rates, but are also well in excess of the highest rates for an area. In Region 2, state program administrators set the daily and weekly maximums for toddler care at child care centers considerably higher than any daily or weekly rate reported by a center. In Region 10, similar results occurred with hourly and weekly maximums for infant care at child care centers. In McLeod County, the weekly maximum for school-age children was more than double the highest rate reported by a provider.

However, the legal issue is somewhat complicated. The department believes the maximums comply with statutory requirements because, in each case, at least one of the maximums—hourly, daily, or weekly—was based on a calculation of the 75th percentile. The other maximums were then based on conversions from the one maximum that was based on the 75th percentile. Whether the maximums technically comply with state law is a complex issue that we cannot answer. But, we think that the department’s procedures produce results that certainly seem inconsistent with the requirement that a maximum rate “not exceed the 75th percentile rate for like-care arrangements in the county as surveyed by the commissioner.”¹³

About one-fourth of the maximum rates for child care centers have been inappropriately calculated.

Overall, the problems with converted maximums and the proportionality rule do not affect a majority of the maximum rates set by the department. But the problems affect a significant number of maximum rates, particularly for child care centers. Table 2.11 indicates the percentage of maximum rates that we think have been inappropriately set for each type of provider. The percentages include cases

Table 2.11: Percentage of Maximum Reimbursement Rates That Were Inappropriately Calculated, FY 2003-05^a

Type of Rates	Child Care Centers	Licensed Family Home Providers	Legal Non-Licensed Providers ^b
Hourly	21%	0%	13%
Daily	34	13	N/A
Weekly	31	13	N/A
Overall	29%	9%	13%

N/A = Not applicable.

^aThis is the percentage of counties for which different maximum rates should have been established. The results for each age group are included in our calculation of this percentage. The percentages do not include any cases in which the maximum rates would be different if the department had obtained complete and accurate information on the licensed capacity of child care centers.

^bAll legal non-licensed care is billed at hourly rates.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

that are not quite as obvious as those we highlighted earlier in this chapter. In all of these cases, however, the principle is the same. Using converted rates in the manner we recommend makes use of more rate information than does the department’s methods. Overall, we found that:

- **At least 29 percent of the maximum reimbursement rates for child care centers were inappropriately set. About 9 percent of the maximum rates for licensed family home providers and 13 percent of the maximums for legal non-licensed care are inappropriate.**

For the most part, these questionable maximum rates should be lower than currently is the case. About 25 percent of the child care center maximums should

¹³ *Minn. Stat.* (2004) §119B.13, subd. 1.

Most of the problems with maximum rates affect counties outside the Twin Cities metropolitan area.

be lower, while 3 percent should be higher than current maximums. All the changes we would make in the maximums for other providers would result in lower maximums. The changes in maximum rates for legal non-licensed care are entirely the result of changes in weekly maximums for licensed family home care.

In general, we think that these changes would slightly reduce state spending for the Child Care Assistance Program. Most of the changes would involve lower maximum rates, although some of the higher maximums would occur in more populous counties. For the most part, the Twin Cities metropolitan area would not be affected, except for a few increased maximum rates in Scott County.

The extent of problems caused by the lack of data on the licensed capacity of centers cannot be fully established. We can identify those cases like McLeod County in which the department's methods do not make sense. But we cannot determine how many maximums would have been set differently if capacity information had been available. The department is unable to identify the names of the providers in the 2001 survey. As a result, we could not match the rates reported with capacity information from the department's Licensing Division, even if capacity information for the fall of 2001 were available.

Regional and Statewide Maximums

Since July 2003, the Department of Human Services has set regional or statewide maximum rates for center-based care in 68 of Minnesota's 87 counties.¹⁴ These maximums are based on rates for more than one county. Regional or statewide maximums are used in a county if the department believes there are not enough centers providing rates in that county. Specifically, the department requires that there be at least three rates of one type—hourly, daily, or weekly—to set county-based maximums for a particular age group. The department requires four rates of one type if capacity information was provided by less than 60 percent of the centers with rates. The department has not needed to set regional or statewide maximums for licensed family home providers because of the large number of such providers in each county.

Prior to the use of regional and statewide maximums, centers in 68 counties were not subject to a maximum rate.¹⁵ Like centers elsewhere in the state, centers covered by the "pay provider rate" system were required to charge subsidized children the same rate they charged the general public. But, unlike centers in other counties, centers in "pay provider rate" counties were not subject to a maximum and could raise the rate charged for subsidized care without restriction as long as it matched their "private-pay" rate. For most centers, the lack of a maximum rate was probably not a major incentive to raise rates. Most centers could not raise their rates without potentially losing private-pay customers and negatively affecting their profits. But, for those centers serving a high percentage of subsidized children, the lack of a maximum rate may have provided an incentive to increase the rates charged to subsidized children without improving the care or services provided to those children.

¹⁴ In 60 counties, there are regional or statewide maximums for all four age groups. In eight counties, there are regional or statewide maximums for between one and three age groups.

¹⁵ The "pay provider rate" system for child care centers applied to all age groups in 60 counties and to one or more age groups in eight other counties.

The Department of Human Services began using regional and statewide rates in July 2003 after the 2003 Legislature required that the schedule of provider rates established in July 2002 by the Department of Education continue to be used until July 2005. The department felt that the “pay provider rate” system was overly generous to some providers in light of the freeze that would be placed on providers elsewhere in the state. And, the department felt the “pay provider rate” system would not generate the cost savings needed to meet the budget targets set by the Legislature. In addition, the department wanted to establish rates in those counties without centers in the event a center opened in those counties. Consequently, the department implemented new regional or statewide maximums for center-based care in the 68 counties that previously had a “pay provider rate” system.

The use of regional and statewide rates, however, affected providers in a manner that may not have been anticipated by the Legislature. The 2003 Legislature directed that: “The provider rates determined under Minnesota Statutes, section 119B.13, for fiscal year 2003 and implemented on July 1, 2002, are to be continued in effect through June 30, 2005.”¹⁶ But, the maximums implemented by the department reduced the rates that could be charged by some centers. We reviewed the actions taken by both departments and think that the state administrators of the Child Care Assistance Program have not paid sufficient attention to state laws governing the setting of maximum rates. First, we think that:

- **The “pay provider rate” system clearly violated state statutes.**

Since at least 1999, Minnesota Statutes have required that the “maximum rate paid for child care assistance under the child care fund may not exceed the 75th percentile rate for like-care arrangements in the county as surveyed by the commissioner.”¹⁷ This provision requires that state program administrators set maximum rates in a county based on the 75th percentile of rates in a county. State law does not allow a system in which there are no maximum rates. To comply with state law, the Department of Education should have set maximum rates for child care centers in all counties and enforced those rates until new rates were set throughout the state based on a new rate survey.

Second:

- **We question whether the Department of Human Services had legal authority to implement regional and statewide rate maximums for child care centers in 68 counties in July 2003.**

A strict reading of the statutes suggests that maximum rates must be based on the 75th percentile of rates surveyed in a county.¹⁸ The regional and statewide maximums implemented by the Department of Human Services are based on rates from numerous counties. The so-called statewide maximums even include rates

The “pay provider rate” system used prior to July 2003 to reimburse child care centers in 68 counties did not set maximum rates as required by law.

¹⁶ *Laws of Minnesota* (1Sp2003), ch. 14, art. 9, sec. 34.

¹⁷ *Minn.Stat.* (2004) §119B.13, subd. 1.

¹⁸ *Minn.Stat.* (2004) §119B.13, subd. 1.

The Legislature did not authorize the department's use of regional or statewide maximum rates.

from counties in different parts of the state. In addition, the 2003 Legislature required that the Department of Human Services continue the provider rate schedule implemented by the Department of Education in July 2002 for another two years. Since that schedule included the “pay provider rate” system, it could be argued that the Department of Human Services was legally required to continue its use.

However:

- **The Department of Human Services thinks its rules give it legal authority to implement regional and statewide maximum rates.**

The department’s rules state that: “When the number of providers in a county or in a provider category is too small to determine the 75th percentile provider rate, the commissioner may establish child care provider rates based on like care arrangements in similar areas or categories.”¹⁹ The rules would appear to give the department some discretion to set maximums that are not based on the rates from a single county. But, it is unclear to us whether the rules take precedence over the statutory language and the specific direction given by the 2003 Legislature to continue using the existing rate schedule.

Even if the department has discretion to set regional or statewide rates, its authority under the rules is subject to interpretation. The rules allow some discretion if the number of providers is too small to determine the 75th percentile of rates in a county. But, it is unclear what “too small to determine the 75th percentile” means. As mentioned earlier, the department’s protocol requires rates of a single type from either three or four providers in order to set county-based maximum rates. But, it is not necessary to have that many rates, since a 75th percentile could be established even with only one rate. If there is only one provider with rates, that provider’s rates represent both the zero and the 100th percentile of rates in the county, as well as the 75th percentile. As a result, it may be questionable for the department to extend its discretion to those cases in which at least one child care center in a county reports its rates during the rate survey.

It should be noted that the program’s inappropriate use of the “pay provider rate” system contributed to the concerns raised about the implementation of regional and statewide rates. If the Department of Education had properly implemented maximum rates for child care centers in all 87 counties, the Department of Human Services could have implemented the legislative directive to continue the existing rate schedule without using regional or statewide rates. In addition, no provider’s maximum rate would have been reduced, and sufficient budgetary savings would likely have been realized without using regional or statewide rates.²⁰

¹⁹ *Minn. Rules* (2003) ch. 3400.0130, subp. 1.

²⁰ Information we received from the department indicates that setting county-based maximum rates using the 100th percentile in each county rather than regional and statewide maximum rates would have resulted in lower maximum rates in twice as many instances as it would have increased rates. In those 68 counties with a small number of centers reporting rates, the 100th percentile of rates would generally be the same as the 75th percentile.

RECOMMENDATION

The Department of Human Services should seek changes in state laws that would clearly allow the department to implement maximum rates based on geographic areas larger than a single county.

Some regional maximums may be appropriate, but there should be a broader and more careful consideration of their impact.

There are some legitimate reasons why the state may wish to set maximum rates using rate information from more than one county. For example, in counties with a small number of centers, maximum rates could change significantly from year to year depending on which centers report rates. This could occur even with the department's use of regional rates or in counties that the department believes has an adequate number of rates to set a county-based maximum. Large year-to-year swings in the maximums can be disruptive for child care centers and may produce undesirable outcomes from a public policy standpoint.

But combining counties to set maximum rates may also be unfair if it combines counties that have centers with very different rate and cost structures. If a county with high rates is combined with several other low-rate counties, the resulting low maximums could be damaging to the use of centers in the high-rate county. Program participants in the county with high rates would face significantly higher out-of-pocket costs than participants in the low-rate counties. Combining the counties for the purpose of setting maximum rates may not make much sense if residents of a county do not have reasonable access to child care in another county. In some cases, the amount of travel time to reach a child care center in another county may be unreasonable. We think that the Department of Human Services should discuss the issues involved in setting regional or statewide maximum rates with the appropriate legislative committees.

RECOMMENDATION

The Legislature should review the advantages and disadvantages of setting regional and statewide maximum rates for child care centers and provide policy direction to the Department of Human Services.

Other Concerns

We have a number of other concerns about the setting of maximum reimbursement rates. Several of the concerns involve the types of providers that the department includes in its rate surveys. In addition, we have a concern about the number of family providers that are needed to set daily and weekly maximums for family home providers in outstate Minnesota.

Inclusion of Providers in Rate Surveys

Currently, the department includes all centers in its rate surveys except centers that exclusively serve preschool children and unlicensed centers that serve

school-age children. Although participants in the Child Care Assistance Program utilize these centers, the department excludes them from the survey because they do not generally provide care for a full day and do not charge hourly rates or rates for a 10-hour day or a 50-hour week.²¹

The department includes centers in its survey regardless of the percentage of a center's customers that receive care subsidized by the Child Care Assistance Program. As we will discuss in the next chapter, providers with a high percentage of subsidized customers have the greatest incentive to increase their rates to the maximum reimbursement rate. At least one state excludes providers with a high percentage of subsidized customers, because those providers may have rates that do not truly reflect the market for child care. Wisconsin excludes a provider from rate surveys and the calculation of maximum rates if the provider has a clientele that has more than 90 percent subsidized customers.

The Department of Human Services does not have information on the extent to which individual providers are dependent on the subsidy program.

In Minnesota, however, the department does not currently have the necessary information on the percentage of subsidized customers served by various providers. Furthermore, it is not clear what effect excluding highly subsidized providers would have on maximum rates. It could be argued that highly subsidized providers have rates that are artificially high because of government subsidies. So, the 75th percentile of rates might be lower if we could adjust their rates downward to reflect the impact of child care subsidies. However, excluding the rates of highly subsidized providers when calculating maximum rates could actually cause some maximum rates to be higher than currently is the case.

Nevertheless, we think that it may be useful for the department to conduct some additional research on this issue. For example, during the next survey, the department could ask providers what percentage of their clients are participants in the Child Care Assistance Program. The department could also consider whether the state's payment system would be able to provide useful information about providers in the 38 counties using that system.

Legislators have also raised concerns about the extent to which centers responding to the survey are providing care at rates below their true cost. A center could provide care below cost if it was subsidized by an outside source or if the center's owner provided a subsidy. This could be true of non-profit centers that raise funds from outside sources. Alternatively, employer-based centers may offer care at below market rates as a benefit to its employees. In addition, there has been some concern that a casino-based center was providing service at below market rates. It is possible that below-cost rates could affect the maximum rates in counties with a small number of centers. The inclusion of centers with below-cost rates could greatly affect maximums in those counties and put centers without outside funding sources at a disadvantage. The inclusion of below-cost centers is less likely to affect maximum rates in the Twin Cities metropolitan area, since there are a considerable number of centers in the Twin Cities area.

²¹ Preschools are typically open for two to three hours per session and charge session rates rather than hourly rates. Unlicensed school-based centers are typically open for three hours before school and three to four hours after school. According to the department, they usually charge rates that are not based on hours or would be difficult to convert to hourly rates.

Available information does not suggest that below-cost rates are a major problem. We were able to identify a limited number of employer-based centers that responded to the 2004 survey, but most of their rates, as surveyed by the department, appear to be relatively high. Only one casino-based center was included in the department's 2004 survey, and that center's rates were relatively high for its region of the state. We identified one tribal-based child care center that reported low rates during previous surveys, but that provider has since gone out of business.

The department is currently conducting research into the amount and nature of the nongovernmental subsidies received by a sample of child care centers across the state. This research may help provide future direction on this issue.

Required Number of Rates from Licensed Family Home Providers

Currently, the department requires that at least four licensed family home providers in a county must report hourly rates in order to set a county-based hourly maximum. For daily and weekly maximums, the department also requires four providers in the Twin Cities metropolitan area. But, elsewhere in the state, the department has additional requirements. In outstate Minnesota, there may be as few as four providers with rates in order to set daily (or weekly) maximums if at least 50 percent of the providers responding to the survey had daily (or weekly) rates. If fewer than 50 percent had daily (or weekly) rates, then the department requires rates from 40 providers as long as 30 percent responded with daily (or weekly) rates. If fewer than 30 percent had daily (or weekly) rates, then daily (or weekly) maximums are based on hourly maximums.

In our view:

- **The department's more stringent requirements for establishing daily and weekly maximums for licensed family home providers in outstate Minnesota are inappropriate.**

It seems illogical that the department would require a greater number of rates and a higher response rate in small counties than it would require in the Twin Cities metropolitan area. As mentioned previously, the department set maximum rates for licensed family home providers in Washington County even though the department had rate information from only 7 percent of the providers in the county.

One reason for requiring a larger response in outstate Minnesota might be that licensed family home providers there are somewhat more likely to have hourly but not daily or weekly rates. For example, about 67 percent of the outstate providers reporting rates for toddler care in 2001 had only hourly rates, compared with 47 percent in the Twin Cities metropolitan area. But, in our view, the difference in rate practices between the Twin Cities area and the rest of the state is not sufficient to justify such vastly different response requirements.

RECOMMENDATION

The Department of Human Services should revise its requirements for the number of rates needed in each county in order to set maximum daily or weekly rates for licensed family home care.

Reasons for Problems

It is not entirely clear why the Department of Human Services uses inappropriate methods in setting some maximum rates and has other problems with its survey. One explanation is that:

- **The Department of Human Services relies too much on a consultant to analyze rate information and set maximum rates and does not have “hands on” experience in collecting or analyzing the data.**

The Department of Human Services has not adequately reviewed the maximum rates calculated by its consultant.

The department uses child care resource and referral agencies to collect rate information and hires a consultant to analyze the data and set maximum rates. The consultant also provides rate and other information for use in fiscal analyses of proposed legislative changes to the program. Department staff generally do not work directly with the rate data as we did during this study. As a result, department staff did not appear to be aware of a number of problems with the survey and with the setting of maximum rates until we mentioned the problems.

In addition, the department may not have been fully aware of the protocol used by the consultant to set rates. The department was not able to present us with the complete protocol when we requested it. On several subsequent occasions, the department provided us with revisions to the protocol when we questioned whether the consultant had followed the protocol we had been given.

There are other possible reasons for the problems. Department and program managers have suggested that examining the survey and maximum rate methodology have not been high priority items. Given their other responsibilities, program staff have not had enough available time to review the work done by the consultant and the child care resource and referral agencies. In addition, managers have suggested that the methods used to calculate maximum rates may reflect the program’s direction prior to 2003. They feel that the program previously was intended to encourage the use of centers and was not focused on fiscal constraint. Since 2003, the Legislature has made fiscal constraint a priority in the program, but the methods for setting maximum rates still reflect the previous priorities of the program to some extent.

We think that the department is overly dependent on others to collect and analyze rate information. The department may have the internal expertise to analyze rates but may not be in the best position to collect rate information. Child care resource and referral agencies work with child care providers, keep track of these providers, and are capable of collecting appropriate rate information with adequate direction from the department.

RECOMMENDATION

The Department of Human Services should consider whether it would be feasible and cost effective for the department to perform the rate analyses currently conducted by a consultant. Even if the department retains its consultant, department staff should become more familiar with the rate information being reported and adequately review the work of the consultant and the child care resource and referral agencies.

COMPARISONS WITH OTHER STATES

Available information from the federal government suggests that Minnesota’s maximum rates for child care centers are among the highest in the nation, particularly for centers in the largest urban areas of each state. Maximum rates for Hennepin County appear to be higher than those for the largest urban area in every other state.²² However, as Table 2.12 indicates:

- **Minnesota’s relatively high maximums for center-based care do not appear to be due to the methods used to calculate maximum rates.**

Minnesota's maximum rates for child care centers may be high compared with other states because market rates are higher in Minnesota.

Table 2.12: State Methods for Calculating Maximum Reimbursement Rates, 2004

<u>Calculation of Maximum Rates</u>	<u>Number of States</u>	<u>Percentage of States</u>
Above the 75th Percentile	1	2%
At or Above the 75th Percentile	1	2
At the 75th Percentile ^a	24	48
At or Below the 75th Percentile	4	8
Below the 75th Percentile	<u>20</u>	<u>40</u>
Totals	50	100%
<u>Year of Rate Survey Used in Calculation</u>		
2003	21	42%
2002	11	22
2001 ^a	7	14
2000	7	14
Earlier than 2000	<u>4</u>	<u>8</u>
Totals	50	100%

^aThis category includes Minnesota.

SOURCE: Office of the Legislative Auditor analysis of information from Karen Schulman and Helen Blank for the National Women’s Law Center, *Child Care Assistance Policies 2001-2004: Families Struggling to Move Forward, States Going Backward* (Washington, D.C.: September 2004), 15.

22 United States Department of Health and Human Services, Administration for Children and Families, *Child Care and Development Fund: Report of State Plans FY 2004-2005* (Washington, D.C.: October 2004), 84-94.

Like many states, Minnesota sets maximum reimbursement rates based on the 75th percentile of market rates. At least half the states set rates at or above the 75th percentile. In addition, Minnesota is using a survey that is older than those used by most states. As a result, one might expect Minnesota's maximum rates to be no higher than the average state.²³

The main source of Minnesota's high center-based maximums in the Twin Cities area may be relatively high market rates at child care centers. The evidence of high market rates comes from a 2000 study by the Children's Defense Fund.²⁴ Data from the study indicate that among centers in the largest urban area in each state, the average annual cost of child care in St. Paul, Minnesota was higher for a four year old in 2000 than all comparison urban areas except Boston and New York. For a 12-month old infant, the annual cost in St. Paul was higher than all comparison urban areas except Boston. The cost of licensed family care in St. Paul was also higher than that for most urban areas but was surpassed by the costs in urban areas in six other states. Similarly, the report compared the cost of care in rural areas. The cost of care in Clay County, Minnesota was above the cost for most of the rural areas in other states examined in the report.

It is unclear why Minnesota's child care rates are higher than those in most other states. But, Minnesota's higher than average incomes and its very high participation rate of women in the workforce might explain the relatively high child care rates. Both higher income and greater workforce participation would tend to increase the demand for child care and thus increase rates. In addition, a higher participation of women in the workforce may also result in fewer women choosing to provide child care in their homes. The Legislature may wish to have the Department of Human Services conduct additional research regarding Minnesota's child care rates.

²³ It is not known whether there are other methodological reasons why Minnesota maximums are higher than those in other states.

²⁴ Karen Schulman, Children's Defense Fund, *The High Cost of Child Care Puts Quality Care Out of Reach for Many Families* (Washington, D.C.: 2000).

SUMMARY

Most child care centers do not appear to raise their rates to take advantage of the maximum reimbursement available from the Child Care Assistance Program. However, an unexpectedly high percentage of licensed family home providers charge the maximum rate for subsidized care. While the reasons for this are unclear, the Department of Human Services needs to examine whether some providers are charging rates higher than they are entitled to charge. Legal non-licensed providers almost always charge the maximum rates, but that is not surprising. These providers care for children of relatives and no more than one unrelated family, and most do not have regular rates.

Evidence from a 1999 study suggests that subsidized families in Minnesota choose child care centers, the most expensive form of care, more often than the general public. But, this evidence is somewhat inconsistent with the results from a 1997 Urban Institute study. In addition, families who receive child care subsidies in Minnesota are less likely to use center-based care than subsidized families in other states.

The freeze on maximum rates established by the Legislature in 2003 has reduced access to child care. But, in early 2004, subsidized families could still use about half of the child care centers and about two-thirds of the licensed family homes in the state without paying more than their required co-payment. Access to affordable child care may decline more before the freeze on maximum rates expires in July 2005.

The 2005 Legislature will face an important decision affecting the future of the Child Care Assistance Program. The two-year freeze on maximum reimbursement rates put in place by the 2003 Legislature expires on June 30, 2005. Continuing budget concerns may cause legislators to consider options for constraining the future growth of child care subsidies.

This chapter does not attempt to examine options for cost control. The 2003 Legislature asked the Department of Human Services to consider options and make recommendations by January 15, 2005. Instead, in this chapter, we examine certain issues that may impact the decisions legislators make about the future of

the Child Care Assistance Program. In particular, we address the following questions:

- **How do providers respond to maximum rates? Do they typically charge the maximum rate allowed by the state?**
- **Do families who receive child care subsidies tend to select the most expensive care available within the maximum rates? What do available data suggest about how the type of child care used by subsidized families differs from that used by other families?**
- **Although the state sets maximum rates based on the 75th percentile of market rates, what percentage of providers can a program participant access without any additional cost besides a co-payment by the time that the maximum rates are implemented?**
- **How has the freeze on maximum rates affected the access of participants to child care?**
- **What are the advantages and disadvantages of using alternative methods for calculating maximum reimbursement rates? Would setting combined, rather than separate, maximum rates for child care centers and family home providers be feasible and legal given federal laws and regulations?**

PROVIDER INCENTIVES

Some legislators have been concerned that too many providers charge the maximum reimbursement rate for subsidized care.

Some legislators have raised concerns that maximum rates for child care quickly become the rates charged by most providers, even though they are only intended to limit the rates that the Child Assistance Program will pay for subsidized care. If providers raise their rates, they do not risk losing subsidized customers as long as their rates do not exceed the maximum. But providers who raise their rates may risk losing private-pay customers. As a result, the providers with the greatest incentive to increase their rates to the state's maximum reimbursement rates are those with a high percentage of children in the state's Child Care Assistance Program.

Our ability to examine provider behavior in a comprehensive manner is limited for several reasons. First, the state lacks the data necessary to identify providers with a high percentage of children who receive subsidies. The Department of Human Services currently does not have information on how many children served by each provider are from the Child Care Assistance Program. Without this information, we cannot determine the extent to which these providers raised their rates to the maximum. Second, the providers who participated in the 2002 and 2004 surveys could not be matched with their responses from the 2001 survey. The department did not maintain data on the names of providers responding to the 2001 survey. As a result, we could not determine how much individual providers increased their rates.

Our ability to examine provider charges is somewhat limited by the lack of relevant data.

However, we were able to examine overall changes in the rates reported to the state between 2001 and 2004. The survey data on market rates help to indicate whether there have been a large number of providers at the maximum rates. Furthermore, the data show how the number of providers at the maximum rates changed following the implementation of new maximum rates in July 2002.

In addition, we compared the rates paid for child care assistance during the first half of 2004 with the rates reported by providers during the rate survey conducted by the state between February and April of 2004. A comparison of payment rates billed by providers serving program participants and market rates of all providers would indicate whether providers serving program participants were more likely to charge rates at or above the maximum than providers serving the general public.

Because the Department of Human Services does not have statewide payment data on child care assistance payments, our analysis was limited to 39 of the state's 87 counties. We examined payments from Hennepin County, as well as the 38 counties that had all of their child care assistance payments made by the state's payment system.¹ Altogether, these 39 counties had about half of the children participating in the Child Care Assistance Program.² Our comparison of payment and rate data was limited to the first half of 2004, because of the availability of data. Rate data were available from the 2001, 2002, and 2004 surveys. But, none of the counties using the state's payment system had all of their payment information on the system before mid-2003. As a result, complete payment data for these counties was not available from the state's system for critical time periods such as the periods just before and after the state set maximum rates in July 2002.

Child Care Centers

When we reviewed payment and rate data for child care centers, we found that:

- **The Child Care Assistance Program probably does not induce most child care centers to increase their rates to the maximum rate.**

Data from rate surveys suggest that child care centers typically increase their rates each year but generally do not increase their rates to the maximum rates. Rate survey data from 2004 indicate that the percentage of child care center rates that were at the maximum was relatively small (about 12 percent). As Table 3.1 shows, the percentage of rates at the maximum has not changed much in recent years. We consider this percentage of rates at the maximum to be small because it is normal for some rates to be at the maximum. For example, the vast majority of providers tend to charge hourly rates at 25-cent intervals, such as \$4.00, \$4.25,

¹ As of July 1, 2004, the state's computerized payment system—also known as the Minnesota Electronic Child Care Information System (or MEC³)—made all the assistance payments in 38 counties, as well as some of the payments in another eight counties. Counties not using the state's system are responsible for making payments to providers used by their residents.

² All of the MFIP participants and about three-fourths of the basic sliding fee participants are included in the payment data. The data do not include about one-fourth of the county's basic sliding fee participants because the Greater Minneapolis Day Care Association (GMDCA) administers that portion of the county's program. The GMDCA could not provide us with payment data that included the units of service—hours, days, and weeks—for which payments were made.

Table 3.1: Provider Rates Compared With Current Maximum Rates, 2001-04

	Year of Provider Rate Survey		
	2001	2002	2004
Child Care Center Rates			
Percentage of Rates			
Less than maximum rate	68%	59%	39%
Equal to maximum rate	13	11	12
Greater than maximum rate	18	30	49
Licensed Family Care Rates			
Percentage of Rates			
Less than maximum rate	61%	50%	40%
Equal to maximum rate	22	27	29
Greater than maximum rate	17	23	31

NOTES: The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because overall licensed capacity for these providers does not vary much and information on capacity by age group is not available.

For both types of providers, we averaged the percentage figures across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties and recipient data from the Minnesota Department of Human Services.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

However, available data suggest that the program does not cause most child care centers to increase their rates to the maximum rate for subsidized care.

\$4.75, and \$5.00 per hour. As a result, there tends to be a group of providers at a number of these 25-cent intervals. The 75th percentile of rates, and thus the maximum rate, is likely to be set at one of these rates that is charged by a number of providers. The relatively small percentage of rates at the maximum may reflect the minor influence that the subsidized program has on the rates of most providers. Those providers with a modest percentage of children from the Child Care Assistance Program cannot increase their rates without affecting their other customers.

The percentage of center rates that exceeded the maximum grew from 18 percent in 2001 to 49 percent in 2004. But most of this growth can probably be explained by inflationary rate increases typical of the service sector of the economy. Between fall 2001 and early 2004, child care center rates increased by an average of about 4 percent per year, slightly more than the 3 percent annual inflation rate in the service sector.³ At the same time, maximum rates for child care centers were unchanged. As a result, the inflationary growth in rates caused rates at a significant number of centers to increase past the maximum reimbursement rates. It is possible that the average increase in rates masks large increases by individual providers that may have been influenced by the maximums set by the state. But,

³ We compared increases in child care center rates with the increases in the Bureau of Labor Statistics' Consumer Price Index (for Urban Consumers) for services.

other than some anecdotal evidence, we lack the data necessary to isolate providers that primarily serve children who receive child care subsidies.

A comparison of payment and rate data shows that the percentage of actual child care center payments at the maximum does not appear unusually high in relation to the share of market rates at or above the maximum. In the 39 counties we examined, about 55 percent of payments for services during the first half of 2004 were at the maximum rate. As Table 3.2 shows, this is less than the percentage of provider rates reported in the survey from the same counties that were equal to or greater than the maximum (about 63 percent). Most of this difference was due to Hennepin County. The percentage of payments at the maximum rate (56 percent)

Table 3.2: Comparison of Child Care Payments with Provider Rates for Selected Counties, 2004

In fact, fewer payments to child care centers are made at the maximum rate than one might expect from examining provider rates.

	<u>Provider Rates</u>	<u>Payments</u>
Child care centers		
Percentage of rates:		
Less than 50 percent of maximum rate	1%	6%
50 to 69 percent of maximum rate	6	10
70 to 79 percent of maximum rate	5	4
80 to 89 percent of maximum rate	8	8
90 to 99 percent of maximum rate	17	16
Maximum rate or above	63	55
Licensed family providers		
Percentage of rates:		
Less than 50 percent of maximum rate	0%	2%
50 to 69 percent of maximum rate	4	3
70 to 79 percent of maximum rate	5	3
80 to 89 percent of maximum rate	17	8
90 to 99 percent of maximum rate	13	8
Maximum rate or above	61	75

NOTES: This table is based on rate survey and payment data from Hennepin County and 38 MEC² counties. The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because overall licensed capacity for these providers does not vary much and information on capacity by age group is not available.

For both types of providers, we averaged the percentage figures for survey rate data across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties.

To determine the percentage of payments in each of the above categories, we first calculated the percentage for each unit type. Then we averaged across unit types based on the estimated hours of service billed under each unit type, as we did for the survey rate data.

We excluded payments for special needs children in all 39 counties. We also excluded Hennepin County payments for special programs that pay non-standard rates.

SOURCE: Office of the Legislative Auditor analysis of rate survey and MEC² child care payment data from the Minnesota Department of Human Services and child care payment data from Hennepin County.

in Hennepin County was less than the percentage of rates at or above the maximum (66 percent).⁴

It appears that the system of setting maximum rates for centers limits the state's costs without creating significant incentives for providers to increase their rates to the maximum rate. There may be some child care centers that increase their rates to the maximum rates because they primarily serve children in the Child Care Assistance Program. But our findings suggest that there may not be a significant number of child care centers that serve mostly subsidized families.

Licensed Family Home Providers

We also reviewed rate and payment data on licensed family home providers. We found that:

- **Licensed family home providers were more likely to have rates at the maximum reimbursement rates than child care centers, but fewer had rates above the maximums.**

About 29 percent of licensed family home providers had rates equal to the maximum reimbursement rates in early 2004, compared with only 12 percent of child care centers. In addition, the percentage of licensed family home providers with rates equal to the maximums has increased modestly since before maximum rates were last increased in July 2002. As Table 3.1 indicates, the percentage of licensed home providers whose rates were at the maximum increased from 22 percent in the fall of 2001 to 27 percent in the fall of 2002 and to 29 percent in early 2004. The relatively high percentage of licensed family home providers with rates at the maximums might suggest that providers are influenced by the state's reimbursement system. However, there are other factors that could explain the relatively high percentage of rates that were at the maximum. First, within a county or region, licensed family child care rates tend to cluster within a narrower range than child care center rates because there are fewer differences in services offered. Second, family providers that were already at or slightly below the maximum in 2001 may have been reluctant to increase their rates above the maximum in 2004 because they did not want to risk losing their customers. In fact, licensed family providers raised their rates above the maximum less often than child care centers. For example, about 31 percent of licensed family provider rates exceeded the maximum in 2004, compared with 49 percent for child care centers.

We also examined payment data for Hennepin County and the 38 counties relying exclusively on the state's payment system. Payment rates during the period January 2004 through June 2004 were compared with provider rates reported to

⁴ We have some concerns about the accuracy of the payment data, particularly the payments that appear to be at rates less than 50 percent of the maximum rates. For example, in Hennepin County, payment data showed that 7 percent of the payments were at rates less than half of the maximum rates, while the survey indicated that no child care centers had rates that low. It is possible that some or all of these payments were made at higher rates than the data seem to indicate or that they reflect adjustments to prior payments and should not be included in the payment data. Even if all of these payments were at the maximum rate, the evidence would still show a slight tendency for child care centers to charge the state rates that were lower than those paid by the general public.

the state during the rate survey conducted between February and April 2004. We found that:

- **A higher percentage of the payments to licensed family home providers were at the maximum rate than one would expect from rate survey information.**
- **This difference raises concerns about provider behavior, particularly in some parts of the state. However, it is not clear what explains the higher share of payments at the maximum rate.**

As Table 3.2 shows, about 75 percent of the payments made to licensed family home providers in these 39 counties during the first half of 2004 were at the maximum rates. In contrast, the rate survey suggests that about 61 percent of the rates were at or above the maximum rates. In seven of the counties, the difference between payments and rates was substantial. For example, in Hennepin County, about 84 percent of the actual payments to licensed family home providers were at the maximum rates during the first half of calendar year 2004. The 2004 rate survey indicated that only 58 percent of providers in Hennepin County had rates equal to or greater than the maximum rates. Similarly, in six of the MEC² counties, the difference between the percentage of payments made at the maximum and the percentage of rates at or above the maximum was at least 20 percentage points.⁵

In 7 of the 39 counties we examined, significantly more licensed family home providers received the maximum payment than one would expect from rate survey information.

It is not clear why the difference between payments and survey rates was so large in these seven counties. There are two explanations that seem more plausible than others. First, it is possible that there are a significant number of licensed family providers in these counties that mostly serve children from the Child Care Assistance Program. These providers may recognize that they can raise their rates to the maximum without losing many of their customers.

Second, providers may have billed the maximum rate to the state even though they reported lower rates during the 2004 survey. Providers are required to bill the state the same rates they charge the general public if those rates are less than the maximum.⁶ Providers with rates below the maximum rates may be able to bill the maximum rates if neither the state nor counties check a provider's rate before paying a bill.

There are other possible explanations. First, it is possible that some providers raised their rates after reporting rates during the 2004 survey. Payment data for the months following the survey would then include payments at higher rates than were reported during the survey. Second, it is possible that payment data were not representative of all payments made in a county. For example, in Hennepin County, we could not include those payments made by the Greater Minneapolis Day Care Association. In one of the six MEC² counties with an unexpectedly high percentage of payments at the maximum rate, the state did not begin processing all of the county's payments until April 2004. Some of the payments

⁵ In 26 of the 39 counties, the percentage of payments at the maximum rate exceeded the percentage of rates at or above the maximum rates. However, in 11 counties, the percentage of payments at the maximum was less than the percentage of rates at or above the maximum. In two counties, the payment percentage was about equal to the rate percentage.

⁶ *Minn. Stat.* (2004) §119B.13, subd. 4.

to providers in that county from January through March 2004 would not have been included in the payment data we examined. Finally, it is possible that the rate data for a county was not representative of rates throughout the county. This seems unlikely, however, since the 2004 rate survey included rates from a high percentage of licensed family home providers in each county.

Even if it is true that the setting of maximum rates induces some licensed family home providers to raise their rates to the maximums, we think the rate setting system serves a useful purpose. The setting of maximum rates clearly limits the state's payments. Providers with rates above the maximum cannot charge more than the maximum rate for subsidized care. It may be difficult to eliminate the incentive for some providers to raise rates to the maximums without creating additional problems.

However, it is possible that some providers are billing the maximum rates even though they are not entitled to the maximums.⁷ Providers are required to file their rate information with counties prior to receiving any payments from the program and are required to update that information with the counties whenever their rates change.⁸ It is not clear that all counties receive and use this information when processing child care assistance payments to providers. The Department of Human Services instructs counties regarding how payments should be calculated. But the department does not provide counties with any direction about how to maintain and use the rate information they receive from providers.

It is not clear why so many licensed family home providers charge the maximum rate in certain parts of the state.

In addition, the state's MEC² payment system does not include information on a provider's rates that can then be compared with the rate the provider is charging to the program. The Department of Human Services is considering changes in the system that would add information about the rates reported to the counties. Effective use of that information would require counties to input the rate information reported to them by providers into the MEC² payment system on an ongoing basis.

We think that the Department of Human Services should conduct some additional research into this issue. Although counties do not bear any additional costs if incorrect payments are made to providers, the Department of Human Services is relying on counties to ensure compliance with rate policies. The department needs to examine what counties are doing to ensure compliance and whether noncompliance with this policy is a significant problem. The department could examine some of the same data we reviewed. That data would help to identify parts of the state where there may be a problem, although the data we examined only covers only 39 of the state's 87 counties.

The department could also do a limited audit of a select number of providers in those areas where billing the maximum rate is standard practice for licensed family home providers. The results would help determine whether billing practices are a problem. If the results show significant noncompliance problems, the department should expand its auditing efforts, enlist the help of counties, and

⁷ Providers that charge private unsubsidized customers a rate that is below the maximum cannot legally charge the maximum rate for subsidized care. They should instead charge the program the same rate they charge private customers.

⁸ *Minn. Rules* (2003) ch. 3400.0120, subp. 1a.

The Department of Human Services should make sure that providers are only charging the maximum rate when they are entitled to it.

make sure that other providers are aware that those not complying with billing policies are at risk.

RECOMMENDATION

The Department of Human Services should examine whether there is a problem in some counties with providers charging the Child Care Assistance Program a higher rate than they charge the general public.

Legal Non-Licensed Providers

The only data on rates charged by legal non-licensed providers comes from actual payment data because the state provider rate surveys do not include legal non-licensed providers. We examined the payment data from Hennepin County and the 38 counties that participated in the state's payment system and found that:

- **The maximum rate set for legal non-licensed providers almost always becomes the rate charged.**

Payment data indicate that less than 5 percent of legal non-licensed providers from these 39 counties charge less than the maximum. This result is expected since most legal non-licensed providers do not have regular rates. They may provide care only for children of relatives and no more than one unrelated family.

PARTICIPANT CHOICES

Legislators have also expressed concerns about how the setting of maximum rates affects the decisions made by program participants. One concern is that participants may be more likely to select the most expensive type of child provider—namely child care centers—because participant's costs do not increase unless the provider charges more than the maximum rate. For example, in Hennepin County, a participant pays \$15 more per week to select a licensed family home provider at the 90th percentile than a licensed child care center at the 75th percentile.⁹ But the center costs taxpayers significantly more because the maximum allowable rate for the center is \$184 while the maximum for the family home provider is \$135. This situation has caused some legislators to wonder if participants in subsidized programs receive child care that is more expensive and of better quality than higher-income families who are not eligible to participate in the program.

A second concern is that participants do not have a financial incentive to select care at rates below the maximum rates set by the state. While participants face higher costs for care at rates above the maximums, their out-of-pocket costs are the same for any rate at or below the maximum rate. As a result, some wonder whether participants are apt to select care at or close to the maximum rates,

Some legislators have been concerned that the program lacks sufficient incentives for participants to select less costly care.

⁹ In 2001, a family provider at the 90th percentile of family provider rates in Hennepin County charged \$150 per week, or \$15 more than the maximum of \$135. A center at the 75th percentile of center rates in Hennepin County charged \$184 per week, which was the same as the maximum rate.

perhaps because participants might think that more expensive care is higher quality care. That behavior would cost the state more than if participants selected providers in a manner more like unsubsidized families.

In this section, we first examine how the type of care used by program participants differs from that used by unsubsidized families. In particular, we examine the percentage of subsidized and unsubsidized families that use child care centers. Second, we consider whether program participants use child care centers that are more expensive than those used by the general public. We also analyze how the costs of licensed family home care used by participants differ from the costs of care used by the general public. Finally, we compare the rates paid by the state for legal non-licensed care to rates paid by the general public.

Type of Care

Information from a 1999 study suggests that program participants are more likely to use child care centers than the general public.

To examine whether subsidized families are choosing more expensive forms of care than other families, we looked at studies that have surveyed Minnesota families regarding their child care arrangements. In addition, we looked at comparisons of the type of care selected by families receiving child care subsidies in Minnesota and other states. We found:

- **Evidence from a 1999 study suggests that subsidized families in Minnesota use child care centers more than other families. Nevertheless, families in Minnesota’s Child Care Assistance Program use centers significantly less than families in subsidized programs in other states.**

Data from a sample of Minnesota families surveyed in 1999 by the Wilder Foundation suggest that subsidized families are more likely to use child care centers than other families.¹⁰ As Table 3.3 shows, 38 percent of families who said they received government subsidized child care used centers as their primary child care arrangement, compared with 20 percent for other families.¹¹ Unsubsidized families were more likely to use relative care, self-care, and activities.¹²

Among families who did not receive government subsidized child care, higher income families tend to use child care centers more than lower income families. For example, we found that unsubsidized families with incomes less than or equal to 200 percent of the federal poverty level used centers less often than unsubsidized families with incomes greater than 200 percent of the federal poverty level (12 percent compared with 23 percent).

But the results also suggest that subsidies make a greater difference than income in the use of child care centers. Not surprisingly, families participating in the Child Care Assistance Program use centers more than unsubsidized families with

¹⁰ The data we analyzed was prepared for the report: Wilder Research Center, *Child Care Use in Minnesota, Report of the 1999 Statewide Household Child Care Survey*, (St. Paul, MN: January 2001).

¹¹ The difference is statistically significant at the 99 percent confidence level.

¹² Relative care includes care by grandparents and siblings but does not include care by parents or stepparents. Activities include lessons, clubs, sports, community recreation, camp, and church activities.

Table 3.3: Primary Child Care Arrangement Used by Subsidized and Unsubsidized Families, 1999

	Government Subsidized Child Care (N=108)	No Government Subsidy (N=1,229)
Child care centers	38%	20%
Formal home-based care	31	25
Relative care	18	30
Informal	9	11
Self care	3	7
Activities	1	7

NOTES: The results include all child care arrangements except K-12 school during the regular school day and parental care. They are based on the youngest child from surveyed households with at least five hours of child care during the study week. The Wilder category for child care centers is similar to the center category used by the Department of Human Services (DHS). However, other Wilder categories do not correspond with categories used by DHS. The Wilder category "formal home based care" includes licensed family child care and some legal non-licensed care. The Wilder category "relative care" includes care by grandparents (legal non-licensed for DHS) and siblings (not eligible to provide subsidized care if they are less than 18).

SOURCE: Office of the Legislative Auditor analysis of data from the Wilder Research Center's 1999 child care survey.

similar incomes because the program substantially reduces the cost of center care. But these program participants also used child care centers more often than unsubsidized families with incomes greater than 200 percent of the federal poverty level.

However, the evidence that subsidized families are more likely to choose center care than unsubsidized families with higher incomes is not conclusive for several reasons. First, some of the results of the Wilder survey appear to be inconsistent with a 1997 study by the Urban Institute.¹³ The Urban Institute study found substantially higher use of child care centers by families with incomes above 200 percent of the poverty level than did the Wilder study (58 percent compared with 30 percent among children less than 5 years of age). Also, it found that low-income families (incomes below 200 percent of the poverty level) used child care centers much less often than higher income families (29 percent compared with 58 percent), while the data from the Wilder study indicate that use of centers was not significantly different between low and high-income families (19 percent compared with 23 percent). The Urban Institute study, however, did not directly compare subsidized families with other families. Low-income families are not a good proxy for subsidized families because data from the Wilder study indicate that most low-income families did not receive child care subsidies.

Second, while subsidies may cause greater use of child care centers, the use of centers by participants in Minnesota's Child Care Assistance Program is substantially lower than in most other states. In federal fiscal year 2001, only 33 percent of the children in Minnesota's program used licensed child care centers compared with 56 percent of the children receiving subsidized care nationwide.

But the evidence from the 1999 study is in part contradicted by an earlier study.

¹³ Kathleen Snyder and Gina Adams, The Urban Institute, *State Child Care Profile for Children with Employed Mothers: Minnesota* (Washington D.C.: February 2001).

Children in only six states used licensed child care centers less than children in Minnesota. As Table 3.4 shows, children in Minnesota's program were more likely to use licensed family home providers and unlicensed care than children receiving subsidized care in other states.

Program participants in Minnesota are much less likely to use child care centers than subsidized families in other states.

Table 3.4: Type of Subsidized Child Care Used in Minnesota and Other States, Federal FY 2001

Type of Care	Minnesota	National Average
Licensed Center	33%	56%
Unlicensed Center	<u>3</u>	<u>2</u>
Subtotal: All Centers	36%	58%
Licensed Family Home	29%	14%
Licensed Group Home	<u>0</u>	<u>4</u>
Subtotal: Licensed Home	29%	18%
Unlicensed Care by Relative	12%	13%
Unlicensed Care by Non-Relative	<u>22</u>	<u>12</u>
Subtotal: Unlicensed Care	34%	25%
Totals	100%	100%

SOURCE: United States Department of Health and Human Services, Administration for Children and Families, *FFY 2001 CCDF Data Tables and Charts*; <http://www.acf.hhs.gov/programs/ccb/research/01acf800/setdet6.htm>; accessed August 5, 2004.

Finally, the evidence from the Wilder study is at least five years old. Child care use, as well as participation in the Child Care Assistance Program, may have changed with time over the last five years. For example, the use of legal non-licensed care by subsidized families has increased somewhat in recent years. The Department of Human Services is currently sponsoring another Wilder survey on the use of child care by Minnesota families in 2004. Unfortunately, data collection for the 2004 Wilder survey was not completed in time for inclusion in our study.

Cost of Care

Our comparisons of the costs of care used by participants and the general public are based on the same data we used to examine whether providers set their rates at the maximums. Table 3.2 shows whether program participants tended to use providers with rates at or above the maximum more often than the general public.

Child Care Centers

The data on child care centers indicate that:

- **The child care centers used by program participants were slightly less expensive than those used by the general public.**

Program participants seem to use more centers with rates below the maximum rate than the general public and fewer centers that charge rates at or above the maximum rate. In addition, if participants use centers charging more than the maximum, the state's cost are limited to the maximum rate. For participants, the

choice of a child center does not seem to depend on the center's rate as long as the rate is below the maximum rate. Participants may focus more on other factors such as familiarity with the provider and proximity to work or home when selecting a child care provider.

Licensed Family Home Providers

We also compared the cost of licensed family home care used by program participants with the cost of care used by the general public. As Table 3.2 indicates:

- **Program participants were generally more likely to use licensed family home providers that had rates at or above the maximum rates than the general public.**

In the 39 counties we examined, 75 percent of the payments were at the maximum rate, while 61 percent of the providers' rates were at or above the maximum. In seven of those counties, the percentage of payments at the maximum rates was more than 20 percentage points higher than the percentage of providers with rates at or above the maximum.

However, it is not entirely clear that participants use more expensive care than the general public. For subsidized care paid at the maximum rates, we do not know what share of the payments was for providers with rates above the maximums but limited to billing the maximum rates. Because of the additional out-of-pocket costs, participants may use care above the maximum rates less than the general public. In any event, the state's costs are capped at the maximum rate. If participants use care at rates above the maximums, the state does not pay any portion of the additional costs.

We suspect that the tendency of program participants to use licensed family home care at or above the maximum rates is not primarily due to deliberate choices on the part of participants. The more likely explanation is that providers choose to charge the maximum rate and participants have no financial incentive to look for another provider as long as the rate is no higher than the maximum.

Legal Non-Licensed Providers

We know approximately what the Child Care Assistance Program pays for legal non-licensed care. The vast majority of payments are made at the maximum rate. In fiscal year 2003, the maximum hourly rates varied from \$1.58 in seven rural counties to \$5.00 in several Twin Cities area counties. As a result of 2003 legislation, maximum rates for legal non-licensed care were reduced in fiscal year 2004. The maximum hourly rates now range from \$1.40 per hour to \$2.48.

The only current evidence of what the general public pays for non-licensed care comes from the 1999 child care survey conducted by the Wilder Research Center. Data from this survey show that unsubsidized families often did not pay for informal child care. In 1999, 79 percent of families who did not participate in a government subsidized child care program and regularly used grandparent care did not pay for such care. About 45 percent of unsubsidized families who

regularly used informal care by nonrelatives did not pay for the child care. Among unsubsidized families who did pay for non-licensed care, the median rate in 1999 was \$2.00 per hour for grandparents and \$2.75 per hour for nonrelatives.

These data suggest that unsubsidized families who paid for non-licensed care in 1999 paid more than what the Child Care Assistance Program currently pays for such care. In fact, the difference may be larger due to the inflation that has occurred since 1999. However, a significant proportion of unsubsidized families receive non-licensed care from relatives and nonrelatives at no cost. As a result, subsidized care probably costs more overall than the non-licensed care received by the general public.

ACCESS TO SUBSIDIZED CHILD CARE

The freeze on maximum child care rates has raised concerns among some legislators about whether families in the Child Care Assistance Program have sufficient access to affordable child care. To understand how the freeze has affected access to child care, we used the department's survey data to examine how many providers had rates less than or equal to the maximum rate at three points in time: (1) Fall 2001—the time of the 2001 survey, which was used to set the current maximums; (2) Fall 2002—about 3 to 6 months after the current maximums were placed into effect; and (3) early 2004—19 to 22 months after the maximums were first placed into effect.¹⁴

These measures provide a limited view of access to child care because they do not take into account the location of providers in relation to where the family lives or works. Nevertheless, it gives a useful perspective on how access has changed over the past few years. Overall, they indicate that:

- **The freeze on maximum rates has reduced access to child care providers. But as of early 2004, subsidized families could still use about half of the child care centers and about two-thirds of the licensed family homes in the state without paying more than the required co-payment.**

Minnesota maximum child care rates are set so that, at the time of the survey, families can access at least 75 percent of the slots at child care centers and at least 75 percent of the family home providers in a county or other geographic area without paying more than the required co-payment. But largely because rates tend to cluster at 25-cent intervals, more than 75 percent of provider rates are at or below the maximum rates at the time of the survey. As Table 3.5 shows, the maximums based on the 2001 survey would have permitted access to about 82 percent of child care center slots and about 83 percent of family care providers if they could have been implemented at the time of the survey.¹⁵

¹⁴ During fiscal year 2003, there were no maximums in effect for child care centers in 68 counties. Beginning in July 2003, DHS used regional or statewide maximums for those counties.

¹⁵ These percentages are greater than 75 percent since rates tend to be clustered at 25-cent intervals. The 75th percentile of rates can be the same as the 85th percentile and, in some counties or regions, the 100th percentile.

Table 3.5: Trends in Access to Child Care Providers by Region, 2002-04

The freeze on maximum rates has reduced affordable access to child care providers, particularly child care centers.

	Percentage of Providers With Rates Equal to or Less Than Maximum Rate		
	Fall 2001 (Maximums Based on 2001 Survey Not Yet in Effect)	Fall 2002 ^a (First Effective Year For Maximums Based on 2001 Survey)	Early 2004 (19 to 22 Months After Maximums Were First Placed Into Effect)
Child Care Centers			
Twin Cities Metropolitan Area	80%	69%	49%
Outstate Minnesota	86	73	60
State Total	82%	70%	51%
Licensed Family Homes			
Twin Cities Metropolitan Area	81%	72%	63%
Outstate Minnesota	84	79	71
State Total	83%	77%	69%

NOTES: The percentage figures for survey rate data are averages across four child age categories and three types of units (hours, days, and weeks). We determined averages across child age categories by weighting each child care center rate by the center's licensed capacity for the applicable age group. If a center reported a rate for a particular age category but did not report the corresponding licensed capacity, we used the average licensed capacity for that age category among providers in the same region. For licensed family home providers, we used unweighted averages because we lacked data on licensed capacity for these providers.

For both types of providers, we averaged across unit types based on the estimated share of service hours billed under each unit type. We assumed days included 10 hours of service and weeks included 50 hours. To estimate the share of hours billed, we used payment data for Hennepin County and the 38 MEC² counties and recipient data from the Minnesota Department of Human Services.

^aThe figures for 2002 represent what the access would have been under the current policy for setting maximum rates. In 2002, the actual access for child care centers would have been about one percentage point higher than shown because 68 counties did not have child care center maximum rates for at least some age categories. These counties did not have enough child care centers responding to the survey to set a maximum rate.

SOURCE: Office of the Legislative Auditor analysis of data from the Minnesota Department of Human Services.

By the time these maximum rates were implemented, however, access dropped below the 75 percent standard for child care centers. Data collection for the Fall 2001 survey was completed in December 2001, and new maximum rates were implemented in July 2002. By then, some providers had already increased their rates. By Fall 2002, 70 percent of child care center rates were at or below the maximums. While access also dropped for licensed family providers by this measure, it was still a little higher than the 75 percent level in the Fall of 2002.

After the 2003 Legislature froze the maximum rates for fiscal years 2004 and 2005, access declined. In early 2004, subsidized families had access to 51 percent of child care centers and 69 percent of licensed family home providers without paying more than their required co-payment.

It is important to recognize that access may have declined even more since the survey of early 2004. The 2004 survey reflected access during the first year of the two-year rate freeze. If child care rates continued to increase during the second

year of the freeze, access would be lower in 2005 than the levels shown for early 2004.

Under the Child Care Assistance Program, families have access to a slightly higher percentage of providers in outstate Minnesota than in the Twin Cities metropolitan area, as shown in Table 3.5. For example, in 2004, subsidized families had access to 60 percent of child care centers in outstate Minnesota without paying more than the required co-payment, compared with 49 percent in the Twin Cities metropolitan area. In addition, subsidized families had access to 71 percent of the licensed family home providers in outstate Minnesota, compared with 63 percent in the Twin Cities area.¹⁶

OTHER METHODS OF SETTING MAXIMUMS

Some legislators have been interested in reducing, or at least limiting any increase in, maximum reimbursement rates for subsidized care. For some, this interest in maximum rates comes from their desire to address state budget shortfalls by reducing expenditures. For others, a reduction in maximum rates could help maximize the number of children served by the Child Care Assistance Program.

Some legislators have expressed interest in setting a "blended" maximum rate that applies to both child care centers and licensed family home providers.

Some legislators and legislative staff have raised concerns about whether the maximum reimbursement rates for subsidized child care—particularly at child care centers—are too high. As mentioned earlier in this chapter, some have suggested that the state's child care programs provide an incentive for participants to select the highest priced care available. During the 2004 legislative session, one legislative proposal would have required that the Department of Human Services establish combined, rather than separate, maximum rates for child care centers and licensed family home providers. The combined maximum would be set at the 75th percentile of market rates for all licensed providers. The purpose of a "blended rate" proposal would be to eliminate the financial incentive to select the most expensive type of child care.

Other legislators have asked whether there are other ways to reduce maximum reimbursement rates. One possible method is to calculate a maximum rate based on a lower percentile than the 75th percentile of market rates. Alternatively, Minnesota could keep rates from rising by continuing the freeze on maximum rates.

The "blended rate" alternative has an advantage over other alternatives. It would substantially change the financial incentive of participants and cause them to consider the cost of child care across different types of care. However, there are significant feasibility and policy issues regarding the desirability of blended rates. First, it would be difficult to blend rates in a fair manner. In order to calculate a blended maximum rate for a particular age group, one would need to know what

¹⁶ These figures represent the average access to child care without payment of more than the required co-payment. However, they do not reflect the fact that there are differences within outstate Minnesota and the Twin Cities area. In addition, they do not consider access from an individual participant's perspective. A participant would be interested in whether there are affordable child care providers within reasonable driving distance from the participant's home or workplace.

rate represents the 75th percentile for both types of providers combined into one group. Because child care centers tend to have much larger licensed capacity than family home providers, a fair way to combine rates from both types of providers would be to weight each provider's rates by the provider's licensed capacity for that age group. Data are available on the capacity of child centers for each age group but are not available for licensed family home providers. Each licensed family home provider has an overall capacity but has flexibility to serve various age groups. Consequently, no information is available on the licensed capacity of family home providers by age group.

However, there are significant feasibility, policy, and legal issues regarding the use of "blended" maximum rates.

Second, it is unclear whether the use of blended rates would receive federal approval. The federal government requires subsidy programs to provide participants with equal access to various types of child care, including care at licensed child care centers. If rates were blended without regard to differences in licensed capacity, a blended rate approach would provide substantially unequal access in some counties. The problem would be of particular concern in Twin Cities metropolitan area counties because of the significant differences in market rates between centers and family home providers in those counties. Some outstate counties with large differences in rates, such as Olmsted County, would also be affected. In Ramsey County, blended maximum rates for preschool care would be equal or close to the current maximums for family home care and substantially less than the current maximums for child care centers. As a result, participants would be able to access fewer than 10 percent of the child care centers in Ramsey County without additional parental cost beyond a co-payment, while participants would be able to access about 75 percent or more of family home providers without additional cost.

Whether this difference in access would trigger federal rejection of a state's plan and cause a state to lose federal funding is not clear. Federal laws and rules require equal access but do not precisely define that concept. In addition, we are not aware of any cases in which a state has adopted a blended rate method and the United States Department of Health and Human Services has reviewed that method. As a result, we cannot provide any clear guidance on whether the blended rate proposal would be acceptable to the federal government.

Finally, it is difficult to predict what would happen to families currently using child care centers if a blended rate approach were adopted. Some families would most likely switch to lower cost providers. But others might leave the program if they cannot find alternative care or are unhappy with the options available to them. It is unclear whether their exit from the program would result in additional or longer enrollments in MFIP and greater costs to the state. Even if the adoption of a blended rate approach reduced the state's costs, some observers might question whether children taken out of care at a child care center would be receiving lower quality care. In addition, a significant increase in enrollment in licensed family home care could cause rates for that type of care to increase and reduce the potential savings to the state.

Other options for reducing or limiting the increase in maximum rates have been used in other states. The federal government has allowed some states to set maximum rates below the 75th percentile of market rates. In addition, the federal government has allowed some states to use out-of-date surveys to set maximum rates. These options, while potentially available to states, also raise some policy

issues. In particular, it is unclear how program participants would respond to lower maximum rates. The effects on workforce participation, future enrollments in MFIP, and school readiness of children are not entirely clear at this time.

A more direct way of addressing concerns about the cost of care used by participants would be to restructure the participant fee used in the Child Care Assistance Program. The methods for calculating maximum rates would not change, but the structure of participant fees would change to provide participants with a consistent financial disincentive to select higher-cost providers. In lieu of a fixed co-payment, participants would pay a percentage of the costs of child care. That percentage would apply to care provided at any rate, so that participants would have some disincentive to select care at higher costs. Under the current system, participants only face that disincentive if a provider's rate exceeds the state's maximum rate. To ease the burden on lower-income families, the percentage could vary depending on family income, although lowering the percentage would reduce the disincentive for participants to select care at higher rates. This option would not directly deal with the concern about participant use of child care centers by changing the maximum rate system. However, it would provide participants with an incentive to select less costly types of care, as well as less costly providers within each type of care.

While a percentage fee system may have some merit, it may not be allowable under current federal law. States are required to have a participant fee that is based on the income and size of the participating family.¹⁷ Federal rules allow the fee to be based on income and family size, as well as other "appropriate" factors.¹⁸ In adopting federal rules governing child care assistance programs in 1998, the Administration for Children and Families in the United States Department of Health and Human Services commented that basing fees on the cost or category of care would not be allowed.¹⁹ A percentage fee system would involve higher fees for higher-priced care and thus may not be allowable under federal law.²⁰

¹⁷ 42 U.S. Code, sec. 9858c. (c)(5), and 42 U.S. Code, sec. 9858n. (12).

¹⁸ 45 CFR sec. 98.42 (b).

¹⁹ 63 Fed. Reg. 39960 (1998).

²⁰ There may be other concerns about a percentage fee system even if it is permissible under federal law. For example, there may be concern that such a system would adversely affect the quality of care and the school readiness of children currently using child care centers. In addition, it is unclear whether a percentage fee system could be designed to provide sufficient incentives while also maintaining affordable fees for participants.

List of Recommendations

- When conducting surveys of market rates for child care, the Department of Human Services should take steps to ensure that rate information is collected from an adequate number of providers in each county. The department and its consultant need to review the rate information to determine whether child care resource and referral agencies are adequately performing their duties (p. 34).
- When calculating maximum reimbursement rates for child care centers, the Department of Human Services should rely primarily on the licensed capacity data available from its Licensing Division. In some cases, the department may need to supplement these data with information gathered during the survey (p. 36).
- The Department of Human Services should become more familiar with the different types of rates reported in the 2004 survey and work with child care resource and referral agencies to ensure consistency in how rates are reported in future surveys (p. 37).
- The Department of Human Services should discontinue using converted maximums and related conversion rules to calculate maximum reimbursement rates. The department should instead consider using converted rates to set an upper limit on maximum rates (p. 42).
- Along with using converted rates to set an upper limit on maximum rates, the Department of Human Services should consider using reverse converted rates to set a lower limit on maximum rates (p. 43).
- The Department of Human Services should seek changes in state laws that would clearly allow the department to implement maximum rates based on geographic areas larger than a single county (p. 49).
- The Legislature should review the advantages and disadvantages of setting regional and statewide maximum rates for child care centers and provide policy direction to the Department of Human Services (p. 49).
- The Department of Human Services should revise its requirements for the number of rates needed in each county in order to set maximum daily or weekly rates for licensed family home care (p. 52).

- The Department of Human Services should consider whether it would be feasible and cost effective for the department to perform the rate analyses currently conducted by a consultant. Even if the department retains its consultant, department staff should become more familiar with the rate information being reported and adequately review the work of the consultant and the child care resource and referral agencies (p. 53).
- The Department of Human Services should examine whether there is a problem in some counties with providers charging the Child Care Assistance Program a higher rate than they charge the general public (p. 63).



Minnesota Department of **Human Services**

December 21, 2004

James Nobles
Legislative Auditor
Office of Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The Department of Human Services (DHS) appreciates the opportunity to respond to your January 2005 report titled “Child Care Reimbursement Rates.” We found portions of the report contained useful analysis of the rate setting process for Minnesota Child Care Assistance Program (CCAP). To the extent that the report makes recommendations in these areas, we welcome the feedback and will look for opportunities to test recommendations and implement them as appropriate.

However, overall the Department is disappointed with the report. The report does not make the necessary connection between the details of the process for setting maximum rates and the impact of the resulting rates on low-income families participating in CCAP, child care providers, and the State budget. As a result, it is not very useful for policy makers who are considering rate-setting alternatives and want to understand the implications of their decisions.

Most importantly, the Department objects to and disagrees with the report’s characterization of some practices in the rate-setting process as inconsistent with state law. As detailed below, we believe the Department complied with the law in implementing regional rates in response to the 2003 legislation requiring a rate freeze. The claim that some rate conversion policies result in maximum rates that exceed the level allowed in state law is unsubstantiated.

The Department’s specific responses to identified “Major Findings” and “Key Recommendations” follow.

Major Findings

- ***The basic methods used by the Department of Human Services to set maximum reimbursement rates for the Child Care Assistance Program are reasonable.***

The Department agrees with this finding. These methods have been developed over six years working closely with a consulting firm. That firm has 20 years experience in providing technical assistance and conducting research and data analyses for state governments, and has worked with other states on setting rates for child care assistance programs.

- ***However, the Department sometimes uses complicated rate conversion procedures that ignore important information about market rates for child care. As a result, some maximum rates exceed the levels we think are allowed under state law.***

We agree that the conversion process used by the Department needs to be reviewed and we have begun such a review, but do not agree that some rates set by the Department exceed those allowed in state law. The process for arriving at 75th percentiles is not specified in the law. Rather, the Department is instructed to calculate the maximum rates based on a survey of market rates. Given the complexity of the market rate data in any given county, and the multiple possible methodologies that could be used to arrive at maximum rates, the conclusion that some rates set by the Department exceed the levels authorized in law is unfounded.

We are generally concerned with the approach the report takes in examining our methodology for converting rates. We understand this to be a compliance audit of the Department's policies for setting maximum rates. As such, we would expect to be measured by: whether we follow the law; whether we consistently implement our own policies; and, how our policies compare with best practices in use across the nation. Instead, the focus of the report is to compare our policies with a conversion methodology created by the report authors. While the methodology may have some merit, it is untested and has not been thoroughly analyzed for unintended consequences. The report presents several cases where the alternative methodology seems to work better than the Department's current methodology, but does not make a case for how the methodology would work if applied system-wide. This makes it difficult to assess the value of the analysis provided in the report, and calls to question the validity of the findings.

- ***We question whether the Department of Human Services complied with state laws in establishing regional and statewide maximum rates for child care centers in 68 counties in July 2003. The Department of Education's prior practice of paying a provider's rate without a maximum clearly violated state statutes.***

The Department set regional rates based on authority provided in administrative rule. We believe the administrative rule is a valid interpretation of state law. Regional rates were established to implement the freeze in maximum rates that was enacted into law in 2003.

At that point, many counties had the “pay provider rate” policy in place for child care centers. Moving to regional rates for those counties allowed us to control costs as anticipated under the legislated rate freeze.

- ***In some parts of the state, an unexpectedly high percentage of licensed family home providers have billed the maximum rate for subsidized care. The reasons for this are unclear, but the department needs to examine whether some providers are inappropriately billing the Child Care Assistance Program.***

We do not believe the report makes a very strong case that providers may be inappropriately billing CCAP, and are thus unsure why the report elevates the importance of this finding. The analysis looks at the tendency of providers to charge at the maximum allowable CCAP rate. We would expect the tendency of licensed family care to be somewhere between the tendency for licensed centers and legal non-licensed care, just as the analysis found. However, we are concerned at any suggestion of impropriety and will investigate this issue. We are also already in the process of developing case management protocols for counties that would address the issue of cross-checking rates before making payments.

- ***There is some evidence that subsidized families in Minnesota use child care centers—the most expensive type of care—more often than unsubsidized families. However the use of centers in Minnesota’s Child Care Assistance Program is much lower than that for subsidized programs in most other states.***

This finding is based on a 1999 study. While this is the best evidence currently available, the study was not designed to isolate families accessing CCAP. In March 2004 the Department initiated a follow up to the 1999 study. The new study includes an over-sampling of low-income families which may provide more reliable comparisons of types of care. This report will be released in the summer of 2005.

While we dispute most of the key findings, we agree with the general direction of most of the report’s recommendations. Specifically:

Key Recommendations:

- ***The Department of Human Services should revise the methods it uses to calculate maximum reimbursement rates, particularly the methods used to convert maximums from one time period to another.***

We agree on the need to review the outcome of some of the converted rates in our current methodology. And, we agree there is likely some merit to the recommendation to use

converted maximums to set upper limits; we are examining how this methodology would work. As stated above, we are concerned the alternative methodology has not been thoroughly analyzed and it is not clear whether it would work well if used system-wide. Initial analysis suggests that it results in “proportionality issues,” e.g., hourly rates that are disproportionately high compared to the daily or weekly rates. While there may be ways to mitigate this concern, it requires more analysis.

- ***The Department of Human Services should seek changes in state laws that would clearly allow the department to implement maximum rates based on geographic areas larger than a single county.***

We believe the Department operated within the authority allowed under rule and law when implementing regional and statewide rates. We will review the statute and rule and determine whether it would be helpful to codify some rule language into statute.

- ***The Department of Human Services should become more familiar with the information reported in rate surveys. Department staff should adequately review the work of the child care resource and referral agencies that collect rate data and the consultant that analyzes the data and calculates maximum rates.***

We agree that the Department should provide closer oversight of the survey conducted by Child Care Resource and Referral agencies, revise and tighten some instructions for data collection and work with contractor to review data in more depth to ensure completeness and consistency. The agency had already taken steps to improve the process between the 2001 and 2004 surveys.

- ***The Department of Human Services should examine whether there is a problem in some counties with providers charging the Child Care Assistance Program a higher rate than they charge the general public.***

As stated above, we do not believe the report has made a very strong case that this problem exists. However, we are concerned at any suggestion of impropriety and will investigate this issue. We are also already in the process of developing case management protocols for counties that would address the issue of cross-checking rates before making payments.

Thank you for the opportunity to review and respond to this report. Child Care Assistance is an important part of Minnesota’s efforts to support working families and support the healthy development of low-income children. While we disagree with many

James Nobles
Page 5
December 21, 2004

of the report's findings and are disappointed it did not provide a clearer roadmap for policymakers, we will seek to use the information in the report to improve our rate setting processes.

Yours sincerely,

/s/ Kevin Goodno

Kevin Goodno
Commissioner



December 22, 2004

Members
Legislative Audit Commission

We are pleased that the Department of Human Services is willing to reconsider some of the methods and procedures it uses to set maximum reimbursement rates for the Child Care Assistance Program. But we are concerned about some of the department's comments in the letter dated December 21, 2004. We think that the department's response misrepresents our report in several ways.

First, the department criticizes our report for comparing the department's rate setting method with an alternative method we created. The only reason we developed an alternative method was because we found significant flaws in the department's procedures for setting maximum rates. In some situations, the department's procedures do not reflect the market rates charged by child care providers. The department uses conversion formulas and procedures that make erroneous assumptions about what providers with hourly rates would charge on a daily or weekly basis. The method recommended in the report bases conversions on the actual rates reported by providers. We think it was appropriate to develop an alternative method once we found that the department's methods have significant problems.

Second, we agree with the department that any new method needs to be analyzed before being implemented. However, the department is holding our recommendation to a higher standard than their current method. The Department of Human Services—and prior to March 2003, the Department of Education—never carefully analyzed their methods for calculating maximums. As a result, neither department was aware of the problems that we found.

We are also concerned that the department may not fully understand the methods recommended in our report. The department says that its initial analysis of our recommendations suggests that they may result in hourly maximums that are disproportionately high compared with daily or weekly rates. It is not clear how the department has reached this conclusion. It seems inconsistent with our own analysis of rates and the alternative rate setting method. We think that the maximums should reflect rate practices in local markets. If the child care providers in a county or region offer a significant discount for daily or weekly care over hourly rates, then the maximums should reflect that discount. We are willing to work with the Department of Human Services to help them understand and analyze our recommendations.

Third, the department is misinterpreting our conclusions on whether existing conversion methods comply with state law. Minnesota Statutes, Sect. 119B.13, subd. 1, requires that a maximum rate “not exceed the 75th percentile rate for like-care arrangements in the county as surveyed by the commissioner.” It also requires the department to calculate hourly, daily, and weekly maximums. Frequently, the department sets an hourly maximum based on the 75th percentile of hourly rates in the county or region and then converts the hourly maximum into daily and weekly maximums. The problem with the department’s conversion method is that it ignores the daily and weekly rates reported by providers. Sometimes, ignoring that information results in daily or weekly maximums that exceed not only the 75th percentile of daily or weekly rates but also any daily or weekly rate charged in the area. We think the department’s conversion methods sometimes result in maximums that are higher than the Legislature may have intended when setting the 75th percentile as a cap on the maximum rates. However, because the department uses the 75th percentile for one of its maximum rates and the statutes do not anticipate the types of complicated conversions used by the department, we could not conclude that the department’s methods clearly violated state statutes.

Fourth, the department suggests that our report has inappropriately elevated the importance of the finding that an unexpectedly high percentage of licensed family home providers in certain counties charge the state the maximum rate for child care. We think that the report fairly and appropriately treats this finding. We clearly state that there are several explanations for this behavior. However, one possibility is that some providers could be charging the maximum rate even though they should be charging a lower rate. Because the department does not currently have a control in its automated payment system to prevent this kind of inappropriate payment, we felt an obligation to report our finding and recommend that the department investigate this concern more thoroughly. At this time, we do not have evidence of any impropriety. But we think the information in our report suggests the need for additional scrutiny in this area.

Finally, the department appears to misunderstand the reasons why the Legislative Audit Commission directed us to examine child care reimbursement rates. The Legislative Audit Commission asked us to examine the details of how the department calculates maximum rates because some legislators were concerned about the accuracy of the information they received from the department. As a result, our study focused primarily on an analysis of the department’s current rate setting methods.

The department expresses disappointment about the usefulness of our report for policy makers and appears to expect that we would recommend alternative rate setting methods that would control costs. In Chapter 3, we discuss some of the rate setting or co-payment methods that might better control costs. Because federal regulators may not allow the use of these methods, we did not recommend these options.

We recognize that policy makers will face a decision this session about whether to allow the freeze on maximum rates to expire on July 1, 2005 as called for under current law. As a result, we present information in the report about how the freeze has affected access to affordable care by program participants. But we deliberately avoided making specific recommendations about

how maximum rates should be set in the near future. The 2003 Legislature directed the Department of Human Services to make recommendations to the 2005 Legislature for containing future cost increases in the Child Care Assistance Program. We did not examine other rate setting options in detail because we did not want to duplicate the department's efforts.

We think that our report will be useful as policy makers consider how maximum rates should be set for the Child Care Assistance Program. We think that policy makers need to be aware that the basic methods used by the department are reasonable but that the department's conversion procedures result in maximums that sometimes exceed the 75th percentile of rates.

Sincerely,

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

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