



DEPARTMENT OF HEALTH AND HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL

WASHINGTON, DC 20201



March 5, 2012

TO: Marilyn Tavenner
Acting Administrator
Centers for Medicare & Medicaid Services

FROM: /Gloria L. Jarmon/
Deputy Inspector General for Audit Services

SUBJECT: Southern California Renal Disease Council, Inc., Claimed Unallowable and Unsupported Costs Under Medicare Contract Number 500-03-NW18 (A-09-10-02045)

Attached, for your information, is an advance copy of our final report on costs claimed by Southern California Renal Disease Council, Inc. (Council), to administer the end-stage renal disease Network Organization Program as a Federal contractor. We will issue this report to the Council within 5 business days. The Centers for Medicare & Medicaid Services, Office of Acquisition and Grants Management, requested that we conduct this contract closeout audit.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact Brian P. Ritchie, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through email at Brian.Ritchie@oig.hhs.gov or Lori A. Ahlstrand, Regional Inspector General for Audit Services, Region IX, at (415) 437-8360 or through email at Lori.Ahlstrand@oig.hhs.gov. Please refer to report number A-09-10-02045.

Attachment



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

March 7, 2012

Report Number: A-09-10-02045

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 500-03-NW18*. 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-09-10-02045 in all correspondence.

Sincerely,

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

Enclosure

Direct Reply to HHS Action Official:

Mr. Daniel F. Kane
Director
Office of Acquisition and Grants Management
Centers for Medicare & Medicaid Services
Mail Stop C2-21-15
7500 Security Boulevard
Baltimore, MD 21244-1850

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 500-03-NW18**



Daniel R. Levinson
Inspector General

March 2012
A-09-10-02045

Office of Inspector General

<http://oig.hhs.gov>

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

Office of Audit Services

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

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

Office of Investigations

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

Office of Counsel to the Inspector General

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

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC

at <http://oig.hhs.gov>

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.

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. According to CMS's *Medicare ESRD Network Organizations Manual*, the networks are responsible for "conducting activities in the areas of quality improvement, community information and resources, administration, and information management."

Southern California Renal Disease Council, Inc. (Council), a nonprofit organization, is one of the 18 networks. The Council administers the program for an area covering 13 California counties. 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 \$2,623,686 of the \$2,749,010 that the Council claimed under Medicare contract number 500-03-NW18, which is a cost-reimbursable contract for the period July 1, 2003, through June 30, 2006. We did not review fixed fees of \$125,324.

CMS requested that we conduct this contract closeout audit. The Council used provisional rates based on estimated costs when calculating fringe benefits and indirect costs that it claimed for reimbursement. 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 \$2,623,686 of costs we reviewed, \$352,262 was allowable under the terms of the contract and pursuant to applicable Federal regulations. The remaining \$2,271,424 consisted of \$19,996 in travel costs and other direct costs that we determined were unallowable and \$2,251,428 that we set aside for CMS resolution. The \$2,251,428 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 using provisional rates based on estimated costs 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 \$19,996 for unallowable travel and other direct costs,
- work with CMS to determine the allowability of \$2,251,428 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 the third recommendation. The Council's comments are included in their entirety as Appendix B.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
End-Stage Renal Disease Network Organization Program	1
Southern California Renal Disease Council, Inc.	1
OBJECTIVES, SCOPE, AND METHODOLOGY	2
Objectives	2
Scope.....	2
Methodology	2
FINDINGS AND RECOMMENDATIONS	3
SALARIES AND WAGES	4
FRINGE BENEFITS	4
INDIRECT COSTS	6
CONSULTANTS	7
TRAVEL	7
OTHER DIRECT COSTS	8
LACK OF ADEQUATE CONTROLS	9
RECOMMENDATIONS	9
AUDITEE COMMENTS	9
OTHER MATTERS	9
REQUIRED ANNUAL SINGLE AUDIT	9
PROCUREMENT POLICIES AND PROCEDURES	10
APPENDIXES	
A: SCHEDULE OF COSTS CLAIMED AND RESULTS OF AUDIT FOR THE PERIOD JULY 1, 2003, THROUGH JUNE 30, 2006	
B: 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. According to CMS's *Medicare ESRD Network Organizations Manual*, the networks are responsible for "conducting activities in the areas of quality improvement, community information and resources, administration, and information management." The networks work with consumers, ESRD facilities, and other providers of ESRD services to refine care delivery systems to ensure that ESRD patients get the right care at the right time.

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's area covers 13 California counties from the Mexico and Arizona/Nevada borders to the central California coastal area and inland. There are 297 member dialysis facilities and 17 renal transplant centers in the area that provide treatment to more than 30,000 dialysis patients and 12,000 transplant recipients.

Under Medicare contract number 500-03-NW18, which is a cost-reimbursable contract, the Council claimed \$2,749,010 for administering the program. Of this amount, \$490,609 was for fringe benefits and \$831,670 was for indirect costs that the Council claimed using provisional rates based on estimated costs. The contract states: "The purpose of this contract is to satisfy the requirements in [Federal directives] ... [for] monitoring, improving, and maintaining the quality of care provided to patients with ESRD." The contract was for the period July 1, 2003, through June 30, 2006.¹ During this period, the Council's primary sources of revenue were two CMS contracts, including the cost-reimbursable contract to administer the program.² In this report, we refer to contract number 500-03-NW18 as "the contract."

¹ The Council had another cost-reimbursable contract with CMS to administer the program for the period July 1, 2006, through September 29, 2010. We will issue a separate report for that contract (A-09-11-02044). As of September 30, 2010, CMS had awarded the Council a fixed-price contract.

² The Council had another cost-reimbursable contract with CMS to provide centralized support for the program for the period September 30, 2002, through September 28, 2006. We will issue a separate report for that contract (A-09-11-02005).

The contract required the Council to comply with Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, and applicable sections of the Federal Acquisition Regulation (FAR). In addition, the contract stated that a contract closeout audit would be performed to determine whether the Council complied with the contract, OMB Circular A-122's cost principles for nonprofit organizations receiving Federal awards, the FAR, and other relevant guidelines.

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 provisional rates based on estimated costs to calculate fringe benefits and indirect costs. 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 \$2,623,686 of the \$2,749,010 that the Council claimed under contract number 500-03-NW18 for the period July 1, 2003, through June 30, 2006. We did not review fixed fees of \$125,324.

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 October 2010 to May 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 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 audited financial statements for the periods July 1, 2003, through June 30, 2004; July 1, 2004, through June 30, 2005; and July 1, 2005, through June 30, 2006;
- 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;³ and
- calculated the fringe benefit and indirect cost rates for each contract 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 \$2,623,686 of costs we reviewed, \$352,262 was allowable under the terms of the contract and pursuant to applicable Federal regulations. The remaining \$2,271,424 consisted of \$19,996 in travel costs and other direct costs that we determined were unallowable and \$2,251,428 that we set aside for CMS resolution. The \$2,251,428 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 using provisional rates based on estimated costs 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., allowable, unallowable, and set-aside amounts.

³ 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.

We calculated fringe benefit and indirect cost rates based on actual costs. See Tables 1 and 2 for the provisional fringe benefit and indirect cost rates that the Council used and our revised rates.

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 \$1,070,573 claimed for salaries and wages, \$90,336 was allowable.⁴ We set aside the remaining \$980,237 for CMS resolution because 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

OMB Circular A-122, Attachment B, subparagraph 8.g.(2), states that fringe benefits can 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(b)(1) states:

For the purpose of reimbursing allowable costs ... the term "costs" includes only—(i) Those recorded costs that, at the time of the request for reimbursement, the Contractor has paid by cash, check, or other form of actual payment for items or services purchased directly for the contract; (ii) When the Contractor is not delinquent in paying costs of contract performance in the ordinary course of

⁴ The \$90,336 of allowable salaries and wages was for three employees for which the Council maintained supporting documentation, such as payroll distribution records and personnel activity reports.

business, costs incurred, but not necessarily paid, for— ... (F) Properly allocable and allowable indirect costs

Of the \$490,609 claimed for fringe benefits,⁵ \$34,819 was allowable.⁶ We set aside for CMS resolution the remaining \$455,790, consisting of:

- \$372,609 that was related to the \$980,237 in unsupported salaries and wages and
- \$83,181 that was the difference between the fringe benefits that the Council claimed using provisional rates based on estimated costs and the fringe benefits that we calculated using rates based on actual costs.

Table 1 illustrates the fringe benefit rates that the Council used to claim fringe benefits, the fringe benefits claimed by the Council, our revised rates based on actual costs, and the fringe benefits calculated by applying the revised rates to the salaries and wages claimed by the Council.

Table 1: Fringe Benefit Rates and Costs

Contract Year	Council Rate (Percentage)	Costs Claimed Using the Council Rate	Revised Rate (Percentage)	Costs Calculated Using the Revised Rate
7/1/2003– 6/30/2004	44.97	\$178,425	40.69	\$161,444
7/1/2004– 6/30/2005	46.95	154,588	38.24	125,910
7/1/2005– 6/30/2006	45.74	157,596	34.85	120,074

⁵ The Council treated the fringe benefits as indirect costs.

⁶ The \$34,819 of allowable fringe benefits was calculated by applying the revised fringe benefit rates (discussed later in this section) to the allowable salaries and wages discussed in the previous section.

INDIRECT 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.”

Of the \$831,670 claimed for indirect costs,⁷ \$85,842 was allowable.⁸ We set aside the remaining \$745,828 for CMS resolution because it related to the \$980,237 in unsupported salaries and wages and \$372,609 of fringe benefits applicable to the unsupported salaries and wages.⁹

Table 2 illustrates the indirect cost rates that the Council used to claim indirect costs, the indirect costs claimed by the Council, our revised rates based on actual costs, and the indirect costs calculated by applying the revised rates to the salaries and wages claimed by the Council and the applicable fringe benefits.

⁷ The Council claimed the indirect costs by using provisional rates calculated as a ratio of the indirect cost pool (i.e., numerator) and the base (i.e., denominator). The indirect cost pool included estimated total facilities and administration costs, and the base included estimated total salaries and wages plus fringe benefits. We revised the indirect cost rates using actual costs.

⁸ The \$85,842 of allowable indirect costs was calculated by applying the revised indirect cost rates (discussed later in this section) to the allowable salaries and wages and fringe benefits discussed in previous sections.

⁹ The amount of set-aside indirect costs was limited to the difference between the amounts of the claimed and allowable indirect costs, because the sum of allowable and set-aside indirect costs calculated based on our revised indirect cost rates was greater than the claimed indirect costs. There were no indirect costs applicable to the \$83,131 of set-aside fringe benefits discussed in the previous section because this amount was not included in the calculation of our revised rates.

Table 2: Indirect Cost Rates and Indirect Costs

Contract Year	Council Rate (Percentage)	Costs Claimed Using the Council Rate	Revised Rate (Percentage)	Costs Calculated Using the Revised Rate
7/1/2003– 6/30/2004	53.23	\$306,174	64.77	\$361,552
7/1/2004– 6/30/2005	52.68	254,892	76.65	348,889
7/1/2005– 6/30/2006	53.89	270,604	69.77	324,166

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).

For the \$10,606 claimed for consultant costs, the Council maintained invoices from the consultants but did not have consultant agreements. According to a Council official, the Council’s previous executive director hired consultants without written agreements. Because there were no consultant agreements, we could not determine the nature and scope of the services provided, the necessity of contracting for the services, or the adequacy of the contractual agreements. Without such documentation, we could not determine the reasonableness of the consultant costs. Therefore, we have set aside the entire amount, \$10,606, for CMS resolution.

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. 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.”

Of the \$70,012 claimed for travel costs, \$44,787 was allowable. The remaining \$25,225 consisted of \$5,593 that we determined was unallowable and \$19,632 that we set aside for CMS resolution:

- The \$5,593 in unallowable costs consisted of travel costs related to board of directors' meetings that were charged as direct rather than indirect costs (\$4,838),¹⁰ costs related to another contract (\$666), and duplicate costs (\$89). Because the minutes of the board of directors' meetings indicated that the board discussed issues related to common or joint objectives of the organization, the \$4,838 should have been charged as indirect costs.
- The \$19,632 that we set aside was for travel costs, for which the Council did not maintain supporting documentation, incurred during the contract year ended June 30, 2004.

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."

Of the \$148,851 claimed for other direct costs,¹¹ \$95,113 was allowable. The remaining \$53,738 consisted of \$14,403 that we determined was unallowable and \$39,335 that we set aside for CMS resolution:

- The \$14,403 in unallowable costs consisted of costs related to board of directors' meetings (\$11,675) and legal fees (\$285) that were charged as direct rather than indirect costs¹² and costs related to a canceled meeting that were refunded to the Council (\$2,443). Because the minutes of the board of directors' meetings indicated that the board discussed issues related to common or joint objectives of the organization, the \$11,675 should have been charged as indirect costs. The legal fees of \$285 were paid to the Council's attorney to review an insurance policy, which is also related to common or joint objectives of the organization. Regarding the \$2,443, the Council prepaid this amount to a vendor for a scheduled meeting and claimed the cost on the public voucher.¹³ The meeting was later canceled, and the vendor refunded the cost to the Council. However, the Council did not credit the public voucher.

¹⁰ We included \$4,838 in the indirect cost pool when calculating the revised indirect cost rates.

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

¹² We included the \$11,675 related to the board of directors' meetings and \$285 related to legal fees in the indirect cost pool when calculating the revised indirect cost rates.

¹³ To claim costs for reimbursement, the Council submitted to CMS the Standard Form 1034, Public Voucher for Purchases and Services Other Than Personal.

- The \$39,335 that we set aside consisted of (1) direct costs claimed during the contract year July 1, 2003, through June 30, 2004, for which the Council did not maintain supporting documentation (\$38,385) and (2) printing costs for which the Council did not maintain documentation to support the allocability of the costs to the contract (\$950).

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 \$19,996 for unallowable travel and other direct costs,
- work with CMS to determine the allowability of \$2,251,428 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 the third recommendation. The Council's comments are included in their entirety as Appendix B.

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, but the audit report did not identify that the audit was conducted in accordance with OMB Circular A-133. Further, the audit report 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 JULY 1, 2003, THROUGH JUNE 30, 2006**

Element of Cost	Claimed	Allowable	Unallowable	Set Aside
Salaries and Wages	\$1,070,573	\$90,336	\$0	\$980,237
Fringe Benefits	490,609	34,819	0	455,790
Indirect Costs	831,670	85,842	0	745,828
Consultants	10,606	0	0	10,606
Equipment	1,365	1,365	0	0
Travel	70,012	44,787	5,593	19,632
Other Direct Costs	148,851	95,113	14,403	39,335
Total Costs	\$2,623,686	\$352,262	\$19,996	\$2,251,428

APPENDIX B: AUDITEE COMMENTS



Southern California
Renal Disease Council
INCORPORATED

ESRD NETWORK 18

January 10, 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-09-10-02045

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 500-03-NW18 dated December 13, 2011.

According to the Summary of Finding, your audit team reviewed \$2,623,686 of costs of which \$352,262 were allowable, allocable and reasonable under the terms of the contract; The remaining \$2,271,424 consisted of \$19,996 in travel costs and other direct cost that were determined to be unallowable; and \$2,251,428 that your audit team set aside for CMS resolution.

The recommendations issued by the audit team are as follows:

- Refund to the Federal Government \$19,996 for unallowable travel and other direct costs,
- Work with CMS to determine the allowability of \$2,251,428 of the set aside funds and refund the amount determined by CMS to be unallowable,
- Strengthen its controls 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 \$19,996 to CMS for unallowable travel and other direct costs.
- SCRDC, Inc. concurs with the recommendation of working with CMS to determine the allowability of the set aside amount of \$2,251,428.
- SCRDC, Inc. has begun implementing policies and procedures that strengthen and improve the control 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.

6255 Sunset Boulevard • Suite 2211 • Los Angeles • California • 90028
(323) 962-2020 • (800) 637-4767 • (323) 962-2891/Fax • www.esrdnetwork18.org

ESRD NETWORK 18

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. 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. 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).

g. Internal Controls

- i. Policies and procedures have been implemented, reviewed, or replaced to insure strict adherence to the Circular A-122 and FAR.

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

Sincerely,

/Harriet L. Edwards/

Harriet L. Edwards, MSW/MSG
Executive Director