

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**MOST OF PINNACLE'S MEDICARE PART B  
ADMINISTRATIVE COSTS REPORTED FOR  
FISCAL YEARS 2008 AND 2009 WERE  
ALLOWABLE**

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**Patricia Wheeler  
Regional Inspector General**

November 2012  
A-06-11-00045

# *Office of Inspector General*

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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 supplementary medical insurance program known as Part B. 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 in Title 48 of the 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 a Medicare Part B contractor for Arkansas, Louisiana, Missouri, New Mexico, Oklahoma, and Rhode Island. Pinnacle reported Medicare costs totaling \$76,143,707 on the FACPs for FYs 2008 and 2009.

### **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.

### **SUMMARY OF FINDINGS**

Pinnacle reported Medicare administrative costs that substantially complied with Federal regulations and the Medicare contract. However, Pinnacle underreported \$93,731 in costs on its FACPs: Pinnacle reported \$65,550 in unallowable costs on its FY 2009 FACP; it underreported \$191,611 in allowable costs and reported \$32,330 in unallowable costs on its FY 2008 FACP.

### **RECOMMENDATIONS**

We recommend that Pinnacle:

- refund to the Federal Government \$65,550 for unallowable costs reported on its FY 2009 FACP and

- report the additional allowable administrative costs of \$191,611 and refund the \$32,330 in unallowable costs on its FY 2008 FACP.

## **PINNACLE COMMENTS**

In written comments on our draft report, Pinnacle agreed with our findings and recommendations and indicated that they implemented additional controls to 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 supplementary medical insurance program known as Part B. 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 in Title 48 of the 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 B contractor for Arkansas, Louisiana, Missouri, New Mexico, Oklahoma, and Rhode Island.<sup>1</sup> Pinnacle reported Medicare costs totaling \$76,143,707 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 administrative costs totaling \$76,143,707.

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<sup>1</sup> Effective March 2008, the Part B workload for Oklahoma and New Mexico was transferred to TrailBlazer and, effective June 2008, the Part B workload for Missouri was transferred to Wisconsin Physicians Service Health Insurance Corporation. In addition, effective June 2009, the Part B workload for Rhode Island was transferred to National Heritage Insurance Corporation.

Our objective did not require us to review Pinnacle's overall internal control structure. 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;<sup>2</sup>
- 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 Pinnacle officials about their cost accumulation processes for cost proposals and gained an understanding of Pinnacle's cost allocation systems;
- reviewed several cost allocation methods Pinnacle used to allocate 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 RECOMMENDATIONS**

Pinnacle reported Medicare administrative costs that substantially complied with Federal regulations and the Medicare contract. However, Pinnacle underreported \$93,731 in costs on its FACPs: Pinnacle reported \$65,550 in unallowable costs on its FY 2009 FACP; it underreported \$191,611 in allowable costs and reported \$32,330 in unallowable costs on its FY 2008 FACP.

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<sup>2</sup> *Audit of Pinnacle Business Solutions, Inc.'s, Medicare Part B Final Administrative Cost Proposals for Fiscal Years 2005 Through 2007 (A-06-08-00016)*, issued April 2, 2009.

## **UNALLOWABLE COSTS**

### **Gift Cards**

Federal regulations (FAR § 31.205.13(b)) state: “Costs of gifts are unallowable.”

Pinnacle reported \$32,330 in its FY 2008 FACP and \$13,358 in its FY 2009 FACP of unallowable costs 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 \$24,341 in unallowable automobile costs on its FY 2009 FACP. Specifically, Pinnacle reported automobile costs that were in addition to the allowed mileage rate.

### **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 underreported \$5,644 in general and administrative costs in its FY 2008 FACP and reported \$14,540 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): “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 the cost of a subcontract to Medicare even though the supporting documentation showed that 40 percent should have been allocated.

### **Penalties**

FAR § 31.205-15(a) states: “Costs of fines and penalties resulting from violations of or failure of the contractor to comply with, Federal, State, local or foreign laws and regulations are unallowable ....”

Furthermore, FAR § 31.201-5 states: “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 reported \$2,639 in unallowable costs for penalties on its FY 2009 FACP. Specifically, Pinnacle reported a credit for the net amount of a tax refund that had been reduced because of penalties.

### **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 \$2,347 in unallowable payroll costs on its FY 2009 FACP. Specifically, Pinnacle duplicated payroll entries, which overstated costs reported to Medicare.

## **UNDERREPORTED COSTS**

### **Adjustment Errors**

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 underreported allowable costs by \$185,967 on its FY 2008 FACP. Pinnacle made several adjustments that decreased the FACP. However, Pinnacle included the same costs in more than one of those adjustments, which understated the allowable costs that could have been reported to Medicare.

### **RECOMMENDATIONS**

We recommend that Pinnacle:

- refund to the Federal Government \$65,550 for unallowable costs reported on its FY 2009 FACP and
- report the additional allowable administrative costs of \$191,611 and refund the \$32,330 in unallowable costs on its FY 2008 FACP.

### **PINNACLE COMMENTS**

In written comments on our draft report, Pinnacle agreed with our findings and recommendations and indicated that they have implemented additional controls to 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 AND UNDERREPORTED COSTS****FISCAL YEAR 2008**

<b>Type of Cost</b>	<b>Unallowable Amount</b>	<b>Underreported Amount</b>	<b>Total</b>
Gift Cards	\$32,330		\$32,330
General and Administrative Costs		(\$5,644)	(5,644)
Adjustment Errors		(185,967)	(185,967)
<b>Total</b>	<b>\$32,330</b>	<b>(\$191,611)</b>	<b>(\$159,281)</b>

**FISCAL YEAR 2009**

<b>Type of Cost</b>	<b>Unallowable Amount</b>
Gift Cards	\$13,358
Travel Costs	24,341
General and Administrative Costs	14,540
Subcontract Costs	8,325
Penalties	2,639
Duplicate Payroll Costs	2,347
<b>Total</b>	<b>\$65,550</b>

## 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-06-11-00045

Dear Ms. Wheeler,

Pinnacle Business Solutions, Inc. (PBSI) has received the draft report for the audit of the Part B 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.