OCT 15 2007

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

FROM: Daniel R. Levinson
Inspector General

SUBJECT: Review of Quality Improvement Organization in Iowa (A-07-06-01035)

Attached is an advance copy of our final report on the Quality Improvement Organization (QIO) program in Iowa. 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, which respond to that request. In Iowa, the Iowa Foundation for Medical Care (IFMC) 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, IFMC received $108.6 million in Federal reimbursement to perform the core QIO contract and 14 special studies. We will issue this report to IFMC 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 $10.3 million of costs reviewed, $9.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, IFMC incurred $208,974 of costs that were unallowable and $530,822 of costs that may not have complied with Federal requirements:

- IFMC incurred $208,974 of costs that were unallowable. These costs were for food that was not allowable for Federal reimbursement ($95,647); equipment purchases that were not allocable to the QIO contract ($83,711); and board member travel costs, related to the use of chartered aircraft, that were not reasonable ($29,616).

- IFMC incurred $530,822 of costs for potentially unreasonable board member fees ($390,219), associated board member travel costs ($77,616), and executive compensation ($62,987).

We recommend that IFMC:

- refund $179,358, which includes $145,091 of direct costs and $34,267 of associated indirect costs, for unallowable food and equipment;

- reduce the indirect cost pool by $29,616 for chartered air travel costs incurred by board members; and

- work with the CMS contracting officer to determine what portion of the $530,822 incurred for board member fees, board member travel costs, and executive compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

In written comments on our draft report, IFMC disagreed with our findings and recommendations.

After reviewing IFMC's comments, we disagree with IFMC's interpretations of the criteria and continue to support our findings.

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 Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-06-01035 in all correspondence.

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF QUALITY IMPROVEMENT ORGANIZATION IN IOWA

Daniel R. Levinson
Inspector General

October 2007
A-07-06-01035

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

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

DEPARTMENT OF HEALTH & HUMAN SERVICES·USA

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

OCT 18 2007

Report Number: A-07-06-01035

Mr. Donald J. Lovasz
Chief Executive Officer
Iowa Foundation for Medical Care
6000 Westown Parkway, Suite 350E
West Des Moines, Iowa 50266

Dear Mr. Lovasz:

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 Iowa." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

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

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

If you have any questions or comments about this report, please do not hesitate to call me, or contact Chris Bresette, Audit Manager, at (816) 426-3591 or through e-mail at Chris.Bresette@oig.hhs.gov. Please refer to report number A-07-06-01035 in all correspondence.

Sincerely,

Patrick J. Cogley

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

James Randolph Farris, MD
Regional Administrator
Centers for Medicare & Medicaid Services, Region VI
1301 Young Street, Suite 714
Dallas, Texas 75202

EXECUTIVE SUMMARY

BACKGROUND

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

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

The Iowa Foundation for Medical Care (IFMC) was the Iowa QIO for the period February 1, 2003, through January 31, 2006. For this 3-year period, known as the seventh scope of work, IFMC received $108.6 million in Federal reimbursement to perform the core contract and 14 special studies. Our review primarily focused on the core contract. During calendar years 2003 through 2005, IFMC incurred total costs of approximately $254 million to support all lines of business, including the QIO contract. As of April 1, 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 $10.3 million of costs reviewed, $9.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, IFMC incurred $208,974 of costs that were unallowable and $530,822 of costs that may not have complied with Federal requirements:

- IFMC incurred a total of $208,974 of costs that were unallowable. These costs were for food that was not allowable for Federal reimbursement ($95,647); equipment purchases that were not allocable to the QIO contract ($83,711); and board member travel costs, related to the use of chartered aircraft, that were not reasonable ($29,616).

- IFMC incurred a total of $530,822 of costs for potentially unreasonable board member fees ($390,219), associated board member travel costs ($77,616), and executive compensation ($62,987).

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

RECOMMENDATIONS

We recommend that IFMC:

- refund $179,358, which includes $145,091 of direct costs and $34,267 of associated indirect costs, for unallowable food and equipment;

- reduce the indirect cost pool by $29,616 for chartered air travel costs incurred by board members; and

- work with the CMS contracting officer to determine what portion of the $530,822 incurred for board member fees, board member travel costs, and executive compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

AUDITEE'S COMMENTS AND OFFICE OF INSPECTOR GENERAL'S RESPONSE

In written comments on our draft report, IFMC disagreed with our findings and recommendations. After reviewing IFMC's comments, we disagree with IFMC's interpretations of the criteria and continue to support our findings.

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INTRODUCTION

BACKGROUND

Quality Improvement Organization Program

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

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

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

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. The QIOs determine the amount of indirect costs to claim by multiplying an indirect cost rate against their direct costs.[1]

During the contract period, CMS usually is unable to calculate an exact indirect cost rate. Therefore, the 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

[1]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.

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.

Iowa Quality Improvement Organization

The Iowa Foundation for Medical Care (IFMC), headquartered in West Des Moines, Iowa, serves as the Iowa QIO. IFMC is a nonprofit organization that was incorporated in 1993. IFMC's contract with the Federal Government is on a cost-plus-fixed-fee basis.

For the 3-year period known as the seventh SOW (February 1, 2003, through January 31, 2006), IFMC received $108.6 million in Federal reimbursement to perform the core contract and 14 special studies.[2] (See Appendix A for details on the special studies.) Our review primarily focused on the core contract. During calendar years 2003 through 2005, IFMC incurred total costs of approximately $254 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 April 1, 2007, DCAA had not reviewed the indirect cost rates for FY 2005. The CMS contracting officer will consider both DCAA's and our recommendations in establishing the final rates and settling the cost differences 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 that issue in another review (OEI-01-06-00170).

[2]This $108.6 million amount included approximately $75.8 million for one special study: the Standard Data Processing System, an information management system that provides automated support to all QIOs nationwide.

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 $10.3 million of the costs that IFMC incurred for the seventh SOW (February 1, 2003, through January 31, 2006). In total, IFMC received $108.6 million in Federal reimbursement for the core QIO contract and 14 special studies. Our review focused on IFMC's core contract.

The $10.3 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 IFMC 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 IFMC's office in West Des Moines.

Methodology

We took the following actions to accomplish our objectives:

- We reviewed applicable Federal requirements.

- We interviewed IFMC officials and reviewed IFMC 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 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 IFMC submitted to CMS), to IFMC's general ledger to determine the costs IFMC incurred and charged to the contract.

- We examined, on a test basis, evidence supporting the $10.3 million of costs included in our review and claimed by IFMC. For each of the six areas reviewed, we identified the general ledger accounts that contained the expenses that IFMC 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 four high-ranking executives, to the amounts included in IFMC'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 IFMC in addition to our analysis of the amounts in the proposal.

- For board member and executive staff travel, we analyzed documentation to determine whether transportation costs of the board members and high-ranking executives were reasonable. 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 chartered air travel, we determined whether commercial air service was readily available and practical. For executives, we reviewed the number of overnight trips and whether IFMC claimed transportation, hotel, and meal costs pursuant to Federal guidelines.

- For costs relating to legal fees, including administrative charges, we reviewed $88,000 in legal expenses incurred to process immigration documentation for 28 foreign employees 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, including payments made to other QIOs and for temporary workers. 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 consistent with CMS's overall objectives for the seventh SOW.

- We reviewed DCAA audits of direct and indirect costs for FYs 2003 and 2004.

We conducted our audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Of the $10.3 million of costs reviewed, $9.6 million appeared reasonable for Federal reimbursement. Of the remaining costs, IFMC incurred $208,974 of costs that were unallowable and $530,822 of costs that may not have complied with Federal requirements. Specifically:

- IFMC incurred $208,974 of costs that were unallowable. These costs were for food that was not allowable for Federal reimbursement ($95,647); equipment purchases that were not allocable to the QIO contract ($83,711); and board member travel costs, related to the use of chartered aircraft, that were not reasonable ($29,616).

- IFMC incurred $530,822 of costs for potentially unreasonable board member fees ($390,219), associated board member travel costs ($77,616), and executive compensation ($62,987).

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 as Appendix B.

UNALLOWABLE COSTS

IFMC incurred $208,974 of costs that were unallowable. These costs were for food that was not allowable for Federal reimbursement ($95,647); equipment purchases that were not allocable to the QIO contract ($83,711); and board member travel costs, related to the use of chartered aircraft, that were not reasonable ($29,616).[3]

Ordinary Food Purchases That Were Not Allowable

OMB Circular A-122, Attachment B, section 14, provides guidance for "Entertainment costs" as follows: "Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable . . . ." The Department of Health and Human Services Departmental Appeals Board (DAB) has sustained disallowances for meal costs, which it characterized as entertainment costs, on the grounds that "applicable cost principles generally preclude claims for meal costs."[4] Specifically, the DAB referred to a "general principle that meal costs are properly considered entertainment costs." In addition, the DAB stated that " 'Expenses for meals are subject to strict scrutiny in view of the cost principles' prohibition against paying for entertainment costs with federal grant funds,' " and " 'meals not taken in connection with travel are presumed to be a personal expense unless the business transacted is documented, and the reason for conducting business over a meal is also documented.' "

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[3]We also set aside $77,616 of board member travel costs that IFMC incurred, which we discuss later in the report.

[4]Ohio Department of Job and Family Services, DAB No. 1961 (2005). Although this decision involved a State agency and so the provisions of OMB Circular A-87 applied, the relevant language in OMB Circular A-122 is substantially the same.

IFMC incurred costs of $61,380 for routine meals and snacks provided to employees—a total of 461 food purchases[5]—for purposes that were not connected with travel. Because IFMC did not document the business transacted during these meals and snacks or the reason for conducting business over a meal, these costs are unallowable under OMB Circular A-122, Attachment B, section 14, as "entertainment costs."

IFMC charged the $61,380 directly to the contract and charged an additional $34,267 of associated indirect costs using the provisional rate. IFMC claimed a total of $95,647 on the vouchers for ordinary food purchases.

Equipment Expenditures for Centers for Medicare & Medicaid Services and Government Contractors That Were Not Allocable

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

> A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances 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.

IFMC incurred costs of $83,711 for equipment, property, and services that were not allocable to the QIO contract. IFMC charged these costs directly to the contract as passthrough costs. IFMC purchased the equipment for the use of CMS officials and CMS contractors. These CMS contractors were not IFMC subcontractors. Such costs were not incurred specifically for the award, did not benefit the award, and were not necessary to the overall operation of the organization and are therefore unallocable. Details of the $83,711 follow:

- IFMC incurred $55,852 for video conferencing equipment and related training and installation at five CMS offices. The equipment was physically located at CMS offices and used by CMS personnel.

- IFMC incurred $17,755 for at least 23 cellular phones, 2 personal digital assistants, accessories, and related service. IFMC and CMS officials informed us that this equipment was intended for use by CMS officials and three CMS contractors.

[5]We identified 461 occasions on which IFMC purchased food. On many of these occasions, it purchased multiple meals; however, IFMC did not have detailed documentation showing how many meals were purchased on each occasion.

- IFMC incurred $10,104 for five laptop computers and related accessories. IFMC and CMS officials informed us that the computers were intended for use by CMS officials.

When we informed CMS management that IFMC was paying for the cellular service, CMS directed IFMC to cease providing the cellular service to the contractors and CMS officials.

Board Member Chartered Travel That Was Not Reasonable

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.

IFMC incurred costs of $35,014 for board members who traveled to meetings via chartered aircraft. These costs were consistent with IFMC's internal travel policy but were not consistent with the Federal requirement that individuals act with prudence under the circumstances. IFMC used chartered aircraft for 25 trips to bring in three board members from three cities that were between 138 and 216 miles away from the location of the meetings. IFMC used chartered air travel in these situations without adequately exploring the reasonableness and feasibility of directing or allowing these board members to use personally owned vehicles to travel to these meetings.

In order to evaluate the reasonableness of chartered air travel, we examined other travel options, specifically commercial air travel and personally owned vehicular travel. Our comparison of commercial versus chartered air travel found that commercial air travel was not practical because there were no direct flights between the cities involved and flights through other cities would have significantly increased travel time. The following is a cost and time comparison for a round trip between Cedar Rapids, Iowa, and Des Moines, Iowa, which are 138 miles apart:

- Using chartered aircraft, the travel time to drive to the airport, fly to Des Moines, drive to IFMC, and return would be approximately 4 hours and would cost $1,400.

- Using commercial airlines, the travel time to drive to the airport, check in for the flight, fly to Des Moines, drive to IFMC, and return could exceed 11 hours. The quickest route went through Chicago, Illinois, to get to Des Moines. The cost would be approximately $800.[6]

- Using a personally owned vehicle, the travel time to drive to IFMC and return would be approximately 4.5 hours. The cost, at 48.5 cents per mile,[7] would be $134.

In this comparison, the cost of a chartered flight is more than 10 times the cost of using a personally owned vehicle but saves only half an hour. Therefore, we believe the individuals concerned did not act with prudence under the circumstances, considering their responsibilities to the organization, its members, employees, clients, the public at large, and the Federal Government. Although we realize that using personally owned vehicles might add travel time in some situations, we do not believe the significantly higher additional cost of chartered aircraft was reasonable.

Because use of commercial air travel was not practical for the three board members, we limited reimbursement for the chartered aircraft to the cost of using a personally owned vehicle. The reimbursement for mileage ranged from 36 to 48.5 cents per mile during the seventh SOW. The average cost of the chartered aircraft was over $1,400 per trip. The use of a personally owned vehicle instead of a chartered aircraft would have saved an average of approximately $1,185 per trip for the 25 trips. Instead of spending $35,014 on chartered aircraft, IFMC could have paid $5,398 in personally owned vehicle mileage costs. Therefore, we are questioning the reasonableness of the difference, or $29,616.

POTENTIALLY UNALLOWABLE COSTS

IFMC incurred a total of $530,822 of costs for potentially unreasonable, and thus unallowable, board member fees ($390,219), associated board member travel costs ($77,616), and executive compensation ($62,987).

[6]We were unable to determine the actual cost of commercial airfare available at the time the trips occurred (2003–2005). During the audit, we determined that the current (2007) cost of this trip using commercial airfare was approximately $800.

[7]IFMC reimbursed travelers for use of personally owned vehicles at no more than the business standard mileage rate established annually by the Internal Revenue Service. In addition, we examined costs associated with the use of rental cars for this comparison. We found that rental costs were lower than the costs of a personally owned vehicle.

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.

Board Member Fees and Associated Board Member Travel Costs

IFMC incurred board fees and associated travel costs to attend meetings and conferences that may have been unreasonable. IFMC conducted significantly more board meetings than it stated it needed in its proposal to CMS. In addition, IFMC paid fees at a rate above its proposed amount. Finally, IFMC paid fees to an ex officio board member that may not have been ordinary and necessary for the performance of the QIO contract. IFMC did not obtain CMS approval for or adequately justify the increased number of board meetings, the increased fees, or the ex officio board member.

As a result, IFMC incurred $655,894 in board fees and $105,949 in board member travel costs. If IFMC had adhered to the number of meetings and rates per meeting it proposed and if it had paid expenses for its ex officio board member that were ordinary and necessary, IFMC would have incurred $265,675 in board fees and $28,333 in associated travel costs:

- In its proposal for the seventh SOW, IFMC indicated that it would seek Federal reimbursement for the fees associated with 12 board meetings and 24 executive committee meetings, for a total of 36 meetings. However, during the seventh SOW IFMC's board members attended approximately 160 meetings. IFMC's board conducted over four times the number of meetings that it stated it needed in its proposal without seeking approval from CMS and without having adequate justification for the additional meetings. Further, IFMC did not include board fees for members to attend conferences in its proposal. As an example, IFMC paid $79,500 in fees for six board members to attend six conferences that were not included in the proposal to CMS.

- In its proposal, IFMC stated that its board members would be paid $750 per board meeting and $1,000 per executive committee meeting. However, beginning in October 2003, IFMC increased the fees for board meetings from the proposed $750 to $1,000 without seeking approval from CMS and without having adequate justification for the increased fees.

- IFMC paid $32,008 of fees to an ex officio board member that may not have been ordinary and necessary for the performance of the QIO contract. IFMC appointed to the ex officio position an individual who was a past president of the American Health Quality Association (AHQA). From the beginning of the seventh SOW (February 2003) through September 2005, IFMC paid him fees of $32,008 for AHQA-related activities, which included attendance at AHQA conferences. It is questionable how his attendance at AHQA conferences was necessary for the performance of the QIO contract, especially because IFMC employees attended those conferences. We believe that these fees may not have been ordinary and necessary for the performance of the QIO contract.

- Travel costs associated with board member attendance at meetings and conferences may also have been unreasonable. For the seventh SOW, IFMC incurred $105,949 for board member travel costs. Had IFMC conducted the number of meetings that it included in its proposal, IFMC would have incurred (based on actual board member attendance) $28,333 in travel costs.[8] For example, IFMC incurred $27,952 in meals and lodging costs associated with a board member retreat in Chicago. The board met on 1 day, but IFMC incurred 3 days of meals and lodging costs for this meeting.

The additional board fees and associated travel costs may not have been necessary for the operation of the organization or the performance of the award. Therefore, we believe that $390,219 of fees ($655,894 incurred minus $265,675 proposed and reasonably incurred) and $77,616 of travel costs ($105,949 incurred minus $28,333 proposed) paid to board members may have been unreasonable. However, we were unable to determine how much of the $467,835 could have been avoided.

Executive Compensation

OMB Circular A-122, Attachment B, paragraph 7.c.2 states: “When the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization’s other activities, compensation for employees on federally-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.”

[8]The $28,333 in travel costs discussed in this section excludes the costs associated with chartered air travel that we discussed earlier in the report.

IFMC paid one of its executives a potentially unreasonable salary. Specifically, IFMC paid its Vice President of Finance and Human Resources more than the salary specified in its own proposal for this position and more than the prevailing rate. In 2004, IFMC paid its Vice President of Finance and Human Resources $254,935. In its proposal, IFMC stated it would pay an annual salary of $213,974 for this position. During 2004 the actual pay exceeded the proposal by $40,961. This individual's compensation also exceeded the $207,272 salary established by DCAA as the prevailing salary for a similar position in a similar organization in the same geographical area, a difference of $47,663.

IFMC may not have acted prudently when it established a compensation level for its Vice President of Finance and Human Resources that exceeded IFMC's proposal to CMS and the prevailing salary for this position established by DCAA. Applying the actual fringe benefits rate of 32.15 percent to the $47,663 of excess salary costs increases the potentially unreasonable costs incurred by $15,324, to a total of $62,987.[9]

RECOMMENDATIONS

We recommend that IFMC:

- refund $179,358, which includes $145,091 of direct costs and $34,267 of associated indirect costs, for unallowable food and equipment;

- reduce the indirect cost pool by $29,616 for chartered air travel costs incurred by board members; and

- work with the CMS contracting officer to determine what portion of the $530,822 incurred for board member fees, board member travel costs, and executive compensation during our audit period should be excluded from the indirect cost pool for purposes of determining final rates.

[9]In DCAA's 2004 review of IFMC's incurred costs, DCAA determined that another IFMC official received unreasonable compensation. However, we did not analyze this official's salary as part of our audit. DCAA reported that IFMC paid its Vice President of Information Services $209,202. DCAA determined that the prevailing salary for a similar position in a similar organization in the same geographical area was $147,649. This resulted in an excess salary of $61,553, of which $36,884 was charged to CMS contracts. DCAA questioned the $36,884.

AUDITEE'S COMMENTS AND OFFICE OF INSPECTOR GENERAL'S RESPONSE

In written comments on our draft report, IFMC disagreed with our findings and recommendations. IFMC's comments appear in their entirety in Appendix C.[10]

After reviewing IFMC's comments, we disagree with IFMC's interpretations of the criteria and continue to support our findings.

Ordinary Food Purchases

Auditee Comments

IFMC stated that in its judgment, all of the direct and indirect costs of meals that we questioned were in fact allowable. IFMC stated that, under OMB Circular A-122, the costs of meals are allowable for general administration, dissemination of technical information, or employee morale. IFMC also stated that "[t]he auditors themselves have established that the meals analyzed were for business purposes rather than for entertainment. The auditors expressly found that the general ledger tied these costs to specific business meetings, identifying them by acronym and name. IFMC has not been provided a detailed breakdown of the meal expenses being challenged such that IFMC could specifically address each expense."

Office of Inspector General Response

We disagree. OMB Circular A-122 (Attachment B, paragraph 29) allows for the cost of meals associated with the conduct of meetings and conferences. However, it also refers to paragraph 14, "Entertainment costs," which states that meals related to amusement, diversion, social activities, and ceremonies are unallowable.

Furthermore, contrary to IFMC's assertion, OMB Circular A-122 does not state that the costs of meals are allowable on the basis that they are incurred "in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance." The section of Circular A-122 to which IFMC may be referring—Attachment B, paragraph 13 (captioned "Employee morale, health, and welfare costs and credits")—specifically states that these costs should be equitably apportioned to all activities of the organization, which would preclude charging them directly to the QIO contract. Also, in Ohio Department of Job and Family Services, DAB No. 1961, mentioned earlier in this report, the DAB stated that "meal costs are not the type of costs generally included as allowable 'employee morale' costs under federal cost principles."

[10]IFMC pointed out that its operations in the seventh SOW came under the purview of the June 1, 1998, edition of OMB Circular A-122, rather than the May 10, 2004, version cited in our draft report. IFMC contended that under the provisions of the 1998 version, the costs that we are questioning and setting aside for CMS adjudication were allowable. After reviewing IFMC's comments, we agree that the June 1, 1998, version of OMB Circular A-122 is applicable, and we have modified the citations in this final report accordingly. In almost all cases, the relevant language—either quoted directly or paraphrased—did not change from the 1998 version to the 2004 version. In those instances where the language did change, the alterations in the language of the criteria did not change our findings or our recommendations.

Meal disallowances have been upheld by the DAB in other cases. The Board as a general principle has stated that "[e]xpenses for meals are subject to strict scrutiny in view of the cost principles' prohibition against paying for entertainment costs with federal grant funds."[11] For example, the DAB applied an entertainment cost provision similar to that in OMB Circular A-87 to deny reimbursement for certain meal costs because the grantee had presented no evidence that the costs were necessary for any "business purposes."[12]

In addition, the documentation that IFMC presented contained no evidence that the costs were necessary for a business purpose (i.e., meetings or conferences). IFMC did not document either the business transacted or, more particularly, the reason for conducting business over meals or snacks. Our review of the general ledger and of associated vouchers found that, while some of these transactions had brief annotations in the general ledger ("identifying them by acronym and name," as IFMC said), these transactions did not include documentation that explained why it was necessary to conduct business over a meal. Over the course of our audit work, we requested such documentation from IFMC, but IFMC was not able to provide documentation of the business transacted or of the reasons why it was necessary to conduct business over meals or snacks. With respect to IFMC's assertion that we did not provide it with a detailed breakdown of the meal expenses being questioned, we note that IFMC made no such request over the course of the audit. If IFMC makes such a request, we will provide the breakdown.

Equipment Purchases

Auditee Comments

With respect to the equipment expenditures on behalf of CMS employees and Government contractors, IFMC stated that it made those purchases at CMS's request. IFMC also stated that these purchases were correctly allocated as direct costs and that "[i]t is fundamental under a test of allocability that a cost is 'incurred specifically' for a cost objective if it would not have been incurred 'but for the requirement of the Government.' "

Office of Inspector General Response

We disagree with IFMC's contention that the equipment purchases were allowable because the purchase was authorized by a Government official. The Government official was not a contracting official and had no authority to make such a request to IFMC. IFMC purchased equipment and services that provided no benefit to the purposes of its contract—a fact that IFMC does not dispute. CMS moved quickly to correct the arrangement when we informed the agency.

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[11]Mid America Health Systems Agency, DAB No. 420, at 11 (1983).

[12]Humanics Associates, DAB No. 860 (1987).

Board Member Chartered Travel

Auditee Comments

Regarding questioned costs associated with the use of chartered aircraft for board member travel, IFMC stated that the 1998 version of the OMB Circular A-122 contains "no discussion or limitations concerning chartered aircraft at all. Therefore, . . . the costs of chartered air travel are allowable *in full* subject only to the general allowability rules of OMB Circular A-122, Attachment A." Further, IFMC stated that "[t]he [draft] audit report assumes that time savings is the only factor underlying the business decision for air travel, and because it imposes a method of operation that impermissibly invades business discretion. Air travel, especially for key employees, is often the preferable means of transportation because it represents a more effective use of time, permits work en route, avoids fatigue and maintains employee effectiveness."

Office of Inspector General Response

Regarding the use of chartered aircraft for board member travel, we agree with IFMC that the 1998 version of OMB Circular A-122 does not explicitly prohibit or restrict costs of chartered air travel, and we have changed the citations in the report accordingly. However, we based our finding on the inherent unreasonableness of the chartered aircraft expense, for which the relevant language in OMB Circular A-122 did not change between the 1998 and the 2004 versions. The comparison of chartered and commercial air travel versus travel by personal vehicle contained in our draft report was furnished to highlight the unreasonable nature of these costs.

Potentially Unallowable Costs

Auditee's Comments

Regarding board member fees and associated travel costs, IFMC stated that the increased number of board meetings was "reasonable and required for valid business reasons" because it was restructuring its organization, which required adding a new CEO. In addition, IFMC stated that "neither IFMC's proposal nor contract contained a ceiling on the amount to be paid to Board members. . . . after several years without an increase in compensation, the Board voted to increase its compensation on September 10, 2003, from $700 to $1000 [per board meeting]."[13] IFMC also stated that "nothing in the contract required IFMC to seek the approval of CMS for this increase" in fees.

Furthermore, IFMC stated that the board fees paid for the ex officio board member were allowable because the individual in question "served in this capacity only through March 12, 2003 – the first month and a half of the 7th SOW contract. . . . According to the IFMC Bylaws in place during the contract period in question, IFMC was free to engage anyone to advise it and perform these services, as long as reasonable."

[13]In its discussion of this finding, IFMC's written comments cite $700 as the previous fee for board meetings. We determined in our review that the previous fee was $750.

Regarding the salary of the Vice President of Finance and Human Resources, IFMC stated that "[t]he contract permits IFMC to recover those costs identified in the proposal, limited only (if at all) by the relevant cost ceilings in the contract (which IFMC has not exceeded)." Specifically, IFMC stated that its compensation costs for this individual were reasonable because it was following industry practice and because this individual's responsibilities were substantially expanded in 2004.

Office of Inspector General Response

IFMC did not provide a justification for the number of meetings or increase in fees to cause us to change our finding that the associated costs may have been unreasonable. IFMC's proposal to CMS specifies the number of meetings and associated fees that we used as a basis for our finding, and that proposal states that "[t]he Board meeting fee of $750 is based on the <u>CMS recommended</u> Board of Directors rate of $100 per hour for a 7.5 hour work day." (Emphasis added.) This language in the proposal contravenes IFMC's assertion that "neither IFMC's proposal nor contract contained a ceiling on the amount to be paid to Board members." While we did examine IFMC's stated reasons for the increase in its board meeting schedule, we continue to be guided by the reasonableness criteria set forth in OMB Circular A-122—the same guidelines whose applicability IFMC acknowledges in its written comments. In addition, paragraph 31 states that "Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable <u>except with prior approval of the awarding agency</u>." (Emphasis added.) IFMC's use of the board's restructuring as justification for additional meetings does not meet this criterion for allowability.

Regarding the board fees paid to the ex officio board member, we continue to support our finding that a portion of these fees may be unreasonable. We have revised our finding to emphasize that these fees may not have been ordinary and necessary for the performance of the QIO contract. In its written comments about compensation for this ex officio member, IFMC stated that the individual "served in this capacity only through March 12, 2003 – the first month and a half of the 7th SOW contract." However, IFMC's general ledger account for board fees showed that IFMC paid this individual from February 2003 through September 2005. In addition to paying this individual, IFMC—like many other QIOs—paid annual membership fees to AHQA, an organization that represents QIOs. In return for its membership fee, IFMC was already entitled to advice from AHQA officers. In addition, IFMC officials attended AHQA conferences. More importantly, IFMC has not established that the fees paid for this individual were ordinary and necessary for the performance of the Federal contract.

Regarding the potentially unreasonable salary paid to the Vice President of Finance and Human Resources, we continue to support our finding that IFMC may not have acted reasonably when it paid this executive a salary that substantially exceeded both the salary specified in IFMC's proposal and the prevailing market rate as determined by DCAA. IFMC did reclassify this executive in 2004. However, this executive was not reclassified until August. At the beginning of that year and before the reclassification of this executive, he was receiving base pay in excess of that of his supervisor, the highest ranking official at IFMC. Therefore, we continue to support our finding that this executive may have been paid in excess of what the position warranted.

OTHER MATTER

IFMC received $2,634,000 for two special studies to advertise a home health care benefit. The special studies were budgeted as a passthough subcontract to another firm. Because CMS directed IFMC to subcontract with a specific media firm, IFMC did not compete this work.

The purpose of these special studies was to obtain professional services to develop and implement a national advertising campaign that promoted a home health care benefit. We do not believe that this project was related to the QIO's objectives of promoting the effective, efficient, and economical delivery of health care services and of promoting the quality of services. Therefore, we believe these special studies should not have been part of the IFMC contract.

Because IFMC complied with CMS's directive to use a specific subcontractor, we will address issues related to this procurement in a separate report to CMS.

APPENDIXES

Special Studies Performed by the Iowa Foundation for Medical Care
Funded Amounts Included In Contract Modifications
February 1, 2003 - January 31, 2006

Special Study Number	Special Study Name	Funded Amount[1]
1	Outpatient Data Quality Improvement Support	$ 2,404,169
2	Hospital Generated Data Support	3,660,869
3	Doctor's Office Quality Pilot	2,067,505
4	Standard Data Processing System	75,516,791
5	Home Health Quality Initiative Phase II	500,000
6	MedQIC Content and Collaboration	3,432,534
7	HHA Advertising	2,181,000
8	MedQIC 2	567,500
9	Statistical Methods for Quality Initiatives	524,710
10	Doctor's Office Quality Information Technology	210,000
11	New Generation Patient Registry	3,789,500
12	CME Project Director	77,140
13	MMA Chronically Ill Database	3,290,095
14	Data Reports QIOSC	873,259
Total		**$99,095,072**

CME = continuing medical education
HHA = home health agency
MedQIC = Medicare Quality Improvement Community
MMA = Medicare Prescription Drug, Improvement, and Modernization Act of 2003
QIOSC = Quality Improvement Organization Support Contractor

[1]Funded amounts represent Centers for Medicare & Medicaid Services-approved funding and project allocations as amended by Contract Modification #41, effective January 27, 2006.

Costs Incurred by the Iowa Foundation 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	$655,894	$265,675	$0	$0	$0	$390,219
-Executives	3,777,495	3,714,508	0	0	0	62,987
Travel						
-Board travel, chartered flights	105,949	28,333	0	0	0	77,616
-Board travel, other	35,014	5,398	0	29,616	0	0
-Executives	86,635	86,635	0	0	0	0
Legal Fees	87,960	87,960	0	0	0	0
Equipment	83,711	0	83,711	0	0	0
Business Relationships						
-Meals, board members	25,318	25,318	0	0	0	0
-Meals, employee nontravel	95,647	0	95,647[1]	0	0	0
-Other QIOs	269,078	269,078	0	0	0	0
-Temporary workers	2,450,443	2,450,443	0	0	0	0
Contract Modifications	2,634,484	2,634,484	0	0	0	0
Total	**$10,307,628**	**$9,567,832**	**$179,358**	**$29,616**	**$0**	**$530,822**

[1]Because $61,380 was directly charged to the contract, IFMC has received approximately $34,267 in additional reimbursement through the application of the provisional indirect cost rates, for a total of $95,647 of questioned costs. The $34,267 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.

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Patrick J. Cogley
Regional Inspector General for Audit Services
Department of Health & Human Services
Region VII
601 East 12th Street, Room 284A
Kansas City, Missouri 64106

Re: Comments to June 2007 draft of Audit Report No. A-07-06-01035

Dear Mr. Cogley:

In your letter dated June 8, 2007, you provided to Iowa Foundation for Medical Care ("IFMC") a copy of Office of Inspector General draft Audit Report No. A-07-06-01035 entitled Review of Quality Improvement Organization in Iowa, which concerns IFMC's contract with Centers for Medicare & Medicaid Services ("CMS") for the period February 1, 2003, through January 31, 2006, (otherwise known as the 7th SOW). In that letter you requested the comments of IFMC along with a statement of concurrence or nonconcurrence with the recommendations in the draft audit report.

For the reasons set forth below, IFMC does not concur with the conclusions reached by the draft audit report with any of the direct or indirect cost adjustments recommended.

I. APPLICABLE COST REGULATIONS

IFMC acknowledges the applicability of Circular A-122. However, during the time period of the contract award, IFMC applied the cost principles of Circular A-122, revision effective June 1, 1998 as guidance. The Circular A-122 version "as revised May 10, 2004" referenced by the OIG was neither available nor applicable for use in interpreting cost principles at the time of the award. As stated in Circular A-122, the effective date is upon execution of new awards unless mutually agreed upon between contracting officer and contractor.

II. THE THREE CATEGORIES OF PURPORTEDLY UNALLOWABLE COSTS

A. Food and Meals Challenged as Unallowable

OMB Circular A-122, Attachment B, effective date June 1, 1998, provides that the costs of meals are allowable under given circumstances, without any mention of the limitations or presumptions that the draft audit report would impose upon those costs. The costs of meals are allowable under this Circular whenever those costs are incurred (i) for meetings and conferences held to "conduct the general administration of the organization" (Cost Principle 29), (ii) for meetings and conferences held for "the dissemination of technical information" (Cost Principle 30), or (iii) "in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance" nothing in these Cost Principles requires "travel" or documentation of the "business transacted" as prerequisites to the allowability of these costs.

The auditors themselves have established that the meals analyzed were for business purposes rather than for entertainment. The auditors expressly found that the general ledger tied these costs to specific business meetings, identifying them by acronym and name. IFMC has not been provided a detailed breakdown of the meal expenses being challenged such that IFMC could specifically address each expense.

As a result, IFMC believes that it applied the cost principles appropriately and that all questioned direct and indirect costs of meals constitute allowable costs under the applicable Cost Principles of OMB Circular A-122, effective June 1, 1998.

B. Equipment Cost Challenged as Unallocable

As stated in the draft audit report, IFMC freely concedes that "IFMC purchased the equipment for the use of CMS officials and CMS contractors." However, as previously provided to audit staff, CMS requested the VTC equipment and cell phones and, in fact, CMS expressly approved the purchases via the Engineering Review Board pursuant to contract policies and procedures.

It is fundamental under a test of allocability that a cost is "incurred specifically" for a cost objective if it would not have been incurred "but for the requirement of the Government." This is so regardless of the ultimate use of the items procured. IFMC would not have purchased this equipment "but for" the contract and the express requests and approvals of CMS. Where a cost is both *identified specifically with* and *incurred specifically for* a cost objective, it is a direct cost of that cost objective and must be charged directly to it, as was done in this case.

C. Travel Costs Challenged as Unreasonable

The June 1, 1998 version of the Circular applies to this contract. Under that version of the Circular, the cost principle on travel cost (at OMB Circular A-122 Attachment B, Item. 55) contains no discussion or limitations concerning chartered aircraft at all. Therefore, under the governing Circular, the costs of chartered air travel are allowable *in full* subject only to the general allowability rules of OMB Circular A-122, Attachment A. Those general allowability rules are satisfied with respect to the chartered aircraft costs incurred by IFMC and at issue here, because, as the draft audit report itself recognizes: a) These costs were consistent with IFMC's internal travel policy; b) Commercial air travel was not practical because there were no direct flights between the cities involved and flights through other cities would have significantly increased travel time; and c) Use of commercial air travel was not practical for the three board members.

Thus, the OMB Circular imposes no specific restrictions on the allowability on chartered aircraft costs under IFMC's 7th SOW, and both the need for those services and their reasonableness is established by the draft audit report itself.

The draft audit report would disallow *all* the airfare costs based on the assertion that Board members should have driven to the board meetings, not flown, because the time savings from flying was (allegedly) only .5 hours per trip. The audit report assumes that time savings is the only factor underlying the business decision for air travel, and because it imposes a method of operation that impermissibly invades business discretion. Air travel, especially for key employees, is often the preferable means of transportation because it represents a more effective use of time, permits work en route, avoids fatigue and maintains employee effectiveness.

As a result, IFMC asserts that all such costs constitute allowable costs under the Cost Principles of OMB Circular A-122, effective June 1, 1998.

III. <u>COSTS IDENTIFIED AS "POTENTIALLY UNREASONABLE"</u>

The contract permits IFMC to recover these costs identified in the proposal, limited only (if at all) by the relevant cost ceilings in the contract (which IFMC has not exceeded). IFMC's contract is cost-based, and entitles IFMC to recover its reasonable costs even if the costs exceed the proposed amounts.

As IFMC has already explained to the government, the increase in its Board meeting schedule was reasonable and required for valid business reasons, including the facts that:

1. the Board went through a restructure six months prior to the beginning of its search for a new CEO which lead to increased Board activity;

2. the CEO position was vacant for six months, resulting in increased Board oversight and necessitating more frequent board meetings;

3. until the new CEO was recruited and in place, the Board was more actively involved in day-to-day operations than anticipated at the time of proposal preparation.

The government is aware of these facts but the audit report fails to address them. The audit report similarly questions the fees paid to IFMC's Board members, based solely on the fact that the fees increased from $700 to $1000. Once again, neither IFMC's proposal nor contract contained a ceiling on the amount to be paid to Board members. As IFMC has already explained to the government, after several years without an increase in compensation, the Board voted to increase its compensation on September 10, 2003, from $700 to $1000.

The draft audit report states that the increase occurred "without seeking approval from CMS". However, nothing in the contract required IFMC to seek the approval of CMS for this increase. It is IFMC's position that no portion of these costs were unreasonable, and that the draft audit report's suggestion to the contrary results from the faulty premise that IFMC's recovery of its costs are somehow limited to the estimates contained in its cost proposal.

As a result, IFMC opposes the conclusions on these costs reached by the draft audit report and asserts that all such costs constitute allowable costs under the Cost Principles of OMB Circular A-122, effective June 1, 1998.

B. Ex Officio Board Member

The draft audit report challenges $43,000 paid to an "ex-officio" member of the Board, because that individual was not qualified according to the IFMC Bylaws. Said "ex-officio" member served in this capacity only through March 12, 2003 – the first month and a half of the 7th SOW contract. The costs challenged are compensation for activities related to attendance at the American Health Quality Association conferences and meetings. According to the IFMC Bylaws in place during the contract period in question, IFMC was free to engage anyone to advise it and perform these services, as long as reasonable. IFMC's decision to obtain these services and the reasonableness of the resulting costs has never been questioned. The audit report seems to suggest that the services provided to the Board, namely (per the audit report) "to attend AHQA conferences and advise the board on AHQA-related activities", could *only* be provided by a past president. That is not the case. Though a past president of IFMC might have performed those services, and might have done so in an ex-officio capacity, IFMC was not *required* to fulfill its needs solely in that fashion under the Bylaws in place during the 7th SOW.

As a result, IFMC asserts that all such costs constitute allowable costs under the Cost Principles of OMB Circular A-122, effective June 1, 1998.

C. Executive Compensation

The contract permits IFMC to recover these costs identified in the proposal, limited only (if at all) by the relevant cost ceilings in the contract (which IFMC has not exceeded). IFMC's contract is cost-based, and entitles IFMC to recover its reasonable costs even if the costs exceed the proposed amounts.

IFMC follows the industry practice to pay at or close to market value as well as follow the industry practice of establishing a minimum and maximum salary range for each pay grade. A employee's salary set at the minimum salary (approximately 80% of market value) of a specific pay grade represents a less experienced individual and a employee's salary set at maximum salary (approximately 120% of market value) represents a highly experienced individual or an individual performing multiple roles. The position of Vice President of Finance was changed to Vice President of Administration in 2004 to reflect the extensive list of responsibilities led by this position such as human resources, compliance, purchasing, facilities, administration, marketing, communications, payroll, contracts, bid and proposal, and accounting, all in addition to finance.

IFMC contends (and has always contended) that compensation costs paid to its Vice President of Administration were reasonable, and asserts that all such costs constitute allowable costs under the Cost Principles of OMB Circular A-122, effective June 1, 1998.

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

Sincerely,

Donald J. Lovasz
Chief Executive Officer

cc: Denise Sturm, IFMC
Thane Peterson, IFMC
Chris Bresette, OIG