This memorandum is to alert you to the issuance on Wednesday, August 19, 1998, of our final report. A copy is attached.

This report presents the results of the audit of the home office cost statement of Staff Builders, Inc. (Staff Builders), for the fiscal year ended February 28, 1994. On its home office cost statement, Staff Builders reported net expenses of $22,806,099 of which $17,541,447 was claimed as the Medicare share of total costs. We found that $6,204,824 of the $22,806,099 included on Staff Builders’ home office cost statement was improperly claimed, resulting in an estimated overstatement of Medicare costs totaling $3,434,274. The actual amount of the Medicare adjustment will be determined by United Government Services when the individual home health agency cost reports are finalized.

The purpose of this audit, under Operation Restore Trust, was to assure that home office costs during the fiscal year ended February 28, 1994 were reasonable, allowable, and allocable under Medicare principles of reimbursement. These objectives were accomplished by combining the audit resources of United Government Services which is the regional home health intermediary and the Office of Inspector General to review the cost statement and documentation supporting the allocation methodology and the expenses claimed. Additionally, we performed a limited review of internal controls during which we obtained an understanding of and evaluated relevant accounting policies and procedures.

The financial results of our review can be grouped into five main categories:

- **HOME OFFICE COST ALLOCATIONS** Home office costs totaling $3,097,674 (Medicare share -$1,356,827) were improperly allocated. Costs totaling $2,446,290 were improperly classified as 100 percent direct Medicare expenses, rather than as pooled expenses to be shared with other Staff Builders components. In addition, improper statistics on the cost statement resulted in overcharges of $65,138 by misstating the allocation bases used to allocate home office costs to the health care providers.
• **COSTS PRIMARILY RELATED TO PRIVATE LINES OF BUSINESS**
  Staff Builders improperly included on the home office cost statement $1,569,682 (Medicare share -$1,082,592) of costs that were primarily related to non-Medicare lines of business including franchise expansion expenses, advertising and sales expenses, and other expenses related to its private lines of business.

• **OTHER UNALLOWABLE COSTS** Staff Builders improperly claimed $864,878 (Medicare share - $559,950) of costs which were not related to patient care or which did not conform to other Medicare allowable cost guidelines. This amount included compensation which was unreasonable, unnecessary, untimely, improperly documented, or not reported to the Internal Revenue Service. It also included legal, consulting, and accounting services related to stockholders and investors.

• **INCOME OFFSETS AND OTHER CLERICAL ERRORS** The cost statement was overstated by $302,637 (Medicare share - $178,559) due to clerical oversights, administrative errors, and expenses which were not properly offset by related rebates and interest income.

• **UNDOCUMENTED EXPENSES** Staff Builders claimed $369,953 (Medicare share - $256,346) in costs whose relation to patient care could not be determined because of missing or inadequate documentation.

Our limited review of internal controls identified significant weaknesses in Staff Builders’ internal control environment. In that regard, we found many of Staff Builders’ accounting policies and procedures were inadequate or unclear, existing policies were not always followed, and internal auditors were not used effectively to identify internal control weaknesses and recommend improvements. Many of our current findings represent repeated instances of weaknesses identified in prior audits.

In summary, we are recommending that reported costs be adjusted downward by $6,204,824, resulting in an estimated reduction of Medicare costs totaling $3,434,274. We are also making procedural recommendations to strengthen controls related to the preparation of future home office cost statements. Staff Builders agreed many of the costs questioned in the draft report were improperly claimed; however, its response also expressed objections to certain findings, particularly with respect to the findings on Costs Primarily Related to Private Lines of Business and Undocumented Expenses.
We wish to thank United Government Services for its efforts on this joint initiative and we believe our collective efforts were another successful demonstration of collaboration under the Operation Restore Trust initiative.

For further information, contact:

Timothy J. Horgan  
Regional Inspector General  
for Audit Services, Region II  
(212) 264-4620

Attachment
AUDIT OF THE HOME OFFICE COST STATEMENT OF STAFF BUILDERS, INC. FOR THE FISCAL YEAR ENDED FEBRUARY 28, 1994
Common Identification Number: A-02-95-0 10 19

Mr. Stephen Savitsky
Chief Executive Officer
Staff Builders, Inc.
1983 Marcus Avenue
Lake Success, New York 11042

Dear Mr. Savitsky:

Enclosed for your information and use are two copies of an Office of Inspector General (OIG) report entitled “AUDIT OF THE HOME OFFICE COST STATEMENT OF STAFF BUILDERS, INC. FOR THE FISCAL YEAR ENDED FEBRUARY 28, 1994.” A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action 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.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG reports issued to the Department’s grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (See 45 CFR Part 5).
To facilitate identification, please refer to the above Common Identification Number in all correspondence relating to this report.

Sincerely yours,

Timothy J. Hargan
Regional Inspector General for Audit Services

Enclosures - as stated

Direct Reply to HHS Action Official:

Ms. Daly Vargas
Associate Regional Administrator
Health Care Financing Administration
U.S. Department of Health & Human Services
105 West Adams Street, Room 16
Chicago, Illinois 60603-6201
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EXECUTIVE SUMMARY

Background

Medicare reimburses home health agencies primarily on the basis of the cost of services rendered to program beneficiaries. The interim payments for services performed are adjusted to cost based on year-end cost reports submitted to regional home health intermediaries. For agencies in a chain organization, these costs include overhead and administrative expenses incurred by the chains home office, subject to cost principles applicable to Medicare providers. In order to evaluate a home health agency’s request for reimbursement of its home office costs, Medicare requires home offices to file cost statements disclosing their total costs and the costs allocable to Medicare home health agencies.

This report presents the results of the audit of the home office cost statement of Staff Builders, Inc. for the fiscal year ended February 28, 1994. For the fiscal year ended February 28, 1994, Staff Builders, Inc. reported on its home office cost statement net expenses of $22,806,099, of which $17,541,447 was claimed as Medicare costs.

Staff Builders was initially established in 1961 to provide supplemental staff to health care facilities and businesses. By the mid-1980s Staff Builders evolved into a major provider of home health care and by 1994 operated 130 offices in 34 states. Though 24 of these offices were owned by Staff Builders, most were operated by franchisees. In 1994, 88 offices in 27 states were certified to provide home health care services to Medicare patients.

Staff Builders’ home office cost statement reports the centralized overhead and administrative costs incurred on behalf of both its home health agencies and its other private lines of business. Medicare requires home offices of such chain organizations to remove unallowable expenses from the total costs before directly assigning costs to the providers or activities which receive the benefits of the expenses. Expenses which cannot be directly assigned are then functionally allocated to distribute costs among the provider and non-provider components or activities receiving the benefits of the costs. Finally, the residual “pool” of costs for general management or administrative services which cannot be allocated on a functional basis is apportioned among the health care facilities and the non-health care lines of business.
Objectives

The purpose of this audit under Operation Restore Trust was to assure that home office costs during the fiscal year ended February 28, 1994 were reasonable, allowable and allocable under Medicare principles of reimbursement. These objectives were accomplished by combining the audit resources of United Government Services, the regional home health intermediary, and the Office of Inspector General to review the cost statement and documentation supporting the allocation methodology and the expenses claimed. Additionally, we performed a limited review of internal controls during which we obtained an understanding of, and evaluated, relevant accounting policies and procedures.

Summary of Findings

We found that $6,204,824 of $22,806,099 included on Staff Builders’ home office cost statement was improperly claimed, resulting in an estimated overstatement of Medicare costs totaling $3,434,274. The results of our review have been grouped into six main categories which are summarized below.

**HOME OFFICE COST ALLOCATIONS** Costs totaling $2,446,290 were improperly classified as 100 percent direct Medicare expenses, rather than as pooled expenses to be shared with other Staff Builders components. This amount includes a $370,500 year-end adjustment to reclassify pooled expenses as direct Medicare expenses based on the unfounded conclusion of a Staff Builders official. In addition, improper statistics on the cost statement resulted in overcharges of $651,384 by misstating the totals used to allocate home office costs to the health care providers.

**COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY** Staff Builders improperly allocated to Medicare $1,569,682 of costs directly related to non-Medicare lines of business. This includes costs either unrelated to patient care or pertaining to profits on related party transactions.

**OTHER UNALLOWABLE COSTS** Staff Builders improperly claimed $864,878 of costs which were not related to patient care or which did not conform to other Medicare allowable cost guidelines. This amount included compensation totaling $398,189 which was unreasonable, unnecessary, untimely, improperly documented or not reported to the Internal Revenue Service. It also included $293,927 for legal, consulting and accounting services related to stockholders and investors.
INCOME OFFSETS AND OTHER CLERICAL ERRORS  The cost statement was overstated by $302,637 due to clerical oversights, administrative errors and inefficiencies, including expenses which were not properly offset by $15,985 of related rebates and interest income, and other clerical errors totaling $286,652, which were chiefly caused by incorrect or improperly authorized journal entries.

UNDOCUMENTED EXPENSES  Staff Builders claimed $369,953 in costs whose relation to patient care could not be determined because of missing or inadequate documentation.

INTERNAL CONTROL STRUCTURE  Our limited review of internal controls identified significant weaknesses in Staff Builders’ internal control environment. In that regard, we found that many of Staff Builders’ accounting policies and procedures were inadequate or unclear, that existing policies were not always followed and that internal auditors were not used effectively to identify internal control weaknesses and recommend improvements. As a result, this section cites many repeated instances of weaknesses identified in prior audits.

Recommendations

In summary, we are recommending that reported costs be adjusted downward by $6,204,824, resulting in an estimated reduction of Medicare costs totaling $3,434,274. We are also making procedural recommendations to strengthen controls related to the preparation of the home office cost statement.

Staff Builders agreed that many of the costs questioned in the draft report were improperly claimed; however, their response also expressed objections to certain findings, particularly with respect to the findings on COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY and UNDOCUMENTED EXPENSES. Subsequent to issuance of the draft report, several findings were revised based on evaluation of additional evidence provided by Staff Builders. Staff Builders’ Comments and the OIG Responses are summarized at the end of each finding in this report; in addition, a copy of Staff Builders’ formal response appears at Appendix E.
This report presents the results of an audit of the home office cost statement of Staff Builders, Inc. for the fiscal year ended February 28, 1994. The cost statement allocated administrative and overhead costs of $22,806,099 among Staff Builders' home health agencies and its other lines of business.

The primary objective of the audit, which was conducted jointly with United Government Services, the regional home health intermediary, was to assure that administrative and overhead costs charged to the home health agencies were reasonable, allowable and allocable under Medicare principles of reimbursement.

**Background**

Medicare reimburses home health agencies primarily on the basis of the cost of services rendered to program beneficiaries. The interim payments for services performed are adjusted to cost based on year-end cost reports submitted to regional home health intermediaries. For agencies in a chain organization, these costs include overhead and administrative expenses incurred by the chain's home office, subject to cost principles applicable to Medicare providers. In order to evaluate a home health agency's request for reimbursement of its home office costs, Medicare requires home offices to file cost statements disclosing their total costs and the costs allocable to Medicare home health agencies.

Staff Builders was initially established in 1961 to provide supplemental staff to health care facilities and businesses. By the mid-1980s Staff Builders evolved into a major provider of home health care and by 1994 operated 130 offices in 34 states. Though 24 of these offices were owned by Staff Builders, most were operated by franchisees. In 1994, 88 offices in 27 states were certified to provide home health care services to Medicare patients. In addition to its home health business, Staff Builders, Inc. includes other business lines, such as personnel agencies, management and other consultants and a centralized supply purchasing division.

Staff Builders reported record revenues and earnings in fiscal 1994, a period for which 94 percent of total revenues related to home health care. For fiscal 1994, the Medicare home health program accounted for 53.5 percent of the total revenues. Management noted a 49.3 percent increase in Medicare revenues between fiscal 1993
and 1994 which it attributed primarily to a significant rise in the number of offices certified to provide services to Medicare patients and an increased demand for those services.

Staff Builders’ home office cost statement includes overhead and administrative costs incurred on behalf of both its home health agencies and its other private lines of business. In preparing the cost statement, Medicare instructs home offices of chain organizations such as Staff Builders to first remove unallowable expenses from their total costs. The allowable costs are then directly assigned to the providers or activities which receive the benefits of the expenses. Expenses which cannot be directly assigned must be allocated on a “functional basis” designed to equitably distribute costs among the provider and non-provider components or activities receiving the benefits of the costs:

*For example, costs of a central payroll operation could be allocated to the ‘chain components based on the number of checks issued; the costs of a central purchasing function could be allocated based on purchases made or requisitions handled.*

Finally, the residual “pool” of costs incurred for general management or administrative services which cannot be allocated on a functional basis must be apportioned to the health care facilities and the non-health care lines of business on an appropriate basis approved by the Medicare intermediary. Medicare’s forms for the home office cost statement separately report the directly assigned, functionally allocated and pooled costs; a summary worksheet combines these allowable expenses with the unallowable expenses to report the total expenses.

**Objectives, Scope and Methodology**

The audit was conducted in accordance with generally accepted government auditing standards for financial-related audits, except that we limited the testing of data from the computer-based accounting system to a comparison of data to source documents, tests of mathematical accuracy, and reconciliation of cost totals to the cost statement and the certified financial statements. The purpose of the audit was to assure that costs included on the home office cost statement and charged to the home health agencies during the fiscal year ended February 28, 1994 were reasonable, allowable
and allocable under Medicare principles of reimbursement. These objectives were accomplished by combining the audit resources of United Government Services and the Office of Inspector General, Office of Audit Services, to judgmentally select invoices, expense vouchers and journal entries for review, to examine appropriate supporting documentation and to evaluate the reasonableness and propriety of cost allocations. In instances where the supporting documents were inconclusive or required further explanation, data analysis and inquiry of Staff Builders officials were conducted. In addition, although a complete assessment of the internal control structure was not made, we performed a limited review of internal controls during which we obtained an understanding of the accounting policies and procedures relevant to the audit objectives.

Field work was conducted at Staff Builders’ corporate headquarters in Lake Success, New York from September 1995 through March 1996 with additional work performed thereafter by the Office of Audit Services in New York City and United Government Services in Valhalla, New York. The results of the audit were discussed with Staff Builders officials as work was completed and relevant comments are included in the discussions of the findings. After the draft report was issued, Staff Builders’ response (June 1997) indicated that significant additional audit evidence would be made available. Review of the additional evidence between June 1997 and February 1998 resulted in substantial revisions to the findings, as noted in the discussions of “Staff Builders Comments” and the “OIG Response” in the FINDINGS AND RECOMMENDATIONS section.

FINDINGS AND RECOMMENDATIONS

The results of this joint initiative indicate that $6,204,824 of the total net costs of $22,806,099 on the home office cost statement was improperly claimed and resulted in an overstatement of Medicare cost totaling $3,434,274. A detailed discussion of our findings and recommendations follows.
HOME OFFICE COST ALLOCATIONS

As explained at Health Insurance Manual (HIM) 15-1 § 2150, home offices of chain organizations are not directly reimbursed by the Medicare program since they are not the actual providers of health care services. Instead, the home office costs of furnishing centralized management and administrative services are allocated to their Medicare-certified providers who then claim reimbursement for both their direct costs and their allocated home office costs.

The allocation of home office costs, as described at HIM 15-1 § 2150.3, requires the home office-to first determine total allowable costs by deducting costs unallowable under the Medicare program from the total costs. Total allowable home office costs are then allocated in the following order:

1. Costs benefitting a specific provider are directly assigned to that entity;

2. Costs which do not benefit a specific provider are functionally distributed using an equitable allocation basis (e.g., labor hours for payroll, square feet for space rental);

3. The residual expenses remaining after the functional cost allocations are pooled and allocated between the health care and non-health care lines of business.

The audit results indicate that Staff Builders classified pooled expenses improperly and calculated the allocation statistics inappropriately, as discussed below.

**Pooled Expenses**

The audit revealed that $2,446,290 of expenses directly assigned or functionally allocated to Medicare home health agencies also benefitted Staff Builders’ other lines of business. Since these entities shared the home office services, an equitable distribution must be achieved through a pooling of the home office costs. The inappropriately allocated costs consist of:
First, a review of job descriptions, performance evaluations and inquiry of Staff Builders officials indicates that $1,684,876 of payroll and fringe benefit costs should have been pooled since these employees serviced Staff Builders’ entire health care operations and/or the entire Staff Builders’ organization. This amount includes:

- $773,334 directly assigned to Medicare for employees who work for both Medicare and other activities such as non-Medicare providers, corporate planning and the managed care program;
- $370,500 reclassified at year end from pooled expenses to direct Medicare expenses. These employees’ non-Medicare functions included work for non-Medicare providers, the franchising program, the accounting department and special projects;
- $360,808 for employees of the Quality Assurance Branches and the National Director of Quality Assurance who monitor performance and assist in the accreditation of providers throughout Staff Builders’ health care operations, and
- $180,234 for two employees whose work pertained to the nationwide health care operations, rather than exclusively to Medicare.

In addition, expenses totaling $508,321 which were directly assigned to the quality assurance and nationwide health care operations should have been included in the pooled allocations for the reasons stated above. This consists of travel and office expenses in the amount of $486,486 and other expenses totaling $2,1835 for these employees or branches. The latter amount includes temporary personnel costs, advertising to recruit employees, dues and subscriptions.
Staff Builders also misclassified $206,246 in consultant costs which should have been pooled. The misclassified expenses include $157,606 for legal and accounting costs which were not reviewed by Staff Builders to determine their relationship to the Medicare program before they were posted to departments charged to Medicare, $25,894 for the physician who serves as the Medical Director for the entire health care operation and $22,746 for a consultant to streamline the billing systems used for all of Staff Builders’ providers.

Subscriptions, memberships and training expenses and their related travel totaling $38,122 were also misclassified. This consists of memberships, conferences and training for organizations such as the National Association of Home Care, the Case Management Society of America and the National Association of Social Workers as well as oft&automation training and other regional meetings sponsored by Staff Builders. Review of conference agendas and registration packages indicated that these activities provide benefits to all of Staff Builders’ health care programs, rather than solely to the Medicare program.

Finally, Staff Builders incurred expenses of $8,725 in preparing for compliance audits, accreditation reviews and internal training which related to the health care operations in general, rather than specifically to Medicare.

The improper classification of pooled expenses resulted primarily from the failure to consider the type of work performed by various branches and employees or the nature of specific expenses when posting items to the accounting records and grouping accounts for cost reporting purposes. The $370,500 year-end reclassification of pooled expenses to directly assigned departments, however, was based on the unsupported, and apparently unfounded, conclusion of an official involved in preparing the home office cost statement.

**Allocation Statistics**

The review also determined that the statistics distributing home office costs to Staff Builders’ home health agencies did not conform to the Health Care Financing Administration (HCFA) guidelines on cost allocations. For example, although costs of the Contract and Insurance Billing Departments are excluded from Medicare reimbursement under Staff Builders’ approved allocation plan, Staff Builders improperly removed only the direct costs of these departments from the home office cost statement. Accordingly, the indirect home office management and administrative
costs for these departments were inappropriately reassigned to other activities reimbursable, in large part, by Medicare.

Furthermore, the HIM 15-2 § 3 104 provides guidance on allocating direct, functional and pooled home office costs. For example, HIM 15-2 § 3104.D states that after the initial allocation of pooled costs between health care and non-health care activities, the health care costs must be redistributed to the individual health care providers (e.g., the home health agencies). To effect a proper distribution of the health care costs, home offices must limit the data to the providers’ direct costs for the period covered by the home office cost statement. Staff Builders’ data, though, included all allocated home office costs, resulting in a duplicate allocation of functional and pooled home office expenses to the providers.

Overcharges to the Medicare program resulting from the use of improper allocation data relate to:

1. Schedule G, Part I did not reconcile to records of Staff Builders’ total costs; ..

2. Schedule G, Part I data allocating costs between health care and non-health care activities understated the non-health care component, and

3. Provider data distributing costs in Schedule G, Part II overstated the allocation of home office costs to the providers.

The allocation statistics in Schedule F-l were also misstated.

The improper allocation statistics resulted in overcharges totaling $65,1384 to the Medicare program. These overcharges are attributed to inattention to the appropriate Medicare guidelines in Staff Builders’ written accounting procedures and the lack of a control to assure that cost statistics used to allocate home office costs are consistent with cost allocation principles and the unadjusted cost data furnished by the health care providers.

**Recommendations**

With respect to the findings on home office allocation issues, we are recommending correction of the improper allocations which will reduce costs by $3,097,674
($1,356,827 estimated Medicare effect). Additionally, we recommend that Staff Builders:

- adopt policies to consider the nature of the work performed, or the specific activity or expense billed, at the time transactions are initially entered into the accounting system;
- assure that indirect home office costs for the Contract and Insurance Billing departments are properly excluded from allocable home office costs;
- properly exclude allocated home office costs from the data which allocates these same costs to the health care providers, and
- adopt written procedures and appropriate controls to assure that allocation statistics on the home office cost statement will be properly stated.

Staff Builders Comments

Staff Builders generally concurred with the reported findings on Pooled Expenses. They disagreed, however, with the proposed reclassification of $56,047 in salary and fringes for the Director of Certified Quality Assurance, stating that the position relates exclusively to the Medicare program.

Staff Builders also generally concurred with the recommendations on Allocation Statistics but disagreed with the assertion that indirect home office management and administrative costs relating to the Contract and Insurance Billing Departments required an adjustment to the non-health care component of Schedule G, Part I. Management also responded that, pursuant to discussions with UGS, they modified their cost allocations effective fiscal 1996 to comply with the audit recommendations. The full text of the auditee comments with respect to HOME OFFICE COST ALLOCATIONS is included in Appendix E.

OIG Response

We reviewed the personnel files of the Director of Certified Quality Assurance to address Staff Builders’ concerns about the Pooled Expenses. Since this review indicated that the work objectives included development of the quality assurance function for non-Medicare providers, we believe that the reclassification is proper.
Regarding the comments on Allocation Statistics, it is noted that Staff Builders assigns indirect costs of the Medicare division to Medicare providers and assigns pooled expenses to the Medicare providers through the Schedule G allocations. The contested Schedule G adjustment applies Staff Builders' allocation methodology for the Medicare division to the Contract and Insurance Billing Department, in order to make the cost allocations consistent and equitable. It is also noted that preliminary examination of the cost allocations for fiscal 1996 indicate only partial compliance with the recommended procedures.

COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY

The audit also indicated that the home office cost statement claimed reimbursement for items related primarily to Staff Builders’ private lines of business or profitability. Expenses totaling $1,569,682, consisting of amounts relating to franchising, investment, and private side activities, as well as costs for marketing, transactions with related organizations and acquisitions and reorganizations, were found to be unallowable for the reasons discussed below.

Franchise and Investment-Related Expenses

Analysis indicated that $928,551 of Staff Builders’ franchising and investment related expenses do not conform to patient care guidelines at HIM 15-1 §§ 2102.2 and 2150 because the costs were incurred primarily to improve corporate cash flows and profits and/or to reduce corporate risk. Furthermore, HCFA guidelines at HIM 15-1 §§ 2100 and 2540 to 2545.2 limit home health agencies’ reimbursement to the reasonable and necessary cost of services covered by Medicare, thus excluding expenses incurred to increase profits.

Franchising Program

In the letter to shareholders included with the financial statements for the audit period, Staff Builders’ management cited the franchising operation as a main objective. The letter noted that 22 franchises (i.e., individual home health care agencies or groups of agencies) were sold during the fiscal year ending (FYE) February 28, 1994. Our review indicates that these initiatives were apparently emphasized to improve cash flows and profits and to reduce risk for the franchisor (Staff Builders’ home office). For example, the franchisor:
o receives cash from franchisee down payments and notes;

o collects all franchisee receivables and withholds a portion of gross profits from amounts distributed to franchisees;

o achieves economies of scale by spreading home office costs among additional providers while avoiding the cost of owning and operating its own branches, and

o earns profits on materials which only it, or its affiliates, is prepared to sell to franchisees.

As the key player in the program, the Franchise Relations Department assumes different roles as Staff Builders searches for, identifies and secures franchisees. The cycle begins with advertisements and seminars attracting investors to manage and operate home health care agencies in an exclusive franchise territory. The investment opportunities range from the acquisition and operation of new facilities to the transfer of Staff Builders-owned agencies to franchisees. As prospective investors are identified, the department distributes, prepares, evaluates and signs franchise agreements. Once a franchise is established, the department resolves franchisee inquiries by coordinating with, or referring matters to, appropriate regional and home office representatives. For example, questions about the Medicare cost report would generally be referred to the Medicare Administration Department at the home office.

Thus, the chief purposes of the Franchise Relations Department are to obtain investors, service investor interests and act as a liaison between franchisees and other corporate and regional departments. These functions do not meet the requirements of HIM 15-1 § 2 150 which limits reimbursable franchisee costs to the reasonable costs of services related to patient care. In addition, HIM 15-1 § 2 135.3 D[4]{2} states that costs associated with "exclusive franchise rights to a particular territory, promotion or sale of a franchise, etc. . . ." are not allowable. Further, an investor’s apparent objective would be to realize a profit from non-Medicare business since Medicare only reimburses an investor’s reasonable costs. Finally, to the extent that the Franchise Relations Department assists in the transfer of existing Staff Builders agencies to, from, or among franchisees, the activity would constitute unallowable corporate reorganization costs under HIM 15-1 § 2 134.10.

Consequently, the entire $717,955 cost of the Franchise Relations Department is considered unallowable. In addition, $90,796 in bonus and commission expenses
transferred from the Franchise Relations Department for cost reporting purposes only, but apparently relating to departmental employees, is recommended for adjustment.

Finally, the following franchise program costs totaling $100,929 are unallowable:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriptions to investigate credit standing of potential franchisees; cost also appears unreasonably high for a year when only 22 franchises were opened</td>
<td>$33,445</td>
</tr>
<tr>
<td>Legal costs for franchise acquisitions</td>
<td>32,015</td>
</tr>
<tr>
<td>Franchise registrations and filings to expand into new geographic areas</td>
<td>15,000</td>
</tr>
<tr>
<td>Franchise agreements</td>
<td>7,524</td>
</tr>
<tr>
<td>Personnel, advertising and shipping costs incurred to coordinate sales, marketing and promotional efforts of the Franchise Relations Department</td>
<td>7,543</td>
</tr>
<tr>
<td>Subscription to plan franchise opportunities</td>
<td>5,402</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$100,929</strong></td>
</tr>
</tbody>
</table>

Staff Builders generally disagreed with the findings about the Franchising Program; their comments are summarized at the end of this section.

*Investment-Related Expenses*

Unallowable expenses apparently incurred to facilitate investment decisions and improve profitability totaled $18,871. This included $13,852 for subscriptions to two stock reporting services, $1,699 for meals with investment bankers and a member of the press, $1,495 for a customized industry newsletter discussing competitors’ financial position and expansion plans, and $1,825 for memberships in an industry clearinghouse which distributes profits to its members and for an organization
apparently related to lines of business other than home health and focused on issues unrelated to patient care. As previously discussed, costs incurred to increase profits are not allowable. Furthermore, membership in an organization bearing little or no relationship to the organization’s field of health care activity does not meet the test of allowable membership costs at HIM 15-1 § 2138.

Unallowable franchise and investment-related costs appeared on the home office cost statement mainly because Staff Builders has no written accounting policies on determining whether costs are covered by Medicare and provides no formal training to employees who code bills for reimbursement purposes. To a lesser extent, some of the items were claimed because Staff Builders contends that certain of the costs should be allowed.

Staff Builders concurred with the findings regarding Investment-Related Expenses; the full text of their comments on this matter are included as Appendix E of this report.

**Private Side Activity**

Staff Builders improperly included billing, payroll, travel, management and tax costs of its private lines of business totaling $291,805 on its home office cost statement. Such costs are not allowable according to HIM 15-1 § 2150.

For example, under HCFA guidelines at HIM 15-1 §§ 2102.1 and 2110, only billing costs for patients covered by the program may be apportioned to Medicare. Staff Builders’ allocation plan and written policies, therefore, specifically propose that the Contract and Insurance Billing Departments, which only deal with self-pay patients and third party payors other than Medicare, should be excluded from Medicare costs. Although Staff Builders removed $687,893 of reported Contract and Insurance Billing costs to implement its allocation plan, the adjustment did not include the following expenses:
The salaries and benefits omitted from Staff Builders’ adjustment pertain to employees working on behalf of the Contract Billing Department, including an employee transferred to this department after the start of the fiscal year. Staff Builders also failed to allocate any travel or utilities costs to the Contract Billing Department and did not remove costs for recruiting and hiring employees for the Insurance Billing Department. Finally, costs to confirm the credit standing of potential non-Medicare patients for these departments are not reasonable and necessary under HCFA guidelines at § 400 of the Home Health Agency Manual (HIM 11) and should have been removed to conform to the approved allocation plan.

Similarly, Staff Builders did not separately identify and accumulate the unallowable costs incurred in providing management services to outside parties. For instance, during the FYE February 28, 1994, Staff Builders opened the Advanced Management Solutions (AMS) division to provide management and other services to hospitals, subacute care facilities and nursing homes. The home office did not, however, take steps to assure that all AMS costs could be identified and removed from the cost statement. As a result, $100,147 in salary, fringe benefits, travel and other costs for employees hired by or transferred to AMS during the fiscal year are recommended for disallowance. For the reasons cited above, Staff Builders was also unable to identify the cost of management services provided to a skilled nursing facility or to provide verifiable documentation that these costs were excluded from the cost statement. Accordingly, in lieu of cost information, we are recommending that the costs be reduced by the $50,000 income from those management services.
In addition, Staff Builders improperly claimed $16,747 for the following private side activities:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes, tax penalties and interest for Staff Builders Services, Inc., a private line of business which provides temporary staffing services</td>
<td>$11,462</td>
</tr>
<tr>
<td>Travel and messenger services to “private side” (non-certified) branches which cannot service Medicare patients under the conditions of participation at HIM §112A and 203</td>
<td>3,895</td>
</tr>
<tr>
<td>Registration for two employees as “Managed Care Organization Executives” at a conference apparently related to the private AMS or Adultcare’ businesses since none of the sessions addressed home health agency services</td>
<td>$1,390</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$16,747</td>
</tr>
</tbody>
</table>

The claiming of costs relating to non-Medicare lines of business is mainly attributable to the fact that there was no department code (branch) to which non-allocable costs could be posted as expenses were incurred. Instead, Staff Builders attempted to identify such costs at year end and adjust the books of account and the cost statement at that time. Based on discussions during audit field work, Staff Builders agreed to modify the accounting system by establishing department codes to capture these expenses as they are posted. As for payroll costs specifically, however, Staff Builders acknowledged that allocations are often based on initial employee assignments and there is no systematic check to assure that allocations are updated when personnel transfer to other departments.

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1 Staff Builders acquired Adultcare during the audit period to develop managed care products for the long term care market.
Staff Builders concurred with the reported findings on Private Side Activity, except for the questioned costs of the Contract and Insurance Billing Departments. Their comments are more fully discussed at the end of this section.

**Marketing Expenses**

The home office cost statement included costs related to promoting Staff Builders and increasing the utilization of its services. Such costs are not related to patient care under Medicare guidelines. Accordingly, $243,044 claimed for advertising and sales efforts, including promotional items, meetings and training on how best to market Staff Builders’ services, should be disallowed.

*Advertising and Other Sales Efforts*

Unallowable costs for advertising and other sales efforts in the amount of $219,967 include payroll and travel expenses, booths, meetings, promotional items, recruitment efforts and preparation of proposals to increase utilization of Staff Builders’ services. For example, although Medicare pays for home health-intake coordination activities, patient solicitation and discharge planning are unallowable coordination activities according to HIM 15-1 §§ 2 113 to 2 113.3. Consequently, salary, fringe, office expense and travel costs totaling $162,792 for three employees engaged in increasing patient utilization through telemarketing and other means, are not reimbursable.

Similarly, the $44,522 cost for toll-free telephone lines and journal advertisements and promotional items such as toothbrushes, lunch bags and calendars featuring Staff Builders’ toll-free telephone number is unallowable per HIM 15-1 § 2 136.1 which requires that advertising costs relate to patient care. The remaining costs, totaling $12,653, found to be unallowable per HIM 15-1 §§ 2102.2 and 2136 to 2136.2, are discussed in further detail at Appendix A.

*Conferences and Training Sessions*

Staff Builders claimed $23,077 for meeting and training costs which are not considered allowable under HCFA guidelines at HIM 15-1 §§ 2 102.3 and 2 136.2. We found that such costs are not necessary and proper costs of developing patient care activities but rather, costs primarily designed to increase utilization of Staff Builders’ services.
Of primary concern in this regard is Staff Builders’ Strategic Marketing Unit (SMU) which sponsored several meetings for employees throughout the country during the audit period. Home office expenses for the SMU included meeting rooms, catering services, audio-visual equipment, stationery and travel costs totaling $21,597. The primary purposes of the SMU relate to assessing local markets, determining competitive position, identifying market opportunities or threats and providing strategies to develop new business. The secondary purposes are to provide a forum to share the ideas with other offices and monitor the results. The only purpose related to patient care is training on new home care services and programs which, in this context, appears to focus on marketing the services, some of which (e.g., the adult residential program, the New Moms’ program) are not even covered by Medicare. The remaining unallowable costs for conferences and training sessions, totaling $1,480, are discussed at Appendix A.

The primary reason that these costs were claimed is that Staff Builders has no written accounting policies or other systems to assure that non-covered costs are not charged to Medicare. To a lesser degree, however, Staff Builders officials consider that some of the costs for conferences and promotional items are allowable.

Staff Builders generally concurred with the findings on Marketing Expenses but objected to the disallowance of certain training costs. Their comments are summarized at the end of this section.

Transactions with Related Organizations

Staff Builders’ related organizations include the corporation’s supply house, Professional Detail Services, its personnel agency and the company-owned and franchised home health agencies. In addition, the principals of Staff Builders are the majority stockholders of Offset House, a printing business whose chief customer is Staff Builders. Organizations related to a provider through common ownership or control may not profit from transactions with the provider under Medicare guidelines at HIM 15-1, Chapter 10; further, these relationships must be fully disclosed under HCFA regulations at HIM 15-2 § 1102 and 42 CFR 420.206. The audit results, however, indicate that Staff Builders overstated the cost of related party transactions by $54,810 and did not fully disclose certain relationships. In addition, unallowable expenses were included in the payments to related organizations.

The audit raised concerns about transactions with Staff Builders Personnel Services (SPS), a related organization which provides temporary secretarial, clerical, data
processing and marketing personnel to other Staff Builders entities and outside parties through one company-owned and two franchised offices. This segment accounted for 1 percent of corporate revenues for the FYs 1992 through 1994. The SPS costs included related organization profits as well as other items improperly charged to Medicare totaling $54,810.

As noted by the United Government Services (UGS) audits of FY 1992 and FY 1993 costs, SPS's billings to the home office included a profit factor which was not removed from the home office cost statement. Specifically, SPS's charges exceeded their cost of providing the services by $44,901 according to a calculation provided by Staff Builders and verified by the auditors.

The home office was also found to have improperly claimed SPS costs related to services performed for a particular supervisor. Although Staff Builders had allocated all of this supervisor’s expenses to Medicare, audit examination revealed that the individual’s effort was split evenly between Staff Builders’ health care operations and its private lines of business. Consequently, only half of the SPS efforts under this individual’s supervision should have been allocated to the health care operations. The remaining half of these costs, or $4,251, relates to private lines of business and should be excluded from costs allocable to Medicare under the guidelines at HIM 15-1 § 2102.2.

Staff Builders also improperly paid and reported on its cost statement $5,658 for SPS agency billing forms which were not signed by the temporary employees. This amount was not payable by SPS according to the billing form which states that a temporary employee "... cannot be paid without a time sheet, your signature and client’s” Further, Staff Builders failed to act prudently or in accordance with its own written accounting policies in paying an improperly authorized document.

The adjustment of SPS profits is necessitated by Staff Builders’ policy of presenting their calculation of SPS profits to the regional home health intermediary auditors for adjustment of the cost statement rather than making the adjustment prior to submitting the cost statement. Improper claiming of the other SPS costs is attributed to lack of attention to the supporting documents when charging items to Medicare.

The audit identified a problem with respect to disclosure of the ownership of branches and franchises related to Staff Builders. As a condition of participation in the Medicare program, guidelines in the Regional Office Manual § 10 16 and the State Operations Manual § 2710 (B)[2] require certified home health agencies to disclose their ownership on HCFA Form 15 13 during periodic State surveys. Review of
Forms 15 13 maintained at Staff Builders’ home office indicate that 20 percent of the forms contained outdated information which did not properly disclose the current ownership while another 12 percent were either undated or unsigned, indicating that the forms may also be outdated or otherwise out of compliance with conditions of participation. Although we did not determine whether Forms 15 13 on file at the home office match those on file with governmental authorities, the results of the review indicate inadequate home office oversight of branch and franchise operations with respect to HCFA’s conditions of participation.

Staff Builders concurred with the findings on Transactions with Related Organizations as reported above. Their comments are summarized at the end of this section. We note that the issues raised in the draft report about Professional Detail Services (PDS) and Offset House are under continuing review and have been removed from this report pending final resolution by the Office of Inspector General.

**Acquisition and Reorganization Costs**

Staff Builders claimed $5 1,472 for unallowable acquisition and reorganization costs’ relating to certificate of need applications, licenses and trademarks.

Certain jurisdictions require a certificate of need (CON) in order to establish a franchise or open a home health agency within their borders. During the audit period, Staff Builders claimed $32,982 for CON applications which were denied and $10,385 for a CON application for a home health agency which never opened. These are unallowable home office planning costs under Medicare guidelines which distinguish between costs of expanding an existing provider and costs of expanding the chain organization itself. With respect to the latter, the discussion at HIM 15-l §§ 2150 and 2154 clarifies that when a home office abandons plans to expand the chain organization, costs of the abandoned plans are unallowable. An additional $8,105 in unallowable acquisition and reorganization costs includes meeting and legal costs discussed in further detail at Appendix B. These costs were apparently allocated to Medicare because of Staff Builders’ lack of written policies on Medicare coverage guidelines.

Staff Builders concurred with the findings on Acquisition and Reorganization Costs; their comments are summarized at the end of this section.
Recommendations

We recommend that costs reported be reduced by $1,569,682 ($1,082,592 estimated Medicare effect) to eliminate costs related to Staff Builders’ private lines of business or profitability. It is also recommended that Staff Builders:

- develop written accounting policies and provide training to furnish guidance on allowable costs and the proper coding of invoices;
- take steps to assure that the accounting department receives timely notification of employee transfers;
- assure that related organization profits are excluded from the home office cost statement;
- improve its written accounting policies to require proper consideration of cost allocations when processing invoices for payment;
- identify and report to UGS any unallowable costs included in the cost statements for fiscal years after the audit period until the appropriate modifications and instructions are fully implemented;
- provide accurate and complete responses to UGS’s questionnaires on related organizations and outside employment, and
- monitor Forms 15 13 for both accuracy and timely submission.

Staff Builders Comments

Staff Builder; commented that the majority of questioned Franchising Program costs are allowable because these are not the typical franchise arrangements described in the Medicare guidelines. They explained that their franchisees act as managers and that, unlike franchisees, these managers have no ownership rights and are not obligated to purchase supplies from Staff Builders. Consequently, the function of the Franchise Relations Department is described as overseeing the managers of its home health agencies. Staff Builders particularly cited the expenses for background checks on potential franchisees, franchise registration and filing fees and advertisements to recruit franchisees as reasonable and necessary costs related to patient care. Finally,
management agreed that the questioned costs for franchise acquisitions, subscriptions and expansions into new territories are not allowable.

As also discussed in the comments about Allocation Statistics, Staff Builders objected to the disallowance of Private Side Activity costs for the Contract and Insurance Billing Departments and reiterated their position that indirect costs of these departments are properly assigned through the Schedule G allocations.

With respect to Marketing Expenses, the auditee did not concur with the proposed disallowance of training costs related to home health programs.

Except as noted above, Staff Builders concurred with the recommendations to assure proper coding of invoices, timely notification of employee transfers, elimination of related organization profits from the home office cost statement and improved monitoring of Forms 15 13.

**OIG Response**

Staff Builders did not address our main concerns about the Franchising Program and the Franchise Relations Department. Although management has asserted that the Franchise Relations Department recruits and oversees branch managers, this line of reasoning ignores the fact that, unlike managers, these franchisees negotiate notes payable to Staff Builders and pay fees in anticipation of receiving something of value, e.g., profits from Staff Builders’ private lines of business. With respect to the specific items which management alleges are allowable, we note that the “background checks” were actually subscriptions to verify the credit standing of potential investors (franchisees), presumably to assure the applicant’s ability and intent to pay the franchise notes to Staff Builders. The registration and filing fees, like the recruitment efforts of the Franchising Program, are unallowable costs which were incurred in order to increase utilization, expand the provider network, and enhance corporate profitability. Finally, we note that a portion of messenger service expenses previously reported as undocumented is now reported as an expense of the Franchising Program.

As previously noted, the proposed disallowance of Private Side Activity costs for the Contract and Insurance Billing Department is consistent with Staff Builders’ assignment of indirect costs for the Medicare division. We also note that a portion of messenger service expenses, previously identified in the draft report as undocumented, is now reported as unallowable Private Side Activity.
After further explanation at the exit conference, Staff Builders concurred that the training costs questioned in the findings on Marketing Expenses are unallowable because the training focused on the marketing of Staff Builders’ services.

We are not addressing the comments about the draft findings on PDS and Offset House previously reported in the section on Transactions with Related Organizations at this time because these matters are under continuing review by the Office of Inspector General.

The full text of management’s comments relating to COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY is included in Appendix E.

OTHER UNALLOWABLE COSTS

The audit also revealed $864,878 in other costs which did not conform to HCFA guidelines. These are expenses in excess of the reasonable compensation guidelines, stock-related costs, tax payments, improperly calculated depreciation expense and other costs not related to patient care.

Compensation Costs

The home office cost statement included compensation totaling $398,189 which was unreasonable, unnecessary, not paid timely, improperly documented or not reported to the Internal Revenue Service (IRS) as required by Medicare guidelines.

In the first place, Staff Builders reported $334,291 in unreasonable compensation; in addition, most of this amount was neither necessary nor paid timely. For instance, salary and fringes amounting to $309,721 during the audit period were paid to Staff Builders’ former president, chief executive officer and director who had resigned in November 1991. That individual is also a Staff Builders shareholder. These payments are neither reasonable nor necessary under HIM 15-1 §§ 902.2 to 902.4 which consider an owner’s compensation reasonable only if it relates to services rendered in connection with patient care and necessary only if the services pertain to the operation of the institution. Further, HIM 15-1 § 906.4 states that compensation unpaid at the end of a cost reporting period is unallowable unless paid within 75 days thereafter. As the individual resigned in November 1991, the payments in fiscal 1994 do not meet any of the above requirements.²

² Based on the significance of this jointly developed issue, UCS also intends to reopen the fiscal 1993 cost statement.
In addition, Staff Builders paid unreasonably high fees to a computer consultant to streamline the billing system. While similar organizations were paying, on average, $370 a day for similar consulting services, Staff Builders paid their consultant $1,000 a day. Since Medicare guidelines at HIM 15-1 §§ 2 102.1 and 2 103 reimburse actual costs only to the extent that the costs do not exceed what a prudent and cost-conscious buyer would pay for a given service, $24,570 found to exceed the reasonable fee for this type of service is considered unallowable.

We also found that Staff Builders did not include $63,898 in fringe benefits on employee W-2s as required by HIM 15-1 § 2144.1 which states that allowable fringe benefits must "... when applicable, have been reported to IRS for tax purposes." These fringe benefits represent company-leased automobiles and other travel expenses ($48,057) as well as moving expenses ($15,841) of management officials. For instance, the home office’s claim for travel allowances and automobile leasing expenses is unallowable due to a lack of appropriate documentation and the failure to report the expenses to IRS on employee W-2 forms. This amount included weekly "travel allowances" to the CEO and the COO and payments for four leased automobiles, including a Jaguar and a Cadillac used primarily by the CEO and the COO for both business and personal use. Since employees are reimbursed for actual travel expenses and an accounting of the above funds was not made to Staff Builders, it was impossible to identify the unduplicated cost related to patient care as required by HIM 15-1 §§ 2 102.2 and 2 102.3. Lacking this documentation, IRS would treat the expenses as payments under a non-accountable plan and would require the entire amount to be reported on employee W-2 forms.³

The home office cost statement also included unallowable calendar year 1993 moving expenses which were not reported on the W-2s of three management officials. Staff Builders also confirmed that they had not issued 1099s for these expenses. Under both the intermediary guidelines on fringe benefits and IRS instructions on moving expenses, reimbursed moving expenses for 1993 had to be included in the employee’s income and reported on Form W-2.⁴ Since these requirements were not met, the moving expenses are unallowable under HIM 15-1 § 2 144.1.

The primary reason that unreasonable compensation was claimed is because Staff Builders’ written accounting policies make no reference to Medicare coverage

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³ IRS Publication 463, 1993

⁴ IRS Publications 17 and 334. 1993 Editions; IRS Instructions for Form W-2, 1993. NOTE that the IRS instructions have been revised for calendar years beginning 1994 and, accordingly, we are not recommending a change in Staff Builders' procedures.
guidelines. The exclusion of travel and moving costs from employee W-2s is attributed to limitations of Staff Builders' accounting system. In that regard, we note that non-payroll costs are processed through the accounts payable system. Though that system cannot generate Form W-2\(^5\), the expenses could have been, but were not, coded to generate a 1099 form. Finally, the lack of proper documentation for travel expenses results from Staff Builders' failure to enforce documentation requirements in its "Policy Manual for Business Related Travel."

Staff Builders generally concurred with the findings on Compensation Costs, but objected to the disallowance of costs for the computer consultant and moving expenses. These issues are discussed in greater detail at the end of this section.

**Stock-Related Costs**

Staff Builders' home office cost statement includes $293,927 of legal, consulting and accounting services related to stockholders and investors. According to the instructions on stockholder servicing costs at HIM 15-1 § 2134.9:

> The following types of costs relevant to proprietary and equity interests of the stockholders, but not related to patient care, are excluded from allowable costs: costs incurred primarily for the benefit of stockholders or other investors, including, but not limited to, the costs of stockholders' annual reports and newsletters, annual meetings, mailing of proxies, stock transfer agent fees, stock exchange registration fees, stockbroker and investment analysis, and accounting and legal fees for consolidating statements for SEC purposes.

Staff Builders reported unallowable expenses in several of the above categories. For example, the home office claimed $85,096 for investor relations services from an outside consultant. In addition, $85,512 in accounting costs were incurred to prepare the annual report, the notice of the annual stockholder meeting and SEC filings for stock registrations and other matters. The unallowable costs also included $17,297 for stock transfer fees and $4,070 for the printing of the SEC filings. Lastly, legal expenses of $100,190 relating to stockholders and expenses of $1,762 relating to subscriptions on securities law and other stockholder matters are considered to be unallowable under the guideline cited above.

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\(^5\) It is, nevertheless, noted that Staff Builders can, and in some of these instances did, include the reimbursements in the employee's payroll checks.
Staff Builders indicated that they claimed these costs principally because they felt that their stock offerings benefitted the Medicare program by lowering reimbursable debt financing costs. To support their position, Staff Builders also cited a precedent\(^6\) in which the U.S. District Court reversed the HCFA Administrator’s disallowance of stockholder servicing costs. Further review, however, indicates that the U.S. Court of Appeals reversed the cited precedent in a decision which specifically ruled that unlike interest expense, stock costs do not relate to patient care.\(^7\) Since the HCFA Administrator has also consistently affirmed the published guideline, it must be applied to the audit period.

Staff Builders raised no objections to the reported findings on Stock-Related Costs; a summary of their comments appears at the end of this section.

**Tax Payments**

Staff Builders improperly reported $57,786 relating to unallowable costs for taxes, tax penalties and late charges.

Unallowable taxes listed at HIM 15-1 §§ 2122.2 and 2122.4 include franchise taxes based on net income as well as:

- **A. Federal income and excess profit taxes, including any interest or penalties paid thereon.**
- **B. State or local income and excess profit taxes.**

In repeatedly affirming decisions of the HCFA Administrator and the Provider Reimbursement Review Board with respect to these guidelines, the Courts have reasoned that as a cost of making a profit, an income tax does not increase the cost of providing medical care, but simply reduces profits. Accordingly, the claim for taxes, tax penalties and late charges in the amount of $57,786 should be denied.

The disallowed tax payment costs are attributed to Staff Builders’ lack of written accounting policies on Medicare coverage guidelines.

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\(^6\) U.S. District Court for the Central District of California. No. SA CV 89-0072 JSL, June 14, 1989 reported in the *CCH Medicare and Medicaid Guide* at ¶ 37,956

\(^7\) U.S. Court of Appeals for the Ninth Circuit, No. 89-55859, October 10, 1990 reported in the *CCH Medicare and Medicaid Guide* at ¶ 38,893
Staff Builders concurred to the findings on Tax Payments as reported above; their comments are outlined at the end of this section.

**Depreciation Expense**

In calculating depreciation expense, Staff Builders utilized improper asset lives and accordingly overstated its depreciation expense by $61,931.

For financial reporting purposes, Staff Builders calculates straight-line depreciation over the estimated useful lives of the assets or leases. Although Staff Builders’ accounting policies for depreciation limit asset lives to a maximum of five years, the depreciation schedules indicate that longer useful lives assigned to the majority of the assets are based, instead, on IRS guidelines. The HCFA regulations at HIM 15-1 §104.17, however, require that depreciation for assets other than computer software and building additions be based on useful lives published by the American Hospital Association (AHA), unless ‘the intermediary approves a request to apply a different useful life.

The audit results indicate that Staff Builders did not properly recalculate depreciation per the books to adjust for the differences in useful lives under the AHA guidelines, nor did they request that the intermediary approve a different useful life. Therefore, reported depreciation was overstated by $61,931.

Although Staff Builders has asserted that their depreciation policies conform with generally accepted accounting principles, the policy limiting asset useful lives to five years neither conforms to generally accepted accounting principles nor to Medicare principles of reimbursement. Despite the evidence that the guideline on five year asset lives was not strictly enforced, the useful lives assigned by Staff Builders were, nevertheless, significantly shorter than those required by the AHA.

Staff Builders raised no objections about the findings on Depreciation Expense; a summary of their comments appears at the end of this section.

**Other Costs Not Related to Patient Care**

The home office cost statement includes $53,045 for dues and meetings, consulting, costs unrelated to Medicare or home health services, bonuses, liquor and contribution expenses which are not related to patient care under Medicare guidelines at HIM 15-1 §2102.2. This guideline states that costs must be necessary, proper, appropriate and
helpful in developing and maintaining patient care facilities and activities and are subject to Medicare regulations prescribing the treatment of specific items.

Dues and Meetings

The HIM 15-1 § 2 138.1 states that Medicare reimburses costs for dues, memberships and meetings of professional, technical, or business related organizations whose functions and purposes are reasonably related to developing and operating patient care facilities and programs or rendering patient care services. However, payments for political purposes are not allowable under HIM 15-1 § 2 139, which has been clarified to indicate that lobbying is an unallowable political activity.

We found, however, that Staff Builders claimed $37,667 for dues of an industry organization which lists its highest priority as: "state and federal legislative and regulatory advocacy." According to the organization, $3,025 of these dues relate to lobbying efforts; therefore, this portion of the dues is unallowable. Related travel expenses of $37 are also deemed to be unallowable.

Consulting

Consulting costs totaling $16,395 were also found to be non-reimbursable. Staff Builders incurred $16,000 in legal fees to defend itself against allegations that it had violated a non-competition agreement. However, HCFA guidelines at HIM 15-1 §§ 12 18.7 and 2 135.3 D[4]{2} indicate that non-competition agreements are not allowable. Staff Builders also paid $395 to register its part-time computer consultant for a home health care conference. It is felt that this is a personal expense which chiefly benefits the consultant rather than Staff Builders and that the cost, therefore, is neither reasonable, proper nor necessary to Staff Builders’ patient care activities and facilities as required by HIM 15-1 §§ 2102.1 and 2102.2.

Bonuses

Staff Builders’ financial incentive plan awards bonuses only to those regions which meet sales and profit targets. Therefore, $20,000 in bonuses to two regional directors are unrelated to patient care concerns of the cost-based Medicare home health program and are considered unallowable.
Costs Unrelated to Medicare or Home Health Services

As previously noted, home offices are instructed to allocate allowable costs between the chain’s health care facilities and its other lines of business. Schedule G of the home office cost statement then develops statistics to properly allocate pooled expenses between health care and other activities. However, Staff Builders’ failure to provide UGS with certain data supporting the Schedule G statistics limits our reliance on the statistical allocation of home office expenses. Therefore, expenses totaling $10,648, relating to Staff Builders’ health care operations but allocable in no part to Medicare, are considered unallowable, as detailed in Appendix C.

Liquor

According to HCFA guidelines at HIM 15-1 §§ 2 144.2 and 2 144.3, fringe benefits inure primarily to the benefit of the employee and must be necessary and proper costs which relate to patient care. The HCFA Administrator has ruled that the cost of liquor is not necessary or proper, has no bearing on the delivery of patient services, and consequently is an unallowable fringe benefit. Therefore, $1,737 claimed by Staff Builders for liquor at a holiday party and two conferences represents unallowable expenditures.

Contributions

Staff Builders’ inclusion of the contributions account in the grouping of accounts chargeable to the health care operations is improper under HCFA guidelines at HIM 15-1 §§ 2 102.2 and 2102.3. Thus, the entire amount of contributions claimed, $1,203, is disallowed.

Staff Builders’ claiming of $53,045 in costs unrelated to patient care is chiefly attributed to the lack of written accounting policies on Medicare coverage guidelines. The costs unrelated to Medicare or home health services, however, result from Staff Builders’ failure to fully disclose the data underlying the Medicare allocation statistics to UGS. To a lesser extent, some of the costs recommended for disallowance were claimed because Staff Builders believes that the dues and meeting costs and portions of the consultant conference and lobbying costs are allowable.

Staff Builders’ concerns about the draft findings on the costs for Dues and Meetings, Consulting and Costs Unrelated to Medicare or Home Health Services are addressed at the end of this section.

**Recommendations**

We recommend that reported costs be reduced by $864,878 ($559,950 estimated Medicare effect). Additionally, it is recommended that Staff Builders:

- assure that Medicare coverage issues such as the compensation and depreciation guidelines are communicated to appropriate officials and included in its written accounting policies;

- **review** both its accounting system and its processing of travel vouchers to assure that items are properly documented and explained and that they are properly reported on employee W-2s;

- take steps to assure that data underlying the allocation bases is fully disclosed to UGS, and

- conform to the published regulations on stock-related costs and, if there are remaining objections to the finding, follow the prescribed appeals process.

**Staff Builders Comments**

With respect to Compensation Costs, management did not concur that the computer consultant’s fee was unreasonable. They also noted that $1,141 of the questioned moving expense is an allowable business expense and stated that, although the questioned moving expenses were improperly excluded from employee W-2 forms, the expenses qualified for full deduction under IRS guidelines and should be allowed.

Management’s objections regarding Tax Payments pertained to a finding which is not included in the final report.

As for the findings on Other Costs Not Related to Patient Care, the auditee objected to the proposed disallowance of Dues and Meetings costs, Consulting costs and Costs Unrelated to Medicare or Home Health Services. Staff Builders acknowledged that these Dues and Meetings related to an organization involved in lobbying activities, but also stated that the cited guideline does not apply since it relates only to cost reporting periods beginning after January 1, 1996. The concern about Consulting
costs relates to the physician serving as Staff Builders’ part-time Medical Director. Although the formal response also indicates disagreement with the proposed disallowance of the entire amount reported under the caption “Costs Unrelated to Medicare or Home Health Services”, management subsequently clarified their concerns on this matter as relating primarily to the reporting language rather than to the questioning of the costs.

Management objected to the proposed adjustment for the cost of a party, but agreed that liquor and contribution costs are unallowable.

Staff Builders also requested additional information about the questioned Stock-Related Costs and Depreciation Expense but raised no further objections about these matters.

OIG Response

The additional documentation provided for Compensation Costs did not address the reasonableness of the fees paid to the computer consultant; consequently, the fee is still considered to exceed reasonable limits. We have modified the finding on Moving Expenses based on our review of audit evidence which confirmed that $1,141 represents allowable costs for moving office effects. We also presented Staff Builders with documentation indicating that Staff Builders had paid an employee amounts in excess of IRS deductible expenses and informed them that we are not authorized to excuse Staff Builders from conforming to IRS and HCFA guidelines.

The finding on Dues and Meetings in the section on Other Costs Not Related to Patient Care has been modified to propose disallowance of only that share of expense which the organization attributes to lobbying. We also note that the relevant guideline was issued in 1993 and permits application to periods prior to March 1994 if this stance is consistent with intermediary policy at those times. Since UGS has confirmed that such costs would have been questioned if identified during the audit period irrespective of the revised guideline, the revised expense amount described above is recommended for disallowance. In addition, after review of additional documentation, costs for the Medical Director, previously reported as unallowable, are now included in the section on HOME OFFICE ALLOCATIONS as expenses which should have been pooled. Furthermore, as Staff Builders has not responded to our suggestion to propose language that would be satisfactory to them in the discussion of Costs Unrelated to Medicare or Home Health Services, we have not modified this section. Finally, in response to Staff Builders’ comments, the draft reporting on Parties has been modified and is now captioned as Liquor.
The full text of management’s comments relating to OTHER UNALLOWABLE COSTS is included in Appendix E.

INCOME OFFSETS AND OTHER CLERICAL ERRORS

Disallowed costs totaling $302,637 include unposted income offsets and other clerical errors. These costs were claimed primarily because of deficiencies in the existing internal control structure rather than because of a lack of conformance to HCFA guidelines.

Documentation supporting the home office cost statement indicated that Staff Builders did not properly offset expenses with related income of $15,985. In particular, the reported costs did not conform to HCFA guidelines at HIM 15-1 §§ 806 and 2110.2 which require that vendor rebates and interest income be deducted from providers’ allowable administrative and general costs.

For instance, Staff Builders negotiated a revenue sharing arrangement with its exclusive travel agency. Under the agreement, the agency rebated to Staff Builders 2 percent of net income derived from sales to Staff Builders. The first class accommodations which the agency provided at coach fares on several occasions were, presumably, another benefit of this agreement. Based on the documentation provided, the agency rebated at least $8,819 in cash during the audit period, none of which was used to offset reported travel expenses. Instead, the rebates were used to fund unallowable contributions.

Likewise, reconciliation of Staff Builders’ interest expense revealed that the reported interest income offset of $4,646 was understated by $7,166, even though the additional amount was properly identified in the accounting records.

Staff Builders officials attributed the misapplied travel rebates to a misunderstanding of the implications of funding non-reimbursable costs with rebates of reimbursable costs. The understated interest income was apparently caused by the failure to reconcile the accounting records to the cost statement.

The audit also identified clerical errors totaling $286,652 which indicate that Staff Builders did not in all instances base its home office cost statement on accurate data as required by HIM 15-1 § 2304. This amount includes:

9 The potential offset for the cost of the first class upgrades furnished by the travel agency cannot be reasonably estimated.
two adjustments totaling $164,000 which improperly offset the reversal of previously accrued tax penalties and interest. These adjustments, of $82,000 each, reinstated the prior year expense twice, once to update the accounting records and a second time, for cost reporting purposes only. Thus, the expense was claimed three times: once in FYE February 28, 1993 and twice in the FYE February 28, 1994;

- a $60,000 bonus previously accrued but not reversed out of current year expenses, and

- an improper $20,000 accrual of an unpaid 1989 bonus under pending litigation as of January 1996. A liability unliquidated more than one year after the cost reporting period is unallowable under HCFA guidelines at HIM 15-1 §§ 2102.1, 2305 and 2305.1.

The remaining amount consists of:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance recovery incorrectly posted as an expense</td>
<td>$20,320</td>
</tr>
<tr>
<td>Duplicate expensing of depreciable computer software</td>
<td>17,033</td>
</tr>
<tr>
<td>Unallowable interest calculation based on outdated data</td>
<td>5,147</td>
</tr>
<tr>
<td>Vendor and employee expense amounts not payable</td>
<td>15,2</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$42,652</td>
</tr>
</tbody>
</table>

These clerical errors went undetected due to weaknesses in the internal control structure, including the failure to properly verify significant journal entries.

**Recommendations**

We recommend that reported costs be reduced by $302,637 ($178,559 estimated Medicare effect). In addition, we recommend that Staff Builders:
o update its accounting procedures to assure proper classification and offsetting of income and expenses for cost reporting purposes and proper reconciliation of data compiled for the home office cost statement, and

o enforce the written accounting policies requiring that all journal entries are recorded in conformity with generally accepted accounting principles and bear proper documentation and approvals.

Staff Builders Comments and OIG Response

Staff Builders fully concurred with the recommendations reported in the section on INCOME AND OTHER CLERICAL ERRORS. The full text of comments is included in Appendix E.

UNDOCUMENTED EXPENSES

Despite repeated requests for the information during the field work period, we were unable to determine whether costs totaling $369,953 related to patient care because of missing or inadequate documentation.

This amount, detailed at Appendix D, includes items for which no supporting evidence could be obtained from Staff Builders’ corporate files during the field work period as well as amounts that were not reconciled or explained in a manner sufficient to determine whether the expenses are allowable under the Medicare guidelines.

In addition to instructions at HIM 15-1 § 2304 which require that cost information be supported by current, adequate and accurate information, Staff Builders is subject to Internal Revenue Service regulations which require taxable entities to maintain supporting documentation for a period of at least three years from the date the tax return is due.”

The lack of sufficient documentation is attributed to weaknesses in Staff Builders’ filing systems as well as vouchers and invoices with no explanation as to the business or patient care relation of the items. Of particular concern is the written policy which directs branches to retain supporting evidence for only two years, a period too short to protect Staff Builders’ interests for audit purposes.
Recommendations

We recommend that reported costs be reduced by $369,953 ($256,346 estimated Medicare effect). In addition, Staff Builders should modify its record retention policy to extend the required retention period to conform to IRS regulations and other audit needs.

Staff Builders Comments

Staff Builders took exception to certain findings in the draft report, stating that documentation had in most cases been provided. With respect to the specific items questioned, the auditee concurred with the finding on undocumented legal accruals. Management also cited attempts to secure documentation regarding the undocumented computer expense and offered additional explanations and documentation on the questioned transportation and telephone expenses. Staff Builders objected to the proposed adjustments on interest expense for unused credit lines, bonus and awards amounts which had been approved by management and a miscellaneous expense item to reconcile the accounts at year end. They also stated that most of the missing documentation was only requested after the field work ended and had previously indicated that some of the missing documentation was difficult to locate. In addition, Staff Builders requested additional details from the auditors regarding several of the undocumented items. Finally, management reported that corporate policy requires that supporting documents be kept on file for a period of five years.

OIG Response

Regarding Staff Builders’ objections to specific items recommended for disallowance, we note that the computer expense remains undocumented. With respect to the items for which additional explanations and documentation have been received, it is noted that we have reduced the undocumented travel and entertainment and transportation expenses. However, certain of the documented travel and entertainment, transportation and messenger expenses are now included in the finding on HOME OFFICE COST ALLOCATIONS as items to be pooled. In addition, a portion of the previously undocumented telephone and messenger expenses is now considered as ‘Marketing Expenses under the section on COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY. Furthermore, we have reduced undocumented interest expense by the amount of interest relating to the unused credit lines. Review of additional documentation on bonus and awards resulted in reporting a portion ($20,000) of the previously undocumented expense as Other Costs Not
Related to Patient Care in the section on OTHER UNALLOWABLE COSTS; the remaining cost is still undocumented. As for the miscellaneous expense item of $46,112, we note that Staff Builders could neither document how the need to post this reconciling item arose nor provide assurances that the presumed expense related to patient care; this item, therefore, is included as an undocumented expense.

For the record, we note that the initial request for the vast majority of the missing documentation was made in writing before the entrance conference. Numerous written requests were also issued during the field work period. We believe that the difficulties cited by management in handling routine requests for documentation raise questions about record keeping and record retention which are discussed more fully in the section on INTERNAL CONTROL STRUCTURE. We also note that we furnished Staff Builders with most of the details requested by the end of the field work period; the remaining items were furnished before the exit conference.

Finally, Staff Builders supported its assertion about the corporate record retention policy with an undated and unidentified policy which cites a section of the Code of Federal Regulations that was deleted in 1989. It would, therefore, appear that the 1992 corporate policy supporting the OIG recommendations superseded the policy supporting Staff Builders’ position. Accordingly, it is recommended that Staff Builders update the outdated corporate policies and revise the 1992 policy to assure that employees are properly informed of the current corporate retention policies.

The full text of management’s comments relating to UNDOCUMENTED EXPENSES is included in Appendix E.

INTERNAL CONTROL STRUCTURE

Although not a primary audit objective, a limited understanding of the internal control structure was obtained in order to properly address the concerns raised by the other audit findings. The understanding of internal controls was accomplished through review of the accounts payable procedures manual, Staff Builders’ written travel and accounting policies and procedures, analysis of responses to an internal control questionnaire, review of the certified financial statements and inquiry of Staff Builders officials.

In particular, the review of written accounting policies included in Staff Builders’ “Policies and Standard Procedures Manual” and the “Policy Manual for Business Related Travel” indicates the need for significant improvement in the control
environment through expansion, clarification, and increased enforcement of the existing policies.

**Recommendation 1 - Expand or Clarify Existing Policies**

While many of Staff Builders’ policies recognize the need to conform to generally accepted accounting principles (GAAP), the policies are generally silent about conforming to the Medicare reimbursement principles and patient care requirements. For example, the present policies require that supporting documentation for invoices and journal entries describe the type of expense and its relation to business. Since Medicare accounts for the majority of Staff Builders’ revenues, it is recommended that the documentation also describe the relation to patient care. The written policies which require conformance to GAAP without discussing relevant differences between GAAP and Medicare principles include the policies on posting of journal entries and on capitalization of fixed assets. Overcharges to Medicare resulting from this weakness are included in the findings on acquisition and reorganization costs, other costs not related to patient care, tax expenses, compensation, franchise and investment-related expenses, marketing expenses and depreciation.

In addition, many of the written policies are directed exclusively to the branches or franchises, although the written procedures assign a significant role in the processes to the home office. For example, the written accounts payable policy requiring all disbursements to be based upon original invoices indicating both the business nature and a description of the expense should be clarified. The observed violations of stated policy include numerous invoices and expense reports which merely state the department for which work was performed, with no explanation of the type or business nature of the expense nor any detailed accounting of the number of hours spent on each task, payments based on statements rather than original invoices, and journal entries to reverse duplicate payment requests generated from statements. These errors highlight the need for expanded home office attention to accounts payable functions in order to assure that the prescribed policies are implemented.

Staff Builders is also reminded that HIM 15-1 § 2304 states that information on the cost statement should be sufficiently detailed to support the costs claimed.

United Government Services’ 1991 and 1993 management letters which accompanied their audit adjustment reports for those years also specifically noted weaknesses in documenting travel expenses. Our examination of the policy for business-related travel indicated that the written policy properly lists certain personal expenses which cannot be charged to the corporation. The policy, however, needs further clarification in the matters of recording the nature and business relationship of travel expenses for
air fares, lodging, personal automobile usage and business meals. To assure that the patient care relationship of expenses is also considered when items are processed for payment, it is recommended that personnel either record or certify the patient care relationship on expense reports, travel vouchers and all but the most routine or obvious invoices and contracts. Examples of overcharges to Medicare resulting from weaknesses in the accounts payable process are included in the findings on pooled expenses, franchise and investment-related expenses, marketing expenses, acquisition and reorganization costs, other costs not related to patient care, compensation, tax expenses, depreciation, clerical errors and undocumented expenses. Staff Builders has expressed both its concern about these issues and its hope that personnel changes near the end of the field work period will help resolve these matters.

Another weakness with respect to the accounts payable policy is the instruction requiring branches and franchises to maintain copies of invoices for two years, a period, too short to protect Staff Builders’ interests with respect to HCFA and IRS requirements, as noted in the finding on undocumented expenses. In addition to modifying the policy to increase the period of record retention, it is recommended that the scope of the revised policy include the home office as well as the branches and franchises.

We also noted that the written policies on allocation of home office administrative costs and shared branch costs need clarification. For example, the policy states that a separate home office cost center (Branch 1039) captures “the administrative overhead costs directly associated with the Medicare program...” although, in fact, costs of other cost-based payors including Medicaid and certain private insurers are also accumulated in this cost center. Further information on overcharges resulting from this unclear policy is included in the finding on pooled expenses.

Observed weaknesses in the personnel function included the lack of documentation for significant bonuses and the lack of job descriptions for key officials in personnel files. As a result, audit findings were based, in part, on job descriptions which were written only upon the request of the auditors. As this explains Medicare overcharges reported in the finding on undocumented expenses, it is suggested that management take immediate steps to establish policies to improve documentation of employee functions in the future.

Management is also encouraged to evaluate the sufficiency of its fidelity bonding insurance and the adequacy of its cash control and lock box procedures in light of a substantial branch theft loss absorbed by the home office.
Staff Builders Comments & OIG Response

Management apparently concurred with this recommendation in full.

**Recommendation 2 - Enforce Existing Policies**

To the extent that adequate policies and procedures have been promulgated, there was little or no observable evidence of enforcement of the policies in several areas. For example, United Government Services’ 1991 and 1993 management letters noted the need for improvement in the written procedures for the approval of financial transactions. While the current audit results indicate that written accounting policies on the processing of journal entries and on the approval lines of authority require that all entries must be properly approved and documented, the review of journal entries disclosed evidence of entries approved by individuals other than those designated by management as well as entries inadequately documented or explained, resulting in reported overcharges to Medicare in several of the findings above. As previously noted, authorizing personnel should also assure that the patient care relationship of journalized expenses is properly documented at the time of posting.

Furthermore, significant non-compliance with respect to the written policy on payroll was observed. Although that policy discusses systems to assure accurate and timely payroll and remittance of deductions, increased enforcement is needed to avoid repeated instances of compensation and fringes omitted from Forms W-2 and for which statutory deductions were neither made nor remitted to appropriate authorities.

With respect to the previously discussed need to extend the record retention period, UGS has also reported a lack of success in obtaining auditable patient census and visit statistics needed to verify cost allocations to Medicare. As Staff Builders’ branches and franchises have reported the relevant records as unavailable at the time of audit, it is recommended that management assure that the accounts payable policy on record retention is properly enforced and that the policy include non-financial data supporting the cost allocation statistics.

Finally, as noted above, several findings relate to items previously brought to Staff Builders’ attention by UGS’s auditors. For instance, the issue of unallowable claims for activities of the Contract and Insurance Billing Departments reported in the finding on private side activity was raised by UGS as early as 1989. Similarly, the reported concerns about improving the documentation for travel expenses and the approval of financial transactions were previously brought to Staff Builders’ attention as a result of UGS's 1991 and 1993 audits. In addition, the fiscal year 1992, 1993 and...
the current 1994 audit results included unallowable costs for stock-related legal, accounting and other stockholder servicing expenses, depreciation expenses based on incorrect asset lives and marked-up fees for services from Staff Builders Personnel Services. Both the 1992 and 1994 audits also identified unreasonable compensation and fringes for the former President.

Staff Builders Comments & OIG Response

Management concurred with the recommendations regarding payroll but, as noted in the management comments on undocumented expenses, apparently disagreed with the recommendation to enforce an extended record retention period. The OIG comments regarding the latter are included in the section on UNDOCUMENTED EXPENSES.

Recommendation 3 - Strengthen the Internal Audit Function

In view of the significant control problems noted in this audit, it is recommended that Staff Builders’ internal auditors devote efforts to examining and improving the internal control structure as it relates to the collection and classification of data used in the home office cost statement. Staff Builders informed us that although this had not been the focus of internal audit interest in the past, it was hoped that a newly hired director would place greater emphasis on these matters.

Staff Builders Comments & OIG Response

Staff Builders’ management expressed no objections about this Recommendation.

The full text of management’s comments relating to INTERNAL CONTROL STRUCTURE is included in Appendix E.

This report and any finding of overpayments herein in no way addresses whether or not there are facts or legal bases to support a criminal, civil or administrative action under applicable criminal statutes or other authorities, such as the Federal Civil False Claims Act, the Program Fraud Civil Remedies Act, or the Civil Monetary Penalties Law. Nor does this report in any way conclude or suggest that the proper disposition of matters discussed herein is through administrative recoupment only.
Marketing Expenses

Advertising and Other Sales Efforts

The cost of unallowable advertising and other sales efforts totaled $219,967, comprised chiefly of $207,314 incurred to increase patient utilization, as discussed at page 14. The remaining costs of $12,653 consist of:

- Consultant and travel expenses to increase utilization of the facilities by commercial insurers and private par-tie? $7,078
- Recruiting an administrative assistant to prepare proposals and coordinate trade shows; recruiting a traveling liaison nurse with a marketing background to perform strategic marketing 1,650
- Booths and a meeting to invite professionals to use Staff Builders’ services and explore other business opportunities apparently unrelated to Medicare home health care 1,483
- Consultant sent to a conference as an “opportunity for marketing to a nationwide group of physician executives” 1,303
- Wind breakers with Staff Builders’ logo for staff use 1,139

TOTAL $12,653

Conferences & Training Sessions

The Strategic Marketing Unit costs of $2,159, discussed at pages 14 and 15, constitute the majority of the unallowable costs for conferences and training sessions. The remaining costs relate to:

- Northwest regional meeting on developing a profitable business, a client referral base and a successful marketing plan $981
- Video training course to help sales staff maximize revenue 499

TOTAL $1,480
Acquisition and Reorganization Costs

The unallowable acquisition and reorganization costs totaled $5,147. $43,367 of this amount related to certificates of need, as reported at page 17. The remaining $8,105 consists of

- Legal costs related to trademark matters which are unallowable under HIM 15-1 § 2135.3 D[4]{2} $4,323
- Costs for duplicate CONs as well as reorganization and licensing fees to expand the chain organization which are unallowable franchise and reorganization costs under HIM, 15-1 §§ 2133.3 and 2134.10 2,040
- Meeting with a potential franchisee 1,193
- Travel and entertainment costs related to an unsuccessful acquisition attempt which are unallowable under HIM 15-1 §§ 2150 and 2154 549

TOTAL $8,105
Other Costs Not Related to Patient Care

Costs Unrelated to Medicare or Home Health Services

Issues concerning expenses of Staff Builders’ health care operations which do not relate to Medicare are discussed at pages 25 and 26. These expenses consist of

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Travel and printing costs related exclusively to the Adult Residential, Live-In, Pediatric, Hospital, <strong>Clinic</strong> and New Moms’ Programs</td>
<td>$5,142</td>
</tr>
<tr>
<td>Publishing two newsletters</td>
<td>3,485</td>
</tr>
<tr>
<td>Travel related exclusively to the Medicaid program</td>
<td>1,136</td>
</tr>
<tr>
<td>Meetings entirely unrelated to Medicare home health services or to patient care</td>
<td>88.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$10,648</td>
</tr>
</tbody>
</table>
As reported at page 31, we could not determine whether the following costs are allowable due to Staff Builders’ inability to provide adequate documentation during the field work period.

<table>
<thead>
<tr>
<th>Expense</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consulting Expense</td>
<td>$70,321</td>
</tr>
<tr>
<td>Computer Expense</td>
<td>7,265</td>
</tr>
<tr>
<td>Legal Accruals</td>
<td>20,710</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>26,677</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>58,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>8,261</td>
</tr>
<tr>
<td>Rent Expense</td>
<td>12,110</td>
</tr>
<tr>
<td>Bonus &amp; Awards</td>
<td>25,545</td>
</tr>
<tr>
<td>Advertising</td>
<td>17,519</td>
</tr>
<tr>
<td>Meetings &amp; Conventions</td>
<td>1,875</td>
</tr>
<tr>
<td>Dues &amp; Subscriptions</td>
<td>8,316</td>
</tr>
<tr>
<td>Training</td>
<td>250</td>
</tr>
<tr>
<td>Postage</td>
<td>575</td>
</tr>
<tr>
<td>Miscellaneous Expense</td>
<td>59,519</td>
</tr>
<tr>
<td>Travel &amp; Entertainment</td>
<td>9,085</td>
</tr>
<tr>
<td>Transportation</td>
<td>42,280</td>
</tr>
<tr>
<td>Printing &amp; Copying</td>
<td>1,645</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$369,953</strong></td>
</tr>
</tbody>
</table>
June 6, 1997

Common Identification Number: A-02-95-01 0 19

Mr. Timothy J. Horgan
Regional Inspector General
for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services
26 Federal Plaza
New York, NY 10278

Dear Mr. Horgan:


Per your discussion with David Frank, Certified Controller, we wish to thank you for the additional time extension granted for our response.

Upon review of this report we would like to point out that full details have yet not been shared with us for all findings addressed subsequent to the on-site audit. We have prepared our responses based on information which has been shared with us up to this time and have requested to obtain additional data in the appropriate sections of our comments. It has also been difficult to address the issues in the draft since they do not always correspond to the proposed adjustment or descriptions classified on correspondence previously presented to us during the audit. I would hope that we would be given another opportunity to review this draft with more informative information prior to finalization.

We appreciate your review and evaluation of internal controls and relevant accounting policies and procedures. We agree that we need to make changes to strengthen controls related to the preparation of the home office cost statement. We have already taken steps to improve areas of allocations and compliance.
We disagree with the summary of findings that found $9,628,567 of $22,806,099 included on Staff Builders' home office cost statement to be improperly claimed, resulting in an estimated overstatement of Medicare costs totaling $5,863,772. Attached are the following areas of which we have taken exception to and which we have a request for additional data as noted.

As discussed and agreed with both the Office of Audit Services and United Government Services (UGS), we would like to schedule a date for UGS to review outstanding issues.

Sincerely,

[Signature]

Gary Tighe
Senior VP Finance/Chief Financial Officer

/gp
enc.

cc: Stephen Savitsky
HOME OFFICE COSTS ALLOCATIONS

Pooled Expenses:

We disagree with the proposed salary and related fringes adjustment for the Director of Certified Quality Assurance in the amount of $47,931 and $8,116 respectively. The sole responsibility is for the oversight of Medicare Plans of Care to ensure compliance with Medicare regulations and guidelines, to ensure the utilization of Medicare benefits, to prevent fraud and abuse and to facilitate Medicare reimbursement.

We have instituted policies and controls to properly classify expenses to determine the relationship to the Medicare program. We have also created a position to ensure the relationship of Medicare expense allocation compliance.

Allocation Statistics

We disagree with the comments regarding the indirect home office costs for the Contract and Insurance Billing. Although the direct costs of these departments were removed from the home office cost statement prior to the pooling of the residual expenses, an additional allocation for the indirect costs is requested. Let us point out that we believe that the residual expenses, which remain for pooling, is, in fact, the indirect expenses which are allocated between health care and non-health care activities. All indirect costs are allocated as pooled costs on Schedule G, Part 1.

We have discussed issues regarding the proper allocation statistics of the home office pooled costs with United Government Services and have already implemented these changes in the fiscal year end 1996 cost report.

COSTS RELATED TO PRIVATE LINES OF BUSINESS OR PROFITABILITY

Franchising Program

Staff Builders has what it terms a “franchise” program, although “franchise” is a misnomer; in reality, Staff Builders has a management program under which it contracts with others to oversee certain day-to-day operations of home health agencies which it owns and for which it holds the license and Medicare provider number. There are vast differences between Staff Builders’ franchise program and a typical franchise program. A typical franchise program involves a franchisee purchasing the rights to a sales or service territory and receiving operational guidelines from the franchisor. The franchisee would also normally be required to purchase all materials, supplies, products and similar material from the franchisor, and would be responsible for all billing,
collections and other financial matters. Most significantly, the franchisee, not the franchisor, would own the business.

The Medicare program adopts this view of a typical franchise program. Provider Reimbursement Manual (PRM) § 2 133.1 states that franchise fees are allowable depending on the value of the service; which the franchisor provides to the franchisee. Specifically, the Manual states that “the provider must identify and value the specific services furnished or made available by a franchisor and for which the provider (as a franchise holder) is claiming franchise fee expenses.” (emphasis added). Therefore, the Medicare program views a franchise as a situation in which the franchisee is receiving services from the franchisor, and most importantly, in which the franchisee is the provider.

Staff builders’ “franchisee” program is not the typical program or one which is envisioned by the Medicare Manual § 2 133.1. Staff Builders owns the home health agency, holds the license, holds the Medicare certification and submits the Medicare cost report, i.e., Staff Builders, not the franchisee, is the provider. Staff Builders has all other indicia of ownership as well: it contracts with third party payors for reimbursement, the home health agency patients are its patients and the caregivers are employees of Staff Builders.

In addition, the Staff Builders’ “franchisee” does not have the ordinary rights or obligations of a franchisee. First, the franchisee does not own the home health agency; instead, the franchisee merely contracts to manage the home health agency. In addition, the franchisee is not required to purchase supplies or other materials from Staff Builders, although it may take advantage of bulk discounts provided by Staff Builders. The franchisee incurs expenses for managing the home health agencies and it submits those Medicare-related expenses to Staff Builders for which Staff Builders reimburses the franchisee.”

In short, then, the Staff Builders’ franchisee is acting as a manager, not as a typical franchisee. The Staff Builders’ franchisee is not paying Staff Builders for its services; instead, Staff Builders pays the franchisee. Moreover, the expenses which the franchisees submit to Staff Builders for managing the home health agencies have been allowed by the Medicare intermediaries. This is consistent with PRM § 2135 which states that management costs are allowable under the Medicare program.

When the management relationship between Staff Builders and its franchisees is properly understood, it becomes apparent that the costs of the Franchise Department are allowable. The costs of Staff Builders’ Franchise Department are essentially the costs of overseeing the franchisees. In effect, the Franchise Department manages Staff Builders’ home health agency managers. The costs of the Franchise Department are not any different than the costs which any other home health agency would incur to recruit and oversee a manager. There is nothing in the Medicare statute, regulations, or Manuals which would indicate that these costs are nonallowable. Again, these costs relate to management of the home health agencies; they are not “franchise” costs.

\footnote{The fee arrangement between Staff Builders and its franchisees for private pay patients is different. For those services, Staff Builders pays a percentage of gross profits.}
They are some specific costs which should be addressed. Staff Builders disagrees with the disallowance of costs associated with performing background checks on potential franchisees. These individuals or entities will be intimately involved in the operations of a Medicare certified agency; certainly, the Medicare program would want to promote the reasonable expenditure of costs to investigate the background of such individuals. In an extreme example, an individual seeking to be a franchisee may have been excluded from the Medicare program for violations of federal law and contracting with such an individual to manage a home health agency would subject Staff Builders to penalties, in addition to exposing the Medicare program to additional criminal activity by that individual.

The Franchise Department also incurs expense for registration and filing fees which are required under State law. They are no different than the filing fees paid to States for incorporation, which are allowable under PRM § 2134.1. Accordingly, the franchise filing fees should also be allowable.

In addition, the Franchise Department incurs expenses to recruit franchisees for existing locations through advertisements. PRM § 2136.1 states that “[c]osts of advertising for the purposes of recruiting medical, paramedical, administrative and clerical personnel are allowable if the personnel would be involved in patient care activities or in the development and maintenance of the facility.” The advertising costs to recruit a franchisee are no different than the costs to recruit any other manager and are allowable under the PRM § 2136.1.

Staff Builders agrees that certain costs of the Franchise Department are not allowable. For example, Staff Builders acknowledges that the costs associated with franchising new territory should not have been reported on the cost report. This would include acquisitions, franchise subscriptions and certain seminars.

However, Staff Builders contends that the vast majority of the costs for the Franchise Department are allowable. Staff Builders believes that this proposed disallowance is chiefly the result of a misunderstanding of the relationship between Staff Builders and its franchisees. As explained above, the franchisees are, in fact, managers of the Staff Builders home health agencies, and the costs associated with them should be evaluated and allowed as such.

Investment-Related Expenses

A separate departmental cost center was created during the audit engagement to address the issues of unallowable costs in response to the auditor’s recommendation.

Private Side Activity

A separate departmental cost center was created during the audit engagement to address the issues of unallowable costs in response to the auditor’s recommendation.

The allocation of pooled expenses between the healthcare and non-healthcare activities will allocate the indirect costs of the Contract Billing and Insurance Billing Departments.
We have instituted procedures to assure that allocations of payroll are updated when personnel transfer to other departments.

Marketing Expenses

We believe that training costs relating to home care programs are allowable costs. A separate departmental cost center was created during the audit engagement to address the issues of unallowable costs in response to the auditor’s recommendation.

Transactions with Related Organizations

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

The markup for Staff Builders Personnel Services (SPS) is no longer applied to Staff Builder transactions.

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

The oversight and responsibility of preparing and maintaining HCFA Form 1513 has been reassigned for a more efficient monitoring.

Acquisition and Reorganization Costs

A separate departmental cost center was created during the audit engagement to address the issues of unallowable costs in response to the auditor’s recommendation.
OTHER UNALLOWABLE COSTS

Compensation costs

We disagree with the proposed adjustment for computer consulting in the amount of $24,570. It is not unreasonable to incur a consulting fee in the range of $125.00 per hour for a high end consultant with home health experience.

We have details to the proposed adjustments relating to moving expenses totaling $11,147.00, we do not have the $16,982.00 referred to in the draft report Please provide details to the total of the $16,982.00 proposed adjustment. Of this amount, $1,140.71 relates to moving a Staff Builder's regional office and should be excluded from this adjustment. The balance relates to moving personal property. Although we agree that the personal moving expense was not included in the respective employees W-2's, we would also note that the employees are able to exclude from income reimbursed moving expenses related to transportation for household goods and personal effects. The expenses we reimbursed the employees qualify for this deduction. As such, we feel that we would be improperly penalized under PRM §2144.1 for an IRS regulation not resulting in a taxable income. It should be noted that the IRS has since changed its rules requiring reimbursed deductible moving expenses to be reported on form W-2.

Stock-Related Costs

Please furnish details to this section.

Tax payments

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.
Depreciation Expense

Please supply the details to this proposed adjustment.

Other Costs not Related to Patient Care

Dues and Meetings

**Staff Builders** objects to this disallowance. The Medicare program allows the costs of membership dues and related travel expense for membership in professional, technical or business related organizations. Provider Reimbursement Manual (“PRM”) §2138.1. The PRM states that these organizations are those whose “functions and purposes can be reasonably related to the development and operation of patient care facilities and programs, or the rendering of patient care services.” The organization for which the membership dues are in question, Home Health Services and Staffing Association ("HHSSA"), is such an organization and the membership dues are allowable.

The stated reason for this disallowance focuses on only one of the purposes of HHSSA. In fact, the Articles of Incorporation and the Bylaws of HHSSA list eight purposes, the first of which is “to encourage and promote greater quality, efficiency, reliability, and safety in the delivery of home health care and nursing services, and otherwise to improve the services of home health providers to the general public.” Clearly, the primary purposes of this organization is related to the rendering of patient care services. HHSSA’s political activities are not its primary focus and, therefore; Staff Builders’ entire membership fee should not be disallowed.

Moreover, PRM § 2139.2 was only recently amended to state that the portion of membership fees related to political activities is nonallowable. That amendment is effective for cost reporting periods beginning on or after January 1, 1996. Because Staff Builders’ cost reporting period began before January 1, 1996, that provision is not applicable for this cost period.

Consulting

*Office Of Audit Services Note* -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

Staff Builders employs a retired physician as a part time Medical Director. This physician does not have any other clients and his entire professional income is derived from Staff Builders. His attendance at the Medical Administrator’s Conference was at our request, for our benefit, not for his personal gain as he has no other clients other than Staff Builders and he is not seeking any other clients.

Costs Unrelated to Medicare or Home Health Services
We disagree with the proposed adjustment and take exception that these expenses are considered unallowable.

Parties

We disagree with the proposed adjustment relating to an annual party, we do agree however, with the disallowance of liquor. We feel that the annual party is significant to employee morale and a common and accepted occurrence in the industry. The entire cost incurred represents less than $15.00 per employee. The HCFA Administrator Decision, quoted in the disallowance, in the reversal of PRRB Dec. No. 91-D60, as cited in the CCH Medicare and Medicaid Guide ¶ 39,649 refers to alcoholic beverages only, not the entire cost of an annual party. Consequently, the cost of the holiday party has never been disallowed and the proposed adjustment to Staff Builders should also be reduced to include only the cost of liquor.

Contributions

This was an oversight in cost report Preparation. We have taken steps to ensure that these costs will be excluded from reimbursable costs.

INCOME OFFSETS AND OTHER CLERICAL ERRORS

We have taken steps to assure the proper classification and offsetting of income and expenses for cost reporting purposes. We will enforce our policy as suggested to require that all journal entries are recorded in conformity with generally accepted accounting principles and bear proper documentation and approvals.

UNDOCUMENTED EXPENSE

We take exception to this section as documentation has been provided for most accounts. The majority of the undocumented expense was requested after the field audit visit. We have offered information to United Government Services and it was decided that they will come back to review additional information after the draft request was issued. We have also had a difficult time in trying to identify dome of the accounts in this schedule. It is our corporate policy to retain supporting documentation for a period of 5 years.

Computer Expense

A copy of the invoice has been requested from the vendor.
Legal Accruals

We agree with the proposed adjustment for the current year, however, the accrual will reverse and correct itself in the following year.

Interest Expense

We disagree with the proposed adjustment. It includes $38,510 in unused line fees paid to our bank. Staff Builders has a revolving line of credit with its lender which requires payment of these fees. Unused line fees are normal in this type of financing and in reviewing the financial statements of several of our competitors it is common within home healthcare to incur these charges. We also have information available on other interest costs which were included as undocumented.

Depreciation and Depreciation Additions

Please supply the details to this proposed adjustment.

Bonus & Awards

We disagree with this proposed adjustment. These are discretionary bonuses given for the performance of managerial positions which were, approved by the employees’ supervisors and included in taxable income. The total compensation was within recommended guidelines.

Dues & Subscriptions

Please supply the details to this proposed adjustment.

Postage

Please supply the details to this proposed adjustment.

Miscellaneous Expense

We disagree with the proposed adjustment. An accounts payable journal entry was provided. At year end accounts payable reconciled the accounts payable control account and proposed an adjustment. It was not deemed cost effective to locate $46,112 out of the $25 million plus dollars processed annually by accounts payable in fiscal 1994.

Travel & Entertainment

Please supply the details to this proposed adjustment.
Transportation

The travel relates to the performance of normal daily job functions. We have incorporated a new travel policy including a revised expense report.

Salaries & Wages

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

State Unemployment

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

Telephone Expenses

We have the telephone expense available for review.

Equipment Rentals

*Office of Audit Services Note -- This paragraph is not applicable because the finding (issue) referred to by the auditee is not included in this report.

Please supply the details to this proposed adjustment.

Internal Control Structure

Expand or Clarify Existing Policies

We have taken steps to adapt a written policy regarding the authorization and documentation of journal entries.

We will give effect to the Medicare principles on capitalization of fixed assets.
We have expanded our policy on disclosure of ownership to include Staff Builders’ officers to address potential conflicts of interest and related party transactions.

Enforce Existing Policies

We agree to implement the recommendations regarding payroll.

Strengthen the Internal Audit Function

As noted, Staff Builders has hired a new Director of Internal Audit.