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DEPARTMENT OF AUDITOR-CONTROLLER

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September 28, 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: **REVIEW OF COUNTY FOOD SERVICE CONTRACTS**

In April 2011, your Board anticipated awarding a contract for janitorial and food services to the lowest "responsible" bidder. Significant questions arose about whether a prospective contractor withheld money received from food manufacturer rebates in other jurisdictions. It was also alleged that this contractor had improperly charged a public agency for food they received at no cost from the United States Department of Agriculture (USDA).

Based on these concerns, the Second Supervisorial District requested an audit of Los Angeles County's food service contractors to determine: 1) the extent of contractors withholding the rebates; 2) the contractors' obligation to provide the County with any benefits resulting from reduced costs of prepared foods sold to them; 3) an inventory of contracts that have capitalized on rebate opportunities resulting in a benefit to the County; and 4) the value of missed opportunities.

Review Summary

We surveyed all County departments, and identified five departments with a combined 34 food services contracts, totaling approximately $44.5 million per year. These departments are Health Services (DHS), Probation, Community and Senior Services (CSS), Children and Family Services (DCFS), and Parks and Recreation (Parks). The following table summarizes the number of food service contracts with their total estimated annual cost by department:

Department	Number of Contracts	Type of Food Service	Estimated Annual Cost
DHS	5	Patient meals and cafeteria operations	$25,300,000
Probation	4	Meal service at juvenile halls and camps	7,800,000
CSS	23	Congregate meals and home-delivered meals for older adults	10,400,000
DCFS	1	Meals and snacks at the Edelman Children's Court	246,000
Parks	1	Summer lunch and afterschool snacks	758,000
Total	**34**		**$44,504,000**

Rebates and Cost Savings in County Contracts

We determined that only DHS' contracts require the contractors to share any rebates or cost savings they may realize with the County. The other contracts under Probation, CSS, DCFS and Parks are fixed price contracts, and do not require the contractors to share any rebates or cost savings with the County. We have noted other areas of concern with these departments' food service contracts which are discussed separately in this report.

DHS' contracts require the vendors to report their budgeted and actual costs each year, and to return a specified percentage of the cost savings to the County. However, only Harbor/UCLA Medical Center (Harbor/UCLA) has been consistently requiring its contractor to provide the required annual report. Harbor/UCLA's contractor, Morrison Management Specialists, Inc. (Morrison), has also been crediting the County an average of $95,000 a year in cost savings.

The other four DHS facilities that have food service contracts have not been consistently requiring their contractors to provide the annual cost reports, and may not have received cost savings as required by their contracts. Without these cost savings analyses, we cannot determine how much the County may have lost in savings opportunities. We have recommended that DHS work with County Counsel to obtain the missing savings analyses, and resolve any savings owed to the County.

Free Food from the USDA

Our review indicates that the County's contractors' do not currently use free food from the USDA. However, we noted that Probation may be able to reduce its costs by providing the contractor with free food that Probation receives. We have recommended that Probation consider providing free food from the USDA to its contractor-served facilities.

Other Food Service Issues

In addition to the rebate/cost savings and free food issues, we noted the following areas where the County departments may be able to improve their contract food service operations:

- County's food service contract provisions, including how cost savings and rebates are handled, vary significantly among the departments.

- Two (40%) of DHS' five dietary contracts require the County to give the contractors funding for the cost of operating public cafeterias in the hospitals. The contractors are supposed to reimburse the County based on the cafeteria revenue. However, some of the facilities may be substantially subsidizing their cafeteria costs. For example, LAC+USC Medical Center has paid their contractor a total of $3.6 million over the last three years to operate the cafeteria.

- Food service contractors are not always required to provide documentation to support their requests for contract price increases.

- Some departments may not be monitoring their food service contracts adequately.

Details of our findings and recommendations are discussed below.

Findings and Recommendations

Need for Standardized Contract Language

As noted earlier, our review disclosed that the County's food service contract terms vary significantly among the departments. We recommend that the County form a food service contracts work group, including the Chief Executive Office (CEO), Internal Services Department (ISD), County Counsel, and each department that contracts for food services. This group should develop a standard framework for County food service contracts, to increase efficiency and ensure the County obtains the best pricing for food services. The work group should also develop standardized requirements and criteria for soliciting and evaluating food service bids. For example, the work group should evaluate whether food service contracts should require contractors to credit the County for the fair market value of free food the contractors may receive from the United States Department of Agriculture (USDA).

The work group should also address how rebates, discounts, and cost savings should be handled in food service contracts, and develop enforceable savings reporting and cost recovery provisions where applicable. In addition, the work group should develop contract provisions to ensure County has the right to review the contractors' costs and

other data necessary to evaluate requested price increases, reported costs savings, and for other contract monitoring and invoice processing purposes. The Auditor-Controller will assist the work group on contract standards and fiscal control issues, as needed.

Recommendations

1. **CEO, ISD, County Counsel, and each department that contracts for food services form a Countywide work group to develop a framework and standardized language for County food service contracts.**

2. **Departments that contract for food services incorporate standardized contract language developed by the Countywide work group into future food service solicitations and contracts, when feasible.**

DHS

Contract Cost Savings Analysis

As noted in Table 1, DHS has five food service contracts, totaling $25.3 million a year. One contract, totaling $4.3 million, is with Sodexo Operations, LLC (Sodexo), and four contracts, totaling $21 million, are with Morrison. Some of the contracts date back to 1995.

All of DHS' dietary contracts require the contractors to report their actual costs, and share any savings between their budgeted and actual costs with the County. However, only Harbor-UCLA has been consistently requiring their contractor, Morrison, to provide all of the cost savings analyses since the start of the contract. For example, Sodexo, the contractor at Rancho Los Amigos National Rehabilitation Center (Rancho), has not provided any cost savings analyses since the contract started in 1995. In addition, while Morrison has given Harbor-UCLA the required cost savings analyses, it has not consistently provided the analyses to the other DHS facilities it serves (Olive View Medical Center (OVMC), LAC+USC Medical Center, and Martin Luther King, Jr. Multi-Service Ambulatory Care Center). Morrison did submit the analyses for the most current three years for OVMC when we inquired about them during our review.

Morrison's cost analyses at Harbor reported that the County's share of savings since 1996 was $1.2 million, or approximately $95,000 a year. Morrison has been crediting Harbor its share of the savings every year. Based on the results at Harbor, it appears that some DHS facilities did not receive food service savings they should have received. We recommend that DHS work with County Counsel to obtain all missing food cost analyses, and resolve any savings owed to the County. DHS should also ensure that contractors submit all future cost savings analyses as required.

Recommendations

DHS Management:

3. **Work with County Counsel to obtain missing cost savings analyses from contractors, and resolve any savings owed to the County.**

4. **Ensure that contractors submit required future cost savings analyses.**

Food Rebates

One way the food service contractors can reduce their food cost is through rebates they receive from food manufacturers. However, Sodexo has refused to give the County any information on rebates they may have received. Morrison has shared some rebate information with the County, and has deducted an "allowance" from reported food costs to give the County some share of the rebates/discounts they received, but has indicated that the County contract does not require them to do so.

County Counsel indicated that DHS' food service contracts do not explicitly give the County the right to receive a cost reduction for rebates the food service contractors receive. In addition, the contractors believe that the County does not have the contractual right to review the contractors' records of the rebates they received. County Counsel has recommended that DHS specifically address the rebates in the new food service solicitations which are currently out for bid.

In addition, we noted that the cost savings analysis required by the contracts do not specifically require the vendors to share cost savings from rebates and discounts. The contracts only require the contractors to share savings with the County if the contractors' total costs, including salaries and employee benefits, supplies, depreciation, etc., are less than budgeted.

Finally, DHS' contracts require the contractors to bill for some items, such as special function meals and incidental food, based on actual cost, but do not indicate if the actual costs should be reduced by any rebates or discounts the contractor receives. DHS should ensure that the contracts specify that items that are billed or reported at the contractor's actual cost should be net of any rebates or discounts the contractor receives.

As noted earlier, DHS has issued a solicitation for new food service contracts. The proposed contracts are based on a fixed price per meal, and do not include sharing of cost savings or rebates. We understand that DHS believes a fixed fee contract will result in the lowest cost, and simplify administration and monitoring of the contracts. However, as noted earlier, we recommend that the Countywide work group develop standardized language to address rebates/savings in County food service contracts.

Until the Countywide workgroup has developed contract language related to cost savings and rebates, DHS should consult with the CEO and County Counsel to determine whether the new solicitations/contracts should include requiring contractors to share cost savings and rebates with the County.

Recommendations

DHS management:

5. **Consult with the CEO and County Counsel to determine whether the new food service solicitations/contracts should include standard language requiring the contractors to share cost savings and rebates with the County**

6. **Ensure that future contracts require contractors to deduct rebates, credits and discounts from items that are billed based on actual costs, and ensure the County has access to cost, rebate and discount data necessary to analyze and validate the contractor's invoices.**

Cafeteria Costs

DHS' food service contracts at LAC+USC, OVMC, and Rancho Los Amigos National Rehabilitation Center (Rancho) include operating public cafeterias in DHS facilities; (The other departments' contracts do not include cafeterias.) Under the contracts, LAC+USC and OVMC pay the contractors the estimated cost of running the cafeterias as part of the monthly payments. It is unclear if Rancho's payments to Sodexo includes the cost of operating the cafeteria at Rancho because the contract does not disntinguish between patient and cafeteria food service cost.

The County is supposed to be reimbursed by the contractors based on actual cafeteria sales. However, because actual cafeteria receipts have been much less than estimated, LAC+USC has paid Morrison a net total of $3.6 million as a subsidy to operate the cafeteria concession for the last three years.

We question whether it is appropriate for the County to subsidize the operation of public cafeterias, given the County's financial situation, and the fact that hospital visitors have other dining options near the hospitals. We recommend that DHS require contractors to clearly distinguish between costs for patient meals and costs for cafeteria operations in future contracts, and notify the Board if DHS will be subsidizing cafeteria operations.

Recommendation

7. **DHS management clearly distinguish costs for patient meals from costs for cafeteria operations in future contracts, and disclose to the Board if DHS will be subsidizing cafeteria operations.**

Contract Monitoring

We noted that DHS facilities were not adequately monitoring their dietary contracts. For example:

- Rancho staff did not appropriately identify the overcharges from Sodexo noted in our August 23, 2012 report to your Board.

- Only Harbor-UCLA Medical Center consistently required its contractor to provide all contract cost savings analyses, even though all of DHS' contracts specifically require these analyses to be submitted annually.

- LAC+USC does not independently verify Morrison's reported cafeteria sales. They rely on Morrison's invoice and supporting documentation to determine the cafeteria sales.

Throughout our review, we noted that DHS staff at various facilities were unable to answer basic questions about the contracts, and in some cases asked the contractor to respond to our questions. We noted a similar issue at Rancho in our August 23, 2012 report. This indicates that contract monitors did not have information needed to effectively monitor the contractors' compliance with contract terms. DHS management needs to provide appropriate training and oversight to ensure food service contracts are adequately monitored. In addition, as recommended in our August 23, 2012 report on Rancho, DHS should consider centralizing the contract monitoring function to provide better oversight and control, and rotate monitors periodically among contracts.

Recommendation

8. **DHS management provide training and oversight to ensure staff adequately monitor food service contractors' compliance with the contracts.**

Probation Department

Probation has food service contracts for the three juvenile halls and Challenger Memorial Youth Center (CMYC), at a total annual cost of approximately $7.8 million. All of the contracts have a fixed price per meal, with no requirement to share any rebates or cost savings with the County.

Use of USDA Free Food

Probation management indicated that the Department uses USDA food at the camps, where Probation staff prepare meals, but does not send USDA food to facilities where contractors prepare meals. Based on our review, it appears Probation did not use all USDA food available to the Department. Probation should consider sending USDA food to contractor-served facilities to reduce food costs.

Documentation For Food Service Price Increases

We also noted that contractors are not required to report their actual costs to Probation, or to allow the County to review documentation of their actual costs. This became an issue when the current contractor raised their price per meal based on a change in the menus required by State nutrition guidelines. The contractor refused to provide documentation that the menu change resulted in higher food costs. We noted that Probation is currently soliciting for new food service contracts. As indicated in Recommendation 2 in this report, Probation should incorporate standardized language to be developed by Countywide work group into its future contracts. Until this language is developed, Probation should consult with the CEO and County Counsel to ensure the new contracts contain appropriate language related to rebates and cost savings, and allowing the County to review the contractors' actual costs to support any requested price increases.

Recommendations

Probation management:

9. **Consider sending USDA food to contractor-served facilities to reduce food costs.**

10. **Consult with the CEO and County Counsel to ensure the current food service solicitations contain appropriate language related to rebates and cost savings, and allowing the County to review the contractor's actual costs to support any price increases.**

CSS

CSS has 23 contracts, totaling $10.4 million, with various cities and non-profit organizations to provide Area Agency on Aging (AAA) Elderly Nutrition Program (Program) services. The contracts require the agencies to provide meals to the Program participants. The agencies are paid a fixed fee per participant, which is intended to cover the cost of providing the meals. The contractors can subcontract for food services with CSS' prior approval. We noted 17 of the 23 service providers have subcontracts with caterers to provide meals.

Program Net Income

CSS' contracts require the cities and non-profit agencies to report their total Program revenue and actual allowable expenses, and return any net Program income (revenue in excess of cost) to CSS, or use the net income to provide additional services. CSS indicated that the net Program income provisions also apply to the food service subcontractors. However, the contracts do not specify how subcontractors' Program income should be monitored, and CSS does not monitor it. CSS should revise the contracts to require service providers to monitor subcontractor's Program revenues and expenses, and report any net Program Income to CSS.

CSS' contracts also do not specify if food discounts and rebates should be included when calculating Program income. It appears that at least some of the contractors and/or subcontractors may receive rebates and discounts. Specifically, ten of the subcontracts are with Morrison, which reported rebates for its Harbor/UCLA contract. CSS should revise its contracts to require service providers and subcontractors to compute their Program Income net of any rebates or discounts.

Recommendations

CSS management:

11. **Revise the Elderly Nutrition Program contracts to require contractors to monitor their subcontractors' Program income, and report any net income to CSS.**

12. **Revise the Elderly Nutrition Program contracts to require contractors and subcontractors to compute Program income net of any rebates or discounts.**

DCFS

The Judicial Council of California contracts with CulinArt of California, Inc. to operate the cafeteria at Edelman Children's Courthouse. DCFS has a sole source contract with the cafeteria operator to provide meals and snacks for children who are at the Courthouse. The contractor is paid a fixed fee per person served at an annual cost of $246,000. The contract does not require the contractor to share any rebates or cost savings with DCFS.

Documentation For Food Service Price Increases

The fixed fee has been increased twice since 2003 by a total of 23% from $5.25 to $6.47 per meal. The contractor has indicated that the increases were necessary because of higher food prices and an increase in the County Living Wage. However,

DCFS could not provide documentation supporting the increases. DCFS should consider amending the current contract to require the contractor to provide adequate support for any proposed price increases, and ensure that documentation is retained in DCFS' contract files. DCFS should also work with the Countywide work group discussed in Recommendation 2 to include standardized language in future contracts, if appropriate.

Recommendations

DCFS management:

13. **Consider amending the current contract with CulinArt, and include language in future food service contracts, requiring the contractors to provide adequate support for any proposed price increases, and retain the documentation in DCFS' contract files.**

14. **Work with the Countywide work group discussed in Recommendation 2 to include standardized language in future contracts, if appropriate.**

Parks

Parks contracts with Arcadia Unified School District (Arcadia) to provide food for a summer food and after-school snack program at various facilities. Arcadia is paid a fixed fee for each lunch or snack served, at an annual cost of $758,000.

Contract Savings Provisions

According to the State's records for FY 2009-10, Arcadia received approximately $227,500 in free USDA food for this program. Arcadia indicated to Parks that savings from USDA foods were already incorporated in their prices. However, we noted that Parks has not verified if Arcadia's prices reflect their actual savings, and the contract does not contain specific language requiring Arcadia to share any cost savings with the County. Parks should work with the Countywide work group to determine if Parks should include standardized cost savings/rebate language in its contract.

Recommendation

14. **Parks work with the Countywide work group to determine if the Department should include standardized cost savings/rebate language in its contract.**

Parks indicated that they will work with the Countywide work group and other appropriate governmental agencies to ensure all available savings are being realized.

Review of Report

We discussed the results of our review with the departments mentioned in this report. The departments have indicated general agreement with our findings and recommendations, and in some cases have begun to take action to implement them. The departments have also agreed to work with the Countywide workgroup, and to incorporate standardized contract terms and language in future solicitations, as appropriate. DHS also provided a written response, which is attached. We thank the managers and staff from these departments for their cooperation and assistance throughout our review.

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

Attachment

WLW:JLS:RGC:TK

c: William T Fujioka, Chief Executive Officer
Mitchell H. Katz, M.D., Director, Department of Health Services
Jerry Powers, Chief Probation Officer
Cynthia D. Banks, Director, Community and Senior Services
Philip L. Browning, Director, Department of Children and Family Services
Russ Guiney, Director, Department of Parks and Recreation
Tom Tindall, Director, Internal Services Department
Sachi A. Hamai, Executive Officer, Board of Supervisors
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Audit Committee

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LOS ANGELES COUNTY

Los Angeles County
Board of Supervisors

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To ensure access to high-quality, patient-centered, cost-effective health care to Los Angeles County residents through direct services at DHS facilities and through collaboration with community and university partners.

September 28, 2012

TO: Wendy L. Watanabe
Auditor-Controller

FROM: Mitchell H. Katz, M.D., Director
Department of Health Services

SUBJECT: **RESPONSE TO THE AUDITOR-CONTROLLER'S REVIEW OF COUNTY FOOD SERVICE CONTRACTS**

Thank you for providing the Department of Health Services with a draft copy of the Auditor-Controller's report of the County Food Service Contracts Review. As requested, we are providing our response to the recommendations that are specific to the Department of Health Services.

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

MHK:tlm:cm

Enclosure: 1

c: Greg Polk
Kathy Hanks

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COUNTY OF LOS ANGELES – DEPARTMENT OF HEALTH SERVICES
RESPONSE TO AUDITOR-CONTROLLER'S
REVIEW OF COUNTY FOOD SERVICE CONTRACTS

This is in response to the Auditor-Controller's review of County Food Service Contracts. The Department of Health Services (DHS) generally agrees with the following Auditor-Controller recommendations:

RECOMMENDATION NO. 1

CEO, ISD, County Counsel and each department that contracts for food services form a work group to develop a framework and standardized language for County food service contracts.

DHS Response:

DHS Contracts and Grants Division (C&G) will gladly participate in the Countywide food service contracts work group.

RECOMMENDATION NO. 2

Departments that contract for food services incorporate standardized contract language developed by the Countywide food service contracts work group into future food service solicitations and contracts when feasible.

DHS Response:

DHS C&G will consider incorporating the standardized contract language developed by the food service contracts work group in future solicitations and contracts.

RECOMMENDATION NO. 3

DHS Management work with County Counsel to obtain missing cost savings analyses from contractors, if possible, and resolve any savings owed to the County.

DHS Response:

DHS C&G will issue a written request to each food service contractor requesting specific cost savings analyses and repayment, accordingly. DHS C&G will also work with County Counsel to resolve noncompliance issues related to the cost savings analyses.

RECOMMENDATION NO. 4

DHS Management ensure that contractors submit required cost savings analyses.

DHS Response:

DHS C&G will provide a written reminder to food service contractors of their required compliance with all terms and conditions in their respective contracts and request the required cost savings analyses.

RECOMMENDATION NO. 5

DHS work with the CEO and County Counsel to finalize standard language to include in the food service contracts currently being solicited, and whether the new contracts should include sharing of cost savings and rebates.

DHS Response:

The current DHS Request for Proposals (RFP) for patient dietary services includes a per meal unit price and a per unit price for specific items listed under incidental and floor supplies. Since the new contract will not be a cost reimbursement contract, it will not involve sharing of cost savings and rebate.

RECOMMENDATION NO. 6

Ensure that future contracts require contractors to deduct rebates, credits and discounts from items that are billed based on actual costs, and guarantee the County access to cost, rebate and discount data necessary to analyze and validate the contractor's invoices.

DHS Response:

DHS will work with County Counsel to determine the appropriate approach to incorporate rebates, credits and discounts in future cost reimbursement contracts.

RECOMMENDATION NO. 7

DHS management clearly distinguish costs for patient meals from costs for cafeteria operations in future contracts, and disclose to the Board if DHS will be subsidizing cafeteria operations.

DHS Response:

DHS C&G will ensure future food service contracts include clear and specific language distinguishing patient dietary meal costs from concession cafeteria costs.

Also, DHS C&G will notify the Board in the event the Department considers subsidizing cafeteria operations.

RECOMMENDATION NO. 8

DHS management provide training and oversight to ensure staff adequately monitor food service contractors' compliance with the contracts.

DHS Response:

DHS is in the process of restructuring its overall contract monitoring operations, including contract monitoring reporting and oversight responsibilities. DHS has also engaged the Auditor-Controller's Countywide Contract Monitoring Division to assist in the development and presentation of training to all contract monitoring staff involved with contracts, which is expected to be implemented by the end of 2012.