DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAY 2 3 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 Texas (A-06-06-00072)

Attached is an advance copy of our final report on the Quality Improvement Organization (QIO) program in Texas. In each State, the Centers for Medicare & Medicaid Services (CMS) 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 that respond to that request. In Texas, the Texas Medical Foundation (TMF) was the QIO for the period February 1, 2003, through January 31, 2006. For this 3-year period, known as the seventh scope of work, TMF received $33 million in Federal reimbursement to perform the core QIO contract and four special studies. We will issue this report to TMF 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 $6.5 million of costs reviewed, $6 million appeared reasonable for Federal reimbursement. Of the remaining costs, TMF incurred $403,581 for costs that were unallowable and $49,157 for costs that may not have complied with Federal requirements:

- TMF incurred $403,581 for costs that were unallowable. These costs were for severance packages and related legal costs ($11,072 direct and $382,956 indirect), legal fees ($5,538 direct), and travel costs ($887 direct and $3,128 indirect).

- TMF incurred $49,157 for potentially unallowable costs for potentially unreasonable compensation ($49,157 indirect).

We recommend that TMF:

- refund $17,497 for unallowable legal fees and consultant travel;
- reduce the indirect cost pool by $386,084 for severance packages for executives, board member and executive travel, and conference costs; and
- work with the CMS contracting officer to determine what portion of the $49,157 incurred for compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

In its comments on our draft report, TMF disagreed with most of our findings. Although TMF agreed that some of the travel expenses and compensation costs were unallowable, TMF disagreed that the severance packages, legal fees, equipment, and media and public relations costs were unallowable. TMF believes that only $35,200 was unallowable.

We disagree with TMF's assertion that the severance packages and legal fees were allowable. We also disagree with TMF's assertion that certain portions of the travel costs and compensation costs were allowable. We agree with TMF that part of the compensation costs and all of the equipment and media and public relations costs were allowable. Therefore, we did not include those findings in this report.

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 Gordon L. Sato, Regional Inspector General for Audit Services, Region VI, at (214) 767-8414 or through e-mail at Gordon.Sato@oig.hhs.gov. Please refer to report number A-06-06-00072 in all correspondence.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Audit Services

Region VI
1100 Commerce, Room 632
Dallas, TX 75242

MAY 28 2008

Report Number: A-06-06-00072

Mr. Thomas Manley
Chief Executive Officer
TMF Health Quality Institute
Bridgepoint 1, Suite 300
5918 West Courtyard Drive
Austin, Texas 78730-5036

Dear Mr. Manley:

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 Texas." 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, this 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 Patricia Wheeler, Audit Manager, at (214) 767-6325 or through e-mail at Trish.Wheeler@oig.hhs.gov. Please refer to report number A-06-06-00072 in all correspondence.

Sincerely,

Gordon L. Sato

Gordon L. Sato
Regional Inspector General
for Audit Services

Enclosure

HHS Action Official

James Randolph Farris, M.D., Consortium Administrator
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Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF QUALITY IMPROVEMENT ORGANIZATION IN TEXAS

Daniel R. Levinson
Inspector General

May 2008
A-06-06-00072

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:

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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.

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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 "the purposes of promoting the effective, efficient, and economical delivery of Medicare health care services and the quality of those 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.

TMF Health Quality Institute (TMF) was the Texas QIO for the period February 1, 2003, through January 31, 2006. For this 3-year period, known as the seventh scope of work, TMF received $33 million in Federal reimbursement for the QIO contract and four special studies. Our review primarily focused on the core contract. During calendar years 2003 through 2005, TMF incurred total costs of approximately $45.6 million to support all lines of business, including the QIO contract. As of July 16, 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 $6.5 million of costs reviewed, $6 million appeared reasonable for Federal reimbursement. Of the remaining costs, TMF incurred $403,581 of unallowable costs and $49,157 of costs that may not have complied with Federal requirements:

- TMF incurred $403,581 of costs that were unallowable. These costs were for severance packages and related legal costs ($11,072 direct and $382,956 indirect), legal fees ($5,538 direct), and travel costs ($887 direct and $3,128 indirect).

- TMF incurred $49,157 of potentially unallowable costs for potentially unreasonable compensation ($49,157 indirect).

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

RECOMMENDATIONS

We recommend that TMF:

- refund $17,497 for unallowable legal fees and consultant travel;

- reduce the indirect cost pool by $386,084 for severance packages for executives, board member and executive travel, and conference costs; and

- work with the CMS contracting officer to determine what portion of the $49,157 incurred for compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

TMF HEALTH QUALITY INSTITUTE COMMENTS

In its comments on our draft report, TMF disagreed with most of our findings. Although TMF agreed that some of the travel expenses and compensation costs were unallowable, TMF disagreed that the severance packages, legal fees, equipment, and media and public relations costs were unallowable. TMF believes that only $35,200 was unallowable.

OFFICE OF INSPECTOR GENERAL RESPONSE

We disagree with TMF’s assertion that the severance packages and legal fees were allowable. We also disagree with TMF’s assertion that certain portions of the travel costs and compensation costs were allowable. We agree with TMF that part of the compensation costs and all of the equipment and media and public relations costs were allowable. Therefore, we did not include those findings in this report.

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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). To date, 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 with respect to 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 established for each contract and 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.[2]

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

[2]Some of the direct costs, including passthrough costs, do not receive an allocation of indirect costs. Section G.3 of the QIO contract requires QIOs to exclude their passthrough costs in the calculation of indirect costs.

During the contract period, CMS usually is unable to calculate an exact 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." 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.

Texas Quality Improvement Organization

TMF Health Quality Institute (TMF), Texas's QIO, is a nonprofit consulting company based in Austin, Texas. TMF's contract with the Federal Government is a hybrid cost-plus-award-fee and cost-plus-fixed-fee completion type contract.

For the 3-year period known as the seventh SOW (February 1, 2003 through January 31, 2006), TMF received $33 million in Federal reimbursement to perform the contract and four special studies. Our review primarily focused on the core contract. During calendar years 2003 through 2005, TMF incurred total costs of approximately $45.6 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 recommendations as to the final rates. As of July 17, 2007, DCAA was in the process of reviewing 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 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 $6.5 million of the costs that TMF incurred for the seventh SOW (February 1, 2003, through January 31, 2006). In total, TMF received $33 million in Federal reimbursement for the core QIO contract and four special studies. Our review focused on TMF's core contract.

The $6.5 million consisted of 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 TMF 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 TMF's office in Austin, Texas.

Methodology

We took the following actions to accomplish our objectives:

- We reviewed applicable Federal requirements.

- We interviewed TMF officials and reviewed TMF policies and procedures to obtain an understanding of how it claimed costs for Federal reimbursement.

- We interviewed the CMS contracting officer, project officer, and program staff at the CMS regional office and CMS 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 TMF submitted to CMS), to TMF's general ledger to determine the costs TMF incurred and charged to the contract.

- We examined, on a test basis, evidence supporting the $6.5 million of costs included in our review and claimed by TMF. For each of the six areas reviewed, we identified the general ledger accounts that contained the expenses that TMF 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 board members and 11 high-ranking executives to the amounts included in TMF's proposal to CMS and the amounts approved by CMS. Because CMS eliminated salary ceilings for QIO executives after the fifth SOW, CMS 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 that analyzed the salary levels incurred by TMF for FYs 2003 and 2004 in addition to our analysis of the salary levels in the proposal.

    - For board member and executive staff travel, we analyzed documentation to determine whether the transportation costs of the board members and seven high-ranking executives were reasonable. We verified the mileage rate and the round trip miles used to determine the reimbursement for driving. We also verified the airline costs that were reimbursed. For executives, we reviewed judgmentally selected overnight trips to determine whether TMF claimed transportation, hotel, and meal costs pursuant to Federal guidelines.

    - For costs related to legal fees, including administrative charges, we reviewed the legal fees incurred to determine whether the costs were reasonable and allowable for Federal reimbursement.

    - For equipment and administrative charges, we analyzed documentation to determine whether the incurred costs were allowable for Federal reimbursement.

    - For business relationships and conflicts of interest, we reviewed selected subcontracts, as well as registration fees at conferences. We then analyzed the documentation to determine whether the incurred 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 approved by CMS and consistent with CMS's overall objectives for the seventh SOW.

- We assessed TMF's accounting policies and procedures related to the capitalizing, expensing, and inventory of fixed-asset purchases.

- We reviewed DCAA audits of direct and indirect costs for FYs 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 $6.5 million of costs reviewed, $6 million appeared reasonable for Federal reimbursement. Of the remaining costs, TMF incurred $403,581 of unallowable costs and $49,157 of costs that may not have complied with Federal requirements:

- TMF incurred $403,581 of costs that were unallowable. These costs were for severance packages and related legal costs ($11,072 direct and $382,956 indirect), legal fees ($5,538 direct), and travel costs ($887 direct and $3,128 indirect).

- TMF incurred $49,157 of potentially unallowable costs for potentially unreasonable compensation ($49,157 indirect).

We recommend the direct 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, accepted, questioned, or set aside is included in Appendix A.

UNALLOWABLE COSTS

TMF incurred $403,581 of costs that were unallowable. These costs were for severance packages and related legal costs ($394,028), legal fees ($5,538), and travel costs ($4,015).

Severance Packages for Executive Staff

OMB Circular A-122, Attachment B, section 49.a, provides:

> Severance pay . . . is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (i) law, (ii) employer-employee agreement, (iii) established policy that constitutes, in effect, an implied agreement on the organization's part, or (iv) circumstances of the particular employment.

Additionally, TMF's severance plan, which was in effect during the seventh SOW, states that severance pay is not provided for a voluntary resignation.

TMF paid $394,028 in connection with three executives' severance packages that were not allowable. The total included $382,956 for severance payments comprising salaries, wages, and fringe benefits categorized as indirect costs and $11,072 for related legal expenses charged directly to the contract. The payments did not qualify as severance payments because the three severance agreements stated that the executives had left TMF voluntarily. In addition, the payments were unreasonable because they were for services beyond the scope of the QIO contract. This finding was disclosed in a prior DCAA audit, but the corresponding recommendation had not been resolved at the time of our audit.

Additionally, the DCAA audit of TMF included, as part of the finding, legal fees of $11,072 that were directly associated with the severance packages. Because the severance packages were not allowed, the $11,072 in related legal fees was also unallowable.

Legal Fees

Pursuant to OMB Circular A-122, Attachment A, section A.2.g, for costs to be allowable under an award, they must be adequately documented.

TMF incurred costs totaling $5,538 for legal fees incurred during the seventh SOW that were not allocable to the QIO contract because the invoice did not indicate what the services were and TMF officials were unable to provide information regarding the purpose of the services.

Travel Costs

Pursuant to OMB Circular A-122, Attachment A, section A.4.a(2) and (3), a cost is allocable if it "benefits both the award and other work and can be distributed in reasonable proportion to the benefits received," or "is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown." OMB Circular A-122, Attachment B, section 55.a, provides that travel costs are certain "expenses . . . incurred by employees who are in travel status on official business of the organization . . . ." It further states that travel costs are allowable "when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization." OMB Circular A-122, Attachment A, section A.2.g, requires costs to be adequately documented. Also, TMF travel policy states that reimbursements for travel expenses will be made upon submission of a travel/expense report and receipts for airfare, car rental, taxi, and hotel accommodations.

TMF incurred costs totaling $4,015[3] for travel that was not allocable to the QIO contract for the following reasons:

- TMF board members and employees incurred $2,732 in travel expenses for trips that did not support any QIO contract obligation, including travel to attend a funeral, travel to receive an honorarium and attend a reception, spousal travel, and travel from a location other than the board member's home. The last violation involved excessive travel costs

[3]The $4,015 in travel costs that were not allocable to the QIO contract consisted of $2,541 claimed by board members, $212 claimed by executives, $887 claimed by subcontractor physicians and consultants, and $375 claimed in other conference-related costs.

incurred by two board members who lived in Texas but traveled from Colorado to attend board meetings a total of four times.

- TMF incurred $1,283 in travel expenses that were not supported by receipts or were for lodging expenses incurred by individuals who were not on official TMF travel but were spending personal time at the location either directly before or after the official travel.

POTENTIALLY UNALLOWABLE COSTS

TMF incurred a total of $49,157 of costs for potentially unreasonable compensation.

Compensation

OMB Circular A-122, Attachment B, section 7.b(1), provides that compensation costs are allowable to the extent that total compensation paid to an individual employee is reasonable for the services rendered, conforms to the established policy of the organization, and is consistently applied to both Federal and non-Federal activities.

In addition, OMB Circular A-122, Attachment B, section 7.i, states:

> Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

TMF incurred costs totaling $49,157 for executive staff bonuses and employee Christmas and performance bonuses that were potentially unallowable. The bonuses were not required under any preexisting good faith agreement between TMF and any of the employees or under any established plan followed by TMF. The Christmas and performance bonuses were not given during each of the years under the seventh SOW. Therefore, we could not determine if TMF had established a consistent plan to make such payments. Previous DCAA reports had questioned the bonuses.

RECOMMENDATIONS

We recommend that TMF:

- refund $17,497 for unallowable legal fees and consultant travel;

- reduce the indirect cost pool by $386,084 for severance packages for executives, board member and executive travel, and conference costs; and

- work with the CMS contracting officer to determine what portion of the $49,157 incurred for compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

TMF HEALTH QUALITY INSTITUTE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In its written comments on our draft report, TMF agreed that some of the travel expenses and compensation costs were unallowable. However, TMF disagreed that the severance packages, legal fees, equipment, and media and public relations costs were unallowable. TMF's comments and our responses are presented below. TMF's comments are included in their entirety as Appendix B.

Unallowable Costs: Severance Packages for Executives and Staff

TMF Health Quality Institute Comments

TMF disagreed that it had incorrectly claimed costs for severance packages for three executives who left TMF voluntarily. TMF said that the agreements between TMF and the executives met the criteria for employer–employee agreements and that the amount of the payments was calculated primarily using TMF's Severance Pay Policy. In addition, TMF disagreed that it had incorrectly claimed costs for related legal fees. TMF said that it paid to a law firm specializing in employment law legal fees amounting to $2,805 for legal guidance on the severance agreements and $8,267 for a legal review of TMF's policy manual.

Office of Inspector General Response

We do not agree with TMF that the severance packages and related legal fees were allowable. The severance packages were agreed on when the employees departed and were not in their original employment agreements. Moreover, TMF's Severance Pay Policy states that severance pay is not provided for a voluntary resignation. Accordingly, we maintain that the severance packages were unallowable. TMF incurred the legal fees because of its termination of the employees and its preparation of the severance packages. Because the legal expenses were directly associated with the unallowable severance expenses, the legal expenses were also unallowable.

Unallowable Costs: Legal Fees

TMF Health Quality Institute Comments

TMF disagreed that it had incorrectly claimed costs for legal fees. TMF said that the contract between the law firm and TMF was based on a verbal agreement and that the invoices provided minimal information to protect the confidential nature of the services.

Office of Inspector General Response

Because TMF did not provide any additional documentation to support the legal fees, we maintain that they were not properly supported and should be disallowed.

Unallowable Costs: Travel Expenses

TMF Health Quality Institute Comments

TMF partially agreed that its board members and employees had incurred travel expenses for trips that did not support any QIO contract obligation. TMF agreed that $2,732 was unallowable but said that $920 should be allowable. TMF said that $805 of the $947 in total costs for the board members to fly from their Colorado residences should be allowable because that is the amount TMF would have paid for mileage if the board members had driven from their Texas residences to the board meeting site. TMF also stated that $115 of the cost for limousine service on two separate occasions should be allowable because the mode of transportation was reasonable. One limousine, rather than several taxis, was used to transport 10 individuals. The second limousine, which provided round-trip transportation for an individual from the airport to the hotel, cost less than a taxi would have cost.

TMF partially agreed that it had incurred travel expenses that were not supported by receipts or that were for expenses incurred by individuals who did not provide documentation indicating that they were on official TMF travel. TMF agreed that $1,108 was unallowable but disagreed that the $175 related to consultant charges for travel time was unallowable.

Office of Inspector General Response

We agree that certain travel expenses incurred by TMF board members and employees (i.e., $920) are allowable and allocable to the QIO contract. Therefore, this portion of the finding reflects a disallowance of only $2,732.

We were unable to verify that the consultants were actually in travel status. Therefore, we maintain that the $175 for consultant travel should be disallowed.

Potentially Unallowable Costs: Compensation

TMF Health Quality Institute Comments

TMF agreed that the $31,477 it paid to employees in Christmas and performance bonuses was unallowable. However, TMF disagreed that it had incorrectly claimed $17,681 for executive staff bonuses and disagreed with the disallowance of $18,930 for bonuses because it had charged that amount to an unallowable account, not to the QIO contract as a direct or indirect charge. TMF contends that the $17,681 in executive bonuses was reasonable compensation. TMF contends that, when an employee reaches the maximum salary within the employee's salary range, TMF's normal procedure is to pay the employee a bonus totaling his or her percentage increase for the year instead of increasing his or her rate of pay. TMF contends that this is consistent with OMB Circular A-122.

Office of Inspector General Response

We agree that the $18,930 in bonuses was charged to an unallowable account rather than the seventh SOW and excluded that amount from the potentially unallowable costs. Regarding the $17,681 in executive staff bonuses, TMF did not provide a written policy (or any other evidence of an established procedure) regarding employees who reached the maximum salary in their salary ranges. Therefore, we maintain that TMF should work with the CMS contracting officer to determine what portion of the $17,681 should be excluded from the indirect cost pool for purposes of determining final rates.

Potentially Unallowable Costs: Equipment

TMF Health Quality Institute Comments and Office of Inspector General Response

Based on additional documentation provided by TMF, we did not include our finding on "Equipment" in this report.

Potentially Unallowable Costs: Media and Public Relations

TMF Health Quality Institute Comments and Office of Inspector General Response

TMF provided additional information regarding this issue separate from its response. After reviewing this information, we agree that these costs are properly supported and did not include our finding on "Media and Public Relations Services" in this report.

Background

TMF Health Quality Institute Comments and Office of Inspector General Response

TMF stated that its total costs were $45,892,783, not $2.6 billion. We agree that TMF's costs for calendar years 2003 through 2005 were $45,892,783, which is the amount we use in this report.

APPENDIXES

Costs Incurred by the TMF Health Quality Institute for Medical Care and Reviewed by the Office of Inspector General February 1, 2003–January 31, 2006

Cost Category	Amount Reviewed	Accepted	Questioned Direct	Questioned Indirect	Set Aside Direct	Set Aside Indirect
Compensation						
-Board members	$189,797	$189,797	$0	$0	$0	$0
-Executives	4,355,611	3,923,498	0	382,956	0	49,157
Travel						
-Board members	70,456	67,915	0	2,541	0	0
-Executives	40,181	39,969	0	212	0	0
Legal Fees	318,229	301,619	16,610	0	0	0
Equipment and Administrative Costs	422,568	422,568	0	0	0	0
Business Relationships						
-Subcontractors and consultants	785,335	784,448	887	0	0	0
-Conference-related costs	303,795	303,420	0	375	0	0
Total	**$6,485,972**	**$6,033,234**	**$ 17,497**	**$386,084**	**$0**	**$49,157**

TMF
Health Quality Institute

Bridgepoint I, Suite 300
5918 West Courtyard Drive
Austin, TX 78730-5036

January 10, 2008

Gordon L. Sato
Regional Inspector General of Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services
1100 Commerce, Room 632
Dallas, TX 75242

Re: Comments to December 2007 draft of Audit Report No. A-06-06-00072

Dear Mr. Sato:

In your letter dated December 3, 2007, you provided TMF Health Quality Institute (TMF) a copy of Office of Inspector General draft Audit Report No. A-06-06-00072 entitled "Review of Quality Improvement Organization in Texas," which concerns TMF's contract with Centers for Medicare & Medicaid Services (CMS) for the period February 1, 2003 through January 31, 2006. In the letter you requested TMF to consider its views on the validity of the facts and reasonableness of the recommendations in this report and to provide written comments. The comments regarding each specific recommendation are below.

UNALLOWABLE COSTS

Severance Packages for Executive Staff
TMF paid severance during 2004 to three executives. The three executives were in protected classes of individuals in relation to age and/or disability. The negotiation of the severance agreements resulted in an agreement that the executives had left TMF voluntarily and released TMF from any future liability related to the termination of employment. TMF believes that this agreement meets the requirement of OMB Circular A-122, Attachment B, section 49.a in that it is an employer-employee agreement. In the opinion of legal counsel, the cost of the severance payments was substantially less than anticipated legal expenses. Furthermore, the amount of the payments was calculated primarily on TMF's Severance Pay Policy that had been approved by CMS on July 21, 2003 and therefore reasonable.

TMF's legal counsel secured the services of a law firm with specialization in employment law to provide guidance for the severance agreements and to review TMF's policy manual to assure compliance with all applicable laws. The $11,072 paid through TMF's legal counsel was for both of these services. TMF disagrees with the disallowance for the services in the amount of $2,805 to provide guidance for the severance agreements per the preceding paragraph. The remaining amount of $8,267 to review TMF's policy manual and assure compliance with all applicable laws should not be disallowed either as it is an allowable, allocable and reasonable cost.

Legal Fees
TMF required the specialized legal services performed by lawyers having expertise in labor law to provide guidance for the termination of a human resources staff member in a protected class. The contract between TMF and the firm was verbal and no written engagement letter or contract was signed for this work which is the normal process with this type of service. To protect the confidential nature of the services, the invoices provided minimal information.

Travel
Travel for TMF board members and employees that didn't support any QIO contract obligation
The travel from Colorado was for 2 Board of Trustee members who have residences in Texas and in Colorado. The 4 trips questioned totaled $947. TMF would have incurred at $805 had mileage been paid to the members from their Texas residence to the meeting site. TMF disagrees that the full amount of the trips should be disallowed and only the excess of $142 should be. The reference to the use of a limousine was for two occurrences and was a reasonable mode of transportation. The first occurrence of $60 was to transport ten individuals in lieu of multiple taxi cabs. The second occurrence of $55 was for round trip ground transportation between the Tampa airport and hotel. According to the Tampa International Airport website, www.tampaairport.com, cab fare is $2.00 plus $2.00 per mile. The hotel is located 28.5 miles from the airport. Round trip ground transportation by cab would have cost $118. TMF disagrees that the use of the limousine should be an unallowable cost. TMF agrees that $2,732 is an unallowable cost.

Travel not supported by receipts or for non official TMF travel
TMF's written travel policy requires receipts, however, when the receipt is lost or otherwise not available, other justification for the charge may be used. As long as the amount is reasonable and appropriately approved, the cost is reimbursed to the employee and charged appropriately. There were only 7 instances of not having a receipt over the 3 year period reviewed. TMF doesn't pay for travel associated with personal time, but the reason for the extended trips wasn't documented on the travel voucher. TMF agrees that since adequate documentation isn't available these costs should be unallowable. TMF disagrees with the disallowance of $175 in consultant charges for travel time where there were no travel expenses billed. Consultants are not required to request reimbursement for travel expenditures.

POTENTIALLY UNALLOWABLE COSTS

Compensation
TMF disagrees with the disallowance of $17,681 for the executive staff bonuses. The two individuals that received the bonuses had reached the maximum salary in their salary range, commonly referred to as "red circled". When this happens, it is an acceptable business practice and TMF's normal procedure to pay the employee a bonus totaling his/her percentage increase for the year instead of increasing his/her rate of pay. This is consistent with OMB Circular A-122, Attachment B, section 7.b(1), in that it provides compensation costs that are allowable to the extent that total compensation paid to an individual employee is reasonable for the services rendered, conforms to the established policy of the organization, and is consistently applied to both Federal and non-Federal activities.

TMF did not charge the disallowance of $18,930 included in your $68,087 finding as a direct or indirect charge to the CMS contract during 2005. The $18,930 was charged as unallowable at the time it was incurred.

TMF agrees that under OMB Circular A-122, Attachment B, section 7.i that the $31,477 in employee Christmas and performance bonuses are an unallowable cost.

Equipment
TMF disagrees with the disallowance for the equipment purchase of $1,348. This cost was a purchase of four printers, directly from the manufacturer who supplied the items to TMF at GSA pricing. This purchase did not deviate from the established policy in the TMF "Accounting Policy and Procedures Manual" to obtain 3 bids or provide an explanation for purchases when the unit cost is greater than $1,000 since the unit cost was only $337.

Media and Public Relations Services
TMF received an email from Matt Moore, Senior Auditor for the Department of Health & Human Services, Office of Inspector General, Office of Audit Services dated January 7, 2008 stating that the information TMF previously provided was sufficient and this finding would be removed from the final report.

BACKGROUND
The audit report on pages i and 2, states that during years 2003 through 2005, TMF incurred total costs of approximately $2.6 billion to support all lines of business, including the QIO contract. The audited financial statements report for this time frame total costs of $45,892,783.

TMF appreciates the opportunity to provide comments to the draft audit report. Please let me know if you have any additional questions.

Sincerely,

Thomas J. Manley
Chief Executive Officer