



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General

Office of Audit Services
1100 Commerce, Room 632
Dallas, Texas 75242

April 8, 2009

Report Number: A-06-08-00015

Mr. Dan Bloodworth
Senior Vice President and CFO
Pinnacle Business Solutions, Inc.
515 Pershing Boulevard
North Little Rock, Arkansas 72114

Dear Mr. Bloodworth:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Audit of Pinnacle Business Solutions, Inc.'s, Medicare Part A Final Administrative Cost Proposals for Fiscal Years 2005 through 2007." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

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

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Paul Chesser, Audit Manager, at (501) 225-8114 or through e-mail at Paul.Chesser@oig.hhs.gov. Please refer to report number A-06-08-00015 in all correspondence.

Sincerely,

A handwritten signature in black ink that reads "Gordon L. Sato".

Gordon L. Sato
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Nanette Foster Reilly, Consortium Administrator
Consortium for Financial Management & Fee for Service Operations
Centers for Medicare & Medicaid Services
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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF PINNACLE BUSINESS
SOLUTIONS, INC.'S, MEDICARE
PART A FINAL ADMINISTRATIVE
COST PROPOSALS FOR FISCAL
YEARS 2005 THROUGH 2007**



Daniel R. Levinson
Inspector General

April 2009
A-06-08-00015

Office of Inspector General

<http://oig.hhs.gov>

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

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

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Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, Office of Inspector General reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Title XVIII of the Social Security Act established the Medicare Program, which provides for a hospital insurance program (Part A) and a supplementary medical insurance program (Part B). The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part A fiscal intermediaries that process and pay Medicare claims. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

At the close of each fiscal year (FY), contractors submit to CMS a Final Administrative Cost Proposal (cost proposal), which reports the costs incurred in performing Medicare functions during the year. For FYs 2005 through 2007, CMS contracted with Pinnacle Business Solutions, Inc. (Pinnacle), to serve as the Medicare Part A contractor for Arkansas and Rhode Island. Pinnacle reported Medicare administrative costs totaling \$32,713,096 in its cost proposals for FYs 2005 through 2007.

OBJECTIVE

Our objective was to determine whether the administrative costs Pinnacle reported in its cost proposals were reasonable, allowable, and allocable in accordance with part 31 of the Federal Acquisition Regulations (FAR) and the Medicare contract.

SUMMARY OF FINDINGS

Pinnacle reported expenditures in its cost proposals that substantially complied with FAR and Medicare contract provisions. However, Pinnacle reported \$4,395 in unallowable costs: \$1,235 in overstated fringe benefit costs and \$3,160 in FY 2004 costs that it reported on the FY 2005 cost proposal. Pinnacle also reported \$95,245 in professional and consulting services costs and \$3,196 in subcontractor services costs that may be unallowable. We are setting aside the potentially unallowable costs for the CMS contracting officer to review for allowability.

Pinnacle had no forward-funding remaining for FYs 2005 through 2007; i.e., Pinnacle had performed all of the services for which it had received funding.

RECOMENDATION

We recommend that Pinnacle:

- decrease its FY 2005 cost proposal by \$3,644 and its FY 2006 cost proposal by \$751 to reflect the unallowable costs and
- work with the CMS contracting officer to determine the allowability of \$98,441 in costs related to professional and consulting services and subcontractor services costs.

PINNACLE COMMENTS

In written comments on our draft report, Pinnacle agreed that it had reported unallowable costs. Pinnacle said that it had made or would make adjustments or offsets to decrease its FY 2005 cost proposal by \$3,644 and its FY 2006 cost proposal by \$751. Pinnacle said that it would work with CMS to determine the allowability of costs relating to professional and consulting services and subcontractor services.

Pinnacle's response to our draft report is included as Appendix D. We excluded the attachments to Pinnacle's comments because they contained personally identifiable information.

OFFICE OF INSPECTOR GENERAL RESPONSE

In addition to its comments, Pinnacle provided additional documentation supporting a portion of the unallowable costs and a portion of the potentially unallowable costs. We adjusted our draft report findings and recommendations based on the additional documentation.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Medicare Program, which provides for a hospital insurance program (Part A) and a supplementary medical insurance program (Part B). The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part A fiscal intermediaries that process and pay Medicare claims. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

At the close of each fiscal year (FY), contractors submit to CMS a Final Administrative Cost Proposal (cost proposal), which reports the costs incurred in performing Medicare functions during the year. For FYs 2005 through 2007, CMS contracted with Pinnacle Business Solutions, Inc. (Pinnacle), to serve as the Medicare Part A contractor for Arkansas and Rhode Island. Pinnacle reported Medicare administrative costs totaling \$32,713,096 in its cost proposals for FYs 2005 through 2007.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the administrative costs Pinnacle reported in its cost proposals were reasonable, allowable, and allocable in accordance with part 31 of the Federal Acquisition Regulations (FAR) and the Medicare contract.

Scope

Our review covered the period October 1, 2004, through September 30, 2007 (FYs 2005 through 2007). For this period, Pinnacle reported Medicare administrative costs of \$32,713,096.

We performed a limited review of the internal controls and procedures Pinnacle had in place to allocate costs in accordance with the FAR and Medicare contract. We performed the review to accomplish our objectives, not to provide assurance on the internal control structure.

We conducted fieldwork at the Pinnacle campus in North Little Rock, Arkansas, from November 2007 through May 2008.

Methodology

To accomplish our objectives, we:

- reviewed applicable Medicare laws, regulations, and guidelines;
- reviewed the applicable sections of the FAR and Pinnacle contract with CMS;

- reviewed the independent auditor's reports for FYs 2005 and 2006;
- reviewed Pinnacle internal audit reports for FYs 2005 through 2007;
- reconciled line-item expenses on cost proposals and cost classification reports to the contractor's subsidiary record of expenses;
- reviewed journal entries, invoices, expense reports, contracts and agreements, and additional supporting documentation;
- interviewed Pinnacle officials regarding the cost accumulation processes for cost proposals and cost allocation systems;
- reviewed payroll and personnel records; and
- tested costs for reasonableness, allowability, and allocability.

Regarding top Pinnacle executives who had salaries allocated to Medicare, we:

- reviewed established personnel and accounting policies and procedures to determine Pinnacle's practices for allocating compensation costs to Medicare,
- compared a sample of executives' compensation to benchmark compensation amounts published in the Federal Register, and
- tested for excessive executive compensation costs.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATIONS

Pinnacle reported expenditures in its cost proposals that substantially complied with FAR and Medicare contract provisions. However, Pinnacle reported \$4,395 in unallowable costs: \$1,235 in overstated fringe benefit costs and \$3,160 in FY 2004 costs that it reported on the FY 2005 cost proposal. Pinnacle also reported \$95,245 in professional and consulting services costs and \$3,196 in subcontractor services costs that may be unallowable. We are setting aside the potentially unallowable costs for the CMS contracting officer to review for allowability.

Pinnacle had no forward-funding remaining for FYs 2005 through 2007; i.e., Pinnacle had performed all of the services for which it had received funding.

UNALLOWABLE COSTS

Fiscal Year 2004 Costs

FAR 31.201-2(a)(3) states: “A cost is allowable when the cost complies with . . . generally accepted accounting principles and practices appropriate to the circumstances.” Also, the “Medicare Financial Management Manual,” chapter 2, section 130, states that the final administrative cost proposals (FACP) “. . . shall not include adjustments related to prior years’ costs on the current FACP.”

Pinnacle incorrectly reported \$3,160 in FY 2004 costs in its FY 2005 cost proposal because the FY 2004 cost proposal was closed for adjustments. The costs include tuition reimbursement credits, subcontractor costs, and outside professional services.

Fringe Benefit Costs

Pinnacle reported unallowable fringe benefit costs of \$1,235 in its FYs 2005 and 2006 cost proposals.

Lobbying Costs

FAR 31.205-22(c) states: “When a contractor seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs.”

Pinnacle reported \$1,000 of unallowable costs in its FYs 2005 and 2006 cost proposals for lobbying activities related to corporate membership in a trade organization.

State Unemployment Tax Refund

FAR 31.201-5 states: “The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.”

Pinnacle received a \$235 State unemployment tax refund that was not included in the FY 2006 cost proposal. Because the refund was not deducted from costs, the FY 2006 cost proposal contains unallowable costs of \$235.

POTENTIALLY UNALLOWABLE COSTS

Professional and Consulting Services

The carrier contract, section II, part I, B, states: “The prior written approval of the Contracting Officer shall be required: . . . (2) for the utilization of the services of any consultant under this contract where such reimbursement exceeds or may exceed \$400.00 per day or \$100,000 per year, exclusive of travel costs.” In addition, the carrier contract, section I, article

XIV, G, states: “If, with respect to any subcontract entered into under this Article requiring the prior written approval of the Secretary, such required approval is not obtained, the United States shall not be obligated to reimburse the Carrier for any costs incurred, relative to such subcontract, prior to the date of the Secretary’s approval unless so stipulated.”

Pinnacle reported costs totaling \$95,245 in its FY 2005 and FY 2006 cost proposals for professional and consulting services for which it was unable to provide written approval. Without prior written approval, CMS is not required to reimburse these costs.

Subcontractor Services

The carrier contract, section I, article XIV, A, states: “The Plan shall not enter into any subcontract with a third party to perform any of the functions set forth in this agreement unless such subcontract received the prior written approval of the Secretary.” In addition, the carrier contract, section I, Article XIV, G, states: “If, with respect to any subcontract entered into under this Article requiring the prior written approval of the Secretary, such required approval is not obtained, the United States shall not be obligated to reimburse the Plan for any costs incurred, relative to such subcontract, prior to the date of the Secretary's approval unless so stipulated.”

Pinnacle reported costs totaling \$3,196 in its FY 2005 and FY 2006 cost proposals for subcontractor services for which it was unable to provide written approval. Without prior written approval, CMS is not required to reimburse these costs.

RECOMMENDATIONS

We recommend that Pinnacle:

- decrease its FY 2005 cost proposal by \$3,644 and its FY 2006 cost proposal by \$751 to reflect the unallowable costs and
- work with the CMS contracting officer to determine the allowability of \$98,441 in costs related to professional and consulting services and subcontractor services costs.

PINNACLE COMMENTS

In written comments on our draft report, Pinnacle agreed that it had reported unallowable costs. Pinnacle said that it had made or would make adjustments or offsets to decrease its FY 2005 cost proposal by \$3,644 and its FY 2006 cost proposal by \$751. Pinnacle said that it would work with CMS to determine the allowability of costs relating to professional and consulting services and subcontractor services.

Pinnacle’s response to our draft report is included as Appendix D. We excluded the attachments to Pinnacle’s comments because they contained personally identifiable information.

OFFICE OF INSPECTOR GENERAL RESPONSE

In addition to its comments, Pinnacle provided additional documentation supporting a portion of the unallowable costs and a portion of the potentially unallowable costs. We adjusted our draft report findings and recommendations based on the additional documentation.

APPENDIXES

APPENDIX A

**FINAL ADMINISTRATIVE COST PROPOSALS AND RECOMMENDED
DISALLOWANCE, SET-ASIDE, AND ACCEPTANCE AMOUNTS FOR FISCAL
YEARS 2005, 2006, AND 2007**

Cost Category	FY 2005	FY 2006	FY 2007	Total
Salaries/wages	\$7,219,281	\$7,105,409	\$5,756,649	\$20,081,339
Fringe benefits	2,028,907	2,054,480	1,601,024	5,684,411
Facilities or occupancy	519,626	468,192	549,436	1,537,254
Data processing equipment	179,043	198,006	200,644	577,693
Subcontracts	738,477	687,948	474,676	1,901,101
Outside professional. services	231,242	128,890	(578,251)	(218,119)
Telephone and telegraph	126,145	156,295	184,120	466,560
Postage and express	427,694	398,582	223,168	1,049,444
Furniture and equipment	621,115	681,821	393,281	1,696,217
Materials and supplies	120,628	86,033	74,004	280,665
Travel	91,961	82,787	69,452	244,200
Return on investment	83,016	37,684	0	120,700
Miscellaneous	67,584	64,381	740,212	872,177
Other	(10,277)	(456)	0	(10,733)
Subtotal	12,444,442	12,150,052	9,688,415	34,282,909
Other adjustments (credits)	(634,030)	(544,860)	(390,923)	(1,569,813)
Total	\$11,810,412	\$11,605,192	\$9,297,492	\$32,713,096
Forward funding	0	0	0	0
Total claimed on cost proposal	\$11,810,412	\$11,605,192	\$9,297,492	\$32,713,096
Recommended disallowance*	3,644	751	0	4,395
Recommended set aside	79,370	19,071	0	98,441
Recommended for acceptance	\$11,727,398	\$11,585,370	\$9,297,492	\$32,610,260

* See Appendix B

RECOMMENDED COST DISALLOWANCE AND SET-ASIDE AMOUNTS

Disallowance Category	Fiscal Year 2005	
	Disallowance	Set-Aside
Fiscal year 2004 costs	\$3,160	
Lobbying costs	484	
Professional and consulting services		\$77,264
Subcontract services		2,106
Total	\$3,644	\$79,370

Disallowance Category	Fiscal Year 2006	
	Disallowance	Set-Aside
Lobbying costs	\$516	
State unemployment tax refund	235	
Professional and consulting services		\$17,981
Subcontract services		1,090
Total	\$751	\$19,071

**COMPARISON OF ADMINISTRATIVE COSTS CLAIMED
TO BUDGET AUTHORIZATION**

Operation	Fiscal Year 2005		Variance— Favorable (Unfavorable)
	Budget Authorization	Administrative Costs Claimed	
Program Management (PM)			
Bills/claims payment	\$3,751,115	\$3,850,666	(\$99,551)
Appeals/reviews	784,809	758,835	25,974
Beneficiary inquiries	413,907	383,827	30,080
PM provider communications	32,192	31,763	429
Reimbursement	911,486	865,128	46,358
Provider enrollment	207,942	154,231	53,711
Provider telephone inquiries	384,549	383,709	840
Credits	(592,527)	(626,532)	34,005
Subtotal	5,893,473	5,801,627	91,846
Medicare Integrity Program (MIP)			
Medical review	1,213,757	1,165,888	47,869
MSP ¹ prepayment	190,714	184,000	6,714
Benefits integrity	17,565	16,866	699
Local provider education and training	140,266	166,427	(26,161)
Provider communications	384,699	381,897	2,802
Audit	2,458,010	2,536,047	(78,037)
MSP postpayment	1,397,097	1,350,983	46,114
Subtotal	5,802,108	5,802,108	0
MMA ² regulatory reform	224,417	206,677	17,740
Total	\$11,919,998	\$11,810,412	\$109,586

Note: All amounts taken from Final Administrative Cost Proposal (Supplement No. 9) and Notice of Budget Approval (Supplement No. 10).

¹MSP – Medicare secondary payer

²MMA – Medicare Prescription Drug, Improvement, and Modernization Act

**COMPARISON OF ADMINISTRATIVE COSTS CLAIMED
TO BUDGET AUTHORIZATION**

Fiscal Year 2006			
Operation	Budget Authorization	Administrative Costs Claimed	Variance— Favorable (Unfavorable)
Program Management			
Bills/claims payment	\$3,997,000	\$3,932,780	\$64,220
Appeals/reviews	396,000	394,408	1,592
Beneficiary inquiries	259,500	277,537	(18,037)
PM provider communications	96,700	114,760	(18,060)
Reimbursement	901,000	917,938	(16,938)
Productivity investment	9,600	0	9,600
Provider enrollment	170,200	209,964	(39,764)
Provider telephone inquiries	641,900	543,948	97,952
Credits	(533,100)	(530,991)	(2,109)
Subtotal	5,938,800	5,860,344	78,456
Medicare Integrity Program			
Medical review	1,039,500	1,223,195	(183,695)
MSP prepayment	140,200	187,568	(47,368)
Benefits integrity	28,600	30,813	(2,213)
Local provider education and training	210,000	264,649	(54,649)
Provider communications	271,700	297,456	(25,756)
Audit	2,566,800	2,345,180	221,620
MIP productivity investment	79,600	40,516	39,084
MSP postpayment	1,330,000	1,251,083	78,917
Subtotal	5,666,400	5,640,460	25,940
<u>Nonactivity Summary</u>			
Nonrenewal	0	104,388	(104,388)
Total	\$11,605,200	\$11,605,192	\$8

Note: All amounts taken from Final Administrative Cost Proposal (Supplement No. 03) and Notice of Budget Approval (Supplement No. 16).

**COMPARISON OF ADMINISTRATIVE COSTS CLAIMED
TO BUDGET AUTHORIZATION**

Fiscal Year 2007

Operation	Budget Authorization	Administrative Costs Claimed	Variance— Favorable (Unfavorable)
Program Management			
Bills/claims payment	\$3,372,200	\$3,299,373	\$72,827
Appeals/reviews	587,900	562,046	25,854
Beneficiary inquiries	60,400	36,533	23,867
Reimbursement	795,900	729,705	66,195
Productivity investment	16,900	0	16,900
Provider enrollment	254,000	253,252	748
Provider telephone inquiries	561,500	489,536	71,964
Provider outreach and education	97,900	97,543	357
Credits	(617,200)	(373,825)	(243,375)
Subtotal	5,129,500	5,094,163	35,337
Medicare Integrity Program			
Medical review	1,263,000	1,171,837	91,163
MSP prepayment	198,300	140,795	57,505
Benefits integrity	25,000	17,489	7,511
Audit	2,518,000	2,410,196	107,804
MSP postpayment	172,700	137,076	35,624
MIP provider outreach and education	364,300	325,936	38,364
Subtotal	4,541,300	4,203,329	337,971
Total	\$9,670,800	\$9,297,492	\$373,308

Note: All amounts taken from Final Administrative Cost Proposal (Supplement No. 00) and Notice of Budget Approval (Supplement No. 12).



MEDICARE
Part A Intermediary
Part B Carrier

March 6, 2009

Report Number: A-06-08-00015

Mr. Gordon L. Sato
Regional Inspector General for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services
1100 Commerce, Room 632
Dallas, TX 75242

Office of Inspector General Note: Portions of this response are no longer applicable because we reduced the unallowable costs and the potentially unallowable costs based on additional documentation submitted by the auditee.

Dear Mr. Sato,

This letter represents Pinnacle Business Solutions, Inc.'s (PBSI) response to draft Report Number A-06-08-00015 dated February 6, 2009. This report was issued as a result of the Office of Inspector General's (OIG) audit of PBSI's Fiscal Years 2005, 2006, and 2007 final administrative cost proposals (FACP).

Below you will find PBSI's written comments in response to each of the findings included within the draft report. An excel sheet summarizing these findings as well as the status of adjustments has been included as Attachment A for reference. The status of adjustments and actions necessary to remediate agreed upon findings is included in both Attachment A as well as discussions below.

Unallowable Costs:

- *Fiscal Year 2004 Costs:* PBSI agrees that FY 2004 costs were recognized on the FY 2005 FACP in the amount of \$3,160. These were allowable costs recognized inaccurately in FY 2005 rather than FY 2004. A settlement agreement has been finalized for the FY 2004 FACP; therefore, an adjustment to increase the FY 2004 expenses is not possible. PBSI will remove these costs in the next FY 2005 FACP submission.
- *Fringe Benefit Costs:*
 - *Lobbying Costs:* PBSI agrees that unallowable costs in the total amount of \$1,000 were included in the FY 2005 and FY 2006 FACP's (FY 2005 - \$484 / FY 2006 - \$516). PBSI did not file \$286,628 of its Program

Mr. Gordon L. Sato
March 6, 2009
Page 2 of 2

Management costs in FY 2006 (see Attachment B) in order to stay within notice of budget approval (NOBA); therefore, PBSI proposes to offset the FY 2006 finding amount of \$516 by these unfilled costs and remove the FY 2005 amount of \$484 in the next FY 2005 FACP submission.

- o *Training Costs*: PBSI does not agree that \$747 of training cost should be disallowed due to lack of supporting documentation. We have included documentation as Attachment C as support for this expenditure.
- o *State Unemployment Tax Refund*: PBSI agrees that unallowable costs in the amount of \$235 were included in the FY 2006 FACP related to a tax refund that was not applied. PBSI made an adjustment to the FY 2006 FACP supplement #05 dated July 31, 2008 to remove this cost. Therefore, no further adjustment is necessary.

Potentially Unallowable Costs:

The audit report recommends that PBSI work with the CMS contracting officer to determine the allowability of \$106,031 in set aside costs related to professional and consulting services and subcontractor services costs. Upon initial review of the detailed listing of vendor payments, PBSI has determined that \$9,220 of the expenses identified in the audit report were not included on the 2006 FACP; therefore, the total set aside amount should be adjusted downward by this amount, leaving a balance of \$96,811. PBSI does believe those remaining expenses to be allowable, and we will work with the CMS contracting officer to validate the allowability of those expenses.

We look forward to continuing our work with you to finalize this audit. If you have any questions or comments about our response please feel free to contact me at 501-210-9105.

Sincerely,



Dan Bloodworth
Sr. VP & CFO

/db

Attachments

cc: Kathy Markman
Janie Fenton
Amy Green