



DEPARTMENT OF HEALTH AND HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL



OFFICE OF AUDIT SERVICES, REGION IX
90 - 7TH STREET, SUITE 3-650
SAN FRANCISCO, CA 94103

April 23, 2012

Report Number: A-09-11-02005

Ms. Harriet L. Edwards
Executive Director
Southern California Renal Disease Council, Inc.
6255 Sunset Boulevard, Suite 2211
Los Angeles, CA 90028

Dear Ms. Edwards:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled *Southern California Renal Disease Council, Inc., Claimed Unallowable and Unsupported Costs Under Medicare Contract Number 500-02-NW18CH*. 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.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Jessica Kim, Audit Manager, at (323) 261-7218, extension 702, or through email at Yun.Kim@oig.hhs.gov. Please refer to report number A-09-11-02005 in all correspondence.

Sincerely,

/Lori A. Ahlstrand/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

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Office of Acquisition and Grants Management
Centers for Medicare & Medicaid Services
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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**SOUTHERN CALIFORNIA RENAL
DISEASE COUNCIL, INC., CLAIMED
UNALLOWABLE AND UNSUPPORTED
COSTS UNDER MEDICARE CONTRACT
NUMBER 500-02-NW18CH**



Daniel R. Levinson
Inspector General

April 2012
A-09-11-02005

Office of Inspector General

<http://oig.hhs.gov>

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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

The Social Security Amendments of 1972, P.L. No. 92-603, extended Medicare coverage to individuals with end-stage renal disease (ESRD) who require dialysis or kidney transplantation. The ESRD Amendments of 1978, P.L. No. 95-292, authorized the formation of ESRD network areas and the establishment of the Network Organization Program (program) to ensure the effective and efficient administration of program benefits.

The Centers for Medicare & Medicaid Services (CMS) contracts with 18 ESRD Network Organizations (network) to administer the program. Also, CMS contracts with the ESRD Network Coordinating Center (NCC) to provide centralized support for the program and coordination between the networks and CMS. The NCC's primary responsibilities include "collection, maintenance and distribution of ESRD information; coordination of national activities including training initiatives; facilitation of special projects, and administrative support services"

Southern California Renal Disease Council, Inc. (Council), a nonprofit organization, served as the NCC from September 30, 2002, through September 28, 2006, under Medicare contract number 500-02-NW18CH (the contract), which is a cost-reimbursable contract. As a nonprofit organization that was awarded a Federal contract, the Council must follow the cost principles in the Office of Management and Budget Circular A-122.

We reviewed \$1,337,950 of the \$7,907,481 that the Council claimed under the contract. In accordance with our agreement with the contracting officer, we did not review subcontract costs of \$6,258,558 claimed under fixed-price contracts. We also did not review fixed fees of \$310,973.

CMS requested that we conduct this contract closeout audit. To calculate fringe benefits and indirect costs that it claimed for reimbursement, the Council used provisional rates stated in the contract or rates based on estimated costs. CMS asked us to calculate the Council's fringe benefit and indirect cost rates using actual costs. CMS might use those rates when negotiating and settling with the Council during the contract closing process.

OBJECTIVES

Our objectives were to (1) determine whether the costs that the Council claimed were allowable under the terms of the contract and pursuant to applicable Federal regulations and (2) calculate the fringe benefit and indirect cost rates based on actual costs.

SUMMARY OF FINDINGS

Of the \$1,337,950 of costs we reviewed, \$650,538 was allowable under the terms of the contract and pursuant to applicable Federal regulations. The remaining \$687,412 consisted of \$29,192 in salaries and wages, fringe benefits, travel costs, and other direct costs that we determined were

unallowable and \$658,220 that we set aside for CMS resolution. The \$658,220 consisted of (1) costs for which the Council did not maintain supporting documentation for review and (2) the difference between fringe benefits that the Council claimed and fringe benefits that we calculated using rates based on actual costs. The Council claimed unallowable or unsupported costs because it did not have adequate controls to account for costs claimed under Federal contracts.

We calculated fringe benefit and indirect cost rates based on actual costs.

RECOMMENDATIONS

We recommend that the Council:

- refund to the Federal Government \$29,192 for unallowable salaries and wages, fringe benefits, travel costs, and other direct costs;
- work with CMS to determine the allowability of \$658,220 that we set aside and refund to the Federal Government any amount that is determined to be unallowable; and
- strengthen its controls to account for costs claimed under Federal contracts.

AUDITEE COMMENTS

In its written comments on our draft report, the Council concurred with our first and second recommendations and provided information on actions that it had taken or planned to take to address our third recommendation. The Council's comments are included in their entirety as Appendix D.

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FOR THE PERIOD SEPTEMBER 30, 2002, THROUGH SEPTEMBER 28, 2006

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D: AUDITEE COMMENTS

INTRODUCTION

BACKGROUND

End-Stage Renal Disease Network Organization Program

The Social Security Amendments of 1972, P.L. No. 92-603, extended Medicare coverage to individuals with end-stage renal disease (ESRD) who require dialysis or kidney transplantation. The ESRD Amendments of 1978, P.L. No. 95-292, authorized the formation of ESRD network areas and the establishment of the Network Organization Program (program), consistent with criteria that the Secretary of Health and Human Services determined would ensure the effective and efficient administration of program benefits.

The Centers for Medicare & Medicaid Services (CMS) contracts with 18 ESRD Network Organizations (network) to administer the program for each State, each territory, and the District of Columbia. Also, CMS contracts with the ESRD Network Coordinating Center (NCC) to provide centralized support for the program and coordination between the networks and CMS. The NCC's primary responsibilities include "collection, maintenance and distribution of ESRD information; coordination of national activities including training initiatives; facilitation of special projects, and administrative support services"

Southern California Renal Disease Council, Inc.

Southern California Renal Disease Council, Inc. (Council), a nonprofit organization, is one of the 18 networks that serves as a Federal contractor to administer the program. The Council also served as the NCC from September 30, 2002, through September 28, 2006, under Medicare contract number 500-02-NW18CH, which is a cost-reimbursable contract.¹ During the contract period,² the Council also had revenue from another CMS contract.³ In this report, we refer to contract number 500-02-NW18CH as "the contract."

The Council claimed \$7,907,481 under the contract. Of this amount, \$87,282 was for fringe benefits and \$144,434 was for indirect costs that the Council claimed using provisional rates stated in the contract or rates based on estimated costs. The contract states: "The purpose of this contract is to obtain services of an ESRD Network contractor to serve as [NCC] contractor in support of the activities of the [ESRD] Networks as required by [Federal directives] related to monitoring, improving, and maintaining the quality of care received by patients with ESRD." As a nonprofit organization that was awarded a Federal contract, the Council must follow the cost principles in the Office of Management and Budget Circular A-122, *Cost Principles for*

¹ After September 28, 2006, CMS did not award the Council a separate contract to continue serving as the NCC.

² The Council's contract year (October through September) differed from its fiscal year (July through June).

³ The Council had another cost-reimbursable contract with CMS to administer the program for the period July 1, 2003, through June 30, 2006. We issued a separate report for that contract on March 7, 2012 (A-09-10-02045, *Southern California Renal Disease Council, Inc., Claimed Unallowable and Unsupported Costs Under Medicare Contract Number 500-03-NW18*).

Non-Profit Organizations. The contract required the Council to comply with applicable sections of the Federal Acquisition Regulation (FAR).

CMS requested that we conduct this contract closeout audit. FAR § 52.216-7 requires CMS to negotiate and settle with the Council the total claimed costs, including the final fringe benefits and indirect costs. The Council used the contract's provisional rates or rates based on estimated costs to calculate fringe benefits and indirect costs for claiming provisional reimbursement. CMS asked us to calculate the Council's fringe benefit and indirect cost rates using actual costs. CMS might use those rates during the contract closing process.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to (1) determine whether the costs that the Council claimed were allowable under the terms of the contract and pursuant to applicable Federal regulations and (2) calculate the fringe benefit and indirect cost rates based on actual costs.

Scope

We reviewed \$1,337,950 of the \$7,907,481 that the Council claimed under contract number 500-02-NW18CH for the period September 30, 2002, through September 28, 2006. In accordance with our agreement with the contracting officer, we did not audit subcontract costs of \$6,258,558 claimed under fixed-price contracts. We also did not review fixed fees of \$310,973.

We did not conduct a full-scope audit addressing the Council's performance. Also, we did not review the overall internal control structure of the Council. We limited our review of the Council's internal controls to those that were significant to the objectives of our audit.

We conducted our audit from November 2010 to July 2011 and performed fieldwork at the Council's office in Los Angeles, California.

Methodology

To accomplish our objectives, we:

- reviewed applicable Federal laws and regulations;
- reviewed the terms of the contract and modifications that CMS made;
- reviewed minutes of board of directors' meetings;
- reviewed a CMS onsite evaluation report of the Council;
- reviewed the Council's policies and/or procedures on the allocation of costs, property management, payroll, and travel;

- interviewed Council officials to gain an understanding of the Council's accounting procedures;
- reviewed the Council's financial statements for fiscal years (FY) 2003 through 2007;⁴
- reconciled the expenses recorded in the Council's general ledger with expenses claimed under the contract;
- reconciled the claimed costs for salaries and wages with the Council's payroll distribution records;
- analyzed the general ledger to identify large, unusual, and/or recurring transactions and judgmentally selected transactions for claimed costs (direct and indirect costs and fringe benefits) to determine their allowability;⁵ and
- calculated the fringe benefit and indirect cost rates for each fiscal year based on the actual costs recorded in the general ledger and the payroll distribution records.

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 objectives.

FINDINGS AND RECOMMENDATIONS

Of the \$1,337,950 of costs reviewed, \$650,538 was allowable under the terms of the contract and pursuant to applicable Federal regulations. The remaining \$687,412 consisted of \$29,192 in salaries and wages, fringe benefits, travel costs, and other direct costs that we determined were unallowable and \$658,220 that we set aside for CMS resolution. The \$658,220 consisted of (1) costs for which the Council did not maintain supporting documentation for review and (2) the difference between fringe benefits that the Council claimed and fringe benefits that we calculated using rates based on actual costs. The Council claimed unallowable or unsupported costs because it did not have adequate controls to account for costs claimed under Federal contracts. See Appendix A for a schedule of the costs claimed by the Council and the results of our audit, i.e., adjusted,⁶ allowable, unallowable, and set-aside amounts.

⁴ The financial statements for FYs 2003 through 2006 were audited. The financial statements for FY 2007 were unaudited.

⁵ When errors were identified for a particular element of cost from the judgmentally selected transactions, we expanded our review to determine the extent of the errors. We determined that the number, dollar amounts, and types of transactions selected were sufficient based on the adequacy of supporting documentation.

⁶ The Council incorrectly classified some consultant and subcontract costs in the general ledger and claimed them under incorrect elements of cost. We adjusted these costs by reclassifying them under the correct elements of cost.

We calculated fringe benefit and indirect cost rates based on actual costs. See Appendixes B and C for the fringe benefit and indirect cost rates, respectively.

SALARIES AND WAGES

OMB Circular A-122, Attachment B, subparagraph 8.m, states:

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more functions or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s)

Of the \$211,281 claimed for salaries and wages, \$181,425 was allowable because the Council maintained for review supporting documentation, such as payroll distribution records and personnel activity reports for some employees. The remaining \$29,856 consisted of \$12,897 that we determined was unallowable and \$16,959 that we set aside for CMS resolution:

- The \$12,897 in unallowable costs was for salaries and wages related to another CMS contract.
- The \$16,959 that we set aside was for salaries and wages for which the Council did not maintain for review supporting documentation, such as personnel activity reports that reflected the distribution of activity for each employee. Based on our review of the Council's payroll records, we were able to determine that the Council incurred these costs for salaries and wages. However, without personnel activity reports, we could not determine the amount of salaries and wages allocable to the contract.

FRINGE BENEFITS AND INDIRECT COSTS

The Council did not always use provisional rates when claiming fringe benefits and indirect costs for provisional reimbursement as required by the contract. The Council claimed fringe benefits and indirect costs using either the provisional rates stated in the contract or rates based on estimated costs. We calculated the rates based on actual costs for each fiscal year:

- For fringe benefits, the rates that the Council used to claim these costs were higher than our revised rates for all fiscal years. We applied the revised rates to salaries and wages

discussed in the previous section and determined unallowable and set-aside fringe benefits.

- For indirect costs, our revised indirect cost rates were higher than the rates that the Council used to claim indirect costs for all fiscal years except 2007. We applied the revised rates to salaries and wages plus fringe benefits and determined that the entire amount claimed for indirect costs was allowable.

See Appendixes B and C for (1) the fringe benefits and indirect costs that the Council should have claimed using the provisional rates for provisional reimbursement, (2) the fringe benefit and indirect cost rates that the Council used to claim fringe benefits and indirect costs, (3) the fringe benefits and indirect costs claimed by the Council, (4) our revised rates based on actual costs, (5) the fringe benefits calculated by applying the revised rates to the salaries and wages claimed by the Council, and (6) the indirect costs calculated by applying the revised rates to the salaries and wages claimed by the Council plus the associated fringe benefits.

Provisional Fringe Benefit and Indirect Cost Rates Not Always Used for Provisional Reimbursement

The contract, section G.10(b), states: “Pending establishment of final rates for any period, provisional reimbursement will be made on the basis of the provisional rates ... [as established by the contract].” Further, this section states that the provisional fringe benefit rate of 40.85 percent is to be applied to direct labor costs and that the provisional indirect cost rate of 21.35 percent is to be applied to direct labor plus fringe benefit costs. Finally, this section states that pending establishment of final rates for all periods of the contract, the provisional fringe benefit or indirect cost rate will be considered a ceiling rate.

The Council did not always use the provisional rates to claim fringe benefits and indirect costs for provisional reimbursement as required by the contract. For the contract period September 30, 2002, through September 30, 2004, the Council appropriately claimed (1) fringe benefits by applying the contract’s provisional rate of 40.85 percent to salaries and wages and (2) indirect costs by applying the contract’s provisional rate of 21.35 percent to salaries and wages plus fringe benefits. However, for the contract period October 1, 2004, through September 28, 2006, the Council used rates based on estimated costs to calculate fringe benefits and indirect costs.⁷ As a result, the Council claimed:

- \$87,282 in fringe benefits for provisional reimbursement when it should have claimed \$86,308 and

⁷ The Council calculated the rates based on a ratio of the cost pool (i.e., numerator) and the base (i.e., denominator). The fringe benefit cost pool included estimated costs for payroll taxes, State unemployment insurance, workers’ compensation insurance, life and disability insurance, health insurance, dental insurance, employee parking, pension expenses, and leave; the base included estimated direct salaries and wages. The indirect cost pool included estimated total facilities and administration costs; the base included estimated total salaries and wages plus fringe benefits.

- \$144,434 in indirect costs for provisional reimbursement when it should have claimed \$63,535.

Unallowable and Set-Aside Fringe Benefits Calculated Using Revised Rates Based on Actual Costs

OMB Circular A-122, Attachment B, subparagraph 8.g.(2), states that fringe benefits may be treated as direct or indirect costs. Further, Attachment A, subparagraph C.1., states: “Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.”

FAR § 52.216-7(d)(2) states: “(i) The Contractor shall submit an adequate final indirect cost rate proposal to the Contracting Officer ... and auditor The Contractor shall support its proposal with adequate supporting data. (ii) The proposed rates shall be based on the Contractor’s actual cost experience for that period.” Further, FAR § 52.216-7(g) states: “At any time or times before final payment, the Contracting Officer may have the Contractor’s invoices or vouchers and statements of cost audited.”

The contract, section G.10(a), states that the period or periods for which final rates will be established must correspond to the Council’s fiscal year. Further, section G.10(b) requires that the provisional rates be used as ceiling rates, pending the establishment of final indirect cost rates. The contract also states: “... in the event the indirect expense rates based on actual allowable costs are less than the ceiling rates, such lower rates shall be applied. The Government will not be obligated to pay any additional amounts on account of indirect expenses above the ceiling rates. ...”

Of the \$87,282 claimed for fringe benefits,⁸ \$68,342 was allowable. We calculated the allowable fringe benefits by applying the revised fringe benefit rates to the \$181,425 in allowable salaries and wages. The remaining \$18,940 consisted of \$4,495 that we determined was unallowable and \$14,445 that we set aside for CMS resolution:

- The \$4,495 in unallowable costs was related to the \$12,897 in unallowable salaries and wages.
- The \$14,445 that we set aside consisted of (1) the fringe benefits related to the \$16,959 in unsupported salaries and wages (\$5,800), and (2) the difference between the fringe benefits that the Council claimed and the fringe benefits that we calculated using revised rates based on actual costs (\$8,645). The rates that the Council used to claim fringe benefits were higher than the revised rates for all fiscal years. Further, we calculated the revised fringe benefit rates for each of the Council’s fiscal years because the contract required that the rates be established for each fiscal year.⁹ (See Appendix B.)

⁸ The Council treated fringe benefits as indirect costs.

⁹ The Council established fringe benefit rates for FYs 2005 and 2006 and applied these rates to the salaries and wages claimed for the contract periods October 1, 2004, through September 30, 2005, and October 1, 2005, through September 30, 2006, respectively.

Indirect Costs Calculated Using Revised Rates Based on Actual Costs

OMB Circular A-122, Attachment A, subparagraph E.1.d., states: “Final rate means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.”

FAR § 52.216-7(d)(2) states: “(i) The Contractor shall submit an adequate final indirect cost rate proposal to the Contracting Officer ... and auditor The Contractor shall support its proposal with adequate supporting data. (ii) The proposed rates shall be based on the Contractor’s actual cost experience for that period.” Further, FAR § 52.216-7(g) states: “At any time or times before final payment, the Contracting Officer may have the Contractor’s invoices or vouchers and statements of cost audited.”

The contract, section G.10(a), states that the period or periods for which final rates will be established must correspond to the Council’s fiscal year. Further, section G.10(b) requires that the provisional rates be used as ceiling rates, pending the establishment of final indirect cost rates. The contract also states: “... in the event the indirect expense rates based on actual allowable costs are less than the ceiling rates, such lower rates shall be applied. The Government will not be obligated to pay any additional amounts on account of indirect expenses above the ceiling rates. ...”

Of the \$144,434 claimed for indirect costs, the entire amount was allowable. The revised rates were higher than the rates that the Council used to claim indirect costs for all fiscal years except 2007. We applied the revised indirect cost rates to the allowable salaries and wages and fringe benefits discussed in previous sections and calculated indirect costs that were higher than the amount claimed by the Council. We calculated the revised rates for each of the Council’s fiscal years because the contract required that the indirect cost rates be established for each fiscal year.¹⁰ The amount of allowable indirect costs was limited to the amount of claimed indirect costs because the indirect costs calculated based on our revised indirect cost rates were greater than the claimed indirect costs based on the provisional rate and the rates based on estimated costs. (See Appendix C.)

CONSULTANTS

OMB Circular A-122, Attachment A, subparagraph A.2., states that to be allowable under an award, costs must be reasonable for the performance of the award and adequately documented. Further, Attachment B, subparagraph 37(b), lists factors that are relevant in determining the allowability of consultant costs, including but not limited to the nature and scope of the service provided in relation to the service required, the necessity of contracting for the service, and the adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

¹⁰ The Council established indirect cost rates for FYs 2005 and 2006 and applied these rates to the salaries and wages plus fringe benefits claimed for the contract periods October 1, 2004, through September 30, 2005, and October 1, 2005, through September 30, 2006, respectively.

The Council claimed \$161,256 in consultant costs when it should have claimed \$381,826. The difference of \$220,570 represents the net of (1) \$288,070 of consultant costs that were incorrectly classified as travel costs (\$13,848) and other direct costs (\$274,222) and (2) \$67,500 of subcontract costs that were incorrectly classified as consultant costs.

For the consultant costs of \$381,826 that we reviewed, we set aside the entire amount for CMS resolution because the Council did not maintain for review consultant agreements that reflected the nature and scope of the services provided, the necessity of contracting for the services, or the adequacy of the contractual agreements. According to a Council official, the Council's previous executive director hired consultants without written agreements. Based on our review of the Council's invoices for consultants, we were able to determine that the Council incurred these consultant costs. However, without consultant agreements, we could not determine the reasonableness of the consultant costs.

TRAVEL

OMB Circular A-122, Attachment A, subparagraph A.2., states that to be allowable under an award, costs must be reasonable for the performance of the award and adequately documented.

The Council claimed \$152,004 in travel costs when it should have claimed \$138,156. The difference of \$13,848 represents consultant costs that were incorrectly classified as travel costs.

Of the \$138,156 of travel costs that we reviewed, \$93,513 was allowable. The remaining \$44,643 consisted of \$888 that we determined was unallowable and \$43,755 that we set aside for CMS resolution:

- The \$888 in unallowable costs was for travel costs for which the Council's accounting records did not support that the expenses had been incurred.
- The \$43,755 that we set aside was for travel costs for which the Council did not maintain supporting documentation for review.

OTHER DIRECT COSTS

OMB Circular A-122, Attachment A, subparagraph A.2., states that to be allowable under an award, costs must be reasonable for the performance of the award and adequately documented. Subparagraph B.1. states: "Direct costs are those that can be identified specifically with a particular final cost objective" Subparagraph C.1. states: "Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective."

The Council claimed \$648,670 in other direct costs when it should have claimed \$374,448. The difference of \$274,222 represents consultant costs that were incorrectly classified as other direct costs.

Of the \$374,448 of other direct costs that we reviewed,¹¹ \$162,301 was allowable. The remaining \$212,147 consisted of \$10,912 that we determined was unallowable and \$201,235 that we set aside for CMS resolution:

- The \$10,912 in unallowable costs consisted of (1) costs for which the Council's accounting records did not support that the expenses had been incurred (\$6,611); (2) payroll taxes, insurance, pension, workers' compensation, parking, and leave costs that were charged as direct costs rather than fringe benefits (\$4,071);¹² and (3) general office expenses related to joint or common objectives of the organization that were charged as direct rather than indirect costs (\$230).¹³
- The \$201,235 that we set aside consisted of (1) direct costs claimed during the period September 30, 2002, through June 30, 2004, for which the Council did not maintain supporting documentation for review (\$198,084) and (2) telephone, conference, and courier costs for which the Council did not maintain invoices (\$3,151).

LACK OF ADEQUATE CONTROLS

The Council did not have adequate controls to ensure that the costs claimed under the contract were allowable under the terms of the contract and pursuant to applicable Federal regulations. The Council did not maintain supporting documentation as required by Federal regulations, and the Council's employees had a limited understanding of cost allocation. For example, the person who was responsible for the Council's accounting was not familiar with the classification of certain costs as direct or indirect costs. Further, the Council did not have policies and procedures for documenting contractual agreements for consultant services. Council officials stated that many of the Council's consultants had provided services to the Council for many years and that the Council's former executive director handled the procurement of consultant services during our audit period.

RECOMMENDATIONS

We recommend that the Council:

- refund to the Federal Government \$29,192 for unallowable salaries and wages, fringe benefits, travel costs, and other direct costs;
- work with CMS to determine the allowability of \$658,220 that we set aside and refund to the Federal Government any amount that is determined to be unallowable; and
- strengthen its controls to account for costs claimed under Federal contracts.

¹¹ Other direct costs included legal fees, meetings and conference expenses, postage fees, printing fees, and telephone expenses.

¹² We included \$4,071 in the fringe benefit cost pool when calculating the revised fringe benefit rates.

¹³ We included \$230 in the indirect cost pool when calculating the revised indirect cost rates.

AUDITEE COMMENTS

In its written comments on our draft report, the Council concurred with our first and second recommendations and provided information on actions that it had taken or planned to take to address our third recommendation. The Council's comments are included in their entirety as Appendix D.

OTHER MATTERS

REQUIRED ANNUAL SINGLE AUDIT

OMB Circular A-133 (*Audits of States, Local Governments, and Non-Profit Organizations*), subpart B, §__200(a), states: "Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year"

OMB Circular A-133, subpart E, §__505, states that the auditor's report must identify that the audit was conducted in accordance with this part and include a report on internal controls related to financial statements and major programs. This report must describe the scope of testing of internal controls and the results of the tests and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

The Council did not have single audits conducted for each year of our audit period, even though it expended more than \$500,000 in Federal awards in each of those years. The Council had its financial statements audited by an independent auditor for FYs 2003–2006, but the audit reports did not identify that the audits were conducted in accordance with OMB Circular A-133. Further, the audit reports did not include a report on the internal controls related to financial statements and major programs as required by Federal regulations.

PROCUREMENT POLICIES AND PROCEDURES

OMB Circular A-110 (*Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*), section__.43, requires that all procurement transactions be conducted in a manner to provide open and free competition. Section__.44(a) requires that all recipients establish written procurement procedures. Section__.45 states: "Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action."

The Council did not establish written procurement procedures and did not have documentation to support that the procurement of consultants provided open and free competition or that a cost or price analysis was performed in procuring consultants.

APPENDIXES

**APPENDIX A: SCHEDULE OF COSTS CLAIMED AND RESULTS OF AUDIT
FOR THE PERIOD SEPTEMBER 30, 2002, THROUGH SEPTEMBER 28, 2006**

Element of Cost	Claimed	Adjusted for Review	Allowable	Unallowable	Set Aside
Salaries and Wages	\$211,281	\$211,281	\$181,425	\$12,897	\$16,959
Fringe Benefits	87,282	87,282	68,342	4,495	14,445
Indirect Costs	144,434	144,434	144,434	0	0
Consultants	161,256	381,826	0	0	381,826
Supplies	523	523	523	0	0
Travel	152,004	138,156	93,513	888	43,755
Other Direct Costs	648,670	374,448	162,301	10,912	201,235
Total Costs	\$1,405,450¹	\$1,337,950	\$650,538	\$29,192	\$658,220

¹ The claimed amount included \$67,500 in subcontract costs that the Council claimed as consultant costs. We did not review subcontract costs.

APPENDIX B: SCHEDULE OF FRINGE BENEFIT RATES AND FRINGE BENEFITS

Contract Year	Fiscal Year	Dates Covered	Provisional Rate (Percentage)	Costs Calculated Using Provisional Rate	Council Rate (Percentage)	Costs Claimed Using Council Rate	Revised Rate (Percentage)	Costs Calculated Using Revised Rate
1	2003	9/30/2002–6/30/2003	40.85	\$2,907	40.85	\$2,907	25.44	\$1,810
1	2004	7/1/2003–9/30/2003	40.85	2,742	40.85	2,742	40.69	2,731
2	2004	10/1/2003–6/30/2004	40.85	6,504	40.85	6,504	40.69	6,479
2	2005	7/1/2004–9/30/2004	40.85	1,009	40.85	1,009	38.24	944
3	2005	10/1/2004–6/30/2005	40.85	26,832	46.95	30,839	38.24	25,118
3	2006	7/1/2005–9/30/2005	40.85	9,103	46.95	10,462	34.85	7,766
4	2006	10/1/2005–6/30/2006	40.85	27,666	45.74 ¹	31,066	34.85	23,602
4	2007	7/1/2006–9/28/2006	40.85	9,545	45.74 ²	1,753	43.59	10,186
		Total Costs		\$86,308		\$87,282		\$78,636

¹ The Council applied the prior year's rate of 46.95 percent in November 2005, resulting in an effective rate of 45.87 percent for the period October 1, 2005, through June 30, 2006.

² The Council applied a rate of –34.69 percent in August 2006 and a rate of 10.57 percent in September 2006, resulting in an effective rate of 7.50 percent for the period July 1, 2006, through September 28, 2006.

APPENDIX C: SCHEDULE OF INDIRECT COST RATES AND INDIRECT COSTS

Contract Year	Fiscal Year	Dates Covered	Provisional Rate (Percentage)	Costs Calculated Using Provisional Rate	Council Rate (Percentage)	Costs Claimed Using Council Rate	Revised Rate (Percentage)	Costs Calculated Using Revised Rate
1	2003	9/30/2002–6/30/2003	21.35	\$2,140	21.35	\$2,140	62.39	\$5,569
1	2004	7/1/2003–9/30/2003	21.35	2,018	21.35	2,018	64.77	6,117
2	2004	10/1/2003–6/30/2004	21.35	4,788	21.35	4,788	64.77	14,509
2	2005	7/1/2004–9/30/2004	21.35	743	21.35	743	76.65	2,617
3	2005	10/1/2004–6/30/2005	21.35	19,752	52.68	50,848	76.65	69,600
3	2006	7/1/2005–9/30/2005	21.35	6,701	52.68	17,251	69.77	20,966
4	2006	10/1/2005–6/30/2006	21.35	20,366	53.89 ¹	53,109	69.77	63,719
4	2007	7/1/2006–9/28/2006	21.35	7,027	53.89	13,537	24.92	8,361
		Total Costs		\$63,535		\$144,434		\$191,458

¹ The Council applied the prior year's rate of 52.68 percent in November 2005, resulting in an effective rate of 53.76 percent for the period October 1, 2005, through June 30, 2006.

APPENDIX D: AUDITEE COMMENTS



Southern California
Renal Disease Council
INCORPORATED
ESRD NETWORK 18

April 3, 2012

Lori A. Ahlstrand
Regional Inspector General for Audit Services
Office of Audit Services, Region IX
90- 7th Street, Suite 3-650
San Francisco, CA. 94103

Re: Report Number: A-09-11-02005
Contract #: 500-02-NW18CH

Dear Ms. Ahlstrand:

Please find this letter in response to the U.S. Department of Health and Human Services, Office of Inspector General (OIG), and draft report entitled Southern California Renal Disease, Inc. Claimed and Unallowable and Unsupported Costs under Medicare Contract Number 500-02-NW18CH dated March 9, 2012.

According to the Summary of Finding, your audit team reviewed \$1,337,950 of costs of which \$650,538 were allowable, allocable and reasonable under the terms of the contract; The remaining \$687,412 consisted of \$29,192 in salaries and wages, fringe benefits, travel costs, and other direct costs that were determined to be unallowable; and \$658,220 that your audit team set aside for CMS resolution.

The recommendations issued by the audit team are as follows:

- Refund to the Federal Government \$29,192 for unallowable other direct costs,
- Work with CMS to determine the allowability of \$658,220 of the set aside funds and refund the amount determined by CMS to be unallowable,
- Strengthen its controls to account for costs claimed under Federal contracts.

Southern California Renal Disease Council, Inc. is presenting the following statements of concurrence for the above recommendations made by the OIG.

- SCRDC, Inc. concurs with the recommendation of refunding the \$29,192 to CMS for unallowable other direct costs.
- SCRDC, Inc. concurs with the recommendation of working with CMS to determine the allowability of the set aside amount of \$658,220
- SCRDC, Inc. has begun implementing policies and procedures that strengthen and improve the control to accounts for costs claimed under Federal contracts.

Mission Statement

To provide leadership and assistance to renal dialysis and transplant facilities in a manner that supports continuous improvement in patient care, outcomes, safety and satisfaction.

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Southern California Renal Disease Council appreciates the opportunity to respond to the recommendations offered by the OIG; and would also like to include the following information:

1. The Contract Awards which were audited during this audit period were Cost Reimbursement Contracts rather than being a Fixed Contract.
2. The previous Executive Director during the audited contract years was replaced on December 28, 2008.
3. It has been brought to my attention that correspondence was sent to the Contracting Officer during the contracts: a) rates for indirect costs; b) and asking when the audit was to be scheduled. Please note that CMS audits for the Council had not been completed since the Contract Year 2001.
4. The NCC cost contract has been removed from Network 18.
5. Current Administration has implemented policies and procedures that will bring the Council into compliance with the Office of Management and Budget (OMB) Circular 122-A, as well as the applicable sections of the Federal Acquisition Regulations (FAR). These implemented policies and procedures include but are not limited to:
 - a. **Salaries and Wages**
 - i. Employee activity reports (including timesheets) have been implemented to provide documentation for charging their compensation to the award.
 - ii. Payroll records are now maintained according to State and Federal laws.
 - iii. Employees dealing with wages, salaries and contract awards have been given the pertinent information from OMB Circular A-122 and FAR.
 - iv. Employee activity reports, timesheets and payroll records will be kept four years after CMS has performed the final audit of contract.
 - b. **Fringe Benefits Cost/Rate**
 - i. In order to calculate the fringe rate, policies and procedures have been implemented for cost contracts to utilized actual fringe costs in accordance with OMB Circular A-122 and FAR, and once approved by CMS, used throughout the contract period.
 - ii. Documents will be maintained four years after CMS has audited contract.
 - c. **Indirect Costs**
 - i. Policies and procedures are in place that will prevent the misallocation of indirect costs to direct costs and vice versa.
 - ii. The Council will submit an adequate final indirect cost rate proposal to the Contracting Officer and this final indirect rate will be supported by adequate supporting data. This indirect rate will be based on the Council's actual cost experience.
 - iii. Documents will be maintained four years after CMS has audited contract.
 - d. **Consultants**
 - i. Implemented policy directed at complying with the procurement of consultants according to the OMB Circular A-122 Attachment A, subparagraph A.2 and Attachment B, subparagraph 37(b); including creating a form for documenting the procurement of consultants and establishing a consultant agreement/contract which delineates the description of services, estimate of time required, rate of compensation and termination provisions.
 - ii. Any and all consultant selection will be conducted in such a manner as to provide open and free competition.
 - e. **Travel Costs**
 - i. The Council has implemented policies and procedures which will insure that proper allocation of costs resulting from travel will be properly represented as either Direct or Indirect.

ESRD NETWORK 18

- f. Other Direct Costs**
 - i. Policies and procedures are in place that will prevent the misallocation of direct costs to Indirect costs and vice versa.
 - ii. The Council will identify and adequately record direct cost to appropriate accounts, along with maintain adequate supporting data.
 - iii. Documents will be maintained four years after CMS has audited contract.
- g. Required Annual Single Audit**
 - i. This required Single Audit was implemented by the new Executive Director in 2010 as part of the increased fiscal awareness and effort to comply with contract requirements (OMB Circular A-133).
- h. Lack of Adequate Internal Controls**
 - i. Policies and procedures have been implemented, reviewed, or replaced to insure strict adherence to the Circular A-122 and FAR.
- i. Procurement Policies and Procedures**
 - i. Procurement Policies and procedures have been implemented to require that all procurement transactions be conducted in a manner to provide open and free competition, in adherence to the Circular A-110.
 - ii. Supporting documents will be maintained four years after CMS has audited contract.

Thank you for allowing us to review and respond to these audit finding.

Sincerely,

/Harriet L. Edwards/

Harriet L. Edwards, MSW/MSG
Executive Director