

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
CONTRACTOR'S PENSION
SEGMENTATION, AETNA LIFE AND
CASUALTY COMPANY**



JUNE GIBBS BROWN
Inspector General

AUGUST 1998
A-07-97-02505



Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

CIN: A-07-97-02505

AUG 5 1998

Mr. Terrence E. Keefe, CPA
Manager Medicare Administration, MAA8
Aetna Life and Casualty Company
151 Farmington Avenue
Hartford, Connecticut 06156-7380

Dear Mr. Keefe:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, Aetna Life and Casualty Company*. The purpose of our review was to evaluate Aetna Life and Casualty Company's (Aetna) compliance with the pension segmentation requirements of its Medicare contract. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

Our review showed that Aetna overstated Medicare segment assets as of January 1, 1996 by \$910,513. The overstatement primarily occurred because Aetna used an incorrect pension cost to assign contributions to the Medicare segment in their update of pension assets.

We recommend that Aetna decrease the January 1, 1996 assets of the Medicare segment by \$910,513. Aetna agreed with our recommendation and its response is included in its entirety as Appendix B.

INTRODUCTION

BACKGROUND

Aetna has administered Medicare Parts A and B under cost reimbursement contracts since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plan. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

Aetna's contract required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of the Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocating a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

...any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

- 1. The majority of the salary dollars is allocated to the Medicare contract/agreement; or*
- 2. Less than a majority of the salary dollars is allocated to the Medicare contract/agreement, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare contract/agreement.*

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year starting after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment first existed.

Our previous segmentation review (CIN: A-07-93-00633) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1991.

In reports provided for our current review, Aetna identified total pension assets of \$2,608,996,219 and Medicare segment assets of \$43,083,142 as of January 1, 1996. Aetna also concluded that separate valuations for the Medicare segment were required.

OBJECTIVE, SCOPE, AND METHODOLOGY

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine Aetna's compliance with pension segmentation requirements of its Medicare contract. Achieving our objective did not require that we review the internal control structure of Aetna. The audit addressed the update of pension assets during the period January 1, 1991 to January 1, 1996.

We performed this review in conjunction with our audit of unfunded pension costs (CIN: A-07-98-02506). The information obtained and reviewed during that audit was also used in performing this review.

We reviewed Aetna's identification of the Medicare segment and its update of Medicare assets from January 1, 1991 to January 1, 1996.

In performing the review, we used information provided by Aetna's consulting actuarial firm. The information included liabilities, normal costs, contributions, benefit payments, expenses, and earnings. We reviewed Aetna's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we updated the Medicare segment assets to January 1, 1996. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at Aetna's corporate offices in Hartford, Connecticut during October 1997. Subsequently, we performed audit work in our Jefferson City, Missouri office.

FINDING AND RECOMMENDATION

Aetna's methodology in updating the Medicare segment assets from January 1, 1991 to January 1, 1996 overstated the segment assets by \$910,513. This overstatement primarily occurred because Aetna used an incorrect CAS pension cost to assign pension contributions to the segment, and did not equitably assign investment earnings to the segment.

As of January 1, 1996, Aetna identified Medicare segment assets of \$43,083,142. We determined Medicare segment assets to be \$42,172,629 as of January 1, 1996. The decrease of \$910,513 resulted from: (1) assigning pension contributions to the segment using the correct CAS pension cost (\$1,407,690 decrease), and (2) equitably assigning investment earnings to the segment (\$497,177 increase).

Pension Contributions

For plan year 1995, Aetna assigned pension contributions of \$2,232,384 to the Medicare segment based on the segment's separately computed CAS pension cost. However, Aetna's CAS pension cost calculations included an unallowable component that overstated the costs. Consequently, the pension contributions assigned to the Medicare segment based on these incorrect pension costs were also overstated.

As of January 1, 1995, Aetna's Medicare segment had accumulated unfunded pension costs of \$9,236,358. In accordance with the CAS effective at that time, the accumulated unfunded pension costs could not be included as a component of plan year 1995 pension costs. However, Aetna included an amortized portion of the accumulated unfunded pension costs as a component of the segment's 1995 pension costs. As a result, the segment's pension costs for 1995 were overstated. Additionally, since pension contributions were assigned to the segment based on the segment's pension costs, the contributions were also overstated.

We calculated the allowable CAS pension cost for 1995, and assigned pension contributions to the Medicare segment based on those costs. We determined that the segment's correct pension contributions for 1995 were \$824,694. Therefore, Aetna's use of an incorrect pension cost to assign contributions to the segment overstated the segment's pension contributions by \$1,407,690 (\$2,232,384 less \$824,694).

Investment Earnings

For years 1991 through 1994, Aetna assigned investment earnings to the Medicare segment in the same proportion as the total plan rate of return. However, for 1995 Aetna did not equitably assign investment earnings to the segment. Instead, Aetna assigned earnings to the segment using a lesser amount than the total plan rate of return. As a result Aetna understated the Medicare segment pension assets.

For plan year 1995, Aetna assigned investment earnings of \$6,798,228 to the Medicare segment. However, using the total plan rate of return for 1995, we assigned investment earnings of \$7,295,405 to the Medicare segment. Thus, Aetna's methodology understated the Medicare segment assets by \$497,177 (\$7,295,405 less \$6,798,228).

Recommendation:

We recommend that Aetna:

- ① Decrease the pension assets of the Medicare segment by \$910,513 as of January 1, 1996.

Auditee Response

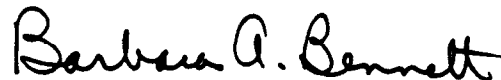
Aetna agreed with our recommendation.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on 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 and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5).

Sincerely,



Barbara A. Bennett
Regional Inspector General for
Audit Services, Region VII

Enclosures

HHS Action Official:

Ms. Judy Berek
Acting Regional Administrator, Region I
Health Care Financing Administration
John F. Kennedy Federal Building, Room 2325
Boston, Massachusetts 02203-0003

Aetna Life and Casualty Company
Hartford, Connecticut
CIN: A-07-97-02505

STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 TO JANUARY 1, 1996

Description		Total Company	Other Segment	Medicare
Assets January 1, 1991	<u>1/</u>	\$1,752,615,089	\$1,725,017,244	\$27,597,845
Contributions	<u>2/</u>	\$0	\$0	\$0
Investment Earnings	<u>3/</u>	\$390,990,966	\$384,842,037	\$6,148,929
Benefits	<u>4/</u>	(\$62,453,412)	(\$61,916,392)	(\$537,020)
Expenses	<u>5/</u>	(\$6,260,403)	(\$6,161,949)	(\$98,454)
Partners Plan Merger	<u>6/</u>	\$2,244,790	\$2,244,790	\$0
Assets January 1, 1992		\$2,077,137,030	\$2,044,025,730	\$33,111,300
Contributions		\$0	\$0	\$0
Investment Earnings		\$57,730,379	\$56,810,109	\$920,270
Benefits		(\$68,953,586)	(\$68,301,229)	(\$652,357)
Expenses		(\$7,802,815)	(\$7,678,432)	(\$124,383)
Assets January 1, 1993		\$2,058,111,008	\$2,024,856,178	\$33,254,830
Contributions		\$0	\$0	\$0
Earnings		\$180,192,300	\$177,280,764	\$2,911,536
Benefits		(\$78,089,498)	(\$77,264,043)	(\$825,455)
Expenses		(\$5,250,652)	(\$5,165,812)	(\$84,840)
Assets January 1, 1994		\$2,154,963,158	\$2,119,707,087	\$35,256,071

Aetna Life and Casualty Company
 Hartford, Connecticut
 CIN: A-07-97-02505

STATEMENT OF MEDICARE PENSION ASSETS
 JANUARY 1, 1991 TO JANUARY 1, 1996

Description	Total Company	Other Segment	Medicare
Assets January 1, 1994	\$2,154,963,158	\$2,119,707,087	\$35,256,071
Contributions	\$0	\$0	\$0
Earnings	\$45,516,928	\$44,772,253	\$744,675
Benefits	(\$88,241,504)	(\$87,278,415)	(\$963,089)
Expenses	\$0	\$0	\$0
Assets January 1, 1995	\$2,112,238,582	\$2,077,200,925	\$35,037,657
Contributions	\$154,475,090	\$153,650,396	\$824,694
Earnings	\$439,802,114	\$432,506,709	\$7,295,405
Benefits	(\$97,519,567)	(\$96,534,440)	(\$985,127)
Expenses	\$0	\$0	\$0
Assets January 1, 1996	\$2,608,996,219	\$2,566,823,590	\$42,172,629
1/1/96 Assets Per Aetna	7/ \$2,608,996,219	\$2,565,913,077	\$43,083,142
Variance	8/ \$0	\$910,513	(\$910,513)

FOOTNOTES

1/ Total actuarial asset values were obtained from Aetna's valuation reports. We computed the Medicare segment assets based on our identification of the segment. The January 1, 1991 Medicare segment assets were established during our previous review (CIN: A-07-93-00633). The amounts shown for the other segment represent the difference between the total company and the Medicare segment.

Aetna Life and Casualty Company
Hartford, Connecticut
CIN: A-07-97-02505

STATEMENT OF MEDICARE PENSION ASSETS

JANUARY 1, 1991 TO JANUARY 1, 1996

FOOTNOTES (Continued)

- 2/ We obtained total contribution amounts, and dates of deposit, from IRS Form 5500 reports. We assigned contributions to the Medicare segment based on the segment's separately computed CAS funding target. Aetna used this same methodology.
- 3/ We calculated total company rates of return on pension investments from information obtained from Aetna's valuation reports. We assigned earnings to the Medicare segment using the total company rates of return. Beginning with 1994, pension administrative expenses were included in our calculations of the rates of return.
- 4/ Aetna provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used an average of the beginning of year and end of year benefit payments for Medicare segment retirees. Aetna used this same methodology.
- 5/ Aetna provided administrative expense amounts for years 1991 through 1993. We assigned administrative expenses to the Medicare segment based on the beginning of year asset values. Beginning with 1994 Aetna did not separately identify plan administrative expenses, but instead included the expenses as a reduction in plan earnings. We used the same methodology.
- 6/ On January 1, 1991, the Partners National Health Plans Retirement Plan (the Partners Plan) was merged into the Aetna plan. The merger did not affect the Medicare segment, therefore, none of the Partners Plan assets were assigned to the Medicare segment.
- 7/ We obtained the total assets as of January 1, 1996 from Aetna's actuarial valuation reports.
- 8/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1996 and the assets calculated by Aetna's actuary.



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July 14, 1998

Ms. Barbara A. Bennett
Regional Inspector General for Audit Services
Region VII
801 East 12th Street
Room 284A
Kansas City, Missouri 64106

RE:CIN: A-07-97-02505
CIN: A-07-98-02506

Dear Ms. Bennett,

I have reviewed your draft audit reports dated January 21, 1998, entitled *Review of Medicare Contractor's Pension Segmentation, Aetna Life and Casualty Company*, and *Review of Unfunded Pension Costs of Aetna Life and Casualty Company*, for the period January 1, 1991 to January 1, 1996, and concur with the results of the audit. I have no additional comments to make concerning the report.

Sincerely,

A handwritten signature in cursive script that reads "Terrence E. Keefe". The signature is written in dark ink and is positioned above the typed name and title.

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

c: Gregory A. Tambke, OIG, Jefferson City
William G. Young, Hewitt Associates, LLC