OFFICE OF

STATE INSPECTOR GENERAL

DEPARTMENT OF CORRECTIONS JUVENILE HOUSING CONTRACTS

Report by

Inspector General Bill Lynch

Prepared for

Governor M.J. "Mike" Foster, Jr.

September 19, 2000

File No. 1-00-0057

State of Louisiana

OFFICE OF

STATE INSPECTOR GENERAL

Department of Corrections
Juvenile Housing Contracts

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September 5, 2000

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Department of Corrections
Juvenile Housing Contracts

The Department of Corrections has left itself vulnerable to contract abuse by failing to properly evaluate, monitor, or enforce expenditure projections used to support the per diem rate charged by private providers for residential services to house juveniles.

Under the request for proposal and contract, the provider's budget projection is used to determine the per diem rate paid. However, the Department of Corrections has failed to adequately review the appropriateness of budget projections. As a result, the Department of Corrections has paid providers their proposed rates without determining whether those rates are reasonable and justified.

Two private providers were reviewed. During the first year of these two current contracts, the excess amount paid by the Department of Corrections is at least $366,000. Of that amount, $221,000 consists of prepayments and costs not incurred and $145,000 results from excessive lease costs. In addition, our review of one provider's actual expenses for a 12 month period during its prior contract showed the Department of Corrections paid at least $150,000 more than the provider's actual costs to house the juveniles.

Using the budget set forth in their proposals, the per diem rates charged by the two providers are excessive due to the inclusion of inflated costs, non-related costs and costs the provider may not incur.

Background

The Department of Corrections (Department) is responsible for the incarceration of approximately 2,680 juveniles who have been adjudicated delinquent. The Department houses the juveniles in both State and privately owned facilities.

According to Department officials there are approximately 1,750 juveniles in State owned facilities and 933 juveniles in private contract facilities. The Department spends approximately $48 million annually on the State owned facilities, and $26 million annually on the private facilities.

Approximately 568 of the 933 juveniles housed in private facilities are in the residential services program, a structured behavior program in a non-secure setting.

Louisiana law allows the Department to negotiate contracts for correctional services. The Department utilizes a request for proposal (RFP) process to obtain services from privately owned facilities. The RFP sets minimum requirements that the prospective provider must meet.

The minimum requirements in the RFP include the provider having sufficient financial resources to operate for 90 days, backed by an audited financial statement or a letter of credit in favor of the Department. The provider must be able to accept juveniles within 90 days of the award. Providers are required to have American Correctional Association accreditation or earn the accreditation within twelve months. The proposed daily rate must be supported by a detailed twelve month budget and a current audited financial statement.

Contracts awarded by the Department have a three year term with two optional twelve month extensions, and may be cancelled with or without cause by either party after giving 30 days written notice. The Department reserves the right to renegotiate the per diem if a renewal option is exercised. The new rate cannot be increased more than the average change in the Consumer Price Index during the initial three year contract.

Proposals submitted by the contractors are graded as follows:

Oral presentation	20 points
Qualifications of Contractor	10 points
Technical Approach	15 points
Proposed Site	5 points
Per diem rate	50 points

Proposals with the highest total score are given priority and awarded contracts until the required number of beds are committed.

Seven contracts were awarded commencing Jan. 1, 1999. The seven contracts totaled 259 beds with per diem costs ranging from \$62.00 - \$88.28. The cost of these contracts is approximately \$7.5 million per year.

We reviewed the RFP and two resulting contracts: Larry Reynolds Institute of Youth Guidance, Inc., located in Ponchatoula, La., and Tyche, Inc., located in Tallulah, La. These companies submitted the two highest per diem rates and house the largest number of juveniles.

RFP Evaluation

The RFP for juvenile residential services requires each potential provider to support its proposed daily rate with a detailed 12 month budget and a current audited financial statement.

The audited statement as required in the RFP does not provide the Department with details of the facility's actual cost of juvenile care. For example, the audited financial statement for Reynolds does not provide sufficient detail to determine its actual expenses for juvenile care; it only provides the total cost of corporate operations. In addition, the Tyche corporate financial statement only includes the combined cost of five separate divisions, one of which is not a juvenile care facility.

The contract allows the Department "the right to audit and examine the Contractor's books and records for the purpose of determining the validity of those amounts included in the determination of the per diem or unit cost."

The Department treats these contracts as a fee for service arrangement. Although an RFP process encourages further negotiation, for the two contracts reviewed, the Department awarded the contracts at the proposed per diem rate. Because the RFP and the contract require the per diem rate to be supported by the annual budget, and because the proposed per diem rate is 50% of the award criteria, the Department should assure itself of the validity of the cost projections and that actual costs are related to the proposed budget. It may then negotiate for lower rates where costs do not support the proposed rate.

According to Department employees, they do not audit the projected expenditures included in the budget before, during, or after the contract is awarded.

As a result of failing to evaluate the proposed per diem rates in relation to the supporting budget and actual costs, contracts have been issued which pay excessive per diem rates.

Excessive Rates

Per diem rates paid by the Department for the care of juveniles are higher than justified due to the inclusion of inflated costs, non-related costs, and costs which the provider may not incur.

The excess $366,000 paid by the Department to providers during the first year of these current contracts is comprised of the following:

1. $112,600 - prepaid expenses.

2. $108,000 – projected costs not incurred.

3. $145,000 – excess lease cost.

In addition, one provider's actual expenses for a 12 month period during its prior contract showed the Department paid at least $150,000 more than the provider's costs for juvenile care.

Larry Reynolds Institute of Youth Guidance, Inc.

Reynolds Institute of Youth Guidance, Inc. has the capacity to house 60 juveniles. Frank P. Letellier II, Chairman of the Board, oversees the operation. Reynolds Institute was founded in 1955 and incorporated in 1970 as a non-profit organization.

1998 Contract

During fiscal year ending June 30, 1998, Reynolds Institute was under contract with the Department to house a maximum of 60 juveniles with a per diem rate of $68.64.

The actual expenditures for Reynolds Institute during that fiscal year were reviewed. The review revealed a number of expenditures not related to juvenile care.

Some of the more significant non-related expenditures are as follows:

- $6,292 - Cost of insurance/retirement policies allocated to Mr. Letellier. Mr. Letellier is not an employee of Reynolds Institute, and therefore this cost should not be allowed. The annual premium for Mr. Letellier is $46,639, however, only $6,292 was charged to contract costs. The remaining cost of the policies, $40,347, is paid from the excess payments generated from the state contract.

- $4,295 - Travel expenses; primarily associated with the Washington, D.C., Mardi Gras ball attended by Mr. Letellier, his wife Rosalind Letellier, and Doreen Bouffard, Reynolds' Financial Officer. This travel was not related to juvenile care.

- $6,000 - Repairs to the parking lot at the Metairie, La. office. These repairs are a one time expenditure and should have been allocated between juvenile care and other Reynolds Institute activities.

- $12,866 - Meals charged to credit cards by Mr. Letellier. The meals are at area restaurants with a frequency of 15 to 25 times per month. Most of the charges range from $20 to $40, however; several meals range from $100 to $360. There was no supporting documentation relating these meals to the care of juveniles.

- $12,000 - Dietitian services performed by Mrs. Letellier. Mrs. Letellier is a consultant to Reynolds Institute. She periodically reviews and approves the menus used by Reynolds. According to Reynolds Institute staff, there are five menus which rotate on a weekly basis. The menus have had only minor changes during the past several years. There is no documentation indicating the hours spent providing services to Reynolds Institute by Mrs. Letellier. According to staff, Mrs. Letellier spends a minimal amount of time providing services to Reynolds.

  Mrs. Letellier is actually paid $24,000 per year by Reynolds Institute, however the budget indicates $12,000 per year was charged to juvenile services. The remaining $12,000 is paid from the excess payments generated by the state contract.

- $5,155 - Miscellaneous expenses for causeway bridge tolls, and a loan which is not collectable. There is no documentation these costs are related to juvenile care.

By adjusting for non-related expenditures, the costs to house juveniles during fiscal year ending June 30, 1998, was calculated to be no greater than $61.35 per day. The difference between adjusted cost and the per diem payments is approximately $150,000.

1999 Contract

Reynolds Institute submitted a proposal in response to the Department RFP for a contract commencing Jan. 1, 1999. The proposal submitted by Reynolds Institute included a proposed budget resulting in a per diem rate of $88.28. Reynolds was awarded a contract beginning Jan. 1, 1999, ending Dec. 31, 2001, with a maximum contract amount of $5,842,701 for the three year period. The contract includes an option to renew for two additional twelve month periods.

The 1999–2001 contract per diem rate of $88.28 is $26.93 greater than the adjusted cost of $61.35 for fiscal year ending June 30, 1998. Cost increases were identified primarily in the following areas:

- $173,000 - Salaries included in the proposed budget are projected to increase by 24%.
- $ 16,600 - Indirect salary expenses (related payroll taxes and insurance) are projected to increase by 21%.
- $161,900 - Costs of employee medical insurance for non-administrative employees. Actual expenses for 1998 did not include medical insurance for non-administrative employees.
- $ 5,100 - Conference expenses for Reynolds Institute employees.
- $ 52,400 - Operating expenses, which includes insurance, maintenance auto/van, building maintenance, and utilities.
- $ 38,200 - Operating supplies, which includes office supplies, food, maintenance supplies, and juvenile offender personal items.
- $ 8,900 - Professional services.
- $ 73,800 - Proposed acquisitions for buildings, automobiles, and other equipment.
- $15,750 - Other costs, which includes interest expense and miscellaneous expenses.

The 1999-2001 contract per diem rate of $88.28 is approximately 44% greater than the adjusted costs for fiscal year ending June 30, 1998, and 29% greater than the prior contract per diem rate of $68.64. The large increase in per diem rate should have caused the Department to scrutinize Reynolds Institute's proposed budget before approving the contract.

Contract Deficiencies

The contract between the Department and Reynolds Institute is flawed in the following manner:

1. Prepayments

The contract per diem rate is based on an average annual projected cost over a five year "contract" period. However, the contract term is a three year period with the option to renew for two 12 month extensions. Costs escalate in each year of the five year budget. Thus, the per diem rate, which is the same for the initial three year term of the contract, includes at the outset increased cost projections for years four and five, even if the renewal options are not exercised

Reynolds Institute included in its response schedules outlining projected costs for each year of the five year period for four budget expenditure categories. By subtracting the projected costs in year one of the contract from the average cost for the five year period for the four expenditure categories, Reynolds Institute will be overpaid $112,600 during the first year of the contract.

For example, salary expenses are projected to be $802,000 in year one of the contract. The per diem rate is based upon five year average salaries of $894,000, resulting in an excess payment of the salary budget in year one of $92,000.

If the contract is renewed during the fifth year, salary expenses are projected to be $955,500 in year five. The per diem rate is again based on $894,000 resulting in an underpayment in the salary budget for year five of $61,000.

The contract allows either party to cancel with 30 days notice. If for any reason the contract is canceled at the end of the first year, the contractor would have received $112,600 in prepaid expenses. At the end of year two an additional $40,000 would be prepaid bringing the total prepayment of projected costs for the first two years of the contract to $152,600.

The state may have no recourse to recover the excess payments if the contract is cancelled or not extended.

2. Projected Cost Not Adhered To

The issue of prepaid cost as described above is compounded if actual costs are less than budgeted. For example, Reynolds Institute projects salary expenses of $802,000 in year one of the contract. Actual salary expenses for year one of the contract were only $785,000.

The $17,000 ($802,000 - $785,000) represents an excess payment resulting from year one actual salaries being less than year one projected salaries. This excess payment is in addition to the $92,000 salaries prepayment detailed above.

For the four categories of expenses which are supported by a detailed five year expense schedule, the difference between the actual first year expenses and the projected budget results in an excess payment of $108,000.

The state may have no recourse to recover these excess payments.

3. Renewal Rate Increase

The contract is for a period of three years. The Department has the option to renew the contract at maturity for two additional 12 month periods. The projected budget on which the per diem rate is based includes cost increases in the annual budget for each year of the initial contract period and each of the two 12 month renewal periods.

The contract states "the Department of Correction reserves the right to renegotiate the per diem if the option to renew is exercised. The renegotiation is at the option of the Department and the rate of the increase for the renewal shall not exceed the average of the change in the Consumer Price Index from the beginning date to the date the renewal option is exercised."

Since cost increases in the two 12 month contract extensions are already factored into the per diem rate, Reynolds Institute would receive multiple increases if the Consumer Price Index contract clause is exercised.

Because the per diem rate exceeded the amount required to cover actual expenses, during the eleven month period Jan. 1, 1999, through Nov. 30, 1999, Reynolds Institute was able to accumulate $185,000, which it invested in a certificate of deposit. Reynolds Institute has additional certificates of deposit totaling $350,000.

According to Mr. Letellier, Reynolds Institute is in the process of increasing the pay scale for direct care workers which will increase the cost of salaries. Reynolds Institute currently has a turnover rate approaching 100% per year. As the result of increased pay scales, Mr. Letellier stated he anticipates the turnover rate will be reduced and more employees will qualify and participate in the medical insurance program resulting in an increase in costs. In addition, he also stated, a new multipurpose building is under construction with an estimated cost of $120,000.

Tyche, Inc.

Tyche, Inc. operates Christian Acres a 106 bed non-secure facility. Tyche was formed in 1981 as a for-profit organization. The corporation operates four separate juvenile facilities in northeast Louisiana: Evangeline Oaks, Briar Hill, Magnolia Ridge and Christian Acres.

The Department contracts for 80-82 beds at the Christian Acres facility with a per diem rate of $82.94. The contract period is for three years from Jan. 1, 1999, through Dec. 31, 2001, with an option to renew for two additional twelve month periods. The Department of Social Services contracts with Tyche for 16 beds at the Christian Acres facility.

The proposal submitted by Tyche includes a lease for the Christian Acres facility. Tyche leases the entire facility from Charles R. Brown for $16 per square foot, totaling $59,089 per month. The yearly payment for the lease equals $709,068, which indicates approximately 44,317 square feet. The Christian Acres facility is comprised of an administrative building, seven cottages, a gymnasium which includes the kitchen and classrooms, a wood shop, a maintenance shop, and a guard house.

The budget submitted to the Department allocates $535,584 for the lease which indicates 33,474 square feet at $16 per square foot. The lease agreement provides Tyche will be responsible for maintenance and repairs to the buildings, equipment and improvements, all taxes and assessments on the property, utilities, and insurance on the buildings. Except for improvements, these costs are normally paid by the lessor and included in the lease rate paid per square foot.

The proposed budget submitted to the Department lists the following:

- Annual lease - $535,584
- Maintenance - $60,672
- Real Estate Tax - $8,219
- Utilities - $68,217

- Property Insurance - $7,651
- Flood Insurance - $4,951

When the above projected expenditures are considered, the annual cost of the lease, climbs to $685,294 per year, or $20.47 per square foot.

The lease totals 29%, or $23.95 of the $82.94 per diem paid to Tyche.

The town of Tallulah is located in Madison parish. A review of State of Louisiana leases in Madison parish indicates a range from $2.91 per square foot for warehouse space not including utilities, to $16.12 for office space including utilities. These properties have 3,500 square feet and 4,402 square feet respectively. Generally smaller square footage leases of comparable properties command larger rates per square foot.

Larger properties leased by the State in north Louisiana include 16,500 square feet of office space in Monroe for $12.01 per square foot, including utilities; and a 132,325 square foot building used as the community college in Bossier City, for $10.58 per square foot, also including utilities.

While these properties are not comparable to the Christian Acres facility they do indicate a significant difference between the costs per square foot paid by Tyche and the amount paid by State agencies.

A comparison of the Christian Acres square footage cost of $20.47 per square foot to the Tallulah cost of $16.12 per square foot, and the Monroe cost of $12.01, per square foot, indicates the Christian Acres annual lease cost is excessive by at least $145,000 - $283,000.

Officials at Tyche, state they have leased the facility from the lessor since its construction in 1981, at approximately the same rate per square foot.

Officials at the Department are aware of the lease and the amount paid per square foot, but have not questioned or attempted to negotiate a lower per diem rate based on the excessive lease cost.

Conclusions:

1. The Department has paid residential juvenile care per diem rates which are greater than justified. The Department's failure to evaluate projected expenditures used to establish the per diem rates and determine providers' actual cost of services has resulted in payment for inflated cost, non-related costs, and costs which may not be incurred during the contract period.

2. The Department's acceptance of a per diem rate for a three year contract based on projected average cost over a five year period has resulted in prepayments to the provider which the state may have no recourse to recover should the contract not be extended.

3. The Department may pay more than once for cost increases as the result of per diem rates containing annual cost increases for a five year period and a contract clause that allows a per diem increase based on the Consumer Price Index.

Recommendations:

1. The Department should develop uniform standards for use by proposers in developing their budgets and calculating the per diem rate. At a minimum, the standards should address:

   - basic considerations; for example, the length of the contract and the contract terms to which all providers will be subject;

   - composition of budget; that is, which proposed costs may be included in the budget, and how they are added to calculate total budget;

   - a formula for deriving the per diem rate from the proposed budget;

   - detailed explanation of proposed costs included in the budget;

   - reasonableness of cost;

   - allocation of costs between the contract and other activities in which the provider participates;

- applicable credits (for example, interest earned on program funds);

- direct costs vs. indirect costs; and

- profit, if any.

2. Before awarding contracts the Department should compare the proposed budget with the providers' historical costs, and require cost increases to be justified.

3. Should the Department extend the current contract with Reynolds Institute, it should consider that the per diem rate includes cost increases for the extended lease periods. Therefore, a per diem increase based on the Consumer Price Index may not be warranted

Inspector General's Comment:

The Department's concept of requiring a budget be submitted to support the proposed per diem rate is sound. However, the Department needs to use the budget information it receives and review proposers' actual cost of services to insure that the rate it contracts to pay is the lowest reasonable rate.

The Department of Corrections response to this report is constructed to defend the use of the RFP process. While the Department deserves considerable credit for instituting a request for proposal process (RFP), the Department has not gone far enough in assuring that the costs used to determine the per diem charges are appropriate. The report does not question the use of the RFP process but exposes areas where improved review and analysis of provider's actual cost and control of proposed rates could lead to large savings. The fact that the Department's per diem rates are lower than the Department of Social Services rates does not make the rates acceptable.

The response states that budgets and audited financial statements are used to "judge the reasonableness of the per diem quoted." The report points out the unreasonableness of the budgets used (*i.e.*, five year budget plans used to develop a rate for a three year contract, proposed increases not supported by historical information, and questionable rental expenses) and the inadequacy of the financial statements to provide the actual historical cost of juvenile care.

1-00-0057
BL/GD/lk

DEPARTMENT OF
PUBLIC SAFETY AND CORRECTIONS

J. "MIKE" FOSTER, JR., GOVERNOR

RICHARD L. STALDER, SECRETARY

August 30, 2000

Mr. Bill Lynch
State Inspector General
P. O. Box 94095
Baton Rouge, LA 70804-9095

RE: Juvenile Housing Contracts
File # 1-00-0057

Dear Mr. Lynch:

The Department of Public Safety and Corrections has not left itself vulnerable to contract abuse. In 1992, to obtain competition among private providers, the Department began procuring social services by Request for Proposals (RFP) in accordance with La. R. S. 39:1503. Office of Contractual Review Rules and Regulations are followed and all contract awards are reviewed and approved by the Office of Contractual Review.

The two contracts reviewed by your office were awarded by the competitive RFP process in October 1998 for contracts to begin in January 1999. The RFP announcement was mailed to 330 proposers as well as advertised in four major newspapers and posted on the American Correctional Association web site. Seventy-nine proposals were received in response to this RFP and twenty-three contracts were awarded. Approximately thirty-two staff members from the Office of Youth Development district offices participated in the review process. These reviewers received eight hours of training prior to the review to become familiar with the process and to be made aware of important points in the proposals submitted.

After award, contracts are monitored a minimum of every six months in accordance with Department Regulation No. C-05-003 "Headquarters Audit-Adult and Juvenile Secure Institutions and Non-Secure Residential Contract Facilities". This regulation requires review of compliance with contractual agreements and extensive follow up of reported deficiencies. These documents were provided to your auditor. In addition to the semi-annual monitoring visits by trained staff, district officers make weekly site visits to ensure programmatic services are being provided to juveniles.

P.O. Box 94304 • Capitol Station • Baton Rouge, Louisiana 70804-9304
(225) 342-6740

The Agency Response will address "Conclusions" of the above referenced report.

These contracts are paid a per diem for services rendered. In order for staff to review and score 79 proposals in three months, a cost proposal that included a budget and an audited financial statement were required. The budget was not intended to constitute the payment authority or to form a cost reimbursement contract. This document, in conjunction with the information provided in the audited financial statement and other sources, was used to judge the reasonableness of the per diem quoted.

There have been several instances noted during monitoring visits by staff that contractors failed to comply with the services required by the contract. The Department reduced the per diem on one contract by $15.65 and deducted sums from payments to other contractors, including $20,980 from Reynolds Institute, for failure to comply with the services required by the contract. This information was available for your auditor's review.

Both Reynolds Institute and Tyche, Inc. have had contracts with the Department since 1990. We were able to compare the proposed per diem to the 26% increase in the consumer price index (CPI) from 1990. The following is a comparison of rates in 1990 as established by the Department of Social Services, Bureau of Rate Setting and the rates in 1999 by the competitive RFP process:

Program	*DSS Rate 1990/1991*	*RFP Rate 1999*	*% Change*
Reynolds Institute	*$69.29*	*$88.93*	*29%*
Tyche-Evangeline Oaks	*$69.29*	*$75.43*	*9%*
**Tyche-Christian Acres*	*$74.44*	*$83.59*	*13%*
Tyche-Briar Hill	*$101.38*	*$96.43*	*5% decrease*
Tyche-Magnolia Ridge	*$101.38*	*$96.43*	*5% decrease*

**Tyche-Christian Acres is currently being paid $103.19 by another state agency for the same services as provided the Department for $83.59.*

Taking into consideration the budget information which shows no cost for the building in the Reynolds proposal, the audited financial statements, the increase in the consumer price index and other information obtained during oral presentations by both contractors, the Department believes the per diems paid the contractors are reasonable and in line with other state and private agency costs for similar services.

The Department is not prepaying any service provider. All payments are made after contract services are provided in accordance with terms of the contract. The prepayments as referred to in your report are budget estimates for scoring cost proposals submitted by proposers. Contractors must anticipate costs for the potential five-year term of the contract to cover cost of living increases, changes in regulatory requirements (i.e.: licensing, fire marshal, health), replacement of equipment, major repairs and increases in the minimum wage. It should be noted that the consumer price index increased 2.7% for the period December 1998 to December 1999, the first year of the Reynolds contract.

Your report also made a point that the contract allows either party to cancel with 30 days notice. This clause sometimes prevents providers from obtaining loans to improve facilities and many like Reynolds rely on donations, grants and fund raising activities to supplement the per diems paid by the Department. The Department feels that this clause is a useful tool in protecting the state's interest. Contracts have been cancelled in the past with the provision because of budget cuts and contract failures.

Contractors are not guaranteed rate increases nor are they guaranteed a renewal at the end of the three-year contract. The Department has the option to renew and if the option is exercised, the Department reserves the right to renegotiate. Contracts have been terminated at the end of the three-year period and contractors have been denied their request to renegotiate the per diem rates. This information was also available to your auditor.

The Department is committed to the RFP process and we are confident that the RFP in conjunction with the Department's internal monitoring program during the past eight years is unique in State government and has resulted in cost containment and quality service to the juveniles adjudicated to the custody and care of this Department.

Sincerely,

Bernard E. "Trey" Boudreaux, III
Undersecretary

BEB:pba

c: Elijah Lewis, Assistant Secretary, Office of Youth Development
James Bueche, DYS Director

IT IS BETTER TO BUILD BOYS, THAN MEND MEN

REYNOLDS INSTITUTE

Ponchatoula Facility:
P. O. Box 595
16143 W. Murray Road
Ponchatoula, LA. 70454
Telephone (504) 386-9669
Fax (504) 386-8281

Corporate Address:
3212 16th Street
Suite 100
Metairie, LA 70002
Telephone (504) 486-7231
Fax (504) 838-8063

August 24, 2000

Mr. Bill Lynch
State Inspector General
P. O. Box 94095
State Capitol Annex
Baton Rouge, LA. 70804-9095

RE: File No. 1-00-0057

Dear Mr. Lynch,

BACKGROUND

	NO. OF JUVENILES	TOTAL COST TO STATE	COST PER JUVENILE
State operated facilities:	1,750	$48,000,000	$27,428
Private contract facilities:	933	$26,000,000	$27,867
Totals for Dept. of Corrections	2,683	$74,000,000	$27,581

While the state cost per juvenile appears to be about the same, it must be noted that the State's annual costs do not include the cost of providing grounds and buildings. For state accounting, these costs are included in the State's capital budget.

The per diem rate for private contractors must include (and in fact does include) payments to recover the costs of grounds and buildings, and must also include a profit incentive. This incentive is necessary to reward the private contractor for his efforts, and to reward him for the risk of his capital by entering a contract that is fraught with risks to the capital employed.

The greatest risk to the private contractor is the Department's right to cancel a contract on 30 days notice, without requiring any reason or deficiency by the contractor.

The second greatest risk to a private contractor is for the Department to reduce the number of juveniles sent to the private facility. This can force the private operator to choose between operating at a loss for an indefinite period, in the hopes that the Department will be able to increase the number of juveniles sent to them; or, to avoid incurring ongoing losses for a period of time that is not predictable, just closing their facility and going out of business.

The Inspector General's Office has suggested that they do not believe that there is much risk involved in the power of cancellation, and is part of the reason that their conclusions are not totally correct.

Some of the risks of contract cancellation or reduction are as follows:

ANNUAL STATE BUDGET RISK:

Each year, the legislature makes appropriations of funds to each state department, to fund its costs for the upcoming year. A large part of the budget is dedicated to specific purposes, and cannot be cut, no matter the size of the budget shortfall. This leaves a smaller part of state government (including the Department of Corrections) to absorb all of the budget cuts. If the Department of Corrections does not receive an appropriation sufficient to cover the prior year costs, and an amount to cover increases in costs, it will have to spend less than it did the year before. Where will these cuts come from? Will they discharge convicts from their prisons to reduce that cost? Will they discharge juveniles from State owned and operated facilities, and close them?

The likelihood is that they will look to outside contracts to reduce their costs.

There are two ways the Department can cut payments to private contractors:

1. Invoke the 30 day cancellation clause, and cease paying the facility until such time (if ever) that the Department's annual appropriation is increased sufficient to re-enter a contract with that facility.
2. Reduce the number of juveniles referred to a facility to less than the number contracted for. While the contract requires that a contractor provide facilities for a stated number of juveniles, it does not require the Department to honor that number, only the contractor. The financial effects on a facility that is forced to operate on a lesser amount of revenue than was projected in the bid can be devastating. Most of the costs of the facility including payroll will remain the same, but its revenue will decrease.

A decrease of only 5% of referrals (3 juveniles per month) would result in an annual decrease in revenue of approximately $95,342; a 10% decrease (6 juveniles) would result in a decrease in revenue of $190,684.

REGULATORY RISKS

The contract requires that performance of the contractor meet many and varied requirements and standards of numerous agencies, organizations, and officials, including the Department of Public Safety and Corrections, their Office of Youth Development, the Department of Social Services, Bureau of Licensing, the American Correctional Association, juvenile court judges of various jurisdictions, in addition to all the other regulators of any other business. Violations of these rules and standards can occur which may not be called to the attention of corporate officers or directors. This can result in monetary penalties, and if not corrected, can result in a 30 day cancellation of contract. Reynolds Institute recently had such an experience. Regulators from State agencies found certain deficiencies, and reported them to the Administrator, the Administrator concealed these reports from the Chairman and the Board, attempting to correct them without the Board ever becoming aware that the deficiencies had ever occurred. Unfortunately for all, he was not able to correct them timely, and Reynolds was issued a 30 day notice of cancellation of its contract. Had not the Board taken immediate action in addressing these deficiencies, Reynolds would today be out of business. The risks posed by the various regulations are substantial. And if any of the regulating or licensing agencies institute new rules or regulations, the contractor must incur the costs to comply with them - even though they were not in existence at the time the contract was signed. This is a contingency that a contractor need be aware of, and consider in his bid.

RFP EVALUATION

The Inspector General notes that "the audited financial statement of Reynolds does not provide sufficient detail to determine its actual expenses for juvenile care; it only provides the total cost of corporate operations". But one must understand that the audit report rules require an audit opinion be issued on the financial statements "taken as a whole", and not on pieces of it.

The Inspector General also states that "the Department treats these contracts as a fee for service arrangement". This is exactly what this is. These are competitive bid contracts, not cost reimbursement or cost appropriations, as are used in intergovernmental units. Neither are these contracts "cost plus" contracts (cost plus overhead and profit), which contracts guarantee that the contractor incurs no loss from contracting with the State, regardless of increases in costs. No, this arrangement is for contractors to put their capital and efforts at risk of loss, in the belief and hope that they are good enough businessmen to make a profit.

EXCESSIVE RATES

1.	"prepaid expenses"	$112,600
2.	"projected costs not incurred"	$108,000

Total costs at Reynolds Institute deemed by the Inspector General's Office as excessive $220,600

1998 CONTRACT - EXPENDITURES NOT RELATED TO JUVENILE CARE:

$6,292 - Cost of Life Insurance/Retirement Policies on the Chairman of the Board.

Because Mr. Letellier had not received compensation for his services, the Inspector General believes that expenses related to his service to Reynolds should be disallowed. Although the Governor doesn't receive a salary, I believe he is classified as an employee of the State.

The life insurance/retirement policies of the senior employees of Reynolds (including its Chairman) are all funded by "split-dollar" policies, in which a full refund of premiums are repaid to Reynolds, and any remaining balance is paid to their beneficiaries.

The Inspector General's report contends that payments transferred from Reynolds bank accounts into retirement funds that are unrestricted, and available for loan or withdrawal by Reynolds, are "costs paid from excess payments generated from the state contract. These payments are not costs to Reynolds. They are on deposit, unrestricted. They are merely segregated funds.

The Inspector General's report also contends that any part of the per diem rates that exceed the actual costs, or that are paid for corporate purposes (as opposed to direct child care expenses), are excessive. He bases his conclusions on this presumption, and adds the presumption that any amount included in the per diem for contingencies, return on invested capital, or profit on the services provided are "excess payments".

$4,295 -- Travel Expenses

It is true that the travel expenses include costs associated with the Washington, D.C. Mardi Gras Ball. But what was omitted from the Inspector General's report was that whether we want to admit it or not we do reside in a state that is run by politics. That we are one of numerous individuals and businesses who find it cost effective to be able to rub shoulders with all of the important business people and political figures, national, state and local officials. More can be accomplished in three or four days than if you spent 365 days a year trying to reach these people. While it may appear to be a social function it is also a business function. Other national, political and business leaders attend this function and we are able to get our point across to them and hopefully we will locate programs beneficial to Reynolds Institute's juvenile and educational programs. We are not alone in this endeavor as many other profit, non-profit, and political bodies deem it advantageous to use their funds to attend this affair.

$6,000 -- Repairs to Parking Lot at Metairie Office

The Metairie office building was donated to Reynolds Institute and houses its corporate offices and all of the records of Reynolds Institute, including the records of the Ponchatoula facility operations. The facility in Ponchatoula is overcrowded and lacks the space to house the CFO and the accounting staff and records of the Ponchatoula facility.

$12,866 -- Meals Charged to Credit Cards by the Chairman of the Board

Reynolds Institute feels this is a very good investment of monies if it results in cost reductions for goods and services, grants or contributions to Reynolds Institute. An example of this is that Reynolds Institute has recently completed construction of a school building, which will appraise for approximately $200,000.00 but which Reynolds Institute's total outlay of cash is $42,000.00. This resulted from obtaining a grant for $52,000, and from the Chairman contracting the construction in-house resulting in a net gain in value to Reynolds Institute of $163,000.00.

During the construction period, the Chairman was able to solicit:

a) A new canopy over the front entrance of the Ponchatoula facility, valued at $800.00.

b) From the plumbing contractor, gratis work on the main building in Ponchatoula and laying of pipe to run the wires and erect our two new flag poles, valued at $1,200.00.

c) From the electrical contractors, gratis work at the Ponchatoula facility, donating the time and materials to run wires to the flag poles, valued at $185.00.

d) Also from the electrical contractors, a donation of the large outdoor light fixture illuminating the flag poles, valued at $240.00.

e) Again from the electrical contractor, re-wiring of the breaker box in the existing school building to accommodate the computers currently housed in that building, valued at $750.00.

f) From Rogers Ready Mix, the sewer plant upgrade, valued at $4,000.00 in labor costs.

The Chairman was also able to obtain new and rehabilitated computers from the local school board and local businesses.

The Chairman solicits contributions for Reynolds Institute, both monetary contributions, and also in-kind contributions. The Chairman additionally searches out the best prices possible on large items. Recently Reynolds Institute needed a new steam table because the bottom had rusted out. The Chairman was able to obtain a steam table which been used by the military. It was in excellent condition, and was constructed of stainless steel throughout and would last for many years to come. This steam table would have cost, if bids were obtained from retail outlets, $2,464.46, however the Chairman was able to obtain the same item for $500.00. Another instance of this is a meat slicing machine which was needed in the kitchen, if bid would have cost $4,561.46 and the Chairman obtained this item for $200.00.

Knowledge of where to seek things, and how to obtain them at little cost, is valuable. So is the knowledge of where and how to obtain grants and contributions. The Chairman uses meals as an opportunity to visit with persons who have, or may have, this knowledge. It has paid off handsomely for Reynolds. The Chairman acknowledges that he has been lax in his documentation of subjects discussed and parties entertained, and will do so in the future.

The Chairman of the Board has always felt that whatever monies are spent to construct buildings at the Ponchatoula facility should be spent in the community. It is an investment not only in the community but helps Reynolds to build a good relationship in the community.

$ 5,155 -- Causeway Bridge Tolls and a Loan Which is not Collectable

The corporate offices are located in Metairie, Louisiana and the facility is located in Ponchatoula, Louisiana, a distance of 45-50 miles. The young ladies that work in the Metairie office must at times travel to Ponchatoula. There are two routes they could travel, one being the I-10 to the I-55 to Ponchatoula, however this route is through the swamp, with stretches of roadway which are uninhabited and isolated. Until recently there was no cellular phone service along stretches of this route. The second route is over the Lake Pontchartrain Causeway to I-12 to Ponchatoula. This is a much safer route as the Lake Pontchartrain Causeway is patrolled by Causeway Police and there are call boxes spaced within walking distances of each other. The entire route along the I-12 is inhabited and heavily traveled. There is also cellular phone service along the entire route. The distance and time to travel both routes are comparable, however the cost increases due to the tolls on the Lake Pontchartrain Causeway. We feel this cost is negligible when compared to the safety of its employees.

These are the Inspector General's examples of "excess costs" in some places, and "non-related expenditures" in others.

By eliminating such "excess" or "unrelated" costs, and any reserve for contingencies, return on invested capital, or profit on services, the Inspector General's report concludes that a per diem rate of $61.35 per day would cover the raw cost of operations of the facility, and that is what he determines is what should have been paid.

By deducting costs and expenses that he deemed "unrelated" or "excess costs" from total costs, he classified the reduced total as "adjusted costs". By using this type of reasoning, the Inspector General's report concludes that Reynolds was overpaid by approximately $150,000.00. I disagree.

1999 CONTRACT

The Inspector General's report notes that the new contract per diem is $26.93 greater than the "adjusted costs" in the last year of the prior (a 29% increase, per Inspector General's report) contract. It also states that the per diem rate that will be used for the next five years is 44% greater than the "<u>adjusted costs</u>". The Inspector General's report does not disclose that Reynolds Institute has not had an increase in per diem rates for the last ten years.

CONTRACT DEFICIENCIES - THE INSPECTOR GENERAL BELIEVES THAT THE CONTRACT IS FLAWED

1. Prepayments

The Department requires that the contract be for an initial three year period, with options (at the Department's discretion only) for two more twelve month periods. (For a total of five years of service under the contract.) The two renewal option years are at the existing contract rate, unless the Department agrees to (or negotiates) a new rate. Only the Department has any power of a changed rate during the option periods. The maximum the rate can increase is the change in the CPI over the first three years of the contract. There is no stated maximum on the amount that the per diem can be reduced.

If there is no agreement to an increase, then the contractor is legally required to continue performing the services for two more years at the same rate as he received on the first day of the contract. For all intents and purposes, this is a five year contract, except that the Department can terminate it at the end of three years, or force a re-negotiated rate if costs have gone down (recession, depression, direct federal supplements).

The Inspector General's report contends that costs for years four and five should not be a factor in the contract. This would leave all of the risk of price increases on the contractor, and none on the Department. If costs did increase, the contractor's only recourse would be to ask the Department to invoke its privilege to re-negotiate rates, and then to grant an increase to the contractor. The Department may have budget constraints on granting an increase at that time, or feel that it's not in their best interest to grant an increase that they're under no risk in refusing. And no matter how much actual costs and expenses have increased over the three years, the Department would be limited to granting only the increase in the CPI.

This would indeed be a benefit to the State, and a great risk to the service contractor and the greater the risk that the State shifts onto the contractor, the greater the reward (profit) the contractor would be entitled to. Of course, only those contractors with the financial strength to suffer such losses and survive could chance bidding on contracts under those conditions, thereby limiting the competition on the bids, probably eliminating some of the smaller units, and perhaps limiting the Department's access to placements

Because of the above conditions, a contractor must project his costs over each of the five years, that he is locked into the contract. Then he must determine his average costs, and bid that amount. Since the contract will pay the same amount in the first month of the contract as it will five years later, this results in more profit being earned in the first year of the contract, and less in the last year. That's the nature of a level payment contract that spans more than one year. Even though the contract is totally slanted in favor of the Department, the Inspector General's report presents a case that this is something bad, and is a deficiency in the contract. I respectfully disagree.

The Inspector General's report speculates on what would be the financial impact on the contractor if either party chose to exercise it's 30 day option to cancel the contract at the end of the first year. He concludes that the contractor would be unfairly enriched, because the level payments in the first year would include some cost increases that would not be incurred until future years. He calculates that Reynolds will be overpaid $112,600 in the first year of the contract. Of course! That's simple arithmetic, but there's nothing sinister or wrong with it! In his examples he illustrates that average projected salaries in the fifth year of the contract will exceed the average salaries paid in the per diem, and that Reynolds will be underpaid by $61,000 of salaries in that year. He also calculates that average projected salaries in the first year of the contract will be $92,000 less than the projected average salaries in the per diem , and deems that to be an overpayment.

The arithmetic is fine, but the concept is not sound. The examples in his report are mere exercises in arithmetic, and do nothing to explain or clarify the bid process, nor support his contention that the contract is flawed.

The report again notes that the contract can be cancelled by either party upon 30 days notice. This puts the contractor at great risk, and prevents him from using the contract as collateral to finance operations or expansion. Reynolds Institute has contracted with the State for 25 years, it's facility is a single purpose facility, designed and built as a non-secure juvenile residential facility. It would be extremely expensive to convert it to another use, even if one could be found. And its location in the woods on the edge of a swamp does not bode well for converting it to a business use. The only party that gains an advantage from the 30 day cancellation clause is the Department. It is a threat and a risk to the contractor. The issue of "prepayments" is a non-issue, and is not a contract deficiency.

2. Projected costs not adhered to (variances between actual and budgeted expenses) in the 1st year of the contract:

Budgeted salaries	$802,000
Actual salaries	$785,000
Budget variance (labeled an excess payment in the Inspector General's report)	$ 17,000

(The Inspector General's report did not

exceed budget, as can happen - only the case of budget exceeding actual.) I submit that budget variances are not contract deficiencies, as represented in the Inspector General's report.

Renewal rate increases

The Inspector General's report states that since the cost increase for the two option periods are already factored into the projected budget, that if the Department granted CPI increases at the time it exercised its options, Reynolds Institute would receive multiple increases. That may be true, but if costs escalated faster than the CPI, the contractor would suffer without some increase. In order for the Department to grant CPI increases, the following would all have to occur:

a. Reynolds would have to demonstrate that actual costs exceeded projected costs.

b. The Department would have to agree that actual costs exceeded projected costs.

c. Even so, the Department would not have to agree to an increase, since only the Department has the right to renegotiate the per diem.

d. No matter how much actual costs exceed the projected budget costs, the contractor would only be allowed to recover his excess costs up to the amount of the CPI. Any excess costs would still be borne by the contractor.

I submit that the provision for the Department, at it's discretion, to grant CPI increases is not a contract deficiency, as represented in the Inspector General's report.

Very truly yours,

Frank P. Letellier, II
Chairman