DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date: OCT 19 1998

From: June Gibbs Brown
Inspector General

June G Brown

Subject: Review of Administrative Costs - Medicare Parts A and B - Aetna Life Insurance Company (A-01-97-00529)

To: Nancy-Ann Min DeParle
Administrator
Health Care Financing Administration

This memorandum is to alert you to the issuance on Wednesday, October 21, 1998 of our final report. A copy is attached.

The audit covered the costs claimed on Aetna Life Insurance Company's (Aetna) final administrative cost proposals (FACP) for Parts A and B of the Medicare program for the fiscal years (FY) 1995 through 1997. Of the total claimed, we are recommending adjustments of $2,906,486 (Part A - $1,335,545; Part B - $1,570,941) because Aetna:

- o included unallowable costs of $1,691,129 (Part A - $730,942; Part B - $960,187) for allocations from various corporate cost centers that did not benefit Medicare, adjustments related to changes in corporate cost pool allocation ratios and other miscellaneous adjustments.

- o allocated to Medicare, $204,930 (Part A - $72,757; Part B - $132,173) for unallowable costs related to the corporate training and conference center. The allocation of these costs was not equitable to the Medicare program based on Medicare's usage of the facilities.

- o claimed $141,342 (Part A - $25,944; Part B - $115,398) for unallowable costs related to Aetna's Property and Casualty (P&C) line of business. A corporate reorganization in January 1995 changed the functions of the cost centers related to P&C and they were no longer allocable to Medicare.

- o overstated the FYs 1995 and 1996 FACPs by $869,085 (Part A - $505,902; Part B - $363,183) for incentive payment fees. These fees were overstated because the FACPs did not reflect (1) HCFA penalty assessments against Aetna for failing to meet minimum performance requirements for certain program safeguards and (2) adjustments initiated by Aetna and other audit adjustments recommended by the Office of Inspector General that resulted in changes to the allowable incentive payment fee.

In its response, Aetna agreed with all recommended adjustments.

For further information, contact:

William J. Hornby
Regional Inspector General
for Audit Services, Region I
(617) 565-2687

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF ADMINISTRATIVE COSTS MEDICARE PARTS A AND B AETNA LIFE INSURANCE COMPANY

JUNE GIBBS BROWN
Inspector General

OCTOBER 1998
A-01-97-00529

OFFICE OF INSPECTOR GENERAL

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DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL

Office of Audit Services
Region I
John F. Kennedy Federal Building
Boston, MA 02203
(617) 565-2684

CIN: A-01-97-00529

Mr. John Bermel
Controller
Aetna US HealthCare MB65
151 Farmington Avenue
Hartford, Connecticut 06156-7380

Dear Mr. Bermel:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) report entitled "Review of Administrative Costs, Medicare Part A and Part B, Aetna Life Insurance Company." The report covered costs claimed during the period October 1, 1994 through September 30, 1997. 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 named below. We request that you respond to 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, OAS reports issued to the Department's grantees or 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 Code of Federal Regulations, Part 5.)

To facilitate identification, please refer to Common Identification Number A-01-97-00529 in all correspondence relating to this report.

Sincerely yours,

William J. Hornby

William J. Hornby
Regional Inspector General
for Audit Services

Enclosures - as stated

Direct Reply to HHS Action Official:

Ms. Lynda Silva
Associate Regional Administrator
Division of Financial Management
Health Care Financing Administration
Room 2275, JFK Federal Building
Boston, Massachusetts 02203

EXECUTIVE SUMMARY

BACKGROUND

The Health Care Financing Administration (HCFA) administers the Medicare program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. The HCFA has contracted with Aetna Life Insurance Company (Aetna) to process Part A claims submitted by certain hospitals and other medical suppliers in the states of Connecticut, California, Florida, Illinois, Massachusetts and Pennsylvania. During the period October 1994 through September 1997, Aetna claimed administrative costs of $125 million to process 32 million Part A claims.

Aetna has also been contracted to process Part B claims submitted by physicians and other medical suppliers in the states of Alaska, Arizona, Georgia, Hawaii, Nevada, New Mexico, Oregon, Oklahoma and Washington. During the period October 1994 through September 1997, Aetna claimed administrative costs of $198 million to process 136 million Part B claims.

OBJECTIVES

The objectives of our review were to determine (1) whether Aetna has established effective systems of internal control, accounting and reporting for administrative costs and (2) the allowability of costs claimed for the period October 1994 through September 1997.

RESULTS OF REVIEW

We found that Aetna has generally established adequate systems of internal control, accounting, and reporting for administrative costs. Further, most of the administrative costs claimed for the period October 1994 through September 1997 were allowable under the provisions of the contract with HCFA and applicable parts of the Federal Acquisition Regulations. However, we identified $2,906,486 ($1,335,545 - Part A and $1,570,941 - Part B) which consist of unallowable charges to Medicare program as well as the net effect of related incentive payments on the Final Administrative Cost Proposals (FACPs) for the period under review. The issues related to these unallowable costs and adjustments are briefly summarized below and reported in more detail in the FINDINGS AND RECOMMENDATIONS section of this report.

- Aetna made a decision to terminate from the Medicare program, effective September 30, 1997. Because of time constraints resulting from this decision, our audit analysis of fiscal year (FY) 1997 administrative costs was based on Aetna's September 30, 1997 Interim Expenditure Reports (IERs). Our review of the IERs disclosed that Aetna inappropriately allocated to Medicare costs of corporate cost centers that provided no benefits to the Medicare program. In addition, during the preparation of the FY 1997 FACPs, Aetna identified other cost centers that were inappropriately allocated to Medicare, adjustments that were necessitated because of revisions to corporate indirect cost allocation ratios and other miscellaneous adjustments that were required for costs included in the IERs. The net effect of these adjustments resulted in a decrease of allowable costs claimed of $1,691,129 ($730,942 - Part A and $960,187 - Part B). These adjustments were made by Aetna in the FACPs submitted to HCFA on January 28, 1998, thus, no further recommendations are necessary (See Page 4).

- Aetna allocated costs of the corporate training and conference facility to Medicare in FYs 1995 and 1996. We found that the basis of the allocations did not provide an equitable allocation to Medicare. We recalculated the allocation based on Medicare usage of the facility for the two years and determined that costs were overstated. We are recommending that the FY 1995 FACPs be decreased by $171,641 ($60,185 - Part A and $111,456 - Part B) and the FY 1996 FACPs be decreased by $33,289 ($12,572 - Part A and $20,717 - Part B) (See Page 8).

- Aetna included costs in the FYs 1995 and 1996 FACPs for certain cost centers that were identified as related to the company's Property and Casualty (P&C) line of business. It was found that, as a result of a corporate reorganization in January 1995, the P&C cost centers were no longer allocable to Medicare because of function changes. However, some of these cost centers continued to be allocated to Medicare into FY 1996. We are recommending that the FY 1995 FACPs be decreased by $73,936 ($12,240 - Part A and $61,696 - Part B) and the FY 1996 FACPs be decreased by $67,406 ($13,704 - Part A and $53,702 - Part. B) (See Page 9).

- Aetna submitted FACPs for FYs 1995 and 1996 that need to be reduced to reflect HCFA assessed penalties, which reduced the amount of allowable incentive payments because Aetna did not meet minimum performance requirements for certain program safeguards. While Aetna was not reimbursed for these penalty reductions, the FACPs were not adjusted to reflect the reductions. In addition, our review disclosed that the incentive payment amounts included on the FYs 1995 and 1996 FACPs need to be adjusted because of the Office of Inspector General, Office of Audit Services' (OIG/OAS) recommended audit adjustments and Aetna adjustments to costs included in the FACPs already submitted to HCFA. We are recommending that the FY 1995 FACPs be decreased by $491,708 ($108,528 - Part A and $383,180 - Part B) and the FY 1996 Part A FACP be decreased by $397,374 and the FY 1996 Part B FACP be increased by $19,997 (See Page 10).

Aetna officially terminated from the Medicare program as of September 30, 1997. The HCFA has agreed to reimburse Aetna for costs related to termination of the contract, including shutdown expenses incurred subsequent to the transfer of the workload and prior to the closure of all Medicare offices and for severance costs related to terminated Medicare employees. These expenses are being submitted to HCFA for reimbursement in separate vouchers. We are currently reviewing the allowability of these termination and severance costs in a separate audit. The results of this review will be included in a separate audit report under CIN:A-01-98-00509.

During our current review of the administrative costs claimed for FYs 1995 through 1997, it was brought to our attention that costs of $1,527,022 related to depreciation and the remaining net book value of assets still on Aetna's Medicare books as of the closing dates of the various Medicare offices were inadvertently included in the FY 1997 FACP as ongoing administrative costs. Discussions with Aetna Medicare and HCFA personnel indicated that it would be a time consuming project to revise the FACP. Thus, to avoid unnecessary administrative work, HCFA indicated that the costs will remain as claimed in the FY 1997 FACPs (See OTHER MATTERS).

In response to our draft report (see **APPENDIX D**), Aetna officials agreed with all recommended adjustments included in the report.

Related Reports

The OIG,OAS Region VII office has conducted reviews of pension costs charged to the Medicare program by Aetna and other Medicare contractors. These individual contractor reviews were performed as part of a nationwide review of pension costs. The most recent review of Aetna's claim for Medicare pension costs included the period January 1, 1991 through January 1, 1996. The results of the Aetna review are included in the following draft audit reports entitled, "Audit of Medicare Contractor's Pension Segmentation - Aetna Life Insurance Company" (CIN: A-07-97-02505) and "Review of Unfunded Pension Costs of the Aetna Life Insurance Company" (CIN: A-07-98-02506) issued January 21, 1998. Aetna's claim for pension costs for the period January 1, 1996 to September 30, 1997 (the date Aetna terminated as a Medicare contractor) will be covered under future nationwide reviews of pension costs. As a result, we excluded all pension costs from the scope of our current review.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Health Insurance for the Aged and Disabled (Medicare) program. This program provides for hospital insurance and related medical insurance for (a) eligible persons aged 65 and over, (b) disabled persons under 65 who have been entitled to Social Security benefits for at least 24 consecutive months and (c) individuals under age 65 with chronic kidney disease who are currently insured by or entitled to Social Security benefits.

Specifically, Part A of the program is the hospital insurance program and provides coverage related to the cost of inpatient hospital care, post-hospital extended care and post-hospital home health care. Part B of the program is the voluntary medical insurance program and provides protection against the cost of physician services, hospital outpatient services, home health care and other health services.

The Health Care Financing Administration (HCFA) administers the Medicare program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. Contractors administering the Part A provisions of the program are known as Intermediaries and those administering the Part B provisions are known as Carriers. The contracts define the functions to be performed by the Intermediaries and Carriers and provide for the reimbursement of allowable administrative costs incurred in their performance. Such costs are claimed for reimbursement through submission of Final Administrative Cost Proposals (FACP) to HCFA.

Aetna Life Insurance Company (Aetna) has been contracted to process Part A claims submitted by certain hospitals and other medical suppliers in the states of Connecticut, California, Florida, Illinois, Massachusetts and Pennsylvania. In addition to the Medicare Home Office Administration, Aetna has also established five Part A field offices to assist in processing claims submitted for payment. During the period October 1994 through September 1997, Aetna claimed for reimbursement, administrative costs of $125,099,603 to process 32,346,903 Part A claims. In addition, Aetna proposed adjustments to the Part A FACPs for this period increasing the claim for reimbursement by $91,575.

Aetna has also been contracted to process Part B claims submitted by physicians and other medical suppliers in the states of Alaska, Arizona, Georgia, Hawaii, Nevada, New Mexico, Oregon, Oklahoma and Washington. Aetna established seven Part B field offices to assist in processing claims submitted for payment. During the period October 1994 through September 1997, Aetna claimed for reimbursement, administrative costs of $198,258,664 to process 136,067,898 Part B claims. In addition, Aetna proposed adjustments to the Part B FACPs for this period increasing the claim for reimbursement by $77,031. The administrative costs claimed under both Parts A and B include direct costs of administering the programs as well as allocations of certain corporate costs associated with corporate services utilized by Aetna's Medicare administration.

OBJECTIVES

The objectives of our review were to determine (1) whether Aetna has established effective systems of internal control, accounting and reporting for administrative costs and (2) the allowability of costs claimed for the period October 1994 through September 1997.

SCOPE

Our review was conducted in accordance with generally accepted government auditing standards. In performing our review, we:

- traced the amounts claimed on the FACPs, for the three fiscal years ending September 30, 1997, to Aetna's corporate books and records;

- identified and analyzed significant changes in the amounts claimed for each type of cost during the three fiscal years;

- reviewed the significant internal control areas identified relevant to our audit objective;

- performed detailed audit tests of costs claimed for salaries and fringe benefits, facility and occupancy, legal, complementary credits and incentive payment fees;

- performed detailed audit tests of various costs allocated to Medicare from corporate cost centers, including a review of the methods and bases of allocation of such costs; and

- followed up on findings and recommendations identified during the previous administrative cost audit conducted at Aetna to determine whether the reported deficiencies were corrected.

With respect to our review of internal controls, we reviewed those controls in place for (1) identifying and accumulating costs related to the administration of the program and the reporting of such costs on FACPs, (2) ensuring that methods used to allocate corporate cost centers to the Medicare program were reasonable and (3) identifying costs that are unallowable under applicable regulations and eliminating such costs from the claims for reimbursement. We also reviewed specific controls in place for individual cost categories selected for review.

We limited our detailed testing of individual transactions in the major expense accounts based on the results of our review of internal controls and other tests. At the time of the start of our audit field work in October 1997, Aetna had not completed the fiscal year (FY) 1997 FACP. The FACP was due on December 31, 1997. As a result, we agreed, along with Aetna and HCFA, to perform our initial audit work for FY 1997 using Aetna's Interim Expenditure Reports (IERs) for FY 1997 for Parts A and B, which were submitted to HCFA on October 17, 1997.

We did not review the pension costs claimed by Aetna as part of fringe benefits. These costs were reviewed by personnel from the Office of Inspector General, Office of Audit Services (OIG, OAS) Region VII office as part of a nationwide review of Medicare pension costs. The results of the Region VII review at Aetna are contained in the draft audit reports entitled, "Audit of Medicare Contractor's Pension Segmentation - Aetna Life Insurance Company" (CIN: A-07-97-02505) and "Review of Unfunded Pension Costs of the Aetna Life Insurance Company" (CIN: A-07-98-02506) issued on January 21, 1998. Both of these audits covered the period January 1, 1991 through January 1, 1996. Aetna's claim for pension costs for the period January 1, 1996 to September 30, 1997 (the date Aetna terminated as a Medicare contractor) will be covered under future nationwide reviews of pension costs.

Our findings on the evaluation of the items tested during our audit are included in the **FINDINGS AND RECOMMENDATIONS** section of this report. We conducted our review at Aetna's Medicare Home Office Administration in Middletown, Connecticut and Aetna's corporate offices in Hartford, Connecticut during the period October 1997 through March 1998.

FINDINGS AND RECOMMENDATIONS

We found that Aetna has generally established adequate systems of internal control, accounting, and reporting for administrative costs. Further, most of the administrative costs claimed for the period October 1994 through September 1997 were allowable under the provisions of the contract with HCFA and applicable parts of the Federal Acquisition Regulations (FARs). However, we identified $2,906,486 ($1,335,545 - Part A and $1,570,941 - Part B) which consist of unallowable charges to the Medicare program as well as the net effect of related incentive payments on the FACPs for the period under review. A more detailed discussion of these findings and recommendations follow.

REVIEW OF INTERIM EXPENDITURE REPORT FOR FISCAL YEAR 1997

Aetna made a decision to terminate its contract with HCFA as an Intermediary and Carrier under the Medicare program effective September 30, 1997. Because of the termination of the contract, HCFA requested that we perform the audit of Aetna's claim for administrative costs for the period October 1, 1994 through September 30, 1997. However, at the time of the start of our audit, Aetna had not yet compiled the FACP for fiscal year FY 1997 as it was not due until December 31, 1997. Because of time constraints resulting from Aetna's decision to terminate from the program, we agreed, in conjunction with HCFA and Aetna, that we would perform our audit analysis for FY 1997 based on Aetna's September 30, 1997 IERs for Parts A and B submitted to HCFA on October 17, 1997. The other years included in the scope of the audit were based on the FACPs submitted by Aetna.

Our review of the FY 1997 IERs disclosed that Aetna allocated to Medicare, costs associated with specific corporate cost centers which provided no benefits to the Medicare program. In addition, during the preparation of the FY 1997 FACPs, Aetna Medicare personnel identified other cost centers that were inappropriately included in the IERs, adjustments that were necessitated because of revisions to corporate indirect cost allocation ratios and miscellaneous adjustments that are routinely made when the FACPs are prepared. The net effect of all these adjustments resulted in a decrease of allowable costs claimed of $1,691,129 ($730,942 - Part A and $960,187 - Part B). Aetna incorporated these adjustments in the FY 1997 FACPs submitted to HCFA on January 28, 1998. The following paragraphs summarize the details on these adjustments.

Corporate Costs Centers Not Allocable To Medicare

During our analysis of the FY 1997 IERs, we noted that Aetna included allocations for a number of corporate costs centers that had not been previously allocated to Medicare and other cost centers which, based on the cost center's name, appeared to be related to specific lines of Aetna's private businesses. In order to be allowable charges to Medicare, costs must be allocable. FAR, Part 31.201-4, addresses allocability as follows:

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

Based on documentation provided by Aetna Medicare officials relative to the selected cost centers, we determined that costs totaling $1,069,925 ($402,614 - Part A and $667,311 - Part B) were inappropriately included in the FY 1997 IERs because the functions of these cost centers were specifically related to lines of business other than Medicare and, thus, provided no apparent benefits to the Medicare program. Details of these inappropriate allocations are as follows:

(1) Costs totaling $670,674 ($222,673 - Part A and $448,001 - Part B) were included in the FY 1997 IERs for cost centers established specifically for the integration of US HealthCare into the Aetna corporation. Aetna and US HealthCare merged in July 1996. These cost centers were established to provide data processing and operational support services specifically associated with the US HealthCare integration and provided no benefits to the Medicare program. Based on this, we concluded that these costs were not allocable to the program. Aetna officials agreed and eliminated the costs from the final claim for Medicare reimbursement.

(2) Costs totaling $204,825 ($64,045 - Part A and $140,780 - Part B) were included in the FY 1997 IERs for Medicare's share of costs related to a corporate facility known as The Hastings. This facility had been used for corporate meetings and training functions. However, we noted that in 1996, the facility was converted to a commercial hotel and conference center and was available for the general public's use. For FY 1997, the facility's costs were allocated to Medicare based on the ratio of full time equivalent (FTE) Medicare employees to companywide FTEs. However, because the facility was now a commercial operation, we questioned whether this was an equitable allocation base. We requested documentation regarding Medicare's usage of the facility for FY 1997 and any other support for the Medicare allocation. Documentation disclosed that Medicare's use of the facility was minimal in FY 1997 and Aetna Medicare officials were not able to obtain adequate documentation to support the costs allocated to Medicare for FY 1997. They agreed that the allocations were not appropriate and eliminated the costs from the FY 1997 final claim for administrative costs.

(3) Costs totaling $194,426 ($115,896 - Part A and $78,530 - Part B) included in the FY 1997 IERs were allocated to Medicare for corporate cost centers that provided desktop support services for Aetna corporate operations in various locations in the United States. We requested documentation to support this allocation and the extent to which the cost center benefitted the Medicare program. Aetna Medicare officials were not able to provide such support and agreed that the allocation to Medicare was not appropriate and eliminated the costs from the FY 1997 final claim for administrative costs.

Based on these adjustments, Aetna Medicare officials eliminated costs of $402,614 from the Part A FY 1997 FACP and $667,311 from the Part B FY 1997 FACP.

Revisions To FY 1997 Indirect Cost Pool Code Ratios

In addition to the cost centers noted above, Aetna Medicare personnel identified other adjustments to corporate cost center expenses that were inappropriately allocated to Medicare. In addition, Aetna Medicare personnel identified other adjustments that were necessitated by revisions to corporate allocations ratios. The latter adjustments were related to the elimination of costs from the allocation bases and changes in statistical data associated with corporate cost centers that resulted from updated information received from these cost centers. The net effect of the adjustments was a decrease in costs claimed for the corporate cost centers of an additional $772,899 ($300,813 - Part A and $472,086 - Part B).

Corporate indirect costs that are associated with the overall administration of the Aetna corporation can be allocated to Medicare. According to FAR Part 31.203(a), such costs include those costs that are general in nature and are assignable to more than one cost objective or business unit but not identified specifically with any final cost objective. In order to properly allocate such costs to Medicare, Aetna develops corporate allocation ratios by accumulating costs and statistical data under various cost groupings based on information provided by the corporate cost centers. Specifically, FAR Part 31.203(b) provides the following guidance for accumulating these costs:

> "Indirect costs shall be accumulated by logical cost groupings...Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives...This necessitates selecting a distribution base common to all cost objectives to which the grouping is to be allocated."

Any changes to the data used to develop the cost groupings or allocation ratios that occur during the course of the year, due to revisions to expense or statistical data, require adjustments to the allocation ratios and, thus, related adjustments to the costs allocated to Medicare. Such changes are due to revisions resulting from inappropriate costs included in the cost groupings or from updated corporate statistical data initially provided to Medicare by corporate departments. Many of these changes are not identified until Medicare personnel are in the process of preparing the FACPs. As a result, adjustments are normally required from the time that the IERs are prepared, as of September 30 of each year, to the preparation of the FACPs.

The three inappropriately allocated cost centers we identified and discussed in the previous section of this report were originally included in the cost groupings used to develop the cost allocation ratios for the FY 1997 IERs. In addition, Aetna Medicare personnel identified other inappropriately allocated cost centers and also determined that certain corporate statistical data that was outdated and needed to be updated. Therefore, it was necessary for Aetna Medicare personnel to adjust the indirect cost groupings and revise the corporate cost allocation ratios. As a result of these adjustments, Aetna Medicare personnel determined that the allocations to Medicare for approximately 300 corporate cost centers need to be revised because of the revisions to the corporate expenses and/or statistical data. Many of these changes resulted in only minor variances of the costs claimed. However, the net effect of these changes resulted in a decrease of $772,899 ($300,813 - Part A and $472,086 - Part B) in allowable Medicare costs for FY 1997. Aetna Medicare personnel made these adjustments and eliminated the costs from the FY 1997 FACPs.

Miscellaneous Adjustments to the FY 1997 IERs

Other miscellaneous adjustments were made to the FY 1997 IERs by Aetna personnel which resulted in a net increase in the total allowable costs from the IERs to the FACPs by $151,695 (decrease of $27,515 - Part A and increase of $179,210 - Part B). These are normal adjustments that were identified by Aetna in the compilation of the FACPs. The adjustments included the following:

Type of Adjustment	Part A	Part B	Total
Various Unallowable Expenses	$ (9,802)	$ (18,761)	$ (28,563)
Adjustments to Credits	125	(43,362)	(43,237)
Salary Transfers	(28,357)	(24,936)	(53,293)
Accrual Adjustments	(40,018)	149,509	109,491
Cost of Money Calculation	54,654	116,760	171,414
Employee Relocation Expenses	(4,117)	-0-	(4,117)
Totals	$ (27,515)	$179,210	$151,695

The above adjustments included such items as, elimination of unallowable travel costs for excess per diem, salary costs that were not related to the regular ongoing Medicare administrative costs, normal adjustments to accruals, the cost of money calculation and other miscellaneous adjustments. Aetna also adjusted for these costs in the FACPs for FY 1997.

RECOMMENDATION

Based on the adjustments we identified, as well as the additional adjustments determined by Aetna, costs of $1,691,129 ($730,942 - Part A and $960,187 - Part B) were eliminated from the FACPs submitted to HCFA on January 28, 1998. As a result, of Aetna's corrective action, no further financial adjustments are necessary. Also, because Aetna is terminating its Medicare contract, no procedural recommendations are necessary.

AUDITEE COMMENTS

In response to our draft report (see **APPENDIX D**), Aetna officials agreed with the recommended adjustments.

ALLOCATION OF CORPORATE TRAINING AND CONFERENCE CENTER

Previously in this report, we discussed the allocation to Medicare of costs related to The Hastings hotel and conference center. We noted that the FY 1997 allocation could not be supported and was disallowed. We expanded our review to include the Medicare allocations of The Hastings for FYs 1995 and 1996. Our review disclosed that the allocations for these fiscal years were also overstated. We are recommending the disallowance of $204,930 ($72,757 - Part A and $132,173 - Part B).

The allocation of costs related to The Hastings for these fiscal years was similar to that used for FY 1997 in that it was based on the availability of the use of the facility to all lines of business. In this regard, Aetna utilized an allocation base related to the percentage of total Medicare FTEs to total company-wide FTEs. Discussions with personnel of The Hastings disclosed that the facility began converting to a commercial operation in mid-1996. However, even before this time frame, the facility had been used by other personnel who are not considered in the FTE ratios, such as Aetna sales agents and also the general public. As a result, using the FTE ratio to allocate costs did not consider all users of the facility and, therefore, we believed that this provided an inequitable allocation of costs to the various lines of business, including Medicare.

Further review of financial data obtained from personnel of The Hastings disclosed that the frequency of usage of the facility by Medicare personnel during 1995 and 1996 was significantly less than the allocations made based on the FTE ratio, which amounted to $243,044 and $171,678 for FYs 1995 and 1996, respectively. Discussions with Aetna Medicare personnel indicated that the data received from The Hastings did not identify all Medicare usage. They stated that the billing system used by the Hastings included both direct charges to specific cost centers and also billings to corporate lines of business which do not specifically identify the department that utilized the facilities. The Medicare personnel stated that because of this billing system, some of Medicare's other periodic meetings and training conferences routinely held at The Hastings by Aetna's Part A and B management as well other Medicare Home Office components, were not identified in the data from The Hastings. We attempted to obtain additional documentation regarding Medicare's usage of the facility for this time frame but none was available. Based on the information received from The Hastings and our discussions with Medicare personnel, we arrived at a reasonable estimate of the amount of costs allocable to Medicare for The Hastings.

Our recalculation of what we believed to be the appropriate amount allocable to Medicare based on these estimates and the amount of overstated costs claimed for FYs 1995 and 1996 is as follows:

	Fiscal Year	Part A	Part B	Total
Per Aetna Claim	1995	$85,176	$157,868	$243,044
Per OIG/OAS		24,991	46,412	71,403
Overstated Claim - FY 1995		$60,185	$111,456	$171,641
Per Aetna Claim	1996	$61,008	$110,670	$171,678
Per OIG/OAS		48,436	89,953	138,389
Overstated Claim - FY 1996		$12,572	$20,717	$33,289

Aetna Medicare personnel agreed that the original allocations for FYs 1995 and 1996 were overstated and agree with our recalculation.

RECOMMENDATION

We recommend that the FY 1995 FACPs be reduced by $171,641 ($60,185 - Part A and $111,456 - Part B) and the FY 1996 FACPs be reduced by $33,289 ($12,572 - Part A and $20,717 - Part B). Because Aetna is terminating its Medicare contract, we have no further procedural recommendations.

AUDITEE COMMENTS

In response to our draft report (see **APPENDIX D**), Aetna officials agreed with the recommended adjustments.

ALLOCATION OF CORPORATE PROPERTY AND CASUALTY COST CENTERS

Our review disclosed that Aetna included costs in the FYs 1995 and 1996 FACPs for a number of cost centers that were identified as related to the company's Property and Casualty (P&C) line of business. As previously noted, FAR Part 31.201-4 states that allowable Medicare expenses are those that are chargeable on the basis of relative benefits received. Based on the fact that these cost centers were solely related to work on the P&C line of business and provided no benefits to Medicare, we recommend disallowance of $141,342 ($25,944 - Part A and $115,398 - Part B).

During our initial analysis of corporate cost centers allocated to Medicare, we identified a number of cost centers that appeared to be related to Aetna's P&C line of business. In order to determine if these costs were appropriate charges to the Medicare program, we requested documentation to explain the functions of the cost centers and their relationship to Medicare. Based on information obtained, it was determined that a corporate reorganization took effect in January 1995 and most of the cost centers in question were no longer allocating costs to

Medicare because their functions had changed and were related specifically to P&C. As a result, most of the P&C cost center allocations to Medicare were discontinued around January 1995. However, we found that 6 of these cost centers continued to allocate costs to Medicare into FY 1996. The costs allocated to Medicare were as follows:

Cost Center	FY 1995	FY 1996	Total
P&C Human Resources	$ 507	$ 3,354	$ 3,861
P&C Bond	2,154	6,995	9,149
P&C Expense Mgmt	3,249	2,377	5,626
P&C OA Server Equip	17,722	3,802	21,524
P&C Environ Mgmt	(10,339)	6,762	(3,577)
P&C Help Desk	60,643	44,116	104,759
Totals	$73,936	$67,406	$141,342

Aetna Medicare personnel indicated that these costs were not eliminated from the Medicare allocations because either corporate did not notify them of the change in function of these cost centers or they inadvertently overlooked adjustments for these cost centers. However, they agreed that these cost should not have been allocated to Medicare.

RECOMMENDATION

We recommend that the FY 1995 FACPs be reduced by $73,936 ($12,240 - Part A and $61,696 - Part B) and the FY 1996 FACPs be reduced by $67,406 ($13,704 - Part A and $53,702 - Part B). Because Aetna has terminated its Medicare contract, no procedural recommendations are necessary.

AUDITEE COMMENTS

In response to our draft report (see **APPENDIX D**), Aetna officials agreed with the recommended adjustments.

ADJUSTMENTS TO INCENTIVE PAYMENT FEE

The Aetna Medicare Part A and B contracts for FYs 1995 and 1996 included provisions to award Aetna with an incentive payment fee, in addition to reimbursement of actual administrative costs, if the overall costs of administering the Medicare program were less than established target amounts. The target amount was based on a projected number of claims processed and other reimbursement activities, adjusted to reflect actual workload, multiplied by an agreed to cost per unit for the various categories of reimbursement. The costs per unit for each reimbursement category were negotiated amounts agreed to by Aetna and HCFA. If the overall actual costs were less than the target amounts for these fiscal years, Aetna was allowed an incentive fee of 50 percent of the difference between actual costs and the target amount. However, any adjustments to costs claimed on the FACPs would also affect the amount of incentive payment fee. For FY 1997, Aetna's Medicare contract called for a fixed incentive fee amount. As a result, the main focus of this phase of our review was on FYs 1995 and 1996.

The FYs 1995 and 1996 Medicare contracts included additional provisions that required Aetna to meet certain minimum performance standards for program safeguard activities in order to receive the full incentive payment amount for the year. The standards included Medicare secondary payer, medical review, fraud and abuse, and provider audit activities. The HCFA measured Aetna's performance related to these standards during their Contractor Performance Evaluation Program (CPEP) reviews. If HCFA found that a standard was not met, penalty assessments were made reducing the amount of incentive payment allowed for the year.

Based on our review, we found that the incentive payment amounts as claimed on the FACPs for FYs 1995 and 1996 need to be adjusted because of (1) OIG/OAS recommenced audit disallowances related to inappropriate allocations of corporate costs to Medicare, and Aetna adjustments to the FACPs submitted for FYs 1995 and 1996, and (2) HCFA's assessment of penalties reducing the amount of incentive reimbursement allowed for these years. The following paragraphs summarize these adjustments.

__OIG/OAS Audit Adjustments and Aetna FACP Adjustments__

As previously noted in this report, we recommended disallowance of certain costs claimed on the FYs 1995 and 1996 FACPs. In addition, during our audit field work, Aetna provided us with additional adjustments to these submitted FACPs that also have an effect on the total costs claimed and, thus, the incentive payment. These adjustments and their effect on the incentive payment are summarized below.

- We recommended audit adjustments to the FYs 1995 and 1996 FACPs which decreased the allowable administrative costs for these years. These recommendations are detailed in the findings entitled "Allocation of Corporate Training and Conference Center" on page 8 of this report and "Allocation of Corporate Property and Casualty Cost Centers" included on page 9 of this report. These recommendations decrease the FACP costs as follows:

Fiscal Year	Part A	Part B
1995	$(72,425)	$(173,152)
1996	(26,276)	(74,419)

- During our audit Aetna Medicare officials provided us with a number of adjustments to the administrative costs claimed in the FACPs submitted for FYs 1995 and 1996. These adjustments resulted in both increases and decreases to the amounts claimed on the FACPs. For the most part, the adjustments were related to corrections for accrued expenses claimed at the end of each fiscal year or to correct errors found by Aetna subsequent to the submission of the FACP. We reviewed these items and found them to be appropriate adjustments that needed to be made to the submitted FACPs. Aetna's proposed adjustments had the net effect of increasing or decreasing administrative costs claimed as follows:

Fiscal Year	Part A	Part B
1995	$(160,519)	$39,513
1996	221,023	34,426

The net effect of the above adjustments in allowable administrative costs subject to the incentive payment fee provisions of the contract is a decrease for FY 1995 Part A and B costs, an increase in FY 1996 Part A costs and a decrease in FY 1996 Part B costs. Because these adjustments result in changes in the difference between the target costs and the actual administrative costs, they also result in changes to the amount of incentive payment fee due Aetna. The changes have the reverse effect on the allowable incentive payment fee, i.e., a decrease in overall allowable costs results in an increase in the incentive fee and an increase in overall allowable costs results in a decrease in the incentive fee. Applying the 50 percent rate for the incentive payment fee for the two fiscal years, we determined the changes to the allowable incentive payment fee to be as follows:

	Total Adjustments	
Fiscal Year	**Part A**	**Part B**
1995	$(232,944) x 50%	$(133,639) x 50%
Effect on Incentive Payment Fee	$116,472	$ 66,820
1996	$194,747 x 50%	(39,993) x 50%
Effect on Incentive Payment Fee	$(97,374)	$ 19,997

HCFA Penalty Assessments

According to the Medicare contracts for FYs 1995 and 1996, the contractor was to draw the full incentive fee, provided it met the minimum performance requirements for each program safeguard activities related to Medicare secondary payer, medical review, fraud and abuse and provider audit. The HCFA rates the contractor's performance during the CPEP reviews and the incentive fee is reduced by $75,000 for each occurrence for which HCFA determines that the contractor fails to meet the minimum requirements for any element of a standard. These reductions are made from the total incentive fee awarded to the contractor.

For FYs 1995 and 1996, HCFA found that Aetna did not meet the minimum standards for certain program safeguards in some of their Part A and B Field Offices. As a result, HCFA penalized Aetna by reducing the amount of allowable incentive fee as follows:

Fiscal Year	**Part A**	**Part B**
1995	$ (225,000)	$(450,000)
1996	(300,000)	-0-

We noted that these reductions were not reflected in Aetna's FACPs submitted for these fiscal years. This was due to the fact that HCFA did not notify Aetna of the penalties until well after the submission of the FACPs. Further review disclosed that Aetna's reimbursement for the incentive fees had been appropriately reduced by the amounts of the penalties However, the FACPs need to be adjusted to reflect these reductions in the amount of allowable incentive.

For FY 1997, we also noted that HCFA reduced the allowable incentive amount because of performance penalties. However, these reductions were reflected in the FACP submitted to HCFA for this period. Therefore, no adjustment is required for FY 1997 FACP.

RECOMMENDATION

Based on the adjustments detailed above, we recommend that:

(1) The amount of allowable incentive payments be increased by $183,292 for FY 1995 ($116,472 - Part A and $66,820 - Part B) and decreased by $77,377 for FY 1996 ($(97,374) - Part A and $19,997 - Part B).

(2) The FACPs be adjusted to reflect the HCFA penalty assessments made to the incentive payments as follows:

Fiscal Year	**Part A**	**Part B**
1995	$ (225,000)	(450,000)
1996	(300,000)	-0-

AUDITEE COMMENTS

In response to our draft report (see **APPENDIX D**), Aetna officials agreed with the recommended adjustments.

OTHER MATTERS

Aetna officially terminated from the Medicare program as of September 30, 1997. Aetna began transitioning out of the Medicare program on January 1, 1997. All allowable costs associated with this process are to be funded by HCFA. For administrative purposes, the costs have been categorized into the following cost categories:

(1) Ongoing Budget - includes all costs incurred and workload to be processed under a business as usual situation. These are costs that are normally included in the FY 1997 FACPs, including those costs incurred through the date that workload was officially transferred to a takeover contractor.

(2) Termination Budget - includes all costs associated with the termination of the contract, i.e., shutdown expenses incurred subsequent to the transfer of the workload and prior to the closure of the Medicare offices. These costs include lease termination expenses, storage of files, moving expenses, salaries of staff still on board and remaining book value of assets still on the books as of the office closing date that could not be sold to the takeover contractor or Aetna.

(3) Severance Budget - includes all cost associated with severance benefits and salary continuation, unused vacation and fringe benefits for severed Medicare employees.

This report deals with the costs included in the Ongoing Budget through September 30, 1997. Costs related to the Termination and Severance Budgets are being reimbursed based on separate expense vouchers submitted to HCFA. We are reviewing the allowability of these costs in a separate audit, the results of which will be reported under CIN:A-01-98-00509.

During the compilation of the FY 1997 FACPs and the subsequent termination vouchers, Aetna discovered that certain costs related to the remaining book value of assets still on Medicare books as of the closing of the various Medicare field offices had been inadvertently included as part of the ongoing costs in the FY 1997 FACPs. These costs should have been included as part of the Termination Budget in the separate vouchers submitted to HCFA. The costs included $287,488 for depreciation expenses related to the remaining assets after the workload transition dates and $1,239,534 for the remaining net book value of assets located in the Medicare offices as of the closing dates of the offices. The costs represent allowable expenses but have been misclassified by Aetna. Aetna notified HCFA of this situation in a letter dated March 11, 1998.

Technically, the FACPs should be adjusted to reduce the total costs claimed for FY 1997 by $1,527,022 and the costs should be resubmitted to HCFA as part of the termination vouchers. However, revising the FACPs is a time consuming effort. Based on our discussions with HCFA personnel it has been decided that, to avoid unnecessary administrative work, the costs will remain in the FACPs as claimed and be reimbursed by HCFA as part of ongoing administrative expenses rather than as part of the termination costs. Therefore, no additional recommendation is necessary to resolve this issue.

AETNA LIFE INSURANCE COMPANY
PART A FINAL ADMINISTRATIVE COST PROPOSAL
FOR THE YEAR ENDED SEPTEMBER 30, 1995

Line of Operation	Administrative Cost Claimed
Claim Payment	$ 12,491,634
Reconsiderations and Hearings	1,146,159
Medicare Secondary Payer	2,952,829
Medical Review and Utilization Review	3,214,287
Provider Desk Reviews	6,547,301
Provider Field Audits	4,464,116
Provider Settlements	4,082,056
Provider Reimbursement	6,487,096
Productivity Investments	139,746
Benefit Integrity	628,684
Incentive Payments	4,294,402
Other	931,184
Credits	(150,351)
Total Costs Claimed	$ 47,229,143
Costs Claimed Subsequently Adjusted by Aetna*	(160,519)
OIG/OAS Recommended Adjustments**	(180,953)
Total Costs Recommended for Acceptance	$ 46,887,671

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
PART A FINAL ADMINISTRATIVE COST PROPOSAL
FOR THE YEAR ENDED SEPTEMBER 30, 1996

Line of Operation	Administrative Cost Claimed
Claim Payment	$ 12,846,064
Reconsiderations and Hearings	1,168,687
Medicare Secondary Payer	2,636,905
Medical Review and Utilization Review	3,491,623
Provider Desk Reviews	6,216,221
Provider Field Audits	4,493,640
Provider Settlements	4,426,041
Provider Reimbursement	6,721,351
Productivity Investments	-0-
Benefit Integrity	1,089,658
Incentive Payments	2,354,598
Other	1,043,250
Credits	(262,938)
Total Costs Claimed	$ 46,225,100
Costs Claimed Subsequently Adjusted by Aetna*	221,023
OIG/OAS Recommended Adjustments**	(423,650)
Total Costs Recommended for Acceptance	$ 46,022,473

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
PART A INTERIM EXPENDITURE REPORT
FOR THE YEAR ENDED SEPTEMBER 30, 1997

Line of Operation	**Administrative Cost Claimed**
Claim Payment	$ 9,424,139
Reconsiderations and Hearings	783,277
Medicare Secondary Payer	2,103,320
Medical Review and Utilization Review	2,070,341
Provider Desk Reviews	3,627,046
Provider Field Audits	1,519,245
Provider Settlements	3,203,239
Provider Reimbursement	4,273,835
Productivity Investments	1,314,683
Benefit Integrity	558,632
Other	587,616
Incentive Payments (including HCFA final adjustments)	3,075,000
Credits	(164,071)
Total Costs Claimed	$ 32,376,302
Costs Claimed Subsequently Adjusted by Aetna*	31,071
OIG/OAS Recommended Adjustments**	(730,942)
Total Costs Recommended for Acceptance	$ 31,676,431

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
PART B FINAL ADMINISTRATIVE COST PROPOSAL
FOR THE YEAR ENDED SEPTEMBER 30, 1995

Line of Operation	Administrative Cost Claimed
Claim Payment	$ 39,969,283
Reviews and Hearings	4,351,730
Beneficiary/Physician Inquiry	8,757,319
Provider Education and Training	2,069,614
Medical Review and Utilization Review	5,239,466
Medicare Secondary Payer	6,699,762
Participating Physician	1,544,500
Productivity Investments	1,313,089
Credits	(5,902,784)
Benefit Integrity	1,345,018
Incentive Payments	9,167,898
Other	228,234
Total Costs Claimed	$ 74,783,129
Costs Claimed Subsequently Adjusted by Aetna*	39,513
OIG/OAS Recommended Adjustments**	(556,332)
Total Costs Recommended for Acceptance	$ 74,266,310

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
PART B FINAL ADMINISTRATIVE COST PROPOSAL
FOR THE YEAR ENDED SEPTEMBER 30, 1996

Line of Operation	Administrative Cost Claimed
Claim Payment	$ 39,052,709
Reviews and Hearings	5,146,967
Beneficiary/Physician Inquiry	8,704,168
Provider Education and Training	2,728,303
Medical Review and Utilization Review	5,989,462
Medicare Secondary Payer	5,001,343
Participating Physician	1,163,722
Productivity Investments	1,503,750
Credits	(7,188,081)
Benefit Integrity	2,534,215
Incentive Payments	5,725,765
Other	1,483,371
Total Costs Claimed	$ 71,845,694
Costs Claimed Subsequently Adjusted by Aetna*	34,426
OIG/OAS Recommended Adjustments**	(54,422)
Total Costs Recommended for Acceptance	$ 71,825,698

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
PART B INTERIM EXPENDITURE REPORT
FOR THE YEAR ENDED SEPTEMBER 30, 1997

Line of Operation	Administrative Cost Claimed
Claim Payment	$ 28,648,778
Reviews and Hearings	3,727,048
Beneficiary/Physician Inquiry	6,117,860
Provider Education and Training	994,604
Medical Review and Utilization Review	4,599,955
Medicare Secondary Payer	3,620,038
Participating Physician	1,007,607
Productivity Investments	2,114,916
Credits	(5,677,838)
Benefit Integrity	2,178,555
Incentive Payments (including HCFA final adjustments)	4,495,000
Other	763,505
Total Costs Claimed	$ 52,590,028
Costs Claimed Subsequently Adjusted by Aetna*	3,092
OIG/OAS Recommended Adjustments **	(960,187)
Total Costs Recommended for Acceptance	$ 51,632,933

* - See Note 1.

** - See Note 2.

AETNA LIFE INSURANCE COMPANY
NOTES TO INTERIM EXPENDITURE REPORTS AND FINAL ADMINISTRATIVE COST PROPOSALS
OCTOBER 1994 THROUGH SEPTEMBER 1997

1. Aetna prepared a series of audit adjustments subsequent to the submission of the final FACPs to HCFA. The audit adjustments were to record either increases or decreases to accruals made in each operational year's FACP or were to correct errors found by Aetna after the submission of the FACPs. The audit adjustments amounted to $91,575 for Part A and $77,031 for Part B. We have reviewed the adjustments as part of our overall audit of administrative costs claimed.

2. **OIG/OAS Recommended Adjustments**

Part A costs recommended for adjustment are the following:

	1995	1996	1997
1. Corporate Cost Centers not Allocable to Medicare			$ 402,614
2. Revisions to Indirect Cost Pool Code Ratios			300,813
3. Miscellaneous Adjustments			27,515
4. Allocation of Corporate Training and Conference Center	$ 60,185	$ 12,572	
5. Allocation of Corporate Property and Casualty Cost Centers	12,240	13,704	
6. Adjustments to Incentive Payment Fee	108,528	397,374	
Totals	$ 180,953	$ 423,650	$ 730,942

**AETNA LIFE INSURANCE COMPANY
NOTES TO INTERIM EXPENDITURE REPORTS AND
FINAL ADMINISTRATIVE COST PROPOSALS
OCTOBER 1994 THROUGH SEPTEMBER 1997**

2. <u>**OIG/OAS Recommended Adjustments**</u> **(continued)**

Part B costs recommended for adjustment are the following:

	1995	1996	1997
1. Corporate cost Centers not Allocable to Medicare			$ 667,311
2. Revisions to Indirect Cost Pool Code Ratios			472,086
3. Miscellaneous Adjustments			(179,210)
4. Allocation of Corporate Training and Conference Center	$ 111,456	$ 20,717	
5. Allocation of Corporate Property and Casualty Cost Centers	61,696	53,702	
6. Adjustments to Incentive Payment Fee	383,180	(19,997)	
Totals	$ 556,332	$ 54,422	$ 960,187

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July 22,, 1998

Mr. William J. Hornby
Regional Inspector General for Audit Services
Office of Audit Services, Region I
Room 2425
Department of Health and Human Services
John F. Kennedy Federal Building
Boston, MA. 02203

RE: CIN: A-01-97-00529

Dear Mr. Hornby,

I have reviewed the draft audit report of administrative costs for Aetna Life Insurance Company for the period October 1, 1994 through September 30, 1997, and I am in agreement with the financial adjustments noted in the report. It is my understanding that as a result of this audit, Aetna Life Insurance Company will owe the Health Care Financing Administration $240,357.

Based on the results of my review, I have no further comments.

Sincerely,

Terrence E. Keefe

Terrence E. Keefe
Manager
Medicare Administration, MC54
Aetna Life Insurance Company

c: L. Aceto, Aetna
J. Bermel, Aetna
J. Bordeau, Aetna
R. Champagne, OIG, Hartford
P. Hamel, HCFA Boston