

LOS ANGELES COUNTY

Audit Report

SERIOUSLY EMOTIONALLY DISTURBED (SED) PUPILS: OUT-OF-STATE MENTAL HEALTH SERVICES PROGRAM

Chapter 654, Statutes of 1996

July 1, 1997, through June 30, 2003



STEVE WESTLY
California State Controller

May 2005



STEVE WESTLY
California State Controller

May 6, 2005

Mr. J. Tyler McCauley
Auditor-Controller
Los Angeles County
500 West Temple Street, Room 525
Los Angeles, CA 90012

Dear Mr. McCauley:

The State Controller's Office audited the claims filed by Los Angeles County for costs of the legislatively mandated Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services Program (Chapter 654, Statutes of 1996) for the period of July 1, 1997, through June 30, 2003.

The county claimed \$45,657,128 for the mandated program. Our audit disclosed that \$41,491,147 is allowable and \$4,165,981 is unallowable. The unallowable costs occurred because the county claimed unsupported costs and overstated indirect costs. The State paid the county \$782,295. The State will pay allowable costs claimed that exceed the amount paid, totaling \$40,708,852, contingent upon available appropriations.

If you have any questions, please contact Jim L. Spano, Chief, Compliance Audits Bureau, at (916) 323-5849.

Sincerely,

Original Signed By:

VINCENT P. BROWN
Chief Operating Officer

VPB:JVB/ams

cc: Leonard Kaye
SB 90 Coordinator
Los Angeles County
Gurubanda Singh Khalsa
Director of Finance
Department of Mental Health
Los Angeles County
James Tilton, Program Budget Manager
Corrections and General Government
Department of Finance
Zoey Todd
Special Education Program
Department of Mental Health

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Audit Report

Summary

The State Controller's Office (SCO) audited the claims filed by Los Angeles County for costs of the legislatively mandated Seriously Emotionally Disturbed (SED) Pupils: Out-of-State Mental Health Services Program (Chapter 654, Statutes of 1996) for the period of July 1, 1997, through June 30, 2003. The last day of fieldwork was November 15, 2004.

The county claimed \$45,657,128 for the mandated program. The audit disclosed that \$41,491,147 is allowable and \$4,165,981 is unallowable. The unallowable costs occurred because the county claimed unsupported costs and overstated indirect costs. The State paid the county \$782,295. The State will pay allowable costs claimed that exceed the amount paid, totaling \$40,708,852, contingent upon available appropriations.

Background

Chapter 654, Statutes of 1996, added and amended *Government Code* Section 7576 by allowing new fiscal and programmatic responsibilities for counties to provide mental health services to SED pupils placed in out-of-state residential programs. Counties' fiscal and programmatic responsibilities, including those set forth in *California Code of Regulations* Section 60100, provide that residential placements for SED pupils may be made out of the state only when no in-state facility can meet the pupil's needs.

On May 25, 2000, the Commission on State Mandates (COSM) determined that Chapter 654, Statutes of 1996, imposed a state mandate reimbursable under *Government Code* Section 17561 for the following:

- Payment of out-of-state residential placements for SED Pupils;
- Case management of out-of-state residential placements for SED pupils, including supervision of mental health treatment and monitoring of psychotropic medications;
- Travel to conduct quarterly face-to-face contacts at the residential facility to monitor level of care, supervision, and the provision of mental health services, as required in the pupil's Individualized Education Plan; and
- Program management, which includes parent notifications as required, payment facilitation, and all other activities necessary to ensure that a county's out-of-state residential placement program meets the requirements of *Government Code* Section 7576.

Parameters and Guidelines establishes the state mandate and defines reimbursement criteria. COSM adopted *Parameters and Guidelines* on October 26, 2000. In compliance with *Government Code* Section 17558, the SCO issues claiming instructions for mandated programs, to assist local agencies and school districts in claiming reimbursable costs.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the SED Pupils: Out-of-State Mental Health Services Program for the period of July 1, 1997, through June 30, 2003.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, not funded by another source, and not unreasonable and/or excessive.

We conducted the audit according to *Government Auditing Standards*, issued by the Comptroller General of the United States, and under the authority of *Government Code* Section 17558.5. We did not audit the county's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that costs claimed were allowable for reimbursement. Accordingly, we examined transactions, on a test basis, to determine whether the costs claimed were supported.

We limited our review of the county's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

Conclusion

Our audit disclosed instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Summary of Program Costs (Schedule 1) and in the Findings and Recommendations section of this report.

For the audit period, Los Angeles County claimed \$45,657,128 for costs of the SED Pupils: Out-of-State Mental Health Services Program. Our audit disclosed that \$41,491,147 is allowable and \$4,165,981 is unallowable.

For fiscal year (FY) 1997-98, the State paid the county \$225,545. Our audit disclosed that \$3,061,324 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$2,835,779, contingent upon available appropriations.

For FY 1998-99, the State paid the county \$199,767. Our audit disclosed that \$3,627,868 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$3,428,101, contingent upon available appropriations.

For FY 1999-2000, the State paid the county \$186,644. Our audit disclosed that \$4,389,961 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$4,203,317, contingent upon available appropriations.

For FY 2000-01, the State paid the county \$169,541. Our audit disclosed that \$6,739,077 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$6,569,536, contingent upon available appropriations.

For FY 2001-02, the county received no payment from the State. Our audit disclosed that \$10,029,360 is allowable, and this amount will be paid by the State contingent upon available appropriations.

For FY 2002-03, the State paid the county \$798. Our audit disclosed that \$13,643,557 is allowable. The State will pay allowable costs claimed that exceed the amount paid, totaling \$13,642,759, contingent upon available appropriations.

**Views of
Responsible
Official**

We issued a draft audit report on March 9, 2005. J. Tyler McCauley, Auditor-Controller, responded by letter dated April 1, 2005 (Attachment), agreeing with the audit results. This final audit report includes the district's response.

Restricted Use

This report is solely for the information and use of Los Angeles County, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original Signed By:

JEFFREY V. BROWNFIELD
Chief, Division of Audits

**Schedule 1—
Summary of Program Costs
July 1, 1997, through June 30, 2003**

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustments	Reference ¹
<u>July 1, 1997, through June 30, 1998</u>				
Salaries and benefits	\$ 4,218,550	\$ 48,452	\$ (4,170,098)	Findings 1, 3
Services and supplies	—	4,204,873	4,204,873	Finding 1
Training and travel	—	13,677	13,677	Finding 1
Indirect costs	386,362	78,780	(307,582)	Findings 3, 6
Total costs	4,604,912	4,345,782	(259,130)	
Less offsetting savings/reimbursements	(1,284,458)	(1,284,458)	—	
Total reimbursable costs	<u>\$ 3,320,454</u>	3,061,324	<u>\$ (259,130)</u>	
Less amount paid by the State		(225,545)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 2,835,779</u>		
<u>July 1, 1998, through June 30, 1999</u>				
Salaries and benefits	\$ 4,843,904	\$ 218,344	\$ (4,625,560)	Findings 1, 3, 4
Services and supplies	—	4,828,114	4,828,114	Finding 1
Training and travel	—	15,790	15,790	Finding 1
Indirect costs	405,739	67,059	(338,680)	Findings 3, 4, 6
Total costs	5,249,643	5,129,307	(120,336)	
Less offsetting savings/reimbursements	(1,501,439)	(1,501,439)	—	
Total reimbursable costs	<u>\$ 3,748,204</u>	3,627,868	<u>\$ (120,336)</u>	
Less amount paid by the State		(199,767)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 3,428,101</u>		
<u>July 1, 1999, through June 30, 2000</u>				
Salaries and benefits	\$ 5,975,520	\$ 238,603	\$ (5,736,917)	Findings 1-4
Services and supplies	—	5,717,781	5,717,781	Findings 1, 5
Training and travel	—	13,137	13,137	Finding 1
Indirect costs	631,170	172,122	(459,048)	Findings 1-6
Total costs	6,606,690	6,141,643	(465,047)	
Less offsetting savings/reimbursements	(1,751,682)	(1,751,682)	—	
Total reimbursable costs	<u>\$ 4,855,008</u>	4,389,961	<u>\$ (465,047)</u>	
Less amount paid by the State		(186,644)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 4,203,317</u>		

Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustments	Reference ¹
<u>July 1, 2000, through June 30, 2001</u>				
Salaries and benefits	\$ 9,374,240	\$ 256,859	\$ (9,117,381)	Findings 1-4
Services and supplies	—	9,032,881	9,032,881	Finding 1
Training and travel	—	21,671	21,671	Finding 1
Indirect costs	957,435	236,561	(720,874)	Findings 2-4, 6
Total costs	10,331,675	9,547,972	(783,703)	
Less offsetting savings/reimbursements	(2,808,895)	(2,808,895)	—	
Total reimbursable costs	<u>\$ 7,522,780</u>	6,739,077	<u>\$ (783,703)</u>	
Less amount paid by the State		(169,541)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 6,569,536</u>		
<u>July 1, 2001, through June 30, 2002</u>				
Salaries and benefits	\$ 13,779,490	\$ 394,196	\$ (13,385,294)	Findings 1-3
Services and supplies	—	13,323,945	13,323,945	Finding 1
Training and travel	—	25,086	25,086	Finding 1
Indirect costs	1,345,007	323,189	(1,021,818)	Findings 2, 3, 6
Total costs	15,124,497	14,066,416	(1,058,081)	
Less offsetting savings/reimbursements	(4,037,056)	(4,037,056)	—	
Total reimbursable costs	<u>\$ 11,087,441</u>	10,029,360	<u>\$ (1,058,081)</u>	
Less amount paid by the State		—		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 10,029,360</u>		
<u>July 1, 2002, through June 30, 2003</u>				
Salaries and benefits	\$ 18,915,826	\$ 297,473	\$ (18,618,353)	Findings 1-3
Services and supplies	—	18,515,348	18,515,348	Finding 1
Training and travel	—	32,727	32,727	Finding 1
Indirect costs	1,711,399	301,993	(1,409,406)	Findings 2, 3, 6
Total costs	20,627,225	19,147,541	(1,479,684)	
Less offsetting savings/reimbursements	(5,503,984)	(5,503,984)	—	
Total reimbursable costs	<u>\$ 15,123,241</u>	13,643,557	<u>\$ (1,479,684)</u>	
Less amount paid by the State		(798)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 13,642,759</u>		

Schedule 1 (continued)

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustments	Reference ¹
<u>Summary: July 1, 1997, through June 30, 2003</u>				
Salaries and benefits	\$ 57,107,530	\$ 1,453,927	\$ (55,653,603)	
Services and supplies	—	55,622,942	55,622,942	
Training and travel	—	122,088	122,088	
Indirect costs	<u>5,437,112</u>	<u>1,179,704</u>	<u>(4,257,408)</u>	
Total costs	62,544,642	58,378,661	(4,165,981)	
Less offsetting savings/reimbursements	<u>(16,887,514)</u>	<u>(16,887,514)</u>	—	
Total reimbursable costs	<u>\$ 45,657,128</u>	41,491,147	<u>\$ (4,165,981)</u>	
Less amount paid by the State		<u>(782,295)</u>		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ 40,708,852</u>		

¹ See the Findings and Recommendations section.

Findings and Recommendations

**FINDING 1—
Costs misclassified on
Form SEDP-1**

The county incorrectly reported all direct costs under the salaries object account in Form SEDP-1 of the reimbursement claims during the audit period. We reclassified costs from the salaries object account for presentation purposes.

Reclassified costs are summarized as follows.

	Fiscal Year						Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	
Salaries and benefits	\$(4,218,550)	\$(4,843,904)	\$(5,733,651)	\$(9,054,552)	\$(13,349,031)	\$(18,548,075)	\$(55,747,763)
Services and supplies	4,204,873	4,828,114	5,720,514	9,032,881	13,323,945	18,515,348	55,625,675
Training and travel	13,677	15,790	13,137	21,671	25,086	32,727	122,088
Indirect costs	(52,788)	(75,635)	(39,970)	(53,497)	92,758	129,132	—
Total	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Recommendation

We recommend the county ensure that all costs claimed are properly classified.

County’s Response

The county concurs with this finding.

SCO’s Comment

The finding and recommendation remain unchanged.

**FINDING 2—
Unsupported DMH
program management
salaries, benefits, and
related indirect costs**

The county claimed \$350,313 of unsupported Department of Mental Health (DMH) program management salaries and benefits for the period of July 1, 1999, through June 30, 2003. The county did not provide any evidence to support mandate-related time spent by the clinical district chief and the clinical program department head. The related indirect costs totaled \$55,561, based on the indirect cost rates claimed during the audit period.

Overclaimed costs are summarized as follows.

	Fiscal Year				Total
	1999-2000	2000-01	2001-02	2002-03	
Salaries	\$ (43,057)	\$ (59,312)	\$ (73,940)	\$ (102,486)	\$ (278,795)
Benefits	(9,731)	(16,323)	(18,818)	(26,646)	(71,518)
Subtotal	(52,788)	(75,635)	(92,758)	(129,132)	(350,313)
Related indirect costs	(8,842)	(10,180)	(13,747)	(22,792)	(55,561)
Audit adjustment	\$ (61,630)	\$ (85,815)	\$ (106,505)	\$ (151,924)	\$ (405,874)

The errors are attributed to the county claiming a portion of the salaries for the clinical district chief and the clinical program department head based on percentages. The percentages were developed by dividing the number of out-of-state clients by the total number of clients for each fiscal year. The resulting percentages were applied to the administrators’

annual salaries. In addition, a benefits rate was applied to the computed labor costs to determine the annual benefits costs. The county claimed 29% of salaries for FY 1999-2000, 36% of salaries for FY 2000-01, 39% of salaries for FY 2001-02, and 48% of salaries for FY 2002-03. The county did not provide any documentation, such as time logs, to validate the percentages of time worked on mandate-related activities.

Parameters and Guidelines states that counties will be reimbursed for program management costs, which include the costs of parent notifications as required, payment facilitation, and all other activities necessary to ensure that a county's out-of-state residential placement program meets the requirements of *Government Code* Section 7576 and the *California Code of Regulations*, Title 2, Subdivision 60110. *Parameters and Guidelines* also states that all costs claimed must be traceable to source documentation that shows evidence of the validity of such costs.

Recommendation

We recommend the county ensure that claimed costs are supported by appropriate documentation.

County's Response

The county concurs with this finding.

SCO's Comment

The finding and recommendation remain unchanged.

FINDING 3— Underclaimed DCFS program management salaries, benefits, and indirect costs

During the audit period, the county underclaimed \$310,533 of the salary and benefits of a Department of Children and Family Services (DCFS) eligibility worker. The related indirect costs totaled \$22,596, based on indirect costs claimed during the audit period. The county inadvertently omitted these costs from the reimbursement claims.

Underclaimed costs were as follows.

	Fiscal Year						Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	
Salaries	\$ 36,250	\$ 36,250	\$ 36,250	\$ 37,280	\$ 39,230	\$ 40,704	\$ 225,964
Benefits	12,202	12,202	12,202	12,548	17,265	18,150	84,569
Subtotal	48,452	48,452	48,452	49,828	56,495	58,854	310,533
Related indirect costs	3,625	3,625	3,625	3,728	3,923	4,070	22,596
Audit adjustment	\$ 52,077	\$ 52,077	\$ 52,077	\$ 53,556	\$ 60,418	\$ 62,924	\$ 333,129

Parameters and Guidelines states that counties will be reimbursed for program management costs, which include the costs of parent notifications as required, payment facilitation, and all other activities necessary to ensure that a county's out-of-state residential placement program meets the requirements of *Government Code* Section 7576 and the *California Code of Regulations*, Title 2, Subdivision 60110.

Recommendation

We recommend the county ensure that all eligible and supported costs are claimed.

County’s Response

The county concurs with this finding.

SCO’s Comment

The finding and recommendation remain unchanged.

**FINDING 4—
Underclaimed DMH
case management
salaries, and related
indirect costs**

The county underclaimed Department of Mental Health case management salaries totaling \$133,940 for the period of July 1, 1998, through June 30, 2001. The related net indirect costs totaled \$16,993, based on the indirect cost rates claimed during the audit period.

The county inadvertently claimed these costs under the Handicapped and Disabled Students mandated cost program. We adjusted the overstatement claimed in that program.

Net underclaimed costs are summarized as follows.

	Fiscal Year			Total
	1998-99	1999-2000	2000-01	
Salaries	\$ 169,892	\$ 1,070	\$ (37,022)	\$ 133,940
Related indirect costs	22,149	152	(5,308)	16,993
Audit adjustment	<u>\$ 192,041</u>	<u>\$ 1,222</u>	<u>\$ (42,330)</u>	<u>\$ 150,933</u>

Parameters and Guidelines states that counties will be reimbursed for case management of SED pupils in out-of-state residential placements, including supervision of mental health treatment and monitoring of psychotropic medications, as specified in *Government Code* Section 7576 and the *California Code of Regulations*, Title 2, Subdivision 60110.

Recommendation

We recommend the county ensure that claimed costs are reimbursable under the mandated program.

County’s Response

The county concurs with this finding.

SCO’s Comment

The finding and recommendation remain unchanged.

**FINDING 5—
Unsupported DMH
contracted service
cost and related
indirect costs**

For FY 1999-2000, the county claimed \$2,733 in unsupported Department of Mental Health contracted mental health service costs. The related indirect cost is \$299, based on the indirect cost rate claimed during that fiscal year.

The county did not provide any documentation to support the cost for 31 days of mental health service claimed for reimbursement. Multiplying the 31 days by the daily rate of \$88.17 totals \$2,733.

Parameters and Guidelines states that counties will be reimbursed for payments to service vendors providing mental health services to SED pupils in out-out-state residential placements as specified in *Government Code* Section 7576 and the *California Code Regulations*, Title 2, Subdivisions 60100 and 60110. *Parameters and Guidelines* also states that all costs claimed must be traceable to source documentation that shows evidence of the validity of such costs.

Recommendation

We recommend the county ensure that claimed costs are supported by appropriate documentation.

County’s Response

The county concurs with this finding.

SCO’s Comment

The finding and recommendation remain unchanged.

**FINDING 6—
Overstated indirect
costs claimed**

The county overstated the indirect costs claimed by \$4,241,137 (\$403,066 for the Department of Mental Health and \$3,838,071 for the Department of Children and Family Services).

Department of Mental Health

Indirect costs for the Department of Mental Health were overclaimed because the county used inflated indirect cost rates. The rates applied by the county included the costs of the management information system (MIS). These costs should not have been used to compute the indirect cost rates because the department did not process any of its payments to contractors and program management through this billing system. We recomputed the rates for the audit period excluding the MIS costs.

The audited and claimed indirect cost rates are summarized below.

	Fiscal Year					
	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03
<u>Vendor Payments</u>						
Allowable indirect cost rate	5.70%	2.77%	7.74%	7.64%	6.47%	4.23%
Less claimed indirect cost rate	(7.20)%	(4.41)%	(10.94)%	(10.31)%	(8.68)%	(6.49)%
Unsupported indirect cost rate	(1.50)%	(1.64)%	(3.20)%	(2.67)%	(2.21)%	(2.26)%
<u>Program Management Payments</u>						
Allowable indirect cost rate	—	—	—	—	13.11%	15.91%
Less claimed indirect cost rate	—	—	—	—	(14.82)%	(17.65)%
Unsupported indirect cost rate	0.00%	0.00%	0.00%	0.00%	(1.71)%	(1.74)%

Based on these unsupported indirect cost rates, the audit adjustments are summarized below.

	Fiscal Year						Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	
Vendor Payments							
Allowable payments	\$1,285,651	\$1,415,752	\$1,736,685	\$2,649,028	\$4,148,818	\$6,006,294	
Unsupported indirect cost rates	× (1.50)%	× (1.64)%	× (3.20)%	× (2.67)%	× (2.21)%	× (2.26)%	
Audit adjustment	(19,285)	(23,218)	(55,574)	(70,729)	(91,689)	(135,742)	\$ (396,237)
Program Management Payments							
Allowable payments	—	—	—	—	163,272	232,032	
Unsupported indirect cost rates	× 0.00%	× 0.00%	× 0.00%	× 0.00%	× (1.71)%	× (1.74)%	
Audit adjustment	—	—	—	—	(2,792)	(4,037)	(6,829)
Total adjustment	\$ (19,285)	\$ (23,218)	\$ (55,574)	\$ (70,729)	\$ (94,481)	\$ (139,779)	\$ (403,066)

Department of Children and Family Services

Indirect costs for the Department of Children and Family Services were overclaimed because the county applied the standard 10% indirect cost rate allowed by *Parameters and Standard Guidelines* to vendor payments. However, *Parameters and Guidelines* allows the standard 10% indirect cost rate only on direct labor, excluding fringe benefits. Therefore, 100% of the indirect costs claimed were unallowable.

Based on misapplication of the standard 10% indirect cost rates, the audit adjustments are summarized below.

	Fiscal Year						Total
	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	
Vendor payments	\$ 2,919,222	\$ 3,412,362	\$ 3,981,096	\$ 6,383,853	\$ 9,175,127	\$ 12,509,054	\$ 38,380,714
Unallowable indirect cost rates applied	× (10)%	× (10)%	× (10)%	× (10)%	× (10)%	× (10)%	× (10)%
Audit adjustment	\$ (291,922)	\$ (341,236)	\$ (398,110)	\$ (638,385)	\$ (917,513)	\$ (1,250,905)	\$ (3,838,071)

Parameters and Guidelines states that claimants will be reimbursed for indirect costs based on 10% of direct labor, excluding fringe benefits, or a rate greater than 10% if an indirect cost rate proposal is prepared.

Recommendation

We recommend the county ensure that indirect costs claimed are eligible and supported.

County's Response

The county concurs with this finding.

SCO's Comment

The finding and recommendation remain unchanged.

**Attachment—
County’s Response to
Draft Audit Report**



J. TYLER McCAULEY
AUDITOR-CONTROLLER

**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-2766
PHONE: (213) 974-8301 FAX: (213) 626-5427

April 1, 2005

Mr. James L. Spano, Chief
Compliance Audits Bureau
Division of Audits
State Controller's Office
Post Office Box 942850
Sacramento, California 94250-5874

Dear Mr. Spano:

Los Angeles County Comments
State Controller's Office Draft Audit Report
Seriously Emotionally Disturbed Pupils: Out-of-State Mental Health Services

We concur with your findings that of the \$45,657,128 claimed for the subject program for the period July 1, 1997 through June 30, 2003, \$4,165,981 is not allowable.

We note that your examination of our out-of-State vendor costs found only \$2,733 not allowable.

The \$4,165,981 in unallowable costs resulted primarily from differences in computing indirect costs. For example, our 6.49% indirect cost rate for processing mental health vendor payments included our management information system [MIS] costs. However, as you note, we did not process vendor bills through our MIS system and, as you found, our indirect cost rate should be 4.23%.

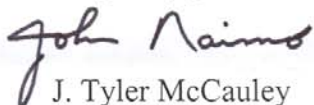
Accordingly, we will be implementing policies and procedures to ensure that indirect costs as well as direct costs are eligible and supported.

"To Enrich Lives Through Effective and Caring Service"

Mr. James L. Spano
April 1, 2005
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Leonard Kaye of my staff is available at (213) 974-8564 to answer questions you may have concerning this submission.

Very truly yours,

 FOR
J. Tyler McCauley
Auditor-Controller

cc: Gurubanda Singh Khalsa
Director of Finance
Department of Mental Health
Los Angeles County
Paul McIver
District Chief, Countywide Programs
Children System of Care
Department of Mental Health
Los Angeles County

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<http://www.sco.ca.gov>