COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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August 19, 2009

TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **TARZANA TREATMENT CENTER (BOARD AGENDA ITEM #35, JUNE 16, 2009)**

On June 16, 2009, the Board of Supervisors directed the Chief Executive Officer to work with the Auditor-Controller, County Counsel, and the affected departments to identify and review all of the County's contracts with the Tarzana Treatment Center (Tarzana or Agency) to determine: 1) the appropriateness of the expenditures and charges made under these contracts; and 2) Tarzana's compliance with all relevant County rules, ordinances, and regulations. Specifically, the Board motion cited concerns over costs (i.e., executive compensation, rental/lease payments involving Tarzana-owned properties, and legal/consulting fees paid to Tarzana's Chief Executive Office) billed to the County.

Tarzana Treatment Center provides behavioral healthcare and addiction treatment services in Los Angeles County. Tarzana's services include alcohol and drug addiction treatment, mental health treatment, medical detoxification and residential rehabilitation for teens/youth and adults. Tarzana also provides outpatient services, sober living housing, after care, HIV/AIDS services, Prop 36 services (Substance Abuse and Crime Prevention Act), family medical care, women's services, family counseling, domestic violence intervention, anger management and community education services. The County contracts with Tarzana to provide services to eligible County residents, principally the uninsured and low income population. Tarzana operates its treatment facilities in the Third, Fourth and Fifth Supervisorial Districts.

During Fiscal Year (FY) 2008-09, Tarzana had 33 active contracts with six County departments, i.e., Department of Children and Family Services (DCFS), Department of Health Services (DHS), Department of Mental Health, Probation, Department of Public Health (DPH) and Department of Public Social Services, (see Attachment I). The County's maximum contract obligation totaled $29.1 million.

Approach/Objectives

To evaluate the Board's concerns, we sampled four contracts, three Fee for Service (i.e., DCFS - Wraparound, DHS - Public Private Partnership, and DPH - Alcohol and Drug) and one cost reimbursement (i.e., DPH - OAPP/Case Management) to determine if Tarzana appropriately charged the County for services provided in accordance with its contract and applicable County, State and federal fiscal guidelines. We examined Tarzana's monthly claims, indirect costs (i.e., executive compensation, rent/lease payments and legal/consulting fees) and supporting documentation, including accounting/payroll records, invoices, federal income tax returns, consultant/vendor contracts, lease agreements, etc. In addition, we reviewed client files to verify whether Tarzana billed the County for services provided to eligible program participants. We also interviewed Tarzana's executive management and the Agency's Certified Public Accountant.

Results of Review

The Agency maintained documentation to support its monthly claims, indirect costs and services provided to program participants. The amounts billed to the County were generally consistent with the Agency's County contracts and applicable County, State, and federal fiscal guidelines. However, we noted instances where Tarzana billed the County for unallowable costs.

Details of our review of Tarzana's monthly claims and indirect costs (i.e., executive compensation, rent/lease payments, and legal/consulting fees) are discussed below.

Monthly Claims

For the monthly claims (i.e., October 2008, December 2008, February 2009 and April 2009) sampled, we noted the following:

Fee for Service - We determined that Tarzana billed the appropriate per-unit-of-service rate in accordance with each contract provision. For example, Tarzana billed $130 per residential day for each client enrolled in the women's residential program. No additional costs were billed and the County paid Tarzana only the negotiated rate. We also verified each unit of service the Agency billed to the County by tracing the unit of service to each participant's case file.

We also reviewed a sample of additional expenditures to determine whether they were allowable under the County contract, properly documented and accurately charged to the program. According to the Auditor-Controller Contract Accounting and Administration Handbook, only those expenditures that are necessary and reasonable to carry out the purpose of the Program are allowable.

We noted $6,327 in tobacco purchases reported under the Alcohol and Drug Residential Program (Residential). However, the $6,327 represents an expenditure allocable to all of Tarzana's Residential contracts, both County and non-County (e.g., federal, State, etc.). The County considers such expenditures as unallowable costs.

Recommendation

1. **Tarzana management ensure that program expenditures are allowable and related to program activities.**

Tarzana management concurs with the recommendation and has agreed to take appropriate corrective action.

Cost Reimbursement - We reviewed each cost category (e.g., salaries, travel, supplies, consultants, rent, etc.) billed by Tarzana to determine the appropriateness of the expenditures and compliance with County rules and regulations. Based on our review of employee timecards, payroll register, vendor invoices, utility bills, etc., Tarzana's costs are appropriate and comply with County contract requirements.

Recommendation

None

Indirect Costs

Indirect costs are those costs that have been incurred for common or joint objectives and cannot be readily identified with a particular program, service or activity. Examples of indirect costs include the salaries and expenditures of executive officers (i.e., executive compensation), lease payments, depreciation, legal and accounting services, etc. For non-profit organizations, these costs are normally classified into one overall pool of costs and are allocated amongst the organization's programs using an approved indirect cost rate. For FY 2008-09, Tarzana's federally approved indirect cost rate was 39.1%. Based on our review, we did not note any instances where Tarzana billed the County in excess of 39.1% for indirect costs.

As previously noted, your Board expressed concerns over Tarzana's executive compensation, lease payments, and legal/consulting fees. To address the Board's

concerns, we reviewed the expenditures and methodology used to compute Tarzana's approved indirect cost rate and noted the following:

Executive Compensation – Tarzana has three executive managers (i.e., Chief Executive Officer, Chief Operating Officer and Chief Financial Officer). During our test period, the federal cap for executive compensation used in computing the indirect cost rate was $186,600 per person.[1] Although the actual compensation paid to each Tarzana executive exceeded $186,600, Tarzana did not exceed the federal cap when computing its indirect cost rate of 39.1% and they did not charge the County salaries in excess of what was allowed. In fact, Tarzana used amounts in its computation that were well below the federal limit.

Recommendation

None

Rent/Lease Payments - According to Tarzana's audited financial statements, it leases 32 real property locations from which various County and non-County programs and services are administered. Four members of Tarzana's Board of Directors, and one immediate family member, hold controlling interest in six of the 32 properties (see Attachment II). When related party transactions exist, the County contract does not allow agencies to charge the County for more than the lower of actual cost or fair market value of the property from the related party.[2]

For the six properties noted above, Tarzana paid rent based on the fair market value of the properties. Tarzana should have charged the County actual cost rather than fair market value. We determined that Tarzana's fair market value exceeded the actual property cost by $1.5 million. However, the $1.5 million represents expenditures allocable to Tarzana's County and non-County contracts. Because Tarzana operates County and non-County programs, the amount reimbursable to the County would be less than $1.5 million. Tarzana needs to determine the amount of rent allocable to County programs and report the applicable amount to the Auditor-Controller for review. Tarzana also needs to ensure that rent/lease expenditures are in accordance with OMB guidelines.

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[1] Source: U.S. Department of Health and Human Services' National Institute of Health (NIH) - http://grants.nih.gov/grants/policy/salcap_summary.htm.

[2] According to the Office of Management and Budget (OMB), Circular A-122, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to, those between an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

Recommendations

Tarzana management:

2. **Determine the amount of rent allocable to County programs, and report the applicable amount to the Auditor-Controller for review.**

3. **Ensure that rent/lease expenditures reported are in accordance with OMB guidelines.**

Tarzana management concurred with the recommendations and indicated that they will work with the Auditor-Controller to make the appropriate adjustments. The Agency has already begun initial steps to determine the allocable cost of the properties. Tarzana management stated it was committed to complying with all County and OMB requirements.

Legal/Consulting Fees – Tarzana incurred $301,128 in legal fees during the review period. Of this amount, Tarzana paid $225,000 ($18,750 per month retainer fee) to Woodlake Law Corporation (Woodlake). A member of Tarzana's executive management/Board of Directors is a principal partner in Woodlake. Woodlake contractually serves as Tarzana's legal counsel for all general corporate (non-litigation) matters including, reviewing government contracts, property leases, purchase contracts, employment contracts, license agreements, liability analysis, insurance, equipment and tax leases, etc. The remaining $76,128 was paid to four other firms for litigation-related services.

We determined that Tarzana's computation of its federally approved indirect cost rate did not include amounts paid to Woodlake. We also verified that, for our sample contracts, Tarzana did not directly bill the County for any legal fees.

Recommendation

None

Summary

We determined that Tarzana generally billed the County for costs consistent with the terms contained in its County contracts. However, as indicated above, we noted a few instances where Tarzana allocated unallowable costs to County programs. Tarzana's management has indicated that it will work with the Auditor-Controller to make appropriate adjustments to ensure its compliance with all relevant requirements and regulations. We will follow-up within ninety days to ensure Tarzana made the appropriate adjustments.

Acknowledgment

On August 13, 2009, we met with CEO and departmental representatives to discuss the results of our review. On August 14, 2009, we discussed the results with Tarzana management. We thank Tarzana management and staff for their cooperation and assistance throughout our review.

If you have any questions, please call me or your staff may contact DeWitt Roberts at (213) 253-0199.

WLW:MMO:DR
L:\Tarzana Board Order

Attachments

c: William T Fujioka, Chief Executive Officer
Robert E. Kalunian, Acting County Counsel
Patricia S. Ploehn, Director, Department of Children and Family Services
John F. Schunhoff, Interim Director, Department of Health Services
Marvin J. Southard, Director, Department of Mental Health
Robert Taylor, Chief Probation Officer
Jonathan E. Fielding, Director and Health Officer, Department of Public Health
Philip L. Browning, Director, Department of Public Social Services
Scott Taylor, President/Chief Executive Officer, Tarzana Treatment Center
Public Information Office
Audit Committee

ATTACHMENT I

Tarzana Treatment Center
County Contract Summary

	Department	Contract Name	Contract No.	Type of Reimbursement (1)	Indirect Cost Rate	FY 2008/09 Contract Amount	Department Subtotals
1	DCFS	Tarzana Treatment Centers, Inc Wraparound (2)	04-011-32	FFS	N/A	$ 1,255,200	$ 1,255,200
2	DHS	Tarzana Treatment Center PPP	H703152	FFS	N/A	115,497	
3	DHS	Tarzana Treatment Center PPP (2)	H703410	FFS	N/A	1,563,226	1,678,723
4	DMH	Tarzana Treatment Center, Inc. EPSDT	MH120266	FFS	N/A	as needed	
5	DMH	Tarzana Treatment Center, Inc. EPSDT	MH040072	FFS	N/A	2,086,036	2,086,036
6	Probation	JJCPA HR/HN HomeBased	64007116	FFS and Admin Fee	10%	220,000	220,000
7	DPH	Tarzana Treatment CASC	H-702189	Staff Hours	N/A	742,554	
8	DPH	Tarzana Treatment GR	H-702192	FFS	N/A	1,470,437	
9	DPH	Tarzana Treatment Center Drug Court, Youth, NonResidential Block Grant	H-702231	FFS & Cost	N/A	2,980,295	
10	DPH	Tarzana Treatment Center Reg County (2)	H-702267	FFS	N/A	4,820,535	
11	DPH	TARZANA TREATMENT CENTER P-36	PH-000164	FFS & Staff Hours	N/A	4,141,822	
12	DPH	Tarzana Treatment Center TANF	PH-000397	FFS & Staff Hours	N/A	4,788,973	
13	DPH	Tarzana Treatment Center DCFS	PH-000400	FFS & Staff Hours	N/A	353,893	
14	DPH	TARZANA TREATMENT CENTER DMC	PH-000402	FFS	N/A	245,826	
15	DPH	TARZANA TREATMENT CENTER Fam Dep DC	PH-000404	FFS	N/A	232,831	
16	DPH	TARZANA TREATMENT CENTER NM Day Tx	PH-000408	FFS	N/A	700,663	
17	DPH	TARZANA TREATMENT CENTER PPNP	PH-000410	Staff Hours	N/A	124,209	
18	DPH	TARZANA TREATMENT CENTER Outreach initia	H-300271-2	Cost	10%	319,511	
19	DPH	Tarzana Treatment Centers, Inc.	PH000231-1	Cost	15%	162,654	
20	DPH	TARZANA TREATMENT CENTER Mental Health	H-210794-4	Cost	10.20%	97,861	
21	DPH	Tarzana Treatment Center Nochaa (2)	H-210795-17	Cost	2.26%	430,144	
22	DPH	Tarzana Treatment Center Jail	H-300127-7	Cost	2.54%	148,635	
23	DPH	Tarzana Treatment Center Self Help	H-700268-2	Cost	8.33%	71,804	
24	DPH	Tarzana Treatment Center HERR	H-700887 17-20	Cost	8.4% - 8.65%	425,747	
25	DPH	Tarzana Treatment Center MTU	H-700890 7-8	FFS & Cost	15%	156,000	
26	DPH	Tarzana Treatment Center HIV trans house	H-700979-4	FFS	N/A	60,919	
27	DPH	TARZANA TREATMENT CENTER HIV res	H-700982-2	FFS	N/A	341,220	
28	DPH	TARZANA TREATMENT CENTER HIV Dtx	H-700983-4	FFS	N/A	323,036	
29	DPH	TARZANA TREATMENT CENTER, INC. HIV trans hse	H-701004-6	FFS	N/A	90,525	
30	DPH	TARZANA TREATMENT CENTER, INC. CAN	H204608-15	FFS & Cost	15%	292,090	
31	DPH	Tarzana Treatment Center HIV MED OP	H209018-10	FFS & Cost	5.77% - 8.92%	195,786	
32	DPH	Tarzana Treatment Center Tx Advocacy	H209078-14	Cost	9.77%	126,725	23,844,695
33	DPSS	FS Application - Tarzan Treatment Center, Inc	FSA07019	FFS		10,000	10,000

(1) FFS = Fee For Service contract; Cost = Cost Reimbursement contract.

(2) This contract was selected for expenditure review.

Total County Contract Obligation **$ 29,094,654**

ATTACHMENT II

Properties Owned by Tarzana Board Members/Executives					
Facilities Owned	**Lessor**	**Related Party Ownership**	**Annual Lease (Fair Value)**	**Total Cost by Facility**	**Variance**
44447 N. 10th Street West, Lancaster, CA	10th Street West LLC	100%	$ 600,000	$ 168,499	$ 431,501
907 Lancaster Blvd. Lancaster, CA	Lancaster Health Center LLC	100%	$ 129,000	$ 38,722	$ 90,278
8330 Reseda Blvd. Los Angeles, CA	Reseda Medical Center LLC	100%	$ 352,452	$ 272,939	$ 79,513
7101 Baird Ave. Los Angeles, CA	Baird Enterprises LLC	100%	$ 392,040	$ 128,347	$ 263,693
18646 Oxnard Street, Tarzana, CA	Oxnard Property LTD	50%	$ 739,642	$ 201,096	$ 538,546
18700 Oxnard Street, Tarzana, CA	Yolanda Equity Partners LLC	100%	$ 402,792	$ 321,189	$ 81,603
			$ 2,615,926	**$ 1,130,792**	**$ 1,485,134**