COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-3873
PHONE: (213) 974-8301 FAX: (213) 626-5427

WENDY L. WATANABE
AUDITOR-CONTROLLER

JUDI E. THOMAS
CHIEF DEPUTY

ASST. AUDITOR-CONTROLLERS
ROBERT A. DAVIS
JOHN NAIMO
JAMES L. SCHNEIDERMAN

August 23, 2012

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

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **ALLEGATIONS OF OVERBILLING BY SODEXO OPERATIONS, LLC FOR DIETARY SERVICES AT RANCHO LOS AMIGOS NATIONAL REHABILITATION CENTER**

Based on a referral from the Board of Supervisors, we reviewed allegations that Sodexo Operations, LLC (Sodexo) overcharged the County for dietary services at the Department of Health Services' (DHS) Rancho Los Amigos National Rehabilitation Center (RLANRC or Rancho). The anonymous allegations included that Sodexo: (1) billed Rancho for some patient food that was already included in the base meal rate; (2) charged an unallowable mark-up on tube feeding supplies; (3) did not complete required comparisons of budgeted and actual food costs, and (4) did not refund a portion of any food cost savings to the County, as required by its contract. Sodexo has provided dietary services at Rancho since 1995, and was paid approximately $4.37 million in Fiscal Year (FY) 2010-11.

Summary of Findings

Based on our review, we estimate that Sodexo overbilled the County by approximately $681,000; approximately $625,000 for patient food, and $56,000 for tube feeding supplies from December 1996 to March 2011. We also confirmed that Sodexo did not provide the contractually required cost savings analyses. In addition, DHS determined that Sodexo overbilled the County by approximately $13,425 in Cost of Living Adjustments.

We have recommended that DHS work with County Counsel and Sodexo to resolve the overcharges identified in this report. DHS and County Counsel indicated that they have negotiated a repayment agreement with Sodexo to resolve the audit exceptions. Under the agreement, Sodexo will repay the County $542,500 by September 2012, without any admission of wrong doing or liability.

In addition to the overbillings, our review disclosed some serious issues with DHS' monitoring of the Sodexo contract that DHS needs to address. The following are the detailed results of our review.

Review of Allegations

Allegation 1: Sodexo inappropriately charged separately for some patient food that was already included in the basic per meal rate, and should not have been billed separately.

Findings

Incidental Food and Floor Supplies

The RLANRC contract pays Sodexo a set rate for patient meals, and specifies that other food and supplies could be billed separately. The contract states Sodexo will bill for these "Incidentals" at Sodexo's actual cost, plus a 15% handling fee. Between December 1996 and March 2011, Sodexo billed Rancho approximately $2 million for Incidentals.

Our review indicates that Sodexo billed for these Incidental items as "Floor Supplies" on their invoices, a term that is not defined in the contract. We noted that Sodexo billed more for these items than the contract rate for Incidentals of actual cost plus 15%. For example, Sodexo billed Rancho an average $3.74, including the 15% handling fee for turkey sandwiches that were provided as Floor Supplies. However, the charge for these items using the contract rate for Incidentals (actual food cost plus 15%) would be approximately $1.25.

Our review of Sodexo's billings for Floor Supplies for calendar year 2010, and a sample of charges from 2008, 2009, and 2011, indicates that Sodexo charged the County an average of approximately 30% more than the contract rate for Incidentals. Applying that 30% average overcharge to Sodexo's total billings for Floor Supplies from the beginning of the contract to March 2011, we estimate that Sodexo overbilled the County a total of approximately $625,000 since 1996.

It should be noted that RLANRC requested Sodexo to provide the food that was billed as Floor Supplies, and did not question Sodexo's charges for those items. Rancho's contract monitor indicated she was not familiar with all of the terms of Sodexo's

contract, did not compare Sodexo's charges to its actual costs, and did not verify that the charges were calculated as specified in the contract.

We also compared Sodexo's charges for Floor Supplies with the three other DHS hospitals, all of which contract with Morrison Management Services, Inc., (Morrison) for dietary services. We noted that Morrison does not bill its client hospitals separately for many of the items Sodexo billed as Floor Supplies, which Morrison indicated are already included in their basic patient meal rates. We also noted that the other hospitals have significantly lower charges for Floor Supplies/Incidentals than Rancho, even though some of the other hospitals serve more patients than Rancho. The chart below summarizes the Floor Supply/Incidentals charges for each County hospital for May and September 2010.

Floor Supplies/Incidentals Billed by Facility, Per Month

	RLANRC (1)	Harbor (2)	OVMC (2)	LAC+USC (2)
Licensed Beds (3)	395	538	377	600
May 2010	$23,636	$792	$1,112	$3,811
September 2010	$26,239	$830	$1,173	$2,814

(1) – Sodexo Operations, LLC
(2) – Morrison Management Services
(3) – From www.ladhs.org

Rancho management indicated that their patients have different needs compared to patients at other County hospitals, and that this may explain their higher costs. However, in May 2011, when we brought the issue of Sodexo's billings for Floor Supplies to management's attention, Rancho management reduced their Floor Supply purchases by approximately 50%. Rancho management subsequently acknowledged that their Floor Supplies had been "overstocked", and that they reduced the purchases as part of a cost-savings initiative.

While it appears that Sodexo overcharged RLANRC for Floor Supplies, and may have charged for items that may be included in the base rate under similar contracts at other hospitals, County Counsel has indicated that the County may not be able to recover the overcharges. This is because RLANRC staff ordered the Floor Supplies and approved

Sodexo's billings, and because of the significant amount of time that has passed since the charges were paid. Sodexo raised similar arguments in this regard.

We recommended that DHS work with County Counsel and Sodexo to resolve the overcharges for Floor Supplies. DHS should also ensure that contract terms and definitions are standardized, and applied consistently in all agreements for similar services. The Department also needs to ensure that contracts are properly monitored, and that contract monitoring staff question/reject charges that are not specified in the contracts.

Recommendations

DHS management:

1. **Work with County Counsel and Sodexo to resolve the $625,000 in overcharges for Floor Supplies.**

As noted earlier, DHS and Sodexo subsequently negotiated a repayment agreement under which Sodexo will repay the County $542,500 by September 2012.

2. **Ensure that contract terms and definitions are standardized, and applied consistently in all agreements for similar services.**

3. **Ensure that contracts are properly monitored, and that monitoring staff question/reject charges that are not specified in the contract**

Allegation 2: Sodexo inappropriately charged a 15% mark-up on tube feeding products.

Findings

The contract requires Sodexo to provide tube feeding supplies at cost, without adding a markup. Our review indicates that Sodexo added a 15% mark-up on tube feeding supplies, resulting in $55,947 in overcharges between December 1996 and March 2011.

Sodexo acknowledged marking up tube feeding supplies, and discontinued this practice after we brought it to their attention. We also noted that Rancho's contract monitor did not question these charges, even though the mark-ups were clearly indicated on Sodexo's invoices. Again, County Counsel has indicated that the County may not be able to recover all of the overcharges if the County were to litigate because RLANRC approved and paid Sodexo's invoices, and because of the amount of time that has passed since the billings. Again, Sodexo raised similar issues in this regard.

Recommendation

4. **DHS management work with County Counsel and Sodexo to resolve the $55,947 in overcharges for tube feeding supplies.**

The repayment agreement negotiated by DHS, Sodexo, and County Counsel discussed earlier includes the tube feeding overcharges.

Allegation 3: Sodexo did not complete a cost savings analysis at the end of each contract year, or return 75% of any cost savings to the County as required by the contract.

Findings

The RLANRC contract requires Sodexo to provide an annual comparison of its actual and budgeted food costs, and refund 75% of any cost savings to the County.

Sodexo did not submit the required cost savings analyses, or determine if there were any cost savings to return to the County. DHS indicated that Rancho's contract monitor was unfamiliar with the cost savings analysis requirement, and did not follow up with Sodexo to obtain the required analysis. In addition, the requirement was not included in Rancho's Contract Monitoring Tool.

County Counsel advised us that Rancho's failure to request the cost analysis in the past will prevent the County from enforcing the requirement retroactively. It should be noted that similar issues exist in other County dietary service contracts. We have reviewed food services contracts within five County departments and will issue a separate report upon completion of our review.

DHS should ensure that, if the Sodexo contract continues, RLANRC requires Sodexo to provide the annual cost analysis, and pay the County its share of any identified savings.

Recommendation

5. **DHS management ensure that, if the Sodexo contract continues, RLANRC requires Sodexo to provide the annual cost analysis, and pay the County its share of any identified savings.**

Contract Monitoring Issues

As noted earlier, many of the issues with Sodexo's billings and missing cost analyses were not identified by RLANRC's contract monitoring staff. In fact, during our discussions with Sodexo management, Sodexo gave us copies of prior memos from RLANRC contract monitoring staff indicating they had "no findings of noncompliance"

with Sodexo's service and invoice processing requirements. In addition, during our review, Rancho staff indicated that we should ask Sodexo's onsite manager to answer many of our questions regarding contract terms and definitions, the types and level of services provided, and for copies of key documents, etc. This indicates that Rancho's monitors lacked the information to effectively monitor Sodexo's operations.

DHS should ensure that contract monitoring staff have the necessary training, independence, and management supervision to ensure vendors comply with the County contract requirements. The Department should also periodically rotate contract monitors among DHS facilities, to ensure their independence, and consider centralizing contract monitoring operations in a single unit to improve the independence and oversight of the monitoring function.

Recommendations

DHS management:

6. **Ensure that contract monitoring staff have the necessary training, independence, and management oversight to ensure vendors comply with the County contract requirements.**

7. **Periodically rotate contract monitors among DHS facilities to ensure their independence.**

8. **Consider centralizing contract monitoring operations.**

Other Issues

Cost of Living Adjustments (COLA)

The Sodexo contract allows for annual COLAs of five percent or less, based on changes in the Consumer Price Index (CPI). DHS recomputed the amounts that should have been paid to Sodexo for COLAs, and determined that Sodexo overbilled Rancho for COLAs by $13,425. DHS should work with County Counsel and Sodexo to resolve the $13,425 in COLA overcharges.

Living Wage Ordinance Adjustments (LWO)

The Sodexo contract was awarded before the County's LWO was enacted. The contract was amended in 2003 to require Sodexo to comply with the LWO. However, DHS did not revise the contract budget to reflect the cost of LWO compliance until 2008.

DHS reviewed the total paid to Sodexo for LWO adjustments, and concluded that the payments were appropriate. DHS should ensure that COLA and LWO adjustments are consistently applied and included in contract amendments.

Recommendations

DHS management:

9. Work with County Counsel and Sodexo to resolve the $13,425 in overcharges for COLAs.

The repayment agreement negotiated by DHS, Sodexo, and County Counsel discussed earlier includes the COLA overcharges.

10. Ensure that COLA and LWO adjustments are consistently applied and included in contract amendments.

We thank Sodexo's management and staff for their cooperation and assistance during our review. Sodexo's response (Attachment I) acknowledges some overcharges, but indicates disagreement with food cost comparisons between Rancho and other hospitals. We have reviewed the available data, and believe that the comparisons are valid, as evidenced by the 50% decrease in incidental purchases after we started the audit. DHS' response (Attachment II) indicates that the Department concurs with our recommendations, and has taken or initiated corrective action. As previously noted in this report, DHS, Sodexo, and County Counsel have a negotiated repayment agreement to resolve the overcharges.

Please call me if you have any questions, or your staff may contact Robert Campbell at (213) 253-0101.

WLW:JLS:RGC:MWM

Attachments

c: William T Fujioka, Chief Executive Officer
Mitchell H. Katz, M.D., Director, Department of Health Services
John F. Krattli, County Counsel
Sachi A. Hamai, Executive Officer, Board of Supervisors
Carol Alesso, Senior Vice President, Sodexo Health Care Services
Kenneth W. Johnson, Assistant General Counsel, Operations, Sodexo
Public Information Office
Audit Committee

To: LA County Department of Auditor-Controller

From: Sodexo Health Care Services

Carol Alesso, Senior Vice President

Date: June 22, 2012

Subject: Response to Allegations of Overbilling by Sodexo Operations, LLC for Dietary Services at Rancho Los Amigos National Rehabilitation Center

By way of this memorandum, Sodexo is responding to the Auditor-Controller's June 13, 2012 Summary of Findings pertaining to the 2011 audit.

As noted on the June 13 correspondence, Sodexo has proudly provided service to Rancho Los Amigos National Rehabilitation Center.

The audit referenced in the June 13 correspondence took place over nearly 8 months during 2011. Sodexo was extremely cooperative during this entire audit, and provided additional resources to our managers at Rancho in order to continue to provide service, while responding in a timely and accurate manner to all requests by the auditors.

Sodexo does not concur with the entirety of the auditor's findings however, Sodexo was able to identify unintentional errors in charging for tube feeding supplies. In addition, while Sodexo was and is operating under the guidance we receive from LA County assigned liaison at Rancho, due to the length of time that has passed, which is in excess of 16 years, some records were not readily available. In addition, Sodexo was routinely audited by the Rancho administration and was found to be in full compliance according to the written audit results received over the years.

One item worth mentioning is the notation in the June 13th correspondence pertaining to Floor Supplies/Incidentals billed by facility. The cost of providing incidentals and floor supplies in a rehabilitation center such as Rancho should not be compared with this cost for large acute care hospitals with high acuity diagnosis. As is known in the industry, in large acute care hospitals with high acuity diagnosis being prevalent, usage of incidentals and floor supplies is minimal. These patients are extremely ill, with many not able to consume food by mouth at all. Conversely, in a rehabilitation facility such as Rancho, the exact opposite is true. There are almost no patients that cannot consume food by mouth and in fact, provision of nourishing snacks and foods between meals is frequently a part of the necessary nutrition therapy these rehab patients need and require. In many cases, full meals are necessary between the

2670 N Main Street, Suite 250 Santa Ana, CA 92705

Cell 310.971.6460 • Fax 714-481-0340• www.sodexousa.com

traditional meal times. This was a key discussion point during our meetings with LA County where we reviewed the initial auditor's findings and should be noted herein. If desired, Sodexo has access to data to support this in hundreds of hospitals nation-wide.

In addition to the "overbilling" claims, during the audit meeting, there were other items that were in fact, under-billed over the years. However, Sodexo does not want to continue to pursue these items, nor prolong putting closure to this audit. Sodexo's goal is to continue to be a strong and valued partner to LA County and to continue to provide excellent service to Rancho Los Amigos. Therefore, without admitting any wrong doing or liability, Sodexo has agreed to pay the County a total of $542, 500 (Five Hundred Forty Two Thousand Five Hundred Dollars and no cents) by September 2012. Sodexo appreciates the ability to provide this response to the Auditor-Controller in this regard. Sodexo trusts that this response will be shared as appropriate with the Los Angeles County Supervisors.

2670 N Main Street, Suite 250 Santa Ana, CA 92705

Cell 310.971.6460 • Fax 714-481-0340• www.sodexousa.com

Health Services
LOS ANGELES COUNTY

Los Angeles County
Board of Supervisors

Gloria Molina
First District

Mark Ridley-Thomas
Second District

Zev Yaroslavsky
Third District

Don Knabe
Fourth District

Michael D. Antonovich
Fifth District

Mitchell H. Katz, M.D.
Director

Hal F. Yee, Jr., M.D., Ph.D.
Chief Medical Officer

Christina R. Ghaly, M.D.
Deputy Director, Strategic Planning

313 N. Figueroa Street, Suite 912
Los Angeles, CA 90012

Tel: (213) 240-8101
Fax: (213) 481-0503

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July 16, 2012

TO: Wendy L. Watanabe
Auditor-Controller

FROM: Mitchell H. Katz, M.D.
Director

SUBJECT: **RESPONSE TO AUDITOR-CONTROLLER'S REVIEW OF ALLEGATIONS OF OVERBILLING BY SODEXO OPERATIONS, LLC FOR DIETARY SERVICES AT RANCHO LOS AMIGOS NATIONAL REHABILITATION CENTER**

Attached is the Department of Health Services' response to the recommendations made in the Auditor-Controller's report of its review regarding allegations of overbilling by Sodexo Operations, LLC (Contract No. 68444) for dietary services at Rancho Los Amigos National Rehabilitation Center. We concur with and have taken or initiated corrective actions to address the recommendations contained in the report.

If you have any questions or require additional information, please contact me or Tobi L. Moree at (213) 240-7901.

MHK:tlm:cm

Attachment

c: Gregory C. Polk
Jorge Orozco
Kathy Hanks
Rich Mason
Audit Committee

COUNTY OF LOS ANGELES – DEPARTMENT OF HEALTH SERVICES
RESPONSE TO AUDITOR-CONTROLLER
ALLEGATIONS OF OVERBILLING BY SODEXO OPERATIONS, LLC FOR DIETARY SERVICES AT RANCHO LOS AMIGOS NATIONAL REHABILITATION CENTER

This is in response to the Auditor-Controller's review of allegations of overbilling by Sodexo Operations, LLC (DHS Contract No. 68444) for dietary services at Rancho Los Amigos National Rehabilitation Center (RLANRC). The Department of Health Services (DHS) generally agrees with the following Auditor-Controller recommendations:

RECOMMENDATION NO. 1

Work with County Counsel and Sodexo to resolve the $625,000 in overcharges for Floor Supplies.

DHS Response:

DHS sent a "Contract Audit Closeout" letter to Sodexo on May 18, 2012. The Contractor agreed to reduce its invoiced contract price to the County during the current contract term by a total of $542,500.

RECOMMENDATION NO. 2

Ensure that contract terms and definitions are standardized, and applied consistently in all agreements for similar services.

DHS Response:

The dietary services contracts for all DHS facilities are currently in the process of a Request for Proposals (RFP) solicitation. The RFP contain clear, standardized definitions for incidental food and floor supplies, which will be included in contracts awarded from the RFP.

RECOMMENDATION NO. 3

Ensure that contracts are properly monitored, and that monitoring staff question/reject charges that are not specified in the contract.

DHS Response:

DHS is in the process of restructuring its overall contract monitoring operations, including reporting responsibilities. DHS' Audit and Compliance Division (DHS A&CD) will absorb DHS' Centralized Contract Monitoring Division (DHS CCMD), which will be the Department's Centralized Monitoring Unit. Facility based contract monitors will report to DHS CCMD and have the sole responsibility of monitoring their assigned contracts at the level of detail and diligence required to perform thorough monitoring reviews.

RECOMMENDATION NO. 4

DHS management work with County Counsel and Sodexo to resolve the $55,947 in overcharges for tube feeding supplies.

DHS Response:

DHS sent a "Contract Audit Closeout" letter to Sodexo on May 18, 2012, which included resolution of the $55,947 in overcharges for tube feeding supplies. Sodexo agreed to reduce its invoiced contract price during the current contract term.

RECOMMENDATION NO. 5

DHS management ensure that, if the Sodexo contract continues, RLANRC requires Sodexo to provide the annual cost analysis, and pay the County its share of any identified savings.

DHS Response:

DHS CCMD will ensure Sodexo provides an annual cost savings analysis, and pays the County its share of any identified savings, beginning with the last contract year.

RECOMMENDATION NO. 6

Ensure that contract monitoring staff have the necessary training, independence, and management oversight to ensure vendors comply with the County contract requirements.

DHS Response:

DHS has engaged the Auditor-Controller's Countywide Contract Monitoring Division (A-C CCMD) to assist in the development and presentation of training to the Department's contract monitoring staff. With the reorganization of DHS CCMD, facility contract monitors will report directly to DHS CCMD, thereby having independence from the facility and increased independence to ensure vendor compliance with contract terms and conditions. The reorganization of DHS CCMD within the A&CD will provide the appropriate management oversight.

RECOMMENDATION NO. 7

Periodically rotate contract monitors among DHS facilities to ensure their independence.

DHS Response:

DHS will consider rotation of facility based contract monitors.

RECOMMENDATION NO. 8

Consider centralizing contract monitoring operations.

DHS Response:

DHS is in the process of implementing this recommendation by restructuring its contract monitoring operations and centralizing the monitoring responsibilities under DHS CCMD to improve the independence and oversight of the monitoring functions. Also, the A-C CCMD will assist DHS with the reorganization and inventory all DHS contracts to determine risk level.

RECOMMENDATION NO. 9

Work with County Counsel and Sodexo to resolve the $13,425 in overcharges for COLAs.

DHS Response:

DHS sent a "Contract Audit Closeout" letter to Sodexo on May 18, 2012, which included resolution of the $13,425 in overcharges for Cost of Living Adjustments. Sodexo agreed to reduce its invoiced contract price during the current contract term.

RECOMMENDATION NO. 10

Ensure that COLA and LWO adjustments are consistently applied and included in contract amendments.

DHS Response:

Cost of Living Adjustments (COLA) and Living Wage Ordinance (LWO) adjustments must be memorialized through a contract amendment by DHS' Contracts and Grants (DHS C&G). DHS facilities do not have the authority to grant such adjustments. DHS C&G has advised facilities of the appropriate process and will continue to work with contract liaisons / monitors to ensure compliance.