



FEB 22 2008

Washington, D.C. 20201

**TO:** Kerry Weems  
Acting Administrator  
Centers for Medicare & Medicaid Services

**FROM:** Daniel R. Levinson  
Inspector General

**SUBJECT:** Review of Quality Improvement Organization in Ohio for August 1, 2002,  
Through July 31, 2005 (A-05-06-00043)

Attached is an advance copy of our final report on the Quality Improvement Organization (QIO) program in Ohio. In each State, the Centers for Medicare & Medicaid Services contracts with QIOs, which were established to promote the effective, efficient, and economical delivery of Medicare health care services and the quality of those services. The Senate Finance Committee requested that the Office of Inspector General assess the fiscal integrity of the QIOs with respect to six specified subject areas. This report is one of a series of nine audits of QIOs in response to that request. In Ohio, Ohio KePRO Inc., was the QIO for the period August 1, 2002, through July 31, 2005. For this 3-year period, known as the seventh scope of work, Ohio KePRO received \$27.2 million in Federal reimbursement to perform the core QIO contract and two special studies. We will issue this report to Ohio KePRO within 5 business days.

Our objective was to review the six fiscal integrity areas requested by the Senate Finance Committee. Specifically, we reviewed board member and executive staff compensation; board member and executive staff travel; costs relating to legal fees, including administrative charges; equipment and administrative charges; business relationships and conflicts of interest; and contract modifications.

We found that of the \$7.7 million of costs reviewed, \$7.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, Ohio KePRO incurred \$11,874 for costs that were unallowable and \$78,267 for costs that may not have complied with Federal requirements:

- Ohio KePRO incurred a total of \$11,874 of costs that were unallowable. The costs were for legal fees (\$9,640 indirect), conference-related costs (\$1,622 direct and \$155 indirect), and travel expenses (\$457 indirect).
- Ohio KePRO incurred \$78,267 for potentially unallowable direct costs for unsupported subcontractor labor costs (\$53,127) and conference-related costs (\$25,140).

Additionally, Ohio KePRO did not comply with Federal requirements for maintaining Government-owned equipment.

We recommend that Ohio KePRO:

- refund \$1,622 identified as unallowable direct conference-related costs;
- reduce the indirect cost pool by \$10,252 identified as unallowable indirect costs;
- work with the CMS contracting officer to determine what portion of the \$78,267 incurred for unsupported subcontractor labor and conference costs should be excluded from Federal reimbursement; and
- maintain all Government-owned equipment in accordance with Federal Acquisition Regulation requirements, including performing periodic reconciliations of inventories, keeping complete inventory records, and reporting any excess equipment.

In written comments on our draft report, Ohio KePRO did not address our findings or recommendations related to unallowable costs. In addition, Ohio KePRO disagreed with our findings related to the potentially unallowable costs, maintaining that the costs were reasonable, allowable, and allocable to the CMS contract. Ohio KePRO did not provide any additional documentation to support the potentially unallowable costs. As a result, we maintain that our findings and recommendations are valid.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at [George.Reeb@oig.hhs.gov](mailto:George.Reeb@oig.hhs.gov) or Marc Gustafson, Regional Inspector General for Audit Services, Region V, at (312) 353-2621 or through e-mail at [Marc.Gustafson@oig.hhs.gov](mailto:Marc.Gustafson@oig.hhs.gov). Please refer to report number A-05-06-00043 in all correspondence.

Attachment



DEPARTMENT OF HEALTH AND HUMAN SERVICES  
OFFICE OF AUDIT SERVICES  
233 NORTH MICHIGAN AVENUE  
CHICAGO, ILLINOIS 60601

REGION V  
OFFICE OF  
INSPECTOR GENERAL

Report Number: A-05-06-00043

FEB 27 2008

Mr. Joseph Dougher  
Chief Executive Officer  
KePRO  
777 East Park Drive  
P.O. Box 8310  
Harrisburg, PA 17105

Dear Mr. Dougher:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Quality Improvement Organization in Ohio for August 1, 2002, Through July 31, 2005." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, within 10 business days after the final report is issued, it will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Jaime Saucedo, Audit Manager, at (312) 353-8693 or through e-mail at [Jaime.Saucedo@oig.hhs.gov](mailto:Jaime.Saucedo@oig.hhs.gov). Please refer to report number A-05-06-00043 in all correspondence.

Sincerely,

Marc Gustafson  
Regional Inspector General  
for Audit Services

Enclosure

**Direct Reply to HHS Action Official:**

James Randolph Farris, MD  
Consortium Administrator  
Consortium for Quality Improvement and Survey & Certification Operations  
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Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF QUALITY  
IMPROVEMENT ORGANIZATION  
IN OHIO FOR AUGUST 1, 2002,  
THROUGH JULY 31, 2005**



Daniel R. Levinson  
Inspector General

February 2008  
A-05-06-00043

# ***Office of Inspector General***

<http://oig.hhs.gov>

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The Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
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Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5).

## **OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

## **EXECUTIVE SUMMARY**

### **BACKGROUND**

In the Medicare program, the Centers for Medicare & Medicaid Services (CMS) contracts with Quality Improvement Organizations (QIO) in each State. Pursuant to section 1862(g) of the Social Security Act, QIOs were established for “promoting the effective, efficient, and economical delivery of health care services, and of promoting the quality of services . . . .”

QIOs submit vouchers for Federal reimbursement to CMS monthly. The vouchers and reimbursements include amounts for both direct and indirect costs. The QIOs determine the amount of indirect costs to claim by multiplying an indirect cost rate against their direct costs. During the contract period, CMS usually is unable to calculate an indirect cost rate. Therefore, the QIOs use provisional rates to determine indirect costs. After the close of each QIO’s fiscal year, the Defense Contract Audit Agency reviews the organization’s actual direct and indirect costs. The CMS contracting officer considers the Defense Contract Audit Agency’s recommendations in establishing the final rate and performing the final cost settlement.

Ohio KePRO Inc., a for-profit organization incorporated in Ohio, was the Ohio QIO for the period August 1, 2002, through July 31, 2005. For this 3-year period, known as the seventh scope of work, Ohio KePRO received \$27.2 million in Federal reimbursement to perform the core contract and two special studies. Our review primarily focused on the core contract. As of June 19, 2007, CMS had not performed the final cost settlement for the seventh scope of work.

The Senate Finance Committee requested that the Office of Inspector General assess the fiscal integrity of the QIOs. The Senate Finance Committee requested that we review, at a minimum, the following areas:

1. board member and executive staff compensation;
2. board member and executive staff travel;
3. costs relating to legal fees, including administrative charges;
4. equipment and administrative charges;
5. business relationships and conflicts of interest; and
6. contract modifications.

### **OBJECTIVE**

Our objective was to review the six fiscal integrity areas requested by the Senate Finance Committee.

### **SUMMARY OF FINDINGS**

Of the \$7.7 million of costs reviewed, \$7.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, Ohio KePRO incurred \$11,874 for costs that were unallowable and \$78,267 for costs that may not have complied with Federal requirements:



- Ohio KePRO incurred a total of \$11,874 of costs that were unallowable. The costs were for legal fees (\$9,640 indirect), conference-related costs (\$1,622 direct and \$155 indirect), and travel expenses (\$457 indirect).
- Ohio KePRO incurred \$78,267 for potentially unallowable direct costs for unsupported subcontractor labor costs (\$53,127) and conference-related costs (\$25,140).

Additionally, Ohio KePRO did not comply with Federal requirements for maintaining Government-owned equipment.

## **RECOMMENDATIONS**

We recommend that Ohio KePRO:

- refund \$1,622 identified as unallowable direct conference-related costs,
- reduce the indirect cost pool by \$10,252 identified as unallowable indirect costs,
- work with the CMS contracting officer to determine what portion of the \$78,267 incurred for unsupported subcontractor labor and conference costs should be excluded from Federal reimbursement, and
- maintain all Government-owned equipment in accordance with Federal Acquisition Regulation requirements, including performing periodic reconciliations of inventories, keeping complete inventory records, and reporting any excess equipment.

## **OHIO KEPRO'S COMMENTS**

In written comments on our draft report, Ohio KePRO did not address our findings or recommendations related to unallowable costs. In addition, Ohio KePRO disagreed with our findings related to the potentially unallowable costs, maintaining that the costs were reasonable, allowable, and allocable to the CMS contract. Regarding Government-owned equipment, Ohio KePRO identified actions planned and taken to comply with Federal requirements.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

Ohio KePRO did not provide any additional documentation to support the potentially unallowable costs. As a result, we could not determine whether the potentially unallowable costs were reasonable, allowable, and allocable to the CMS contract. We maintain that our findings and recommendations are valid.

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# INTRODUCTION

## BACKGROUND

### Quality Improvement Organization Program

Part B of Title XI of the Social Security Act (the Act), as amended by the Peer Review Improvement Act of 1982, established the Utilization and Quality Control Peer Review Organization Program, now known as the Quality Improvement Organization (QIO) Program. Pursuant to section 1862(g) of the Act, QIOs were established to promote the effective, efficient, and economical delivery of Medicare health care services and the quality of those services.

Pursuant to 42 CFR § 475.101, “to be eligible for a QIO contract an organization must – (a) Be either a physician-sponsored organization . . . or a physician-access organization . . . and (b) Demonstrate its ability to perform review . . . .”

The Centers for Medicare & Medicaid Services (CMS) awards the contracts for 41 QIO organizations, which administer 53 QIO contracts (all 50 States plus the District of Columbia, Puerto Rico, and the U.S. Virgin Islands), every 3 years. Each contract requires a specific scope of work (SOW). Seven SOWs have been completed. The SOW for each contract may be modified to make adjustments to the contract tasks. Certain modifications, referred to as special studies, generally receive the majority of funding increases. Federal funding for QIOs was budgeted at approximately \$1.3 billion for the seventh SOW.

The Federal Acquisition Regulations System was established to codify uniform policies and procedures for acquisition of supplies and services by executive agencies. The Federal Acquisition Regulations System consists of the Federal Acquisition Regulation (FAR, Chapter 1 of Title 48, CFR), which is the primary document, and agency acquisition regulations that implement or supplement the FAR. FAR part 31, “Contract Cost Principles and Procedures,” establishes the principles for determining allowable costs with respect to contracts with for-profit organizations.<sup>1</sup>

### Claims for Federal Reimbursement

Pursuant to its contract with CMS, each QIO submits vouchers to CMS monthly. The vouchers include claims for both direct and indirect costs. Pursuant to FAR 31.202(a), a direct cost is “any cost that can be identified specifically with a particular final cost objective,” while an indirect cost (FAR 31.203(a)) is “any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective.” The QIOs calculate indirect costs to claim by multiplying an indirect cost rate against their direct costs.

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<sup>1</sup>In this report, citations to the FAR are to the February 20, 2002, version. The FAR has been revised many times, including revisions during and after the seventh SOW. FAR 1.108(d)(1) provides that “FAR changes apply to solicitations issued on or after the effective date of the change.” The February 20, 2002, version of the FAR applies to this QIO contract because the solicitation letter for this QIO contract was issued on February 25, 2002, after the effective date of the February 20, 2002, version.

During the contract period, CMS usually is unable to calculate an exact indirect cost rate. Therefore, the QIOs use provisional or “billing rates” established temporarily for interim reimbursement of incurred indirect costs (FAR 42.701). After the close of a QIO’s fiscal year (FY), CMS contracts with the Defense Contract Audit Agency (DCAA) to review the indirect cost rate proposals, which contain the actual direct and indirect costs, and to make recommendations as to the final rates for that FY. The CMS contracting officer considers DCAA’s recommendations in establishing the final rate for each QIO.

### **Ohio Quality Improvement Organization**

Ohio KePRO Inc., located in Seven Hills, Ohio, serves as the Ohio QIO. Ohio KePRO is a for-profit organization incorporated in 1999 and a wholly owned subsidiary of Keystone Peer Review Organization, Inc. (KePRO). Ohio KePRO’s contract with the Federal Government is on a cost-plus-fixed-fee basis.

For the 3-year period known as the seventh SOW (August 1, 2002, through July 31, 2005), Ohio KePRO received \$27.2 million in Federal reimbursement to perform the core contract and two special studies. Of this amount, \$6.2 million was for the reimbursement of indirect costs using provisional billing rates. During the seventh SOW, over 99 percent of Ohio KePRO’s revenue was derived from this CMS contract.

For FYs 2003 and 2004, which covered part, but not all, of the seventh SOW, DCAA has reviewed the indirect cost rates and made recommendations as to the final rates. As of June 19, 2007, DCAA had not reviewed the indirect cost rates for FY 2005. The CMS contracting officer will consider both DCAA’s and our recommendations in establishing the final rates and settling the cost differences that occurred between the provisional and final rates for the seventh SOW.

### **Senate Finance Committee Request**

The Senate Finance Committee requested that the Office of Inspector General review the fiscal integrity of the QIOs. The Senate Finance Committee requested that we review, at a minimum, the following areas:

1. board member and executive staff compensation;
2. board member and executive staff travel;
3. costs relating to legal fees, including administrative charges;
4. equipment and administrative charges;
5. business relationships and conflicts of interest; and
6. contract modifications.

The Senate Finance Committee also expressed concern about the extent to which QIOs addressed beneficiaries’ quality of care concerns and the beneficiary complaint resolution process. We have examined these issues in another report (OEI 01-06-00170).

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

Our objective was to review the six fiscal integrity areas requested by the Senate Finance Committee.

### **Scope**

We reviewed a judgmental sample of approximately \$7.7 million of costs that Ohio KePRO incurred for the seventh SOW (August 1, 2002, through July 31, 2005). In total, Ohio KePRO received \$27.2 million in Federal reimbursement for the core QIO contract and two special studies. Our review focused on the Ohio KePRO core contract.

The \$7.7 million consisted of costs incurred for the six areas that the Senate Finance Committee requested we review. We reviewed these costs to determine whether they were (1) reasonable, allowable, and allocable under the terms of the contract and (2) supported by accounting records and other reliable documentation.

We limited our internal control review to Ohio KePRO systems and procedures for claiming Federal reimbursement of costs to the extent necessary to achieve our objectives.

Our audit was intended to supplement information contained in DCAA audits.

We performed fieldwork at KePRO in Harrisburg, Pennsylvania, and the Ohio KePRO office in Seven Hills, Ohio.

### **Methodology**

We took the following action to accomplish our objectives:

- We reviewed applicable Federal requirements.
- We interviewed KePRO and Ohio KePRO officials and reviewed policies and procedures to obtain an understanding of how costs were claimed for Federal reimbursement.
- We interviewed the CMS contracting officer, project officer, and program staff by telephone to obtain an understanding of their roles in the contracting process.
- We reconciled the Federal reimbursement, in total (as indicated on the vouchers that Ohio KePRO submitted to CMS), to Ohio KePRO's general ledger to determine the costs incurred and charged to the contract.
- We examined, on a test basis, evidence supporting the \$7.7 million of costs included in our review and claimed by Ohio KePRO. For each of the six areas reviewed, we

identified the general ledger accounts containing the expenses that Ohio KePRO incurred during the seventh SOW.

- For board member and executive staff compensation, we examined how frequently meetings were held, the rate used to pay the board members, and source documentation, including W-2s, 1099s, and payroll reports. We compared compensation for board members and 15 high-ranking executives to the amounts included in Ohio KePRO's contract bid proposal to CMS.
  - For board member and executive staff travel, we analyzed documentation to determine whether transportation costs of the board members and high-ranking executives were reasonable and in compliance with Federal and contractor guidelines.
  - For costs relating to legal fees, including administrative charges, we reviewed documentation to determine whether the costs were reasonable, allocable, and allowable for Federal reimbursement.
  - For equipment and administrative charges, we analyzed documentation to determine whether the incurred costs were allowable for Federal reimbursement. We also performed an equipment inventory at Ohio KePRO's offices.
  - For business relationships and conflicts of interest, we reviewed selected subcontracts, including payments made to other QIOs. We then analyzed the documentation to determine whether the incurred costs were allowable for Federal reimbursement.
  - For contract modifications, we reviewed documentation to determine whether they increased the funding for the seventh SOW, added a special study, or were technical in nature. For modifications that added special studies, we reviewed the objectives of the studies to determine whether they were consistent with CMS's overall objectives for the seventh SOW.
- We reviewed DCAA audits of direct and indirect costs for 2003 and 2004 and interviewed DCAA auditors.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

## FINDINGS AND RECOMMENDATIONS

Of the \$7.7 million of costs reviewed, \$7.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, Ohio KePRO incurred \$11,874 for costs that were unallowable and \$78,267 for costs that may not have complied with Federal requirements:

- Ohio KePRO incurred a total of \$11,874 of costs that were unallowable. These costs were for legal fees (\$9,640 indirect), conference-related costs (\$1,622 direct and \$155 indirect), and travel expenses (\$457 indirect).
- Ohio KePRO claimed \$78,267 of potentially unallowable direct costs for unsupported subcontractor labor costs (\$53,127) and unreasonable conference-related costs (\$25,140).

In addition, Ohio KePRO did not comply with Federal requirements for maintaining Government-owned equipment.

We are recommending the direct recovery or resolution of those costs charged directly to the contract and elimination or reduction of those costs allocated to the contract as indirect costs. A schedule of the direct and indirect costs that we reviewed and either accepted, questioned, or set aside is presented as Appendix A.

### UNALLOWABLE COSTS

Ohio KePRO claimed a total of \$11,874 for costs that were unallowable. These costs were for unallowable legal fees (\$9,640 indirect), conference-related costs (\$1,622 direct and \$155 indirect), and travel expenses (\$457 indirect).

#### Legal Fees

FAR 31.205-27(a) states that “. . . expenditures in connection with . . . planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions . . . are unallowable.” In addition, FAR 31.201-4 states that “A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.”

Ohio KePRO incurred \$9,640 in unallowable or unallocable legal costs. Contrary to Federal regulations, Ohio KePRO incurred \$6,274 for costs incurred by itself and its parent organization, KePRO, for the creation of two limited liability corporations. The remaining \$3,366 represented unallocable legal costs unrelated to the QIO contract.

#### Conference-Related Costs

FAR 31.201-3(a) states that “A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.” FAR 31.201-3(b) provides that:

What is reasonable depends upon a variety of considerations and circumstances, including –

- (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance;
- (2) Generally accepted sound business practices . . . and Federal and State laws and regulations;
- (3) The contractor’s responsibilities to the Government, other customers . . . and the public at large; and
- (4) Any significant deviations from the contractor’s established practices.

Ohio KePRO incurred \$1,622 in unallowable direct costs by several employees and board members before their attendance at American Health Quality Association (AHQA) conferences. In one example, four employees arrived in San Francisco, California, on Sunday for a conference that started on Tuesday morning. The additional lodging and subsistence expenses incurred because of employees’ and board members’ early arrival at conference locations for personal convenience were neither reasonable nor necessary for the performance of the contract. Ohio KePRO also incurred \$155 in unallowable indirect costs associated with these expenditures, resulting in a total of \$1,777 unallowable conference-related costs.

### **Travel Expenses**

Because FAR 31.205-46(a)(1) limits allowable travel-related costs to costs “incurred by contractor personnel on official company business,” spousal travel expenses are not allowable. In addition, FAR 31.205-46(a)(2)(i) provides that costs incurred for lodging, meals, and incidental expenses must not exceed the maximum per diem rates in the Federal Travel Regulations, except in special or unusual situations.

Ohio KePRO incurred \$457 for unallowable travel costs. Of this total, \$228 related to spouses and \$229 were expenses in excess of applicable Federal lodging per diem amounts for an Ohio KePRO board member and KePRO executive. These costs were not allowable under the FAR or the Federal Travel Regulations.

### **POTENTIALLY UNALLOWABLE COSTS**

Ohio KePRO claimed \$78,267 for potentially unallowable direct costs related to unsupported subcontractor labor (\$53,127) and conference attendance (\$25,140).

### **Subcontract Costs**

Ohio KePRO entered into a subcontract with the Oklahoma Foundation for Medical Quality (OFMQ), a nonprofit QIO. The Office of Management and Budget (OMB) Circular A-122, “Cost Principles for Non-Profit Organizations,” as revised June 1, 1998, establishes the



principles for determining allowable costs with respect to contracts and subcontracts with nonprofit organizations.<sup>2</sup> OMB Circular A-122, Attachment B, section 7.m(1) states that “The distribution of salaries and wages to awards must be supported by personnel activity reports . . . .” OMB Circular A-122, Attachment B, section 7.m(2) states that “Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards.”

Ohio KePRO incurred unsupported subcontract labor costs of \$53,127 related to subcontracted work performed by OFMQ. Several OFMQ subcontract invoices maintained by Ohio KePRO did not contain all required information. Specifically, the invoices identified only total labor hours and total labor charges for all staff members, with no detailed breakdown of who worked on the project, the number of hours worked by each individual, or the tasks they performed. Since the Ohio KePRO did not maintain activity documentation supporting these OFMQ invoices, we were unable to determine whether the costs were allowable, reasonable, and allocable. We asked Ohio KePRO representatives to request additional documentation from OFMQ, but none was provided. We have, therefore, set aside these costs for CMS adjudication.

### **Conference-Related Costs**

FAR 31.201-3(a) states that “A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.” FAR 31.201-3(b) provides that:

What is reasonable depends upon a variety of considerations and circumstances, including –

- (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance;
- (2) Generally accepted sound business practices . . . and Federal and State laws and regulations;
- (3) The contractor’s responsibilities to the Government, other customers . . . and the public at large; and
- (4) Any significant deviations from the contractor’s established practices.

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<sup>2</sup>In this report, citations to OMB Circular A-122 are to the June 1, 1998, version. On May 10, 2004, OMB revised the circular, which generally became effective on the May 10, 2004, publication date, during the seventh SOW (70 Federal Register 51927 (Aug. 31, 2005)). However, the circular states that, for existing awards, the new principles may be applied if the organization and the cognizant Federal agency agree (section 9 of OMB Circular A-122, as revised May 10, 2004.) The 2004 version does not apply to the subcontract with OFMQ because the parties did not make such an agreement.

Ohio KePRO incurred conference-related costs that may have been unreasonable. In its bid proposal to CMS, Ohio KePRO proposed to send 30 individuals to Quality Net conferences.<sup>3</sup> However, it incurred costs for 50 employees to attend these conferences.

The number of staff members set forth in KePRO’s bid proposal was based on the prior year’s experience. We considered the additional 20 attendees and the estimated costs of \$25,140 as potentially unreasonable. These costs are detailed in Table 1.

**Table 1. Conference-Related Costs for 20 Additional Attendees**

<b>Additional Attendees’ Cost</b>	<b>Amount<sup>4</sup></b>
Travel (including hotel)	\$17,440
Meals	2,020
Registration	5,680
<b>Total</b>	<b>\$25,140</b>

These additional conference-related costs may not have been in accordance with FAR 31.201-3(a). Specifically, the additional costs may not have been prudent or necessary for Ohio KePRO’s operations related to the QIO contract. Therefore, \$25,140 of conference-related costs may have been unreasonable and, thus, unallowable. We were unable to determine how much of the \$25,140 could have been avoided.

#### **EQUIPMENT EXPENDITURES NOT IN COMPLIANCE**

Ohio KePRO did not comply with Federal requirements for managing Government-owned equipment. Specifically, Ohio KePRO:

- maintained computer equipment costing \$74,165 in excess of contract requirements,
- did not reconcile physical inventories to its records, and
- did not keep complete equipment inventory records.

#### **Excess Computers**

Under section C.2.B.2 of CMS’s contract, CMS allows the contractor to maintain one computer for each position that has a full-time-equivalent (FTE) of 0.5 or greater. In addition, FAR 45.502(g) states that “The contractor shall promptly report all Government property in excess of the amounts needed to complete full performance under the contracts providing it or authorizing its use.”

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<sup>3</sup>QualityNet is an Internet site established by CMS to provide healthcare quality improvement news, resources, and data reporting tools and applications for healthcare providers and others. CMS sponsors QualityNet conferences for QIOs.

<sup>4</sup>Costs were estimated using average actual conference costs incurred and actual number of attendees for contract years 2003 and 2004.

Ohio KePRO maintained computer equipment costing \$74,165 in excess of contract requirements during the audit period. At the end of the contract period, Ohio KePRO had 72 excess computers or almost two computers for each position that had an FTE of 0.5 or greater.

**Table 2. Computer Equipment On Hand—July 31, 2005**

<b>Number of Computers</b>	<b>Number of Positions with an FTE of 0.5 or Greater</b>	<b>Average Number of Computers per Position with an FTE of 0.5 or Greater</b>
153	81	1.9

An analysis of the number of computers and employees showed that Ohio KePRO maintained an excessive number of computers for the entire 3-year contract period. Ohio KePRO had an annual average of approximately 77 total employees (both full- and part-time) and no more than 90 total employees during any given month during the contract period. However, Ohio KePRO had an average of 131 computers on hand during the contract period. This represents an average excess of 54 computers on hand versus contract requirements.

During our physical inventory on August 24, 2006, Ohio KePRO identified 41 computers that were unused and maintained in storage. The 41 computers were between 1 and 5 years old and were purchased and claimed during the contract period. Ohio KePRO officials informed us that this excess equipment was not reported to CMS.

### **Inventories Not Reconciled**

FAR 45.508 states that, “The contractor shall periodically physically inventory of all Government property . . . in its possession or control . . . [and] with the approval of the property administrator, shall establish the type, frequency, and procedures. These may include electronic reading, recording and reporting or other means of reporting the existence and location of the property and reconciling the records.” Finally, FAR 45.506(a) states that, “Upon receipt of Government property, the contractor shall promptly—(1) Identify the property . . . ; (2) Mark the property . . . ; and (3) Record the property in its property control records.”

Ohio KePRO did not reconcile its physical inventories to its records for Government-owned equipment in its control as required by the FAR. In addition, Ohio KePRO’s inventory records, dated October 24, 2005, and reported to CMS on Form HHS (Health and Human Services) 565, “Report of Capitalized Non-Expendable Equipment,” disclosed that 362 of 404 inventory items (90 percent) did not contain a Government identification number. At the time of our physical inventory at Seven Hills, Ohio, on August 24, 2006, 80 of the 85 sampled inventory items (94 percent) did not have a Government inventory tag. The FAR requires contractors to identify Government-owned equipment, perform routine physical inventories, and reconcile those inventories to its records. This would ensure accurate accountability and control of Government-owned equipment.

## **Incomplete Inventory Records**

FAR 45.505(a) states that “The contractor’s property control records shall constitute the Government’s official property records . . . . The contractor shall establish and maintain adequate control records for all Government property . . . .” FAR 45.505(c) states that “Official Government property records must identify all Government property and provide a complete, current, auditable record of all transactions.” FAR 45.505-1 provides that:

(a) . . . the contractor’s property control records shall provide the following basic information for every item of Government property in the contractor’s possession, regardless of value . . . : (1) The name, description . . . . (2) Quantity received. . . . (3) Unit price . . . . (4) Contract number . . . . (5) Location. (6) Disposition. (7) . . . and date of transaction.

(b) Summary records are normally adequate . . . . Summary records shall provide the information listed in paragraphs (a)(1) through (a)(7) of this section . . . .

Ohio KePRO did not maintain complete equipment inventory records as required by Federal regulations. A review of inventory records disclosed that 128 of 404 inventory items (32 percent) did not have a unit price. In addition, some items did not contain a summary record of their dollar value. Inventory records maintained by CMS contractors must be complete because they constitute the official Government record.

## **RECOMMENDATIONS**

We recommend that Ohio KePRO:

- refund the \$1,622 identified as unallowable direct conference-related costs,
- reduce the indirect cost pool by \$10,252 identified as unallowable indirect costs,
- work with the CMS contracting officer to determine what portion of the \$78,267 incurred for unsupported subcontractor labor and conference costs should be excluded from Federal reimbursement, and
- maintain all Government-owned equipment in accordance with the FAR requirements, including performing periodic reconciliations of inventories, keeping complete inventory records, and reporting any excess equipment.

## **OHIO KEPRO’S COMMENTS AND OFFICE OF INSPECTOR GENERAL’S RESPONSE**

In written comments on our draft report, Ohio KePRO did not address the unallowable costs. However, Ohio KePRO disagreed with our findings related to the potentially unallowable costs, maintaining that the costs were reasonable, allowable, and allocable to the CMS contract.

Regarding Government-owned equipment, Ohio KePRO identified actions planned and taken to comply with Federal requirements.

Ohio KePRO did not provide any additional documentation with its comments, or in response to requests during the course of the audit, to support the potentially unallowable costs. As a result, we could not determine whether the potentially unallowable costs were reasonable, allowable, and allocable to the CMS contract. We maintain that our findings and recommendations are valid.

A more detailed presentation of Ohio KePRO's comments and our response follows.

### **Subcontract Costs**

#### *Ohio KePRO's Comments*

Ohio KePRO stated that even though it did not provide information about OFMQ's subcontract costs to us, OFMQ assisted KePRO in completing a special study for CMS, and Ohio KePRO provided CMS with the results of the special study.

#### *Office of Inspector General's Response*

Ohio KePRO did not provide documentation to support the subcontract labor costs. As a result, we were unable to determine whether the costs were allowable, reasonable, and allocable.

### **Conference-Related Costs**

#### *Ohio KePRO's Comments*

Ohio KePRO stated that additional attendees were sent to conferences because of an "unanticipated strong" training agenda and because some of the additional attendees were presenters:

- For the 2003 Quality Net conference, Ohio KePRO sent three additional information technology (IT) staff because of an unexpectedly strong agenda relating to safety and security training for its IT staff. Ohio KePRO also sent two additional staff as presenters.
- For the 2004 Quality Net conference, Ohio KePRO stated that it was required to send six additional staff to the conference because the conference included Doctor Office Quality-Information Technology (DOQ-IT) training. Ohio KePRO also sent eight additional staff as presenters.

#### *Office of Inspector General's Response*

Ohio KePRO did not provide additional documentation with its comments, or in response to requests during the course of the audit, to support the conference-related costs:

- Ohio KePRO did not provide a list of participants, including their job titles, or any additional documentation with its comments, or in response to requests during the course of the audit, that would support its argument that the additional staff needed to attend the 2003 Quality Net conference to ensure understanding of and compliance with security issues. In addition, Ohio KePRO did not give us the names of the additional staff sent as presenters so we could compare them to the agenda.
- Ohio KePRO did not provide a list of participants, including their job titles, or any additional documentation with its comments, or in response to requests during the course of the audit, that would support its argument that the DOQ-IT training at the 2004 Quality Net conference required Ohio KePRO to send additional staff. In addition, Ohio KePRO did not give us the names of the additional staff sent as presenters so we could compare them to the agenda.

Of the 20 additional attendees identified in our finding, we were unable to determine whether Ohio KePRO was justified in sending five additional individuals to the 2003 Quality Net Conference and 14 additional individuals to the 2004 Quality Net Conference. Ohio KePRO did not provide any justification for the remaining individual's conference attendance.

## **Equipment**

### *Ohio KePRO's Comments*

Ohio KePRO confirmed that it had 153 computers in its inventory at the time of our audit and currently has 110 computers, 9 of which will be reported as excess to CMS. Ohio KePRO did not indicate the disposition of the other 43 computers. Ohio KePRO stated that it reconciled inventories annually to records of Government-owned equipment, acknowledged that not all inventory records had unit prices and not all computer equipment had Government identification numbers at the time of our audit, and indicated that now all computer equipment is tagged with Government identification numbers. Ohio KePRO also stated that some of the equipment items did not have a unit price on the inventory records because those items were purchased in bulk from the previous contract holder.

### *Office of Inspector General's Response*

The property records must be complete and include a unit price because they constitute the official Government record.

Appendix B contains Ohio KePRO's comments in their entirety.

# **APPENDIXES**

**APPENDIX A**

**Costs Incurred by Ohio KePRO and  
Reviewed by the Office of Inspector General  
August 1, 2002–July 31, 2005**

<b>Cost Category</b>	<b>Amount Reviewed</b>	<b>Accepted</b>	<b>Questioned</b>		<b>Set Aside</b>	
			<b>Direct</b>	<b>Indirect</b>	<b>Direct</b>	<b>Indirect</b>
<b>Compensation</b>						
-Board Members	\$339,054	\$339,054	\$0	\$0	\$0	\$0
-Executives	5,875,830	5,875,830	0	0	0	0
<b>Travel</b>						
-Board Travel	179,800	179,343	0	457	0	0
-Conferences <sup>1</sup>	153,854	126,937	1,622	155	25,140	0
-Other Executive Travel	163,194	163,194	0	0	0	0
<b>Legal Fees</b>	47,539	37,899	0	9,640	0	0
<b>Equipment</b>	220,795	220,795	0	0	0	0
<b>Business Relationships</b>						
-AHQA Dues	221,117	221,117	0	0	0	0
-Other QIOs	129,518	76,391	0	0	53,127	0
-Temporary workers & Other	296,315	296,315	0	0	0	0
<b>Contract Modifications<sup>2</sup></b>	83,834	83,834	0	0	0	0
<b>Total</b>	<b>\$7,710,850</b>	<b>\$7,620,709</b>	<b>\$1,622</b>	<b>\$10,252</b>	<b>\$78,267</b>	<b>\$0</b>

AHQA = American Health Quality Association

QIO = Quality Improvement Organization

<sup>1</sup>Conference costs listed include all reviewed conference costs related to the three major conferences: Quality Net, AHQA, and Tri-Regional. The costs reviewed include travel and meal costs, as well as registration fees.

<sup>2</sup>There were two modifications for special projects: Mod 5 for the Oklahoma QIO subcontracted work on the Surgical Care Improvement Project (SCIP) and Mod 12 for the redesign of the Case Review Information System (CRIS). Modification amounts we included here are those amounts only related to the CRIS project. We included the SCIP project costs in the "Other QIOs" category.





October 31, 2007

Mr. Marc Gustafson  
Regional Inspector General for Audit Services  
Department of Health and Human Services  
Office of Audit Services  
233 North Michigan Avenue  
Chicago, IL 60601

Re: Report Number A-05-06-00043 "Review of Costs Claimed by the Quality Improvement Organization Ohio KePRO for August 1, 2002, through July 31, 2005"

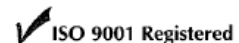
Dear Mr. Gustafson:

This letter is in response to your request that Ohio KePRO provide written comments to the findings and recommendations contained in the above-mentioned report.

The report indicates that the audit revealed \$11,874 of costs that were unallowable and \$78,267 of costs that may not have complied with Federal requirements. The report also indicates that there were equipment expenditures that were not in compliance with Federal requirements. Ohio KePRO appreciates the opportunity to present its views on the validity of the findings and reasonableness of the recommendations.

Regarding costs that are referenced as potentially unallowable costs, our responses are as follows:

Subcontract Costs: Even though information as referenced in OMB Circular A-122 was not provided to OIG for the Oklahoma Foundation for Medical Quality (OFMQ) subcontract costs, Ohio KePRO maintains that these costs, in the amount of \$53,127, are reasonable, allowable and allocable to the CMS contract. The subcontractor, Oklahoma Foundation for Medical Quality, assisted KePRO in completing the Surgical Care Improvement Project Special Study for the Centers for Medicare & Medicaid Services (CMS). OFMQ provided project strategy and work plan development, assisted with the project manual and intervention materials development, via conference calls with CMS and the workgroup. They were also responsible for training hospital staff, recruiting hospitals for participation, and supervision of data collection. Ohio KePRO



provided CMS with the results of the special study, which will support the labor effort on the part of OFMQ.

Conference-Related Costs: Ohio KePRO maintains that the costs for the 20 additional attendees, above the 30 attendees that were proposed for the 7<sup>th</sup> SOW, are reasonable, allowable and allocable to the CMS contract based on the following support.

The Quality Net conference in 2003 had an unanticipated strong agenda relating to safety and security training for our Information Technology staff. Therefore, Ohio KePRO sent three additional IT staff to ensure our understanding and compliance regarding the security issues. We also sent two additional staff as presenters for the conference. In total Ohio KePRO sent five additional staff to the 2003 conference, which we feel is reasonable, allowable, and allocable for the reasons stated above.

The Quality Net conference in 2004 included Doctor Office Quality-Information Technology (DOQ-IT) training which required Ohio KePRO to send six additional staff. We also sent eight additional staff as presenters for the conference. In total Ohio KePRO sent fourteen additional staff to the 2004 conference, which we feel is reasonable, allowable, and allocable for the reasons stated above.

Regarding equipment expenditures not in compliance with Federal requirements, our response is as follows:

Excess Computers: Ohio KePRO confirms that it did have 153 computers in inventory at July 31, 2005; however, Ohio KePRO currently has 110 computers in inventory. Of the 110 computers currently in inventory, 83 are for current employees, 13 are laptops needed for sign-out purposes for employees who travel, and 5 have been authorized by CMS to use for replacement parts. The remaining 9 computers will be reported as excess computers to CMS.

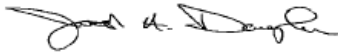
Inventories Not Reconciled: Ohio KePRO did reconcile its physical inventories to its records for Government-owned equipment. Ohio KePRO completes a physical inventory annually, which is used to complete Form 565. The government-owned furniture and equipment is tracked in our accounting system and all of our furniture had been tagged with Government identification numbers at the time of the inventory audit by OIG. While at the time of the inventory audit by OIG not all of the computer equipment had Government identification numbers, all government-owned computer equipment is currently tagged with a Government identification number.

Incomplete Inventory Records: Ohio KePRO's inventory is reconciled annually when completing Form 565. As identified in the report, some equipment does not have a unit price. The reason that some of the equipment items do not have unit prices on the inventory records is because these items were purchased in bulk from the previous contract holder. All other equipment purchases are recorded with a unit price as required.

Please incorporate these comments into the OIG audit report.

If you have any questions regarding the information in this response, please contact me at 717-564-8288.

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph Dougher". The signature is fluid and cursive, with a prominent initial "J" and a long, sweeping underline.

Joseph Dougher  
Chief Executive Officer