Tiered Reimbursement Q&A:
For States in the Early Planning Stages for a Tiered Reimbursement Component to their QRIS

This “frequently asked question” resource has been developed for states based on a recent conversation with Louise Stoney, co-founder of the Alliance for Early Childhood Finance. With increasing fiscal tension, state child care and QRIS administrators are challenged to find a good balance among factors of supply and cost while still emphasizing the importance of quality. Many have questions about structuring an effective reimbursement system that appropriately rewards quality. This resource is designed to assist state administrators' thinking and planning around these challenging dynamics.

How do we get started in thinking about this issue of tiered reimbursement?
It’s important first to think about the total financing for a child care program and where all the revenues come from that support the costs of a child care program – whether profit or nonprofit. The primary revenues that a typical child care provider will receive include:
- Subsidy reimbursement
- Parent tuition and fees
- Grants
- Rewards linked to quality rating systems

Child care providers have to link together these revenue streams to cover the cost of providing care to young children. Their financing plan also has to include strategies that emphasize full enrollment and full fee collection. Louise Stoney, co-founder of the Alliance for Early Childhood Finance, calls this the Iron Triangle – a formula for child care providers that looks at full enrollment, full fee collection and third party funding to cover the costs of providing early care and education to young children.

When thinking about a tiered reimbursement plan, it’s important to understand the Iron Triangle and the fact that, while tiered reimbursement may provide an incentive for a provider to move to a higher level of quality, it is only one component of the triangle and is likely not even enough to fill the gap. Moreover, as most small business owners will tell you, it is highly unlikely that you can assume the optimum level of “full enrollment” and “full fee collection”. Throughout the course of a year, there will be gaps in enrollment and fee collection. That is the reality of the business. That then leaves a bigger gap to cover the cost of maintaining a higher level of quality. So, while a tiered reimbursement is important, remember that there are other ways of providing financial rewards (such as quality grants) that can augment rates without driving up prices for non-subsidized families. Additionally, think in terms of strategies that will assist child care providers in achieving that goal of full enrollment and full fee collection to cover all the costs entailed in providing high quality early care and education. Those two sides of the triangle can make or break a program and are sometimes more important than the rates.
Some states just offer a flat rate versus a percentage tiered reimbursement rate. Does this make a difference? Is one more beneficial than another?

What matters is NOT whether it is a flat rate or a percentage but how much funding a program is receiving (it could receive some from a reimbursement rate + some from a quality grant.) The key is to make sure that whatever financial rewards are provided as part of QRIS, the level of these rewards is informed by the actual cost of providing high quality care. What does it cost to provide high quality care at each star level in your rating system? Once you know the answer to that question then you can set your tiered reimbursement levels, or other financial rewards, based on those cost assumptions. How can you determine the likely cost of each star level? Anne Mitchell, co-founder of the Alliance for Early Childhood Finance, has created economic models that take a state’s quality rating standards and then establishes budget templates for a child care center at each quality level. Once you have an estimated budget, you can factor in what a program is projected to collect in subsidies, parent fees, etc, assuming full enrollment and fee collection. If programs at higher star levels are also able to tap prekindergarten or Head Start funding this can be factored in as well. The Alliance for Early Childhood Finance has run cost models like this in several states and have found that the tiered reimbursement rates that states are setting often do not correlate well with costs. States typically offer subsidies to programs at the lower star levels that are more generous than they need to be, while programs at the higher star levels are often not receiving the funds they need to break even. In short, we often see a need to re-structure financial rewards. Four- and Five-star programs are costly. It is simply not realistic to expect that these programs can generate sufficient revenue on parent fees alone unless they serve a very high-income population. Thus, if states want children from low- or moderate-income families to have access to 4 and 5-star programs, it is essential that they understand the cost of meeting these standards and think strategically about financing.

The most important thing a state can do in planning financial incentives for its QRIS is to conduct cost modeling so that they understand what the likely costs are at each star level. Then think about how you can assist in filling the gap. Tiered reimbursement is one option. Quality grants are an additional option. Tax credits are another one – depending upon the tax structure in your state. You can structure financial rewards differently at various star levels. You can also require that programs participate in QRIS in order to receive subsidy dollars (and, over time, raise the floor as your supply of higher quality programs grows). Policies such as this will not only create a greater incentive for providers to move to the higher levels but also concentrate your subsidy dollars on a smaller pool of higher-quality providers, where you can have a bigger impact. These are just a few funding streams. There are many more potential options. Think about how to maximize all your revenue streams to support providers who want to move to the higher quality levels. The point is that the difference of flat rate vs. percentage is all about how you fill the gap. Do the cost modeling first so that you will know how big the gap is.

Are states giving higher rates at the top end?

This question goes back to the idea of cost modeling that was previously referenced. The sad truth is that most states are not giving really high rates to providers at the top end of the quality scale. They are often giving incentives at the lower level – where it may not be as needed – and not giving enough incentives beyond level 3 (in a 5-star scale) to push them higher.

But remember – tiered reimbursement alone isn’t sufficient. Tiered reimbursement, even at a higher rate, will not fill the quality cost gap at higher star levels – although it can at least help. Used with blended funding, quality rewards, wage supplements and recruitment/retention rewards, tiered reimbursement can be much more effective in helping centers attain and then maintain the highest quality rating levels.
Do states offer both tiered reimbursement and quality incentives? Yes. This is absolutely essential. Go to the link below for a snapshot of the kinds of incentives and reimbursements that states offer in their quality rating and improvement systems. 

Can a state make participation in the child care subsidy system a requirement for participation in QRIS? Absolutely. Examples of states that already do this include Maine, New Mexico, North Carolina, Oklahoma and Tennessee. You can also limit participation in the child care subsidy system to only centers at the higher levels of quality. North Carolina is an example of a state that has done that. (Caution: These strategies are only possible if you have enough “supply” at the higher quality levels to meet the need for children in subsidized care. Start building your quality, and create good data systems that allow you to map the availability of quality, before instituting such a policy.)

Does tiered reimbursement drive participation in QRIS and increase the quality levels? No. There needs to be a menu of incentives to help drive participation. Tiered reimbursement can be only one component of a multi-tiered incentive plan. States that provide a broad range of incentives and are using these to drive participation and higher levels of quality include Louisiana, North Carolina, Pennsylvania and Montana.

How do states determine the percentage differences in tiered reimbursement at the various star levels in a system? Up until now, there has been no real strategy used that was based on costs. Now, with the economic models previously referenced, there is a way to do it. States should consider using these models and setting their tiered rates based on cost modeling. While a state may not be able to afford to fill the entire cost gap, it can at least establish financial incentives such as tiered rates based upon an informed strategy that utilizes cost estimates as a basis for decision-making.

Do states set differential rates based on age, geography, etc.? Does it increase the capacity of care? States do set differential rates based on age and geography. Unfortunately it does not lead to greater capacity. The cost of serving infants is so high that it’s really hard for a state to have a rate high enough to cover the cost of serving infants. Moreover, in some cases the unintended consequence of paying an extremely high subsidy rate for infants is that it drives up the cost of care. In a market-rate system, this means that a parent who does not receive subsidy may not be able to afford infant care.

Should there be a requirement that a center participating in QRIS reserve a certain percentage of slots for children on subsidy? While you certainly want participating centers to serve subsidized children, there are unintended consequences to setting a specific percentage. For example, North Carolina started off with that policy in their quality rating system. Over time though, they found that the policy alone could put a provider out of compliance simply because they had vacancies that impacted the percentage of slots for children on subsidy. Their star rating was therefore endangered because of these vacancies. Do not set a percentage requirement. If you set a higher reimbursement rate for children on subsidy, your participating centers are more likely to serve more subsidized children and that becomes the primary incentive.

What is an example of a state that has been able to maximize the use of its funds to drive participation in QRIS to a higher level? There are many examples: Pennsylvania, North Carolina, Louisiana and New Mexico, are a few that come to mind. Each of these states created significant financial incentives for participation in QRIS. The first three – PA, NC, LA – have multiple financial incentives that ‘layer’ to increase incentives for participation. New Mexico relies largely on tiered reimbursement.
(and their rate differentials are quite significant) coupled with a requirement that providers participate in QRIS in order to receive subsidy.

**Is anyone using automation in their quality rating systems?** There are some new ideas around automation that are provider driven and help reduce the cost of administering a QRIS. While there is not yet hard data, Maine is a good example of what may be possible with automation. The state had limited funds and wanted to use those funds for provider supports rather than administration. They chose to put their system totally online. Providers now enter the application online. The system is integrated with the state’s professional development registry and that’s one way they verify information. They’ve also linked it to other databases so that information can be verified electronically as much as possible. The automation though is basically a provider driven, self-report system. Once they complete the application, the online system tells them what the estimated quality rating is. State-level staff conduct an initial review of the online application to assure that it has been filled out completely and, based on the information entered online, to assure that the provider meets the estimated rating level. Additionally, the state conducts audits on a randomly selected number of providers to make sure that they have all of the required documentation to back up what was reported on the web-based QRIS application. (To date, almost all providers have the required documentation.) The Maine QRIS does not require an ERS classroom assessment. Rather, Maine is conducting random assessments on a selected sample of participating providers, in an effort to determine if the ratings assigned by the web-based system correlate with scores on ERS assessments. They still do not have enough data to be statistically significant however early data suggest that the trend is in a positive direction. Classroom assessments appear to correlate with the ratings assigned by the on-line system. While there is not yet hard data, this is definitely a state to look at and could be an excellent example of how to create administrative efficiencies and use your programmatic funding more effectively. Miami also has a good automated system for their Quality Counts QRIS, which is called WELS (Web-Based Early Learning System). This system was originally built to support the technical assistance process but has grown to include a host of helpful data points. Most recently a ‘director’s portal’ has been launched, which is intended to offer opportunities for program directors to submit the Quality Counts application on-line.

Miami is also launching a web-based Shared Services Alliance with a customized version of www.ecesharedresources.org and they intend to link these resources to the QRIS. (PA and LA are also using custom or branded versions of the shared services platform, and exploring links to the QRIS technical assistance system.) These are just a few examples but there are likely many more. There are some interesting opportunities with automation.

**Have states tracked how additional funding is spent?** No state has tracked it comprehensively on a statewide basis in any way that would be useful. It is very difficult to get this type of data in a format that will give you a true basis for comparison since centers are so different.

**The biggest issue with tiered-reimbursement is that traditionally the funding follows the child. This leaves programs vulnerable as children move in and out. How do other states address this in their compensation models?**

This is not an easy issue to address in CCDF funding. Unlike Head Start, child care subsidy eligibility is based on each child. However, if tiered reimbursement is part of a bigger package of incentives, it is potentially possible to provide some ‘buffers’ for enrollment fluctuations. The key is to create some supports that are not specific to the individual child. Overall though, this isn’t an easy issue to address in a market-based system. The ECE industry as a whole is quite fragile and very vulnerable to enrollment fluctuations. This is where cash flow and funding diversification matters significantly. It’s one of the key reasons why a shared services strategy can be so helpful in providing some additional stability for small ECE programs.
Some states have models that include both vouchers for parents and contracts with individual licensed facilities (to hold slots for kids on subsidy). How has this worked and is there a way to **braid this into your model**? Contracts won’t address the problem if the rate is still too low and eligibility is based on parental employment factors. In other words, a contract does not necessarily mean that funding is uncoupled from individual child eligibility. It just means that you have ‘guaranteed’ a certain number of slots to a particular program. But if that program doesn’t recruit/retain enough eligible families, or the family paperwork isn’t processed on time, the program still loses money. States continue to move away from contracts for this very reason. They find that programs have too many vacant slots and/or don’t stay on top of the paperwork. If you do establish contracts with centers, consider only undertaking contracts with centers that are at the highest level of quality in your rating system.

An alternative approach would be to consider a “shared service alliance” contract – in other words contract with a hub agency that provides management services to a network of centers/homes – either for a specific number of slots (e.g. dedicated vouchers) or for a quality enhancement contract that covers the cost of quality improvement services in multiple settings (e.g. a flat amount tied to enhanced quality in lieu of tiered reimbursement.) In exchange, the hub is responsible for:

- ensuring that X children receive services in ECE programs that are of the highest quality level;
- for processing all the eligibility paperwork properly and making sure that all dollars are spent on eligible children within the appropriate time frame;
- for providing comprehensive budget information for all sites; and
- working with you to evaluate the model and track efficiencies.

This would be a very interesting pilot--particularly in states like Washington, Colorado, Tennessee or Virginia, where there are already strong and comprehensive Shared Service Alliances.

**Have any states linked the goal of increasing overall compensation to ECE teachers to public policies and fiscal supports for the systems that train and educate the workers? (Ex. Community and technical colleges, 4-year institutions, community-based training) Can this be a strategy to help the field consciously move toward a more livable wage?**

The best example of this is Louisiana, which has four refundable tax credits that are available to ALL early care and education programs that participate in QRIS and for qualified early childhood teachers that work in those programs. It’s an excellent example of effective policy and real systems change. Another example is Pennsylvania, which has done something similar but with state/federal/private funding. They have recruitment/retention awards linked to QRIS that go to the centers (not the teachers directly) plus a very innovative, foundation-funded initiative that makes small grants available to institutions of higher education to address practitioner barriers to obtaining college education. These grants, called “gate-openers,” are flexible and can be used for things like:

- innovative student training supports;
- offering classes off-site or at odd hours or on-line;
- up-fronting tuition for students who will receive scholarships;
- Praxis tests (remedial courses in math, reading, writing);
- ECE certification for teachers who already have degrees in other fields;
- strategies that translate work experience into credits; and
- supports for teachers who are reluctant to go back to school (e.g. peer networks, dedicated counselors, etc.) or other barriers.

*For more information and resources on this and other QRIS-related topics, go to [www.qrisnetwork.org](http://www.qrisnetwork.org).*