Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF DOUGLAS CONSULTING AND COMPUTER SERVICES, INC., CLAIMED COSTS FOR CALENDAR YEARS 2008 THROUGH 2011

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

Stephen Virbitsky
Regional Inspector General

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Office of Inspector General

https://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

Douglas Consulting & Computer Services, Inc., claimed unallowable costs of approximately $316,000 from January 1, 2008, through May 20, 2011.

WHY WE DID THIS REVIEW

The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program. All Medicare applicants must complete the Initial Eligibility Questionnaire (questionnaire), which provides the information that CMS uses to determine Medicare eligibility. Douglas Consulting & Computer Services, Inc. (Douglas), collected and processed the questionnaires under a subcontract with Group Health Incorporated. CMS requested that we perform an audit of the costs claimed by Douglas from January 1, 2008, through May 20, 2011.

Our objective was to determine whether costs claimed by Douglas were accurate, allowable and reasonable in accordance with the terms of the contract and Federal regulations.

BACKGROUND

The Medicare program provides health insurance for Americans aged 65 and over and those who are disabled or have permanent kidney disease. However, the Social Security Act requires that: "[b]efore an individual applies for benefits under part A or enrolls under part B, the Administrator [CMS] shall mail the individual a questionnaire to obtain information on whether the individual is covered under a primary plan and the nature of the coverage provided under the plan, including the name, address, and identifying number of the plan."

CMS contracts with Group Health for the questionnaire process as part of its Coordination of Benefits contract. Douglas processed the questionnaires as a subcontractor for Group Health under contract GHI-DCCS-500-00-0001/COB (the contract). During 2011, CMS moved the paper questionnaire process to an electronic format, and on May 20, 2011, Group Health terminated the contract with Douglas.

From January 1, 2008, through May 20, 2011, Douglas claimed costs of $11,512,458 under the contract. We did not audit termination costs incurred after May 20, 2011.

WHAT WE FOUND

Douglas generally claimed costs under the contract that that were accurate, allowable and reasonable. Of the $11,512,458 in costs that we reviewed, $11,196,818 was allowable under the terms of the contract and Federal regulations. The remaining $315,640 was unallowable. Douglas claimed these unallowable costs because it did not have adequate internal controls in place to ensure that only allowable costs were charged to the contract.

WHAT WE RECOMMEND

We recommend that Douglas:

- refund $315,640 to the Federal Government and
- follow its policies and procedures to comply with Federal regulations.

DOUGLAS CONSULTING & COMPUTER SERVICES, INC., COMMENTS AND OUR RESPONSE

In written comments on our draft report, Douglas partially concurred with our findings and listed corrective action it plans to take to address $48,454 of unsupported costs. Douglas did not concur that costs of $267,186 for fringe benefits and employee morale and welfare were unallowable. Douglas described its unwritten policy for providing fringe benefits to employees hired as full time regardless of their hours worked and said that its costs for a television and group meals were reasonable and necessary for employee morale. Douglas stated that, because the majority of the costs claimed were allowable, its internal controls were adequate.

After reviewing Douglas' comments, we maintain that our findings and recommendations are valid. The unwritten policy that Douglas described did not conform to the written policies and carried a high risk of indirect discrimination. Employee morale and welfare costs must be reasonable; that is, ordinary and necessary for the contractor's performance. However, Douglas claimed, among other things, $10,946 for one television and $1,868 for Thanksgiving meals. These costs were neither reasonable nor necessary. We have modified our report to more clearly reflect the disallowed costs in our findings. Douglas' internal controls were inadequate to prevent some unallowable costs from being claimed.

TABLE OF CONTENTS

INTRODUCTION

WHY WE DID THIS REVIEW

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OBJECTIVE

Our objective was to determine whether costs claimed by Douglas were accurate, allowable and reasonable in accordance with the terms of the contract and Federal regulations.

BACKGROUND

The Medicare program provides health insurance for people aged 65 and over and those who are disabled or have permanent kidney disease. The Social Security Act (the Act) states: "[b]efore an individual applies for benefits under part A or enrolls under part B, the Administrator [CMS] shall mail the individual a questionnaire to obtain information on whether the individual is covered under a primary plan and the nature of the coverage provided under the plan, including the name, address, and identifying number of the plan" (the Act, §1862(b)(5)(D))." [1]

The Amendments required that CMS contract with an entity within 60 days to distribute the questionnaire (the Amendments, § 151(a)(1)(B)). To implement this section of the law, CMS contracted with Douglas to develop the questionnaire, collect the applicant information, and provide it to CMS.

In 1999, CMS moved the questionnaire process to a larger Coordination of Benefits contract with Group Health. Douglas continued to process the questionnaires as a subcontractor for Group Health under contract GHI-DCCS-500-00-0001/COB (the contract). During 2011, CMS moved the paper questionnaire process to an electronic format, and on May 20, 2011, Group Health terminated the contract with Douglas.

HOW WE CONDUCTED THIS REVIEW

We reviewed costs of $11,512,458 that Douglas claimed from January 1, 2008, through May 20, 2011 (audit period). We reviewed costs from the general ledger, expense reports, payroll journals, and personnel records and reconciled them to the invoices Douglas submitted to determine whether the costs claimed were accurate, allowable and reasonable based on Federal requirements and the terms of the contract.

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[1] The Social Security Amendments of 1994, P.L. No. 103-432, enacted October 31, 1994, (the Amendments) established this requirement.

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.

See Appendix A for the details of our scope and methodology.

FINDINGS

Douglas generally claimed costs under the contract that that were accurate, allowable and reasonable. Of the $11,512,458 in costs that we reviewed, $11,196,818 was allowable under the terms of the contract and Federal regulations. The remaining $315,640 was unallowable.

Unallowable Costs Claimed During the Audit Period

Costs	Unallowable Amount
Fringe Benefits	$233,272
Unsupported Costs	$48,454
Employee Morale and Welfare	$33,914
Total Unallowable Costs	**$315,640**

See Appendix B for a schedule of costs claimed.

Douglas claimed these unallowable costs because it did not have adequate internal controls in place to ensure that only allowable costs were charged to the contract.

UNALLOWABLE COSTS CLAIMED

Unallowable Fringe Benefit Costs

Federal standards do not define a full-time or part-time employee, but instead allow the employer to determine the number of hours an employee must work to be considered a full-time employee. However, employers may not act indirectly in a discriminatory fashion.

The Douglas Employee Handbook states, "Full-time employees are those personnel who are not in a temporary status and work a minimum of 40 hours per week on an ongoing basis." It also states "Part-time employees are not eligible for company benefits except for those specifically stated in writing between Douglas and the employee." Douglas officials informed us that no employee they identified as part-time had received any company paid benefits.

Douglas claimed $233,272 in unallowable fringe benefit costs for employees who did not meet its requirement for full-time employment. To calculate the average hours worked in a week for each employee, we reviewed timesheets and included all paid time off as hours worked. We considered any employee who worked less than 39 hours per week a part-time employee. For example, one employee worked an average of 24.5 hours per week in 2009 and received $1,641 in paid time off and $1,106 in holiday pay.

We found that 38 employees averaged less than 39 hours per week on an ongoing basis during at least one year in the audit period. The table below summarizes the number of Douglas employees who averaged less than 39 hours per week on an ongoing basis during each year of our audit period.

Table: Part-Time Hours Worked

Average Hours Worked Per Week	Number of Employees CY 2008	Number of Employees CY 2009	Number of Employees CY 2010	Number of Employees CY 2011
35 to 39	11	9	12	8
25 to 35	5	3	5	3
less than 25	8	5	8	6
Total	**24**	**17**	**25**	**17**

Douglas did not follow its policy for fringe benefits. Rather, Douglas officials said that they considered most employees full-time and included them in the fringe benefit calculations.

Unsupported Automobile and Telephone Costs

The Federal Acquisition Regulation (FAR) requires that, "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported" (FAR § 31.201-2(d)).

The FAR also states that the "portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees" (FAR § 31.205-6(m)(2)).

Douglas claimed $48,454 of unsupported costs as follow:

- Automobile-related costs of $45,977, including $34,633 for depreciation and $11,344 for general automobile costs, such as insurance, repair, and towing. Douglas provided company vehicles to employees, but did not provide documentation to distinguish between business and personal use.

- Costs of $2,477 for telephone service. Douglas used company accounts and funds to pay the telephone costs but did not provide documentation to distinguish between business and personal use.

Unallowable Employee Morale and Welfare Costs

The FAR states that costs are allowable only when the cost complies with all of the following requirements: "(1) Reasonableness, (2) Allocability, (3) Standards promulgated by the CAS [Cost Accounting Standards] Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances, (4) Terms of the contract, and (5) Any limitations set forth in this subpart" (FAR Part 31.201-2(a)).

In addition, the FAR states that the reasonableness of a cost depends upon a variety of considerations, including whether the type of cost is generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance (FAR § 31.201-3). Although the FAR allows certain costs for employee morale and welfare, costs for gifts to employees are unallowable (FAR § 31.205-13(5)(b)). Costs for amusement, diversion and social activities are also unallowable (FAR § 31.205-14).

Douglas claimed $33,914 in unallowable Employee Morale and Welfare costs. These unallowable costs included, but were not limited to, $10,946 for the purchase of a television and $1,868 for Thanksgiving meals. Douglas failed to properly account for costs appropriately and did not demonstrate that costs claimed were reasonable or allocable to the contract.

INADEQUATE INTERNAL CONTROLS

Douglas did not have adequate internal controls to ensure that it properly followed its policy for classifying full-time employees in providing fringe benefits. Furthermore, Douglas did not maintain adequate supporting documentation and did not have adequate procedures to ensure that the costs claimed under the contract were allowable based on the terms of the contract and applicable Federal regulations.

RECOMMENDATIONS

We recommend that Douglas:

- refund $315,640 to the Federal Government and
- follow its policies and procedures to comply with Federal regulations.

DOUGLAS CONSULTING & COMPUTER SERVICES, INC., COMMENTS

In written comments on our draft report, Douglas concurred with our finding that it claimed $48,454 in unsupported automobile and telephone costs and listed corrective action it plans to take to address it. Douglas did not concur with our findings that it claimed unallowable fringe benefit costs of $233,272 and employee morale and welfare costs of $33,914. Douglas stated that the audit based its fringe benefit finding on one line in its Employee Handbook taken out of context. Douglas described its unwritten policy for providing fringe benefits to employees hired as full time regardless of the hours worked, as long as the employees continued to work in that position. Douglas stated that the employee morale and welfare costs were for television and cable service for the break room, modest group meals, and ordinary and necessary expenses that were allowable to maintain satisfactory relations with its employees and to improve working conditions, employee morale, and employee performance.

In addition, Douglas did not concur that it lacked adequate internal controls to prevent unallowable costs from being charged to the contract. Douglas stated that, because the audit report concluded that the majority of the costs claimed were allowable, its internal controls were adequate.

Douglas' comments are included as Appendix C.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing Douglas' comments, we maintain that our findings and recommendations are valid. Douglas had written policies in its Employee Handbook that established eligibility for fringe benefits. The unwritten policy that Douglas described did not conform to these written policies and carried a high risk of indirect discrimination. Employee morale and welfare costs must be reasonable; that is, ordinary and necessary for the contractor's performance. However, Douglas claimed, among other things, $10,946 for one television and $1,868 for Thanksgiving meals. These costs were neither reasonable nor necessary. We have modified our report to more clearly reflect the disallowed costs in our findings.

We further maintain that Douglas' internal controls were inadequate to prevent Douglas from claiming some unallowable costs.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our review identified costs totaling $11,512,458 submitted by Douglas for January 1, 2008, through May 20, 2011. We did not audit termination costs incurred after May 20, 2011.

We conducted fieldwork at the CMS Central Office in Baltimore, Maryland, and at the Douglas offices in Columbia, Maryland.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal statutes and regulations;
- reviewed the contract;
- reviewed Douglas' policies and procedures,
- held discussions with Douglas officials to gain an understanding of their work and costs related to the contract;
- obtained invoices and supporting schedules submitted by Douglas for the audit period;
- reviewed costs from general ledger listings, expense reports, payroll journals, and personnel records and reconciled them to the invoices and supporting schedules;
- determined whether the costs claimed were accurate, allowable and reasonable based on Federal requirements, contract terms and Douglas' internal policies; and
- discussed our findings with officials from CMS and Douglas.

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.

APPENDIX B: SCHEDULE OF COSTS CLAIMED

Element of Cost	Costs Claimed	Unallowable Costs	Allowable Costs
Wages & Fringe Benefits	$10,259,760	$233,272	$10,026,488
Supplies	27,446	0	27,446
Transportation	62,134	45,977	16,157
Travel	4,536	0	4,536
Phone	255,349	2,477	252,872
Maintenance	141,422	0	141,422
Other	111,389	33,914	77,475
Computer Hardware & Software	650,422	0	650,422
Total	**$11,512,458**	**$315,640**	**$11,196,818**

DOUGLAS Consulting & Computer Services, Inc.

Innovative Concepts for the Right Solution

October 8, 2013

Mr. Stephen Virbitsky
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Audit Services, Region III
Public Ledger Building, Suite 316
150 S. Independence Mall West
Philadelphia, PA 19106

Re: Report No. A-03-12-03302; Response to Draft Report Entitled *Review of Douglas Consulting and Computer Services, Inc., Claimed Costs for Calendar Years 2008 through 2011*

Dear Mr. Virbitsky:

Thank you for the opportunity to provide these comments on the above-referenced draft audit report. Except as indicated below, Douglas Consulting and Computer Services, Inc. ("DCCS") does not concur with the draft report's assertion that DCCS claimed unallowable costs of $316,000 from January 1, 2008 through May 20, 2011. In addition, DCCS does not concur that it lacked sufficient controls to ensure that only allowable costs were charged to its subcontract with Group Health Incorporated ("GHI"), Contract No. GHI-DCCS-500-00-0001/COB ("the contract"). Our responses to the four findings in the draft audit report are set forth below.

Fringe Benefit Costs

The draft audit report questions fringe benefit costs totaling $233,272 based on the auditors' opinion that 38 of DCCS's full-time employees did not meet DCCS's requirement for full-time employment and should therefore have been treated as part-time employees who are not entitled to company-paid benefits. Federal Acquisition Regulation ("FAR") 31.205-6(m)(1) expressly states that "the costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor." As the draft audit report acknowledges, Federal standards do not define full-time or part-time employee, but instead allow the employer to determine the number of hours an employee must work to be considered a full-time employee. The draft audit report focused exclusively on a single sentence, taken out of context, from the Douglas Employee Handbook, and ignored DCCS's established policy of providing fringe benefits to all employees hired into full-time positions. DCCS has never applied the language in its employee handbook for either defining full-time employees or determining who is eligible to receive benefits. Instead, it has been DCCS's established and consistently followed policy and practice to hire employees into either full-time positions or part-time positions and maintain that categorization for as long as the

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employee continues to work in the same position. It has also been DCCS's established and consistently followed policy and practice to inform new employees who are hired into full-time positions that, if they are retained as employees after the probationary period ends, they are expected to report to work on time each workday (Monday through Friday, except Federal holidays) and that they are expected to work eight hours per day, five days each week, unless authorized by their manager to be absent from their workstation. Any employee hired on those terms is considered a "full-time" employee, regardless of whether there is sufficient work available for the employee to work 40 hours each and every week. Further, it is DCCS's established and consistently followed policy and practice to provide fringe benefits to employees hired into such full-time positions. This policy and practice has been in effect since 1992, when DCCS first began hiring employees. The practice is not applied in a discriminatory fashion; it applies equally to all work performed by DCCS.

DCCS's long-standing, established and consistently followed policy and practice, not the sentence taken out of context from the employee handbook, is determinative. *See, e.g.*, *Boeing Aerospace Operations, Inc.*, ASBCA No. 46274, 94-2 BCA § 26,802 (holding that a company policy need not be in writing, and can be established through consistent application over a long period of time). Thus, contrary to the draft audit report's assertion, the questioned fringe benefit costs are expressly allowable under FAR 31.205-6(m)(1).

Unsupported Costs

The draft audit report questions automobile-related costs of $45,977 and telephone service costs of $2,477 based on inadequate supporting documentation. Specifically, the draft audit report alleges that DCCS failed to provide documentation to distinguish between business and personal use of the company-furnished automobiles and company-paid telephone service. Inasmuch as DCCS did not maintain adequate records to substantiate the business purpose of certain expenses related to the company-owned vehicles ($45,977) and certain telephone charges ($2,477), DCCS concurs with the proposed disallowances.

In terms of corrective action, DCCS will establish and maintain vehicle logs documenting the business purpose of the vehicle expenses. These logs will identify the vehicle, mileage to/from destination, purpose, etc. to establish the business purpose. Alternatively, the costs will not be claimed for re-imbursement under any Government contract. Out of the hundreds of thousands of telephone expenses incurred by DCCS, our failure to document the business purpose of this small amount is not considered to be a major internal control deficiency. However, we will stress to the employees the importance of documenting this and all other expenses.

Mr. Stephen Virbitsky
<October 8, 2013>
Page 3

Employee Morale and Welfare

The draft audit report questions employee morale and welfare costs of $33,914. The draft audit report cites three reasons for questioning the costs, but does not specify which costs were questioned for which reason. Therefore, we will respond in general to all three reasons.

First, the draft audit report states that although the FAR allows certain costs for employee morale and welfare, costs for gifts are unallowable under FAR 31.205-13(b). Very few, if any, of the costs itemized on the lists provided by the auditors can properly be characterized as “gifts.” A gift is something given gratuitously without any expectation of receiving a benefit in exchange. However, the vast majority of the questioned costs are for things such as group meals, coffee and water service for the office, cleaning supplies for the office, and a television and cable TV for the employee break room. All of these costs are expressly allowed under FAR 31.205-21(a) because they were incurred to maintain satisfactory relations between DCCS and its employees. In addition, the group meals, coffee and water service, and employee break room expenses are expressly allowed under FAR 31.205-13(a) because the costs were incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance. Indeed FAR 31.205-13(a)(5) specifically cites, as an example of allowable employee morale and welfare costs, food services for the contractor’s employees, including canteens, vending machines, living accommodations and similar types of services.

Second, the draft audit report asserts that DCCS did not demonstrate that the costs are reasonable. As the draft audit report correctly observes, FAR 31.201-3(b) states that the reasonableness of a cost depends upon a variety of considerations, including whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance. Modest group meals for significant occasions, office coffee and water service, and supplying an employee break room are ordinary and necessary expenses. Indeed, professional service companies commonly provide such amenities to their staff for precisely the reasons noted in FAR 31.205-21(a) and FAR 31.205-13(a), *i.e.*, to maintain satisfactory relations between the company and its employees, and to improve working conditions, employer-employee relations, employee morale, and employee performance.

Third, the draft audit report asserts that DCCS did not demonstrate that the costs are allocable to the contract. These costs are allocable to the contract because they were incurred for the benefit of the DCCS employees working on the contract. The costs are therefore allocable to the contract under FAR 31.201-4(a).

Internal Controls

Finally, the draft audit report asserts that DCCS did not (a) have adequate internal controls to ensure that it properly followed its policy for classifying full-time employees, (b) maintain adequate supporting documentation, and (c) have adequate procedures to ensure that the costs claimed under the contract were allowable. Because the draft audit report is incorrect in its contentions that the full-time employees are ineligible for fringe benefits, and that the allowable employee morale and welfare costs are unallowable, it follows that the draft audit report is also wrong in asserting that DCCS lacks adequate internal controls. However, even assuming for the sake of argument that $315,640 of the claimed costs under the contract were unallowable (which they were not), it would still represent less than 2¾ percent of the costs claimed. Internal controls need not be perfect, they need only be adequate. The draft audit report itself concedes that DCCS "generally claimed costs under the contract that were accurate, allowable and reasonable," and of the $11,512,458 in costs claimed, the auditors determined that $11,196,818 was allowable under the terms of the contract and Federal regulations. Accordingly, even if the draft audit report were correct in its first three allegations (and it is not for the reasons discussed above), there would still be no basis for a finding that DCCS lacks adequate internal controls.

Although we concurred with the proposed disallowed costs for the automobiles and certain minor telephone expenses, we do not concur that any monies are now due and owing to CMS, if ever. The allowable contract costs are yet to be finalized with CMS and, we believe that once they are finalized, the CMS will find that DCCS has significantly under-billed their allowable contract costs.

Sincerely,

/James M. Douglas, Jr./

President and Chief Executive Officer