

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**ALMOST ALL OF PINNACLE'S MEDICARE
PART A ADMINISTRATIVE COSTS
REPORTED FOR FISCAL YEARS 2008 AND
2009 WERE ALLOWABLE**

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



**Patricia Wheeler
Regional Inspector General**

November 2012
A-06-11-00044

Office of Inspector General

<http://oig.hhs.gov>

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program known as Part A. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts with CMS provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims.

Following the close of each fiscal year (FY), each Medicare contractor submits to CMS a Final Administrative Cost Proposal (FACP) reporting Medicare administrative costs incurred during the year. The FACP and supporting data provide the basis for the CMS contracting officer and the Medicare contractor to negotiate a final settlement of allowable Medicare administrative costs. When claiming costs, Medicare contractors must follow cost reimbursement principles contained in part 31 of the Federal Acquisition Regulation (codified at 48 Code of Federal Regulations), the Medicare contract, and other applicable requirements.

Pinnacle Business Solutions, Inc. (Pinnacle), is a wholly owned subsidiary of BlueCross BlueShield of Arkansas. During our audit period (FYs 2008 and 2009), CMS contracted with Pinnacle to serve as Medicare Part A contractor for Arkansas, Louisiana, Mississippi, and Rhode Island. Pinnacle reported Medicare costs totaling \$17,699,913 on the FACP for FYs 2008 and 2009.

OBJECTIVE

Our objective was to determine whether the Medicare administrative costs that Pinnacle reported on the FACP for FYs 2008 and 2009 were allowable, allocable, and reasonable in accordance with Federal regulations and the Medicare contract.

SUMMARY OF FINDINGS

Pinnacle reported Medicare administrative costs that substantially complied with Federal regulations and the Medicare contract. However, Pinnacle reported \$52,147 in unallowable costs in its FY 2008 FACP and \$40,615 in unallowable costs in its FY 2009 FACP.

A breakdown of the unallowable costs is included as Appendix A.

RECOMMENDATION

We recommend that Pinnacle refund to the Federal Government \$52,147 for unallowable costs reported in its FY 2008 FACP and \$40,615 for unallowable costs reported in its FY 2009 FACP.

PINNACLE COMMENTS

In written comments on our draft report, Pinnacle agreed with our findings and recommendations. Pinnacle reported that it had implemented additional reviews of expenses charged to the contract to help prevent these types of charges in the future. Pinnacle's comments are included in their entirety as Appendix B

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INTRODUCTION

BACKGROUND

Medicare Program

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program, which provides for a hospital insurance program known as Part A. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contracts with private organizations that process and pay Medicare claims. The contracts with CMS provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims.

Following the close of each fiscal year (FY), each Medicare contractor submits to CMS a Final Administrative Cost Proposal (FACP) reporting Medicare administrative costs incurred during the year. The FACP and supporting data provide the basis for the CMS contracting officer and the Medicare contractor to negotiate a final settlement of allowable Medicare administrative costs. When claiming costs, Medicare contractors must follow cost reimbursement principles contained in part 31 of the Federal Acquisition Regulation (FAR) (codified at 48 Code of Federal Regulations), the Medicare contract, and other applicable requirements.

Pinnacle Business Solutions, Inc., Contract

Pinnacle Business Solutions, Inc. (Pinnacle), is a wholly owned subsidiary of BlueCross BlueShield of Arkansas. During our audit period (FYs 2008 and 2009), CMS contracted with Pinnacle to serve as a Medicare Part A contractor in Arkansas, Louisiana, Mississippi, and Rhode Island.¹ Pinnacle reported Medicare costs totaling \$17,699,913 on the FACPs for FYs 2008 and 2009.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the Medicare administrative costs that Pinnacle reported on the FACPs for FYs 2008 and 2009 were allowable, allocable, and reasonable in accordance with Federal regulations and the Medicare contract.

Scope

Our audit covered the period October 1, 2007, through September 30, 2009 (FYs 2008 and 2009). For this period, Pinnacle reported Medicare administrative costs of \$17,699,913.

Our objective did not require us to review Pinnacle's overall internal control structure.

¹ Effective June 2009, the Part A workload for Rhode Island was transferred to National Heritage Insurance Corporation.

Therefore, we limited our internal control review to Pinnacle's procedures for reporting costs on the FACPs.

We conducted fieldwork at the Pinnacle campus in North Little Rock, Arkansas.

Methodology

To accomplish our objective, we:

- reviewed (1) applicable Medicare laws, regulations, and guidelines, (2) the applicable sections of the FAR, and (3) Pinnacle's contract with CMS;
- reviewed Pinnacle's prior independent auditor's reports and a prior Office of Inspector General audit report;²
- reconciled the FACPs from FYs 2008 and 2009 to Pinnacle's accounting records;
- judgmentally selected and reviewed invoices, expense vouchers and reports, and journal entries;
- interviewed officials at Pinnacle about their cost accumulation processes for cost proposals and gained an understanding of its cost allocation systems;
- reviewed several cost allocation methods Pinnacle used in allocating costs to the FACPs;
- reviewed payroll journals, corporate bonus plans, and personnel records; and
- tested costs for allowability, allocability, and reasonableness.

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 RECOMMENDATION

Pinnacle reported Medicare administrative costs that substantially complied with Federal regulations and the Medicare contract. However, Pinnacle reported \$52,147 in unallowable costs in its FY 2008 FACP and \$40,615 in unallowable costs in its FY 2009 FACP.

A breakdown of the unallowable costs is included as Appendix A.

² *Audit of Pinnacle Business Solutions, Inc.'s, Medicare Part A Final Administrative Cost Proposals for Fiscal Years 2005 Through 2007 (A-06-08-00015)*, issued April 8, 2009.

UNALLOWABLE COSTS

Duplicated Costs

Pursuant to FAR § 31.201-4:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it: (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Pinnacle reported \$32,529 in unallowable costs in its FY 2008 FACP and \$25,600 in unallowable costs in its FY 2009 FACP. Specifically, Pinnacle included the same costs in multiple places when it adjusted its FACPs.

General and Administrative Costs

Pursuant to FAR § 31.201-4:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it: (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Pinnacle reported \$14,190 in unallowable general and administrative costs in its FY 2008 FACP and \$1,392 in unallowable general and administrative costs in its FY 2009 FACP. Pinnacle allocated general and administrative costs based on direct cost percentages for its different lines of business. However, Pinnacle did not include all direct costs and included some indirect costs in its calculation of the direct cost percentages.

Subcontract Costs

Pursuant to FAR § 31.201-3: “A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.”

Additionally, FAR § 31.201-4 states:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject

to the foregoing, a cost is allocable to a Government contract if it: (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Pinnacle reported \$8,325 in unallowable subcontract costs on its FY 2009 FACP. Specifically, Pinnacle allocated 50 percent of a subcontract to Medicare even though the supporting documentation showed that 40 percent should have been allocated.

Gift Card Costs

Pursuant to FAR § 31.205.13(b): “Costs of gifts are unallowable.”

Pinnacle reported \$5,428 in unallowable costs in its FY 2008 FACP and \$2,542 in unallowable costs in its 2009 FACP for holiday gift cards given to each employee.

Travel Costs

Appendix B, section XII, of the Medicare contract states: “... The reasonable cost of such automobiles which may be charged to this agreement/contract shall be the actual cost not to exceed the rate published in the Federal Travel Regulations, as issued by the General Services Administration during the term of this agreement/contract.”

Pinnacle reported \$1,951 in unallowable automobile costs in its FY 2009 FACP. Specifically, Pinnacle reported automobile costs that were in addition to the allowed mileage rate.

Duplicate Payroll Costs

Pursuant to FAR § 31.201-4:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it: (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Pinnacle reported \$593 in unallowable payroll costs in its FY 2009 FACP. Specifically, Pinnacle duplicated payroll entries.

Penalties

Federal regulations (FAR § 31.205.15(a)) state: “Cost of fines and penalties resulting from violations or failure of the contractor to comply with, Federal, State, Local or foreign laws or

regulations are unallowable.”

Furthermore, FAR § 31.201-5 states: “Applicable portions of any income, rebate, allowance, or other credit relating to any allowable cost and received or accruing to the contractor shall be credited to the Government cost reduction or by cash refund.”

Pinnacle reported \$212 in unallowable costs for penalties in its FY 2009 FACP. Specifically, Pinnacle reported a credit for the net amount of a tax refund that had been reduced because of penalties.

RECOMMENDATION

We recommend that Pinnacle refund to the Federal Government \$52,147 in unallowable costs reported in its FY 2008 FACP and \$40,615 for unallowable costs reported in its FY 2009 FACP.

PINNACLE COMMENTS

In written comments on our draft report, Pinnacle agreed with our findings and recommendations. Pinnacle reported that it had implemented additional reviews of expenses charged to the contract to help prevent these types of charges in the future. Pinnacle’s comments are included in their entirety as Appendix B.

APPENDIXES

APPENDIX A: SUMMARY OF UNALLOWABLE COSTS

Type of Cost	Unallowable Amount	
	Fiscal Year 2008	Fiscal Year 2009
Duplicate Costs	\$32,529	\$25,600
General and Administrative Costs	14,190	1,392
Subcontract Costs		8,325
Gift Card Costs	5,428	2,542
Travel Costs		1,951
Duplicate Payroll Costs		593
Penalties		212
Total	\$52,147	\$40,615

APPENDIX B: PINNACLE COMMENTS



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October 26, 2012

Office of Inspector General
Office of Audit Services, Region VI
Attn: Patricia Wheeler, Regional Inspector General for Audit Services
1100 Commerce Street, Room 632
Dallas, Texas 75242

RE: Report Number A-06-11-00044

Dear Ms. Wheeler,

Pinnacle Business Solutions, Inc. (PBSI) has received the draft report for the audit of the Part A Administrative Costs for Fiscal Years 2008 and 2009. We concur with both the Summary of Findings and Recommendations that are listed within the report. PBSI has implemented additional reviews of expenses charged to the contract to help prevent these types of charges in the future. This includes, but not limited to, monthly reviews of allocation calculations, second level reviews of all adjustment calculations and entry, as well as additional reviews on specific expense accounts related to non-allowable expenses. We appreciate the opportunity to address the findings within the report. Please feel free to contact me at (501) 210-9108 should you or your staff have any further questions.

Sincerely,

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Amy Green
Controller & CFO
Pinnacle Business Solutions, Inc.