



JUN 30 2008

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

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

SUBJECT: Review of Quality Improvement Organization in Tennessee for August 1, 2002, Through July 31, 2005 (A-04-06-00023)

Attached is an advance copy of our final report on the Quality Improvement Organization (QIO) in Tennessee. In each State, the Centers for Medicare & Medicaid Services contracts with QIOs, which were established to promote the effective, efficient, and economical delivery of 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 represents part of our response to that request. In Tennessee, QSource 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, QSource received \$18.2 million in Federal reimbursement to perform its core contract and six special projects. We will issue this report to QSource within 5 business days.

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

Specifically, the costs we reviewed related to 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.

Of the \$13.81 million of costs reviewed, \$13.66 million appeared reasonable for Federal reimbursement. Of the remaining costs, QSource incurred \$30,654 of costs that were unallowable and \$123,581 of costs that were potentially unallowable. Specifically:

- QSource incurred a total of \$30,654 of costs that were unallowable. These costs were for Board of Directors travel costs (\$14,648) that were unnecessary and unsupported; physician consultant fees that were unreasonable, unnecessary, and unsupported (\$6,701); and relocation expenses (\$5,482) and membership costs (\$3,823) that were not allocable to the QIO contract.

- QSource incurred \$123,581 of costs for unreasonable and potentially unallowable conference-related costs.

We recommended that QSource:

- refund \$6,701, which includes \$4,549 of direct costs and \$2,152 of associated indirect costs, for unallowable physician consultant fees;
- reduce the indirect cost pool by \$23,953 for the balance of unallowable costs incurred; and
- work with the CMS contracting officer to determine what portion of the \$123,581 incurred for conference-related costs during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

In its written comments to our draft report, QSource addressed each of our findings and recommendations. QSource agreed with our first recommendation and with the unallowable relocation expenses in the second recommendation. However, QSource disagreed with unallowable Board of Directors travel costs (\$14,648) and unallowable membership costs (\$3,823) in the second recommendation. QSource also disagreed with our third recommendation and submitted for our review additional documentation regarding conference costs. The comments and additional documentation provided by QSource did not change our findings or recommendations. QSource's comments are included as Appendix B; however, we did not include the additional documentation because it contains personally identifiable information.

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 or Peter J. Barbera, Regional Inspector General for Audit Services, Region IV, at (404) 562-7750 or through e-mail at Peter.Barbera@oig.hhs.gov. Please refer to report number A-04-06-00023 in all correspondence.

Attachment



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

REGION IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

JUL -7 2008

Report Number: A-04-06-00023

Ms. Dawn Fitzgerald, CEO
QSource
3175 Lenox Park Boulevard
Memphis, Tennessee 38115

Dear Ms. Fitzgerald:

Enclosed is the Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Quality Improvement Organization in Tennessee 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 are made available to the general public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, the final report 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 Eric Bowen, Audit Manager, at (404) 562-7789 or through e-mail at Eric.Bowen@oig.hhs.gov. Please refer to report number A-04-06-00023 in all correspondence.

Sincerely,

A handwritten signature in cursive script that reads "Peter J. Barbera".

Peter J. Barbera
Regional Inspector General
for Audit Services, Region IV

Enclosure

Direct Reply to HHS Action Official:

James Randolph Farris, MD
Consortium Administrator
Consortium for Quality Improvement and
Survey & Certification Operations
Centers for Medicare & Medicaid Services
1301 Young Street, Suite 714
Dallas, Texas 75202

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

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



Daniel R. Levinson
Inspector General

July 2008
A-04-06-00023

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides 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.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

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. 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, 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.

QSource served as the Tennessee QIO for the period August 1, 2002, through July 31, 2005. For this 3-year period, known as the seventh scope of work, QSource received \$18.2 million in Federal reimbursement to perform its core contract and six special projects. During the period August 1, 2002, through July 31, 2005, QSource incurred total costs of approximately \$21 million to support all lines of business, including the QIO contract. As of July 27, 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 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.

OBJECTIVE

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

SUMMARY OF FINDINGS

Of the \$13.81 million of costs reviewed, \$13.66 million appeared reasonable for Federal reimbursement. Of the remaining costs, QSource incurred \$30,654 of costs that were unallowable and \$123,581 of costs that were potentially unallowable. Specifically:

- QSource incurred a total of \$30,654 of costs that were unallowable. These costs were for Board of Directors travel costs (\$14,648) that were unnecessary and unsupported; physician consultant fees that were unreasonable, unnecessary, and unsupported (\$6,701); and relocation expenses (\$5,482) and membership costs (\$3,823) that were not allocable to the QIO contract.
- QSource incurred \$123,581 of costs for unreasonable and potentially unallowable conference-related costs.

We are recommending the direct recovery or resolution of those unallowable costs charged directly to the contract and elimination or reduction of those costs allocated to the contract as indirect costs.

RECOMMENDATIONS

We recommend that QSource:

- refund \$6,701, which includes \$4,549 of direct costs and \$2,152 of associated indirect costs, for unallowable physician consultant fees;
- reduce the indirect cost pool by \$23,953 for the balance of unallowable costs incurred; and
- work with the CMS contracting officer to determine what portion of the \$123,581 incurred for conference-related costs during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments to our draft report, QSource agreed with our first recommendation and that the relocation expenses in the second recommendation were unallowable. However, QSource disagreed that the Board of Directors travel costs (\$14,648) and membership costs (\$3,823) in the second recommendation were unallowable. QSource also disagreed that the conference costs in our third recommendation were unallowable and submitted additional documentation for our review. The comments and additional documentation provided by QSource did not change our findings or recommendations. QSource's comments are included as Appendix B; however, we did not include the additional documentation because it contains personally identifiable information.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
Quality Improvement Organization Program	1
Claims for Federal Reimbursement	1
Tennessee Quality Improvement Organization	2
Senate Finance Committee Request.....	2
OBJECTIVE, SCOPE, AND METHODOLOGY	3
Objective	3
Scope.....	3
Methodology	3
FINDINGS AND RECOMMENDATIONS	5
UNALLOWABLE COSTS	5
Board of Directors Travel Costs	5
Physician Consultant Fees	6
Relocation Expenses	7
Membership Costs	7
POTENTIALLY UNALLOWABLE COSTS	8
RECOMMENDATIONS	9
AUDITEE COMMENTS AND OFFICE OF INSPECTOR	
GENERAL RESPONSE	9
Board of Directors Travel Costs	10
Membership Costs	10
Potentially Unallowable Costs.....	11
 APPENDIXES	
A – COSTS INCURRED BY QSOURCE FOR MEDICAL CARE AND REVIEWED BY THE OFFICE OF INSPECTOR GENERAL AUGUST 1, 2002–JULY 31, 2005	
B – AUDITEE COMMENTS	

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 QIOs, 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 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 for contracts with nonprofit organizations.¹

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 OMB Circular A-122, Attachment A, direct costs are amounts “that can be identified specifically with a particular final cost objective” (section B.1), and indirect costs are amounts “that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective” (section C.1). An indirect cost rate is generally calculated by dividing allowable indirect costs by all direct costs. QIOs determine the amount of indirect costs to claim by multiplying an indirect cost rate against their direct costs.

¹In 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 this QIO contract because the parties did not make such an agreement.

During the contract period, CMS usually is unable to calculate an indirect cost rate. Therefore, QIOs use provisional rates to determine indirect costs. Pursuant to OMB Circular A-122, Attachment A, section E.1.e, a provisional rate is a temporary indirect cost rate “applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.” CMS contracts with the Defense Contract Audit Agency (DCAA) to review, after the close of a QIO’s fiscal year (FY), 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.

Tennessee Quality Improvement Organization

QSource serves as the Tennessee QIO. QSource is an independent, nonprofit, federally approved QIO that has been under contract with CMS since 1973. QSource’s contract with the Federal Government is a hybrid cost-plus-award-fee and cost-plus-fixed-fee contract.

For the 3-year period, known as the seventh SOW (August 1, 2002, through July 31, 2005), QSource received \$18.2 million in Federal reimbursement to perform the core contract and six special studies. Our review primarily focused on the core contract. During the period August 1, 2002, through July 31, 2005, QSource incurred total costs of approximately \$21 million to support all lines of business, including the QIO 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 recommendation as to the final rates. As of July 31, 2007, DCAA had not reviewed indirect cost rates for FY 2005. The CMS contracting officer will consider both DCAA’s and our recommendations in establishing the final rates and in settling the cost difference between the provisional and final rates for the seventh SOW.

Senate Finance Committee Request

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

- 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.

The Senate Finance Committee also expressed concern about the extent to which QIOs addressed quality of care concerns and the beneficiary complaint resolution process. We have examined this issue in another review (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 \$13.81 million in costs for the seventh SOW (August 1, 2002, through July 31, 2005). In total, QSource received \$18.2 million in Federal reimbursement for the core QIO contract and six special studies.

The \$13.81 million consisted of costs incurred in 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 QSource's systems and procedures for claiming costs to the extent necessary to accomplish our objective.

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

We performed fieldwork at QSource's office in Memphis, Tennessee.

Methodology

We took the following actions to accomplish our objectives:

- We reviewed applicable Federal requirements.
- We interviewed QSource's officials and reviewed QSource's policies and procedures to obtain an understanding of how it claimed costs for Federal reimbursement.
- We interviewed the CMS regional project officer and program staff at the CMS regional office and headquarters office to obtain an understanding of their roles in the contracting process.
- We reconciled the Federal reimbursement, in total (as indicated on the vouchers that QSource submitted to CMS), to QSource's general ledger to determine the costs QSource incurred and charged to the contract.
- We examined, on a test basis, evidence supporting the \$13.81 million of costs included in our review and claimed by QSource. For each of the six areas reviewed, we identified the general ledger accounts that contained the expenses that QSource 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 the number of board members who attended the meetings. We compared compensation, for both the board members and three high-ranking executives, to the amounts included in QSource's proposal to CMS. CMS eliminated salary ceilings for QIO executives after the fifth SOW and no longer prescribes specific salary limitations. Accordingly, the general standards for reasonableness in executive salaries, as established by OMB Circular A-122, are applicable. To apply this standard, we relied on DCAA's reports and workpapers that analyzed the salary levels incurred by QSource in addition to our analysis of the amounts in the proposal.
 - For board member and executive staff travel costs, we analyzed documentation to determine whether transportation costs of selected board members and high-ranking executives were reasonable. Because board members often drove to and from the board meetings, we verified the mileage rate and the round trip miles used to determine the reimbursement. For executives, we reviewed the number of overnight trips and whether QSource claimed transportation, hotel, and meal costs pursuant to Federal guidelines. In addition, for conference travel, we analyzed the travel costs incurred by QSource executive and nonexecutive employees to determine whether costs claimed were reasonable.
 - For legal fees, including administrative charges, we reviewed documentation to determine whether the costs were reasonable and allowable for Federal reimbursement.
 - For equipment and administrative charges, we reviewed documentation to determine whether the costs were allowable for Federal reimbursement.
 - For business relationships and conflicts of interest, we reviewed selected subcontracts, payments made to other QIOs, and payments for temporary workers to determine whether the costs were allowable for Federal reimbursement.
 - For contract modifications, we reviewed the modifications 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.
 - For various administrative charges, we reviewed documentation to determine whether the costs were allowable for Federal reimbursement.
- We reviewed DCAA audits of direct and indirect costs for FYs 2002, 2003, and 2004.

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 \$13.81 million of costs reviewed, \$13.66 million appeared reasonable for Federal reimbursement. Of the remaining costs, QSource incurred \$30,654 of costs that were unallowable and \$123,581 of costs that were potentially unallowable. Specifically:

- QSource incurred \$30,654 of costs that were unallowable. These costs were for Board of Directors travel costs (\$14,648) that were unnecessary and unsupported; physician consultant fees that were unreasonable, unnecessary, and unsupported (\$6,701); and relocation expenses (\$5,482) and membership costs (\$3,823) that were not allocable to the QIO contract.
- QSource incurred \$123,581 of costs for unreasonable and potentially unallowable conference-related costs.

We are recommending the direct recovery or resolution of those unallowable 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, accepted, questioned, or set aside is presented in Appendix A.

UNALLOWABLE COSTS

QSource incurred \$30,654 of costs that were unallowable. These costs were for Board of Directors travel costs (\$14,648) that were unnecessary and unsupported; physician consultant fees that were unreasonable, unnecessary, and unsupported (\$6,701); and relocation expenses (\$5,482) and membership costs (\$3,823) that were not allocable to the QIO contract.

Board of Directors Travel Costs

OMB Circular A-122, Attachment A, section A.2.g, states that to be allowable, costs must “[b]e adequately documented.” Moreover, pursuant to OMB Circular A-122, Attachment A, section A.4.a: “A cost is allocable to a particular cost objective . . . in accordance with the relative benefits received.” Additional principles regarding allowability of travel costs are located at OMB Circular A-122, Attachment B, sections 55.a and 55.b, which provide that:

- a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to subparagraphs b through e, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.
- b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the

method used results in charges consistent with those normally allowed by the organization in its regular operations.

In describing the types of travel costs normally allowed, QSource's travel policy states that official travel "will be reimbursed based on actual, necessary, and reasonable expenses incurred. . . . Federal travel regulations will be adhered to as much as possible." The Federal Travel Regulations (FTR) referenced in QSource's travel policy are located at 41 CFR chapters 300–304. FTR section 301-2.4 requires that travelers be responsible for excess costs resulting from circuitous routes, delays, luxury accommodations, or services unnecessary or unjustified in the performance of official business. Pursuant to FTR section 301-11.21(a), travelers will be reimbursed for per diem or actual expenses on leave or nonworkdays as long as travel status requires staying a nonworkday and staying is the most cost-effective situation.

QSource incurred unallowable indirect costs of \$14,648 for Board of Directors retreats in New Orleans, Louisiana, in November 2002, 2003, and 2004. Following the completion of the business agenda around midday on Saturday, several QSource directors and employees stayed Saturday night at the French Quarter hotel that hosted the retreat, incurring additional lodging costs for Saturday and additional per diem costs for Sunday. Other attendees did not stay Saturday night and did not incur additional lodging or per diem costs. On average during the 3 years, 19 people stayed and 5 left following the conclusion of the business agenda at approximately 12:30 p.m. QSource stated that it allowed attendees to stay Saturday night if the airfare savings resulting from leaving on Sunday were greater than the cost of staying the additional night. However, QSource provided no documentation to support that there were relative benefits received from the extended stay, that the extended stay was necessary and related to the performance of official business, or that staying the extra night was the most cost-effective situation. As a result, QSource incurred \$14,648 of unnecessary, unsupported, and, therefore, unallowable board member and executive travel costs.

Physician Consultant Fees

Pursuant to OMB Circular A-122, Attachment A, section A.3: "In determining the reasonableness of a given cost, consideration shall be given to: a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award"

Pursuant to OMB Circular A-122, Attachment B, section 39.b: "In determining the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions)." OMB Circular A-122, Attachment A, section A.2.g, states that to be allowable, costs must "[b]e adequately documented."

QSource incurred \$6,701 of unallowable costs for a consulting agreement with its Medical Director: \$4,549 of physician consultant fees charged directly to the contract and an additional \$2,152 of associated indirect costs calculated using the provisional rate. Generally, QSource paid its consultants within the terms of its contractual agreements. However, QSource paid the

Medical Director more than the rate of compensation specified in the consulting agreement. QSource stated that payment beyond the \$75 rate of compensation in the agreement was based on a verbal agreement between the organization and the consultant. However, the consulting agreement clearly stated that it could be amended only by mutual written consent. These direct costs were as follows.

Hours Worked	Hourly Rate Per Agreement	Allowable Per Agreement	Amount Paid	Excess
111	\$75	\$8,325	\$12,874	\$4,549

In determining the allowability of costs in a particular case, such as these physician consultant fees, adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions) is relevant. However, QSource provided no documentation to support the amendment to the consulting agreement or to justify payments in excess of the \$75-an-hour rate of compensation specified in the contractual agreement. As a result, QSource incurred \$6,701 in unreasonable, unnecessary, unsupported, and, therefore, unallowable physician consultant fees.

Relocation Expenses

Pursuant to OMB Circular A-122, Attachment A, section A.4:

- a. A cost is allocable to a particular cost objective . . . in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs . . . and if it: (1) Is incurred specifically for the award. (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

QSource incurred \$5,482 of unallowable indirect costs for relocation of an employee whose services did not benefit the Federal award. In May 2003, QSource hired the employee for business unrelated to the QIO contract. In June 2003, QSource relocated the employee from Atlanta, Georgia, to Nashville, Tennessee. After this relocation, which was the only relocation claimed during the seventh SOW, the employee continued to work as a Senior Analyst on business unrelated to the QIO contract. These costs should have been charged directly to the line of business that benefited from the services. Instead, the relocation expenses were charged to the indirect cost pool used in calculating the organization’s indirect cost rate for the QIO contract and, therefore, allocated in part to the QIO contract. As a result, QSource incurred \$5,482 of relocation expenses that were not allocable to the QIO contract and, therefore, were unallowable.

Membership Costs

Pursuant to OMB Circular A-122, Attachment B, section 30.d: “Costs of membership in any civic or community organization are allowable with prior approval by Federal cognizant agency.”

QSource incurred \$3,823 of indirect costs for memberships to civic or community organizations, which were unallowable because QSource failed to obtain prior approval from CMS, as required by OMB Circular A-122, Attachment B, paragraph 30.d. QSource incurred \$1,500 for membership to a civic organization that's mission was to build quality awareness and a reputation for the greater Memphis area. QSource also incurred \$2,323 for a membership to a civic organization that's mission was to recruit industry and create jobs for the greater Memphis regional area.

As a result, QSource incurred \$3,823 for membership costs to civic or community organizations that were not approved by CMS, the cognizant Federal agency, and were, therefore, unallowable.

POTENTIALLY UNALLOWABLE COSTS

QSource incurred \$123,581 of potentially unallowable conference-related costs.

Pursuant to OMB Circular A-122, Attachment A, section A.3:

A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs In determining the reasonableness of a given cost, consideration shall be given to:

- a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
- b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.
- c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.
- d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

QSource incurred conference-related costs that may have been unreasonable. In its bid proposal to CMS, QSource proposed to send 53 staff members to three Quality Net, three American Health Quality Association (AHQA), and three Tri-Regional conferences.² However, it incurred costs for 121 employees to attend these nine conferences.

²For the AHQA and Tri-Regional conferences, QSource proposed sending seven staff members in 2003, 2004, and 2005. For the Quality Net conferences, QSource proposed sending five staff members in 2003 and three staff members in 2004 and 2005.

The number of staff members set forth in QSource’s bid proposal was based on the prior year’s experience. We considered the additional 68 attendees and the estimated costs of \$123,581 as potentially unreasonable. These costs are detailed in the table.

Table. Conference-Related Costs for 68 Additional Attendees

Additional Attendees’ Cost	Three Quality Net Conferences	Three AHQA Conferences	Three Tri-Regional Conferences	Total
Travel (including hotel)	\$35,312	\$25,983	\$20,676	\$81,971
Meals	3,482	3,276	2,215	8,973
Registration	9,240	17,047	6,350	32,637
Total	\$48,034	\$46,306	\$29,241	\$123,581

The additional conference-related costs may not have been in accordance with OMB Circular A-122. Specifically, the additional costs may not have been prudent or necessary for QSource’s operations related to the QIO contract. Therefore, \$123,581 of conference-related costs may have been unreasonable and, thus, unallowable. We were unable to determine how much of the \$123,581 could have been avoided.

RECOMMENDATIONS

We recommend that QSource:

- refund \$6,701, which includes \$4,549 of direct costs and \$2,152 of associated indirect costs, for unallowable physician consultant fees;
- reduce the indirect cost pool by \$23,953 for the balance of unallowable costs incurred; and
- work with the CMS contracting officer to determine what portion of the \$123,581 incurred for conference-related costs during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments to our draft report, QSource agreed with our first recommendation and that the relocation expenses in the second recommendation were unallowable. However, QSource disagreed that the Board of Directors travel costs (\$14,648) and membership costs (\$3,823) in the second recommendation were unallowable. QSource also disagreed that the conference costs in our third recommendation were unallowable and submitted additional documentation for our review. The comments and additional documentation provided by QSource did not change our findings or recommendations. QSource’s comments are included as Appendix B, but we did not include the additional documentation because it contains personally identifiable information. QSource disagreed with the following recommendations.

Board of Directors Travel Costs

Auditee Comments

QSource acknowledged that several members of the Board of Directors and associates stayed an additional night following the conclusion of business meetings, but it disagreed that the additional night's stay represented excess costs resulting from circuitous routes, delays, luxury accommodations, or services unnecessary or unjustified in the performance of official business. QSource stated that the additional night's stay was a generally accepted practice for members of the board and associates in response to travel option limitations and calculated differences in airfare for Saturday versus Sunday travel. QSource also stated that neither internal nor DCAA auditors questioned the hotel stays.

Office of Inspector General Response

The practice of extended stays to increase overall travel cost efficiency is an acceptable practice if proper controls are in place, such as documenting that there were relative benefits received from the extended stay, that the extended stay was necessary and related to the performance of official business, or that staying the extra night was cost effective. However, QSource did not submit any documentation to show that travel option limitations forced the additional night's stay or to show calculated differences in airfare for Saturday versus Sunday travel. Therefore, our finding and recommendation remain unchanged.

Membership Costs

Auditee Comments

QSource cited general provisions of OMB Circular A-122 and requested that these costs be approved and not disallowed because they meet general reasonableness standards. QSource stated that membership in the organizations is in concert with its responsibility to foster improved quality awareness and the economic health of the community. Furthermore, QSource stated that similar costs had been accepted and allowed "via prior audit" and that it had relied on that acceptance as approval of these costs.

Office of Inspector General Response

Specific provisions of OMB Circular A-122 are controlling over more general provisions. This is the case regarding membership costs. OMB Circular A-122, Attachment B, section 30.d, states: "Costs of membership in any civic or community organization are allowable with prior approval by Federal cognizant agency." Despite QSource's inference based on historical practices and despite the nature of the memberships, the membership costs incurred during this audit period were subject to the specific criteria at OMB Circular A-122, Attachment B, section 30.d. QSource did not obtain prior approval from the cognizant Federal agency, CMS, for these specific membership costs. The fact that the costs may have been allowed previously in an audit does not constitute approval by CMS. Therefore, our finding and recommendation remain unchanged.

Potentially Unallowable Costs

Auditee Comments

QSource disagreed with the findings relative to unallowable conference-related costs based on the number of attendees in the business proposal compared with the number of actual attendees. QSource felt the number of attendees at the subject conferences was “more than justified” because the conferences were unique opportunities for staff members to network with other QIO and CMS staff and to share best practices and lessons learned throughout the contract period. QSource stated that CMS has historically approved and reimbursed conference costs based on recognizing the values of the conferences to the QIO programs, and QSource submitted additional information supporting this statement. QSource also stated:

- The actual travel costs incurred in the seventh SOW were less than the travel costs proposed in the contract.
- In determining the proposed budget for travel costs, the Office of Inspector General left out the budgeted travel costs and number of proposed attendees for special studies staff, but counted the number of special studies staff members that actually attended the conferences. QSource concluded that, if proposed numbers pertaining to special studies staff were taken into account, the total number of budgeted travelers proposed by QSource would be 90, not 53 as calculated by the Office of Inspector General.
- There was a disparity between the average cost for the accepted attendees and that for potentially unallowable attendees.
- According to QSource’s understanding of Federal Acquisition Regulation subpart 16.3, the QIO contract was a performance-based, cost-reimbursement contract. Therefore, QIO expenditure decisions are at the QIO’s discretion as long as the overall costs are reasonable, allowable, allocable, and do not exceed the contract ceiling amount. Additionally, because cost-reimbursement contracts are used only when contract performance involves uncertainties, QSource questioned the use of the proposal as a benchmark “due to the relative uncertainty associated with using budgeted assumptions as a base for determinations of reasonableness.”

Office of Inspector General Response

We agree that CMS has historically recognized the values of the conferences to the QIO programs, and we recognize that some increase in the number of conference attendees may have been justified. Our response to QSource’s specific arguments follows:

- QSource did not provide documentation to support that actual travel costs incurred were less than the travel costs proposed in the contract.
- QSource did not provide documentation that the total number of budgeted travelers was different than the number we determined. Specifically, QSource did not provide

documentation to support the budgeted travel costs and number of proposed attendees for special studies staff as alluded to in its response.

- The difference in the average cost for accepted versus potentially unallowable conference attendees is attributable to inclusion of registration fees in the attendees' cost for the set-aside amount but not for the amount accepted. To clarify this issue, we added \$64,167 of registration fees to the total conference-related costs reviewed and adjusted the amount accepted to include \$64,167 for conference registration fees.
- Notwithstanding the fact that QSource's contract with the Federal Government is a cost-reimbursement contract, the amounts paid must be determined to be allowable by the CMS contracting officer in accordance with OMB Circular A-122, which requires that costs be reasonable. The number of conference attendees set forth in QSource's bid proposal was based on the prior year's experience. The actual number of conference attendees being more than double the number in QSource's bid proposal raises the question of reasonableness. Given these circumstances and the criteria at OMB Circular A-122, Attachment A, section A.3, prudence justifies using the budgeted assumptions to evaluate the reasonableness of conference-related costs and setting aside any potentially unreasonable costs for review by the CMS contracting officer.

Therefore, we continue to recommend that QSource work with the CMS contracting officer to determine what portion of the conference-related costs should be excluded from the indirect cost pool for purposes of determining final rates.

APPENDIXES

**Costs Incurred by QSource for Medical Care
and Reviewed by the Office of the Inspector General
August 1, 2002–July 31, 2005**

Cost Category	Amount Reviewed	Accepted	Questioned		Set Aside	
			Direct	Indirect	Direct	Indirect
Compensation						
- Board members	\$177,271	\$177,271	\$0	\$0	\$0	\$0
- Executive staff	1,292,808	1,292,808	0	0	0	0
- Fringe benefits	3,618,693	3,618,693	0	0	0	0
Total Compensation	5,088,772	5,088,772	0	0	0	0
Travel						
- Board retreats	14,648	0	0	14,648	0	0
- Conference attendance	229,290	105,709	0	0	0	123,581
- Board conference and travel	68,745	68,745	0	0	0	0
- Conference lodging and per diem	228,667	228,667	0	0	0	0
- Executive travel	73,654	73,654	0	0	0	0
Total Travel	615,004	476,775	0	14,648	0	123,581
Legal Fees	101,328	101,328	0	0	0	0
Equipment	277,077	277,077	0	0	0	0
Business Relationships	601,308	594,607	6,701 ¹	0	0	0
Contract Modifications	5,669,425	5,669,425	0	0	0	0
Administrative Charges						
- Relocation expense	5,482	0	0	5,482	0	0
- Membership costs	195,869	192,046	0	3,823	0	0
- Advertising and public relations costs	295,800	295,800	0	0	0	0
- Other accounts reviewed	960,284	960,284	0	0	0	0
Total Administrative Charges	1,457,435	1,448,130	0	9,305	0	0
Total	\$13,810,349	\$13,656,114	\$6,701	\$23,953	\$0	\$123,581

¹Because \$4,549 was directly charged to the contract, QSource has received \$2,152 in additional reimbursement through the application of the provisional indirect cost rates, for a total of \$6,701 of questioned costs. The \$2,152 is indirect costs, but it was charged to the contract. Therefore, unlike the other items included in the indirect cost pool, we are recommending it for refund.



November 27, 2007

Peter J. Barbera
Regional Inspector General for Audit Services
Department of Health and Human Services
Region IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, GA 30303

RE: Comments on November 2007 draft of Audit Report No. A-04-06-00023

Dear Mr. Barbera:

In your letter dated November 6, 2007, you provided to QSource a copy of the Office of Inspector General draft audit report A-04-06-00233, entitled "Review of Quality Improvement Organization in Tennessee for August 1, 2002 through July 31, 2005." You requested written comments within 30 days of your November 6 letter. Our comments are provided below.

Unallowable Costs

Board of Directors Travel Costs

QSource acknowledges that several members of the Board of Directors and associates stayed one additional night following the conclusion of the business meetings that adjourned at 12:40 pm, 12:50 pm and 1:10 pm for years 2002, 2003 and 2004, respectively. QSource also acknowledges that the additional night's stay has been a generally accepted practice for members of the board and associates due to travel option limitations and calculated differences in airfare for Saturday versus Sunday travel.

According to the audit findings, QSource should have provided documentation to support the relative benefits received from the additional night's stay, i.e., that the extended stay was necessary and related to the performance of official business, or that staying the additional night was the most cost effective situation.

QSource respectfully disagrees with the auditors' conclusion that the additional night's stay represents "excess costs resulting from circuitous routes, delays or luxury accommodations or service unnecessary or unjustified in the performance of official business." The questioned hotel stays were incurred per QSource accepted practice, unquestioned by either internal or DCAA auditors, and designed specifically to improve the organization's efficiency.

November 27, 2007

Page 2

Physician Consultation Fees

QSource acknowledges that it paid the Medical Director more than the rate of compensation specified in the consulting agreement. The increased rate of payment was based on a verbal agreement between the organization and the consultant, although the consultant's written contract was not amended. While from a practical and legal standpoint, such an amendment would have been superfluous, QSource agrees that the costs are not supported by required documentation, and are therefore unallowable. Prior audit by the DCAA also captured this error, and QSource has already corrected for these costs in our accounting system.

Relocation Expenses

QSource agrees that the \$5,482 of indirect costs for relocation of an employee was a clerical error in cost allocation and immediately removed the associated indirect costs from the QIO contract work.

As a result of this finding, QSource has implemented a cost allocation report to verify indirect cost allocations on a monthly basis to ensure that costs are justifiable and allocable to this cost element.

Membership Costs

According to OMB Circular A-122, a "cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time of the decision was made to incur the costs."

QSource has historically been given discretion in deciding how it operates its business, which has been with prudence and in accordance with the overall mission of the organization. Membership in the local chamber of commerce and the local Malcolm Baldrige award organization are clearly in concert with the responsibilities of the organization, its members and employees to foster improved quality awareness and the economic health of the community in which it operates.

OIG has disallowed these costs because the "costs of membership in any civic or community organization are allowable with prior approval of Federal cognizant agency." These costs have been consistently accepted and allowed as a cost in the past, and QSource has relied on this acceptance as grounds for approval of such costs as approval via prior audit. We therefore respectfully request that these costs be approved and not disallowed.

Potentially Unallowable Costs

CMS has historically approved and reimbursed conference costs based on the recognition of the value of conferences to the QIO program. CMS officials, including Administrators, Deputy Administrators and the Secretary of the Department of Health and Human Services have spoken at these meetings and CMS officials have supported the attendance of QIO staff, both verbally and in writing (see Attachments).

QSource respectfully disagrees with the auditors' findings relative to unallowable costs for associate travel to three approved conferences, based on the number of attendees in our business proposal compared to the number that actually attended, for the following reasons.

Where there are differences in a contractor's proposed costs and actual costs, an auditor may compare the two and determine the reasonableness of the two. The direct and indirect travel costs proposed in this contract were \$1,025,607. The actual travel costs incurred in the 7th scope of work (SOW) were \$879,960. QSource was, in fact, 14.2% under the approved travel costs for the contract.

Second, the number of attendees in the QSource budget proposal for the contract separated out costs for 7th SOW training, as it was unclear as to whether or not these associates would have training in association with one of the scheduled conferences. This training was provided at the 2002 QualityNet conference. In 2004 and 2005, the AHQA annual and technical conferences were combined, whereas the QSource budget separated the attendance and budget estimates. Further, budgeted travel costs for special studies' staff and number of attendees were also not included, despite the fact that they are represented in the actual attendees count provided by the OIG. If the special studies' associates, as well as associates who were budgeted under the AHQA Annual Conference and "7th SOW training – Baltimore," are added to the total number of budgeted travelers, the number QSource proposed is actually 90, not 68 as calculated by the OIG.

Third, the total dollars attributed to AHQA, QualityNet and Tri-Regional conferences by the OIG audit is \$165,125. The total dollars budgeted for the three conferences was \$157,695 and \$24,774 was budgeted for the 7th SOW training for a total of \$182,469. The \$165,125 represents 90.5% of the conference-related budget dollars and 18.76% of the total travel dollars spent in the 7th SOW. Of the \$165,125 the amount listed in the Appendix as accepted for 53 staff members attending those conferences was \$41,542, which equates to \$783.81 per attendee. The amount listed as potentially unallowable for the remaining 68 attendees was \$123,581, which equates to \$1,817.37 per attendee. We are unable to determine why there is such a large disparity in the average cost for the accepted number of attendees and that for the potentially unallowable attendees.

November 27, 2007

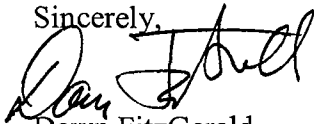
Page 4

Finally, CMS's contracts with the QIOs are performance based, cost reimbursement contracts. Therefore, it is understood that QIO expenditure decisions are at the QIO's discretion, as long as the overall costs are reasonable, allowable, allocable and do not exceed the contract ceiling amount and all contract deliverables are met and the Indirect Cost Rate, and Fringe Rate ceilings are not exceeded by 5% or more. Since the evaluation in this contract was partially based on QIO sharing as evaluated by the CMS Project Officer, QSource felt that the number of attendees at the subject conferences was more than justified because these conferences provide unique opportunities for staff members to network with other QIOs, as well as CMS staff, and share best practices and lessons learned throughout the contract period.

We reference FAR Subpart 16.3, for the detail related to this understanding, due to the relative uncertainty associated with using budgeted assumptions as a base for determinations of reasonableness. 16.301-2 provides: "Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed price contract."

QSource appreciates the opportunity to review and comment on the draft audit report. If you should have any questions regarding our response, please do not hesitate to contact me.

Sincerely,



Dawn FitzGerald
Chief Executive Officer

- cc. Eric Bowan, Audit Manager, OIG
- Robert A. Kerlan, M.D., Chairman, QSource Board of Directors
- Craig T. Hofer, CPA, Chairman, QSource Compliance & Audit Committee
- Patrick Brown, Chief Financial Officer, QSource
- Donna Lee, Controller, QSource
- Gayle Jones, Compliance Officer, QSource