

REGION IV  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

DEC 16 2003

Report Number: A-04-02-02022

Mr. John F. Hoey, Vice President  
CIGNA HealthCare Medicare Administration  
Two Vantage Way  
Nashville, Tennessee 37228

Dear Mr. Hoey:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled, *Review of CIGNA's Fiscal Year 1996-2001 Medicare Final Administrative Cost Proposals*. A copy of this report will be forwarded to the HHS action official noted below for review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official. 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, 5 United States Code 552, as amended by the Public Law 104-231, OIG reports are made available to members of the press and the 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). As such, within 10 business days after the final report is issued, it will be posted on the World Wide Web at <http://oig.hhs.gov>.

To facilitate identification, please refer to the report number A-04-02-02022 in all correspondence relating to this report. If you have any questions, please contact me or have your staff contact Peter Barbera at (404) 562-7758.

Sincerely,

Charles J. Curtis  
Regional Inspector General  
for Audit Services, Region IV

Enclosures – as stated

Page 2 – Mr. John F. Hoey

**Direct Reply To HHS Action Official:**

Mr. Dale Kendrick  
Associate Regional Administrator  
Centers for Medicare & Medicaid Services  
U.S. Department of Health and Human Services  
61 Forsyth Street, S.W., Suite 4T20  
Atlanta, Georgia 30303-8909

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF CIGNA'S FISCAL YEAR  
1996 – 2001 MEDICARE FINAL  
ADMINISTRATIVE COST PROPOSALS**



**DECEMBER 2003  
A-04-02-02022**

# *Notices*

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**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
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In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

## **OAS FINDINGS AND OPINIONS**

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



## EXECUTIVE SUMMARY

### BACKGROUND

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS). CMS administers the Medicare Program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. CMS has contracted with CIGNA to serve as a Medicare Part B Carrier and to serve as a Durable Medical Equipment Regional Carrier (DMERC) to process Medicare Part B and durable medical equipment claims submitted by physicians, clinics and other medical providers. CIGNA is a holding company for Connecticut General Life Insurance Company, the legal entity that holds the Medicare contracts.

CIGNA's contracts with CMS provide for reimbursement of allowable administrative costs incurred. Such administrative costs include the direct costs of administering the contract as well as allocations of certain indirect costs of services or assets used by Medicare and other entities. CIGNA claims reimbursement of administrative costs through submission to CMS of a Final Administrative Cost Proposal (FACP). During the period from October 1, 1995 through September 30, 2001, CIGNA claimed administrative costs of \$380,645,837.

### OBJECTIVE

The objective of our review was to determine if the costs CIGNA claimed on its FACP's for administering the Medicare Part B and DMERC contracts from fiscal years (FY) 1996 through 2001 (October 1, 1995 through September 30, 2001) were reasonable, allocable, and allowable for Medicare reimbursement.

### SUMMARY OF FINDINGS

Based on our review we conclude that:

- \$370,602 of direct costs are unallowable;<sup>1</sup> and
- \$30,690,542 of indirect costs claimed throughout the audit period are considered unsupported and set aside for CMS adjudication.

The majority of the \$370,602 that we found to be unallowable in FY 2001 represented costs that were expensed in FY 2001, but should have been capitalized and expensed in later years. CIGNA's record keeping procedures were not adequate to ensure that asset purchases and prepaid service contracts were properly capitalized and expensed. CIGNA's procedures included:

- expensing assets at the time of purchase;

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<sup>1</sup> The \$370,602 does not include the issue discussed in the Other Matters section of the report.

- expensing deposits paid for assets not yet placed in service; and
- expensing prepaid services at the onset.

The remainder of the unallowable costs relate to crossover billings. Crossover billings occur when CIGNA transfers the claim data to an insurance company that holds a beneficiary's supplemental health insurance policy and bills the insurer for the administrative costs of the transfer. CIGNA did not have adequate supporting documentation of collection efforts for \$30,710 of Medicare crossover billings written off and charged to the Medicare program.

Concerning the indirect costs claimed, we concluded that the \$30,690,542 of indirect costs reported by CIGNA on its FY 1996-2001 FACP's should be set aside as unsupported based on disclosures by CIGNA to CMS and to the Office of Inspector General (OIG) that the system used to calculate and allocate indirect costs needed to be revised because it did not reflect actual, allocable and allowable expenses. Specifically, CIGNA determined that the existing overhead allocation methodology was too complex, had no proactive removal of unallowable costs, included imprecise charging methodologies and failed to reconcile all cost estimates with actual expenses. Based on CIGNA's conclusions, we considered the claimed indirect costs to be unsupported and therefore have set them aside for CMS adjudication. Federal Acquisition Regulations (FAR) provision 31.201-2(d) stipulates that "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs principles... The Contracting Office may disallow all or part of a claimed costs which is inadequately supported."

In light of the system deficiencies noted above, CIGNA has previously proposed a revised indirect cost allocation methodology. This proposal was reviewed and reported on as a separate audit by OIG (Report Number A-04-02-02019 dated August 8, 2003) in which we concluded that the new methodology appeared to be reasonable but could not be applied retroactively. However, we believe the revised methodology could be used to negotiate a settlement of indirect costs for FYs 1996-2001 up to, but not exceeding, the amounts claimed.

The Other Matters section of this report includes a discussion of CIGNA's potential Medicare direct benefits and payroll taxes (B&T) adjustment. CIGNA proposes reducing these costs currently claimed on the FY 2001 FACP by \$26,162.

## **RECOMMENDATIONS**

We recommend that CIGNA:

- reduce its direct costs claimed on the FY 2001 FACP by \$370,602;
- improve its procedures for capitalizing assets and expensing prepaid services in accordance with Federal guidelines;
- improve its procedures for performing and documenting billing and collection efforts on Medicare crossover billings; and

- reduce its FACP claimed expenses by the amount of indirect cost not supported or otherwise work with CMS to reach a settlement on the \$30,690,542 of indirect costs set aside.

In responding to our draft report, CIGNA agreed with most of our recommended financial adjustments to direct costs claimed, but disagreed with the crossover billing adjustment of \$30,710. Regarding the indirect costs, CIGNA noted that it had reached a negotiated settlement with CMS for the indirect costs claimed from FYs 1996 through 2001. The complete text of CIGNA's response is included as Appendix B.

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## **GLOSSARY, ABBREVIATIONS, AND ACRONYMS**

<b>B&amp;T</b>	Benefits and Payroll Taxes
<b>CFR</b>	Code of Federal Regulations
<b>CMS</b>	Centers for Medicare & Medicaid Service
<b>DME</b>	Durable Medical Equipment
<b>DMERC</b>	Durable Medical Equipment Regional Carrier
<b>DOJ</b>	Department of Justice
<b>FACP</b>	Final Administrative Cost Proposal
<b>FAR</b>	Federal Acquisition Regulations
<b>FY</b>	Fiscal Year
<b>GAAP</b>	Generally Accepted Accounting Principles
<b>OIG</b>	Office of Inspector General

## INTRODUCTION

### BACKGROUND

The Medicare program is administered by CMS. Medicare was established by Social Security Amendments in 1965, and is known as Title XVIII of the Social Security Act. Medicare provides insurance to people age 65 and over, those who have permanent kidney failure, and certain people with disabilities. The Medicare program consists of two distinct parts. Hospital Insurance (Part A of the program) covers expenses of medical services furnished in an institutional setting, such as a hospital or skilled nursing facility, or provided by a home health agency. Supplemental Medical Insurance (Part B of the program) covers physician services, certain other medical equipment and services [such as durable medical equipment (DME)], and other outpatient services.

CMS administers the Medicare program by contracting with private organizations to process and pay claims for services provided to eligible beneficiaries. CMS has contracted with CIGNA to serve as a Medicare Part B Carrier and to serve as a DMERC to process Medicare Part B and DME claims submitted by physicians, clinics and other medical providers. CIGNA is a holding company for Connecticut General Life Insurance Company, the legal entity that holds the Medicare contracts. CIGNA HealthCare, one of CIGNA's main lines of business, administers the two Medicare contracts.

CIGNA's contracts with CMS provide for reimbursement of allowable administrative costs incurred. Such administrative costs include the direct costs of administering the contract as well as allocations of certain indirect costs of services or assets used by Medicare and other entities. CIGNA claims reimbursement of administrative costs through submission to CMS of an FACP. During the period from FYs 1996 through 2001 CIGNA claimed administrative costs of \$380,645,837 for providing these contractual services, as indicated in the following table.

**Total Costs Claimed for FYs 1996 to 2001 FACPs (Part B vs DMERC)**

	1996	1997	1998	1999	2000	2001	Total
<b>Part B</b>	\$51,347,905	\$45,076,169	\$47,353,200	\$44,395,435	\$45,269,741	\$46,311,689	\$279,754,139
<b>DMERC</b>	\$14,349,418	\$13,594,794	\$15,348,568	\$17,115,362	\$19,425,022	\$21,058,534	\$100,891,698
<b>Total</b>	<b>\$65,697,323</b>	<b>\$58,670,963</b>	<b>\$62,701,768</b>	<b>\$61,510,797</b>	<b>\$64,694,763</b>	<b>\$67,370,223</b>	<b>\$380,645,837</b>

### Prior Audits and Investigations

CIGNA was recently involved in settlement negotiations with CMS and the Department of Justice (DOJ) concerning costs claimed for Medicare reimbursement in FYs 1990-1995 (and some costs through 1997). The negotiations included issues concerning duplication of expenses

claimed, findings from a prior OIG audit of CIGNA's FYs 1990-1995 FACP's, and an audit of a supplemental claim submitted by CIGNA for FYs 1990-1997. The OIG disclosed some concerns related to the direct and indirect costs claimed during these earlier FYs.

Due to the settlements and reviews, CIGNA began a compliance program to address the direct and indirect cost issues. Where applicable, we refer to these settlements and audits in the body of this report.

## OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to determine if the costs CIGNA claimed on its FACP's for administering the Medicare Part B and DMERC contracts from FYs 1996 through 2001 (October 1, 1995 through September 30, 2001) were reasonable, allocable, and allowable for Medicare reimbursement.

CIGNA claimed approximately \$380 million during our audit period, as indicated below.

Total Costs Claimed for FYs 1996 to 2001 FACP's (Direct vs Indirect)							
	1996	1997	1998	1999	2000	2001	Total
<b>Direct</b>	\$61,106,177	\$53,955,011	\$57,645,819	\$56,632,923	\$59,932,138	\$60,683,227	\$349,955,295
<b>Indirect*</b>	\$4,591,146	\$4,715,952	\$5,055,949	\$4,877,874	\$4,762,625	\$6,686,996	\$30,690,542
<b>Total</b>	<b>\$65,697,323</b>	<b>\$58,670,963</b>	<b>\$62,701,768</b>	<b>\$61,510,797</b>	<b>\$64,694,763</b>	<b>\$67,370,223</b>	<b>\$380,645,837</b>

*\*Indirect expense totals represent the costs currently claimed on the FACP's that CIGNA wishes to replace with the newly proposed allocation methodology.*

We began our review with a focus on the \$60 million of direct costs claimed (costs identified specifically with the Medicare operations) in FY 2001. The results of this review determined the extent of testing we would perform on direct costs claimed from FYs 1996 through 2000.

We did not specifically test direct costs claimed from FYs 1996 through 2000 for the following reasons:

- The majority of costs reviewed in FY 2001 were found to be allowable.
- We did not have any material findings during our review of FY 2001 direct costs that warranted going back to the earlier years. Additionally, a majority of the costs questioned in 2001 were due to timing differences, meaning the same questioned cost in an earlier year would have become allowable in a subsequent year. Therefore, a review of the 2001 findings in the earlier years was not considered an efficient use of resources.
- We also prepared a trend analysis of the costs claimed in each of these years. Our purpose was to determine if there were any noteworthy variances in the costs claimed and if so, determine the reasons. We discovered no significant events that would cause a difference in the type of costs claimed or the method for claiming the costs.

A settlement between CIGNA and the Federal government (CMS and DOJ) also affected our decision not to review costs claimed from 1996 through 2000. As a result of the settlement certain costs claimed in FYs 1996 and 1997 (travel, indirect return on investment, duplicate paper charges and CIGNA Systems Division variance adjustments) were adjudicated and therefore not subject to our review. As a result of this settlement, CIGNA also revised and refiled its FACP for 1998 through 2000 for these issues.

For our review of FY 2001 direct expenses, we selected expenses for review based on the following:

- expenses that were high dollar in total (e.g. salaries, overtime, office rent, data processing, crossover credits and related allowance for doubtful accounts, automated mail);
- expenses related to findings of the most recent OIG reviews and/or the recent CMS and DOJ settlements (e.g. legal service fees, travel, vehicle usage);<sup>2</sup>
- expenses involved in a recalculation by the auditee due to prior calculation errors and/or a change in the calculation methodology (e.g. fringe benefits, payroll taxes, return on investment, Distributed Technology Services); and
- expenses related to areas that historically involve reporting errors and/or are typically selected for review (e.g. subcontracts, independent contractors, office equipment and furniture depreciation and repair, electronic data processing equipment and software purchases and maintenance, personal computer depreciation, telephone rent, postage, office supplies, printing and photocopying).

To determine whether the expenses selected for review were allowable for Medicare reimbursement we referred to the following criteria: 48 Code of Federal Regulations (CFR) Chapter 1 Part 31 of the FAR (referred to as 48 CFR 31), and the Medicare contracts with CMS including the appendix to the CMS contracts titled “Appendix B.”

We initially reconciled the direct costs claimed on the FACP to the CIGNA Medicare general ledger. We then performed the following audit procedures on the selected areas of direct expenses, where applicable, to test for allowability, allocability, and reasonableness:

- interviewed CIGNA personnel to gain an understanding of how the various expenses were computed and charged;

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<sup>2</sup> The OIG findings and DOJ settlement issues related to indirect costs, CIGNA Systems Division variances, and adjustment for the double billing for cost of paper, were reviewed as part of the overhead allocation methodology audit identified as Report Number A-04-02-02019.

- traced selected costs to applicable general ledger histories, journal entries, vouchers, invoices, payroll registers, depreciation reports, utilization reports, per diem schedules, mileage logs and other supporting documentation for justification that the claim should have been made and support for the amount claimed;
- reviewed various CIGNA policies and procedures (e.g. capitalization policy, prepaid expensing procedures, crossover billing and collection procedures) for compliance with Medicare regulations;
- reviewed various costs related to contracts and leases for evidence of CMS approval, competitive bidding, and support;
- reviewed the cost allocations between the Part B operation, the DMERC operation and CIGNA’s private Health Maintenance Organization operation for accuracy;
- compared the FACP to the Notice of Budget Approvals for unapproved over expenditure; and
- traced expenses related to unallowable recent legal matters and settlements to verify they were not claimed on the FACPs.

The direct costs claimed by CIGNA included about \$8.7 million (see table below) of pension and 401K expenses related to Medicare employees. We did not review these expenses due to the complex issues involved with pension expensing. We have deferred a review of CIGNA’s pension and 401K expenses claimed for all FYs for a separate pension audit by OIG auditors from Region VII.

<u>Direct Pension and 401K Expenses Claimed on the FACPs</u>						
<u>FY 1996</u>	<u>FY 1997</u>	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>Total</u>
\$1,104,701	\$1,016,277	\$1,260,986	\$1,504,013	\$1,655,341	\$2,237,794	<b>\$8,779,112</b>

We also did not review the approximate \$30 million of “indirect” expenses (overhead expenses allocated to Medicare from corporate) reported on the FYs 1996 to 2001 FACPs since CIGNA has proposed a new methodology for claiming these expenses. The proposal, which was submitted to CMS, was reviewed as a separate audit by OIG (Report Number A-04-02-02019, with a report issue date of August 2003).

We conducted our audit in accordance with generally accepted government auditing standards. Our fieldwork was performed at CIGNA’s Medicare Division headquarters in Nashville, Tennessee and our regional office in Atlanta, Georgia, from September 2002 to June 2003.

## RESULTS OF REVIEW

Based on our review we conclude that:

- \$370,602 of direct costs in FY 2001 are unallowable; and
- \$30,690,542 of indirect costs claimed throughout the audit period are considered unsupported and are set aside for CMS adjudication.

The majority of the \$370,602 found to be unallowable in FY 2001 represented costs that were expensed in FY 2001, but should have been capitalized and expensed in later years. CIGNA's record keeping procedures were not adequate to ensure that asset purchases and prepaid service contracts were properly capitalized and expensed. CIGNA's procedures included:

- expensing assets at the time of purchase;
- expensing deposits paid for assets not yet placed in service; and
- expensing prepaid services at the onset.

In addition, there were indications that CIGNA lacked adequate procedures over the areas of Medicare crossover billings and collections. Crossover billings occur when CIGNA transfers the claim data to an insurance company that holds a beneficiary's supplemental health insurance policy and bills the insurer for the administrative costs of the transfer. We found incidences where CIGNA billed other insurers twice for the same claim, and incidences where CIGNA could not provide adequate support of collection efforts for crossover billings written off and charged to Medicare. As a result, we identified \$30,710 that we considered unallowable.

The \$30,690,542 of indirect costs reported by CIGNA on its FY 1996-2001 FACPs was set aside as unsupported, based on disclosures by CIGNA. CIGNA revealed to CMS and to the OIG that the allocation system used to calculate the indirect costs claimed on the FACPs was in need of revision to reflect actual, allocable and allowable expenses. Specifically, CIGNA determined that the existing overhead allocation methodology was too complex, had no proactive removal of unallowable costs, included imprecise charging methodologies and failed to reconcile all cost estimates with actual expenses.

In light of the system deficiencies noted above, CIGNA had previously proposed a revised indirect cost allocation methodology. This proposal was reviewed and reported on as a separate audit by OIG (Report Number A-04-02-02019 dated August 8, 2003) in which we concluded that the new methodology appeared to be reasonable but could not be applied retroactively. However, we believe the revised methodology could be used to negotiate a settlement of indirect costs for FYs 1996-2001 up to, but not exceeding, the amounts claimed.

The Other Matters section of this report includes a discussion of CIGNA's potential Medicare direct B&T adjustment. CIGNA proposes reducing these costs currently claimed on the FY 2001 FACP by \$26,162.

The following findings provide more details on the results of our review. See Appendix A for a summary of these findings.

### **UNALLOWABLE COSTS CLAIMED ON THE FY 2001 FACP**

For the most part, the costs we tested on the FY 2001 FACP were adequately supported and allowable for Medicare reimbursement. However, CIGNA claimed \$370,602 on the FY 2001 FACP that we considered unallowable for Medicare reimbursement. The majority of the \$370,602 represents costs that were expensed in FY 2001, but should have been capitalized and expensed in later years. The \$370,602 is further detailed below.

#### **Expensing Assets at the Time of Purchase**

CIGNA expensed some assets, valued at more than \$500 and with a useful life of more than 1 year, at the time of purchase although Medicare guidelines require the assets be capitalized over their useful life. As a result, Medicare was overcharged in FY 2001.

In FY 2001 the Part B contract was overcharged \$130,658 and the DMERC contract was overcharged \$44,303 for telephone system costs. CIGNA capitalized the hardware portion of the telephone systems, yet they expensed the software and installation portions of the same invoices. CIGNA should have capitalized the software and installation expenses as well.

First, Appendix B of CIGNA's Medicare contract (Section IV, Depreciation and Use Charges) states that, "All contractors must depreciate all items of equipment having a useful life of more than 1 year." The telephone system had a useful life greater than one year and therefore should be capitalized and depreciated.

Second, Title 48 CFR 31.201-2, states that the application of generally accepted accounting principles (GAAP) is a factor in considering whether a cost is allowable. Under GAAP's basic accounting concepts, it is generally accepted that the cost of a fixed asset (i.e. equipment) should include all expenses necessary to properly place it in service for its intended use. The software and installation are necessary for the telephone system to be placed into service. Therefore, these costs should have been considered as part of the cost of the system and capitalized and depreciated over the proper useful lives.

Concerning the software portion of the purchase, we learned through discussions with CIGNA finance personnel that typically the CIGNA Medicare Division applies the corporate policy to software purchases in determining whether they should be capitalized or expensed. CIGNA's corporate policy is to expense all software purchases under \$5 million. CIGNA's policy does not address the expected life of the software as required by the Medicare contract.

### **Auditee's Comments**

CIGNA concurs with the OIG on this matter that the assets should be capitalized and will adjust its FACP's accordingly. CIGNA also proposed specific action steps to ensure that proper controls and procedures are put in place to ensure appropriate accounting treatment for these items.

### **Expensing of Asset Deposits**

CIGNA expensed some cash deposits for voice recognition systems prior to the systems being placed in service. These deposits should have been capitalized as part of the cost of the asset, and expensed over the life of the asset. In FY 2001 Part B was overcharged \$33,348 and DMERC was overcharged \$28,253.

When fixed assets are placed in service, any deposits should be capitalized as part of the fixed assets' total cost and depreciated over the useful lives of the assets. CIGNA was not in compliance with Appendix B of its Medicare contract or Title 48 CFR 31. Appendix B (Section IV Depreciation and Use Charges) requires that equipment having useful lives greater than 1 year, must be capitalized and depreciated. The voice recognition system's useful life is greater than 1 year and therefore it's cost should be capitalized.

To determine what constitutes the system's "cost," we refer to GAAP. Under GAAP's basic accounting concepts, it is generally accepted that the cost of a fixed asset (i.e. equipment) should include all expenses necessary to properly place it in service for its intended use. The deposits in question were costs related to placing the systems in service. They were for the development, purchase, and installation of voice recognition systems. Therefore, the deposits should have been capitalized as part of the cost of the system and depreciated over the system's useful life.

CIGNA charged its Part B contract for the full \$46,000 deposit in FY 2001, instead of spreading the costs over the life of the asset. Given that CIGNA's Part B voice recognition system was placed in service on March 15, 2001, we allowed for a partial year depreciation and determined that in FY 2001, Part B charges were overstated by \$33,348.

Similarly, the DMERC's voice recognition system was not installed nor providing a benefit during the FY 2001 period. Therefore, no expense should have been claimed in FY 2001. Thus, we consider the entire \$28,253 charged to the DMERC to be unallowable.

### **Auditee's Comment**

CIGNA concurs that the asset deposits should be capitalized and that depreciation should begin when the asset is placed in service. CIGNA will adjust its FACP's accordingly. CIGNA also proposed specific action steps to ensure that proper controls and procedures are put in place to ensure appropriate accounting treatment for these items.

### **Expensing of Prepaid Costs**

In some instances CIGNA Medicare expensed prepaid services at the time of acquisition rather than expensing them over the periods of service. As a result, in FY 2001 Medicare was overcharged by \$103,330 (\$86,663 for Part B and \$16,667 for DMERC).

This practice is contrary to Federal regulations since it does not follow GAAP. GAAP's basic accounting concepts require that income, assets, and liabilities be determined by way of accrual accounting. Accrual accounting records the financial effects of transactions in the periods in which they have their primary economic impact, rather than when cash is paid or received. Under this principle, costs are incurred and expensed when services have been rendered.

CIGNA should not expense in the first FY the entire sum paid for a prepaid service contract that spans several FYs. The cost should be expensed throughout the service period as the service is received.

### **Auditee's Comment**

CIGNA notes that it has policies and procedures in place to properly account for prepaid expenses, but these particular items were not handled in accordance with those procedures. CIGNA agrees that the items identified in the review should be treated as prepaid items, and will adjust its FACPs accordingly.

### **Medicare Crossover Billings Allowance for Doubtful Accounts**

CIGNA did not have adequate supporting documentation of collection efforts for \$30,710 of Medicare crossover billings written off and charged to the Medicare program. Therefore, we consider the \$30,710 (\$21,907 for Part B and \$8,803 for DMERC) to be unallowable for Medicare reimbursement on the FY 2001 FACP.

Crossover billings occur when CIGNA Medicare transfers claim data to an insurance company that holds a beneficiary's supplemental health insurance policy or transfers claim data to a Medicaid agency. The claim was originally charged to Medicare with the remaining balance being a liability to the supplemental insurer. Therefore, the claim is transferred to the supplemental insurer. When CIGNA transfers the claim to the supplemental insurer, CIGNA bills the insurer for the administrative costs of the transfer.

CIGNA has two accounts devoted to Medicare crossover billings. One of the accounts is used to record the credits (billings). The second account is used to record the allowance for doubtful accounts (write-offs). This second account represents the administrative expenses billed but not collected. If the administrative expenses are not collected from the supplemental insurers, the expenses become part of the administrative costs claimed on the FACP and are reimbursed by CMS. Therefore, the greater the write-offs (amounts considered uncollectible from the other insurance companies), the greater the expenses reimbursed by CMS.

Title 48 CFR 31.201-2, states that one of the factors to be considered in determining whether costs are allowable is the application of GAAP. Under GAAP's basic accounting concepts, GAAP requires the disposition of receivables to be made by collection or write-off of uncollectible balances. CIGNA's crossover policy requires that a reasonable attempt should be made to collect the administrative fees from the parties responsible for the claim that the fee is originally billed to. Therefore, we believe before a receivable balance can be considered uncollectible, some collection efforts must be made and they should be documented.

We tested \$147,950 of the crossover billings written off and found that \$30,710 did not have evidence of adequate collection efforts.

We also found that \$73,795 (50 per cent) of the total we tested represented duplicate entries in the billing and write-off records. The duplicate entries occurred because CIGNA lacked the accounting controls to prevent billing the other insurers twice for the same claims. Although the duplicate billings have no reimbursement effect, they indicate the need for CIGNA to improve its accounting procedures and controls over these areas.

#### **Auditee's Comment**

CIGNA agrees that its controls and procedures were not as strong as they could have been, and that documentation was not always maintained. However, CIGNA contends that collection efforts were made and should not incur a loss for unpaid invoice amounts. Since the \$30,710 represents monies never collected by CIGNA, it does not feel obligated to reimburse CMS for this amount. CIGNA will maintain proper documentation of collection efforts and write-offs.

#### **OAS Response**

Without support that CIGNA did perform reasonable collection efforts on these invoices, we have no basis to accept the costs. Additionally, the \$30,710 represented 100 percent of the \$147,950 that required collection efforts. Regarding the \$30,710, we found only one instance of a collection effort, and that was a note indicating a phone call was made to customer service. We did not consider this an adequate effort. Thus, we questioned CIGNA's right to be reimbursed for this amount. The remaining balance of the \$147,950, for various reasons, represented costs that did not require collection efforts. It appeared to us that CIGNA was able to collect most of its billings without collection efforts, but made little effort when the billed parties were not responsive.

#### **INDIRECT COSTS CLAIMED FROM FYs 1996 THROUGH 2001**

We did not audit the \$30,690,542 of indirect costs reported on the FYs 1996-2001 FACPs. We concluded these indirect costs were unsupported and therefore set them aside for CMS adjudication, based on disclosures by CIGNA.

In response to the prior OIG audits and CMS and DOJ settlements, CIGNA's compliance group reviewed the existing overhead allocation methodologies, which are the basis for the \$30,690,542. This work led the group to the opinion that the existing allocation methodology

was too complex, had no proactive removal of unallowable costs, included imprecise charging methodologies and failed to reconcile all cost estimates to actual. CIGNA revealed to CMS and to the OIG that the allocation system used to calculate the indirect costs claimed on the FACP was in need of revision to reflect actual, allocable and allowable expenses. In addition, CIGNA stated that while summary level information could be available or reconstructed, the expense details necessary to analyze the allocability and allowability of the indirect expenses was lacking.

FAR provision 31.201-2(d) stipulates that “A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles.... The Contracting Officer may disallow all or part of a claimed costs which is inadequately supported.”

Since CIGNA has proposed a new methodology for claiming indirect costs, has indicated that the current system was flawed, and has implied that the overhead costs could not be easily supported or audited, we set aside the \$30,690,542 for CMS adjudication.

In light of the system deficiencies noted above, the compliance group proposed implementing a new overhead allocation methodology. This proposal, which was submitted to CMS, was reviewed as a separate audit by OIG (Report Number A-04-02-02019, dated August 8, 2003). In our Report Number A-04-02-02019, we concluded that the new methodology appears to be reasonable but it cannot be applied retroactively. However, we believe the revised methodology could be used to negotiate a settlement of indirect costs for FYs 1996-2001 up to, but not exceeding, the amounts claimed.

### **Auditee’s Comment**

CIGNA announced that it had negotiated a settlement with CMS regarding the indirect costs claimed for FYs 1996 through 2001.

## **OTHER MATTERS**

### **Benefit Rate Changes**

CIGNA claimed certain benefit costs and payroll taxes on the FY 2001 FACP based on a methodology that is now being refined. Recognizing this, CIGNA proposes reducing the B&T currently claimed by \$26,162 (\$17,928 Part B and \$8,234 DMERC) due to the following.

First, CIGNA proposes removing a healthcare accrual component from the benefit rate used to calculate total benefits charged directly to Medicare. The removal of the healthcare accrual component is part of CIGNA’s recently proposed corporate expense allocation methodology (reviewed by OIG as a separate audit under Report Number A-04-02-02019). Second, CIGNA proposes applying the revised benefit rate and existing tax rate to a more current Medicare salary

total. Originally, CIGNA applied the benefit rate and the tax rate to a salary total that was not current.

CIGNA provided us supporting documentation calculating the proposed changes. We reviewed the documentation and found no errors with the computations. Therefore, if CMS approves CIGNA's proposed corporate expense allocation methodology, the B&T accounts should be decreased by \$26,162 (\$17,928 Part B and \$8,234 DMERC).

## **CONCLUSION AND RECOMMENDATIONS**

Based on our review we conclude that:

- \$370,602 of direct costs in FY 2001 are unallowable and should be removed from the FY 2001 FACP; and
- \$30,690,542 of indirect costs claimed throughout the audit period are considered unsupported.

We recommend that CIGNA:

- reduce its direct costs claimed on the FY 2001 FACP by \$370,602, (\$272,576 for Part B and \$98,026 for DMERC) representing the unallowable costs identified by our review;
- improve its procedures for capitalizing assets and expensing prepaid services in accordance with Federal guidelines;
- improve its procedures for performing and documenting billing and collection efforts on Medicare crossover claims; and
- reduce its FACP claimed expenses by the amount of indirect costs not supported or otherwise work with CMS to reach a settlement on the \$30,690,542 of indirect costs set aside.

In other matters, if CIGNA's proposed methodology is accepted by CMS, the B&T accounts should be decreased by \$26,162 (\$17,928 Part B and \$8,234 DMERC) on the FY 2001 FACP.

# **APPENDIX**

## APPENDIX A

### Results of Review of CIGNA's FACPs (Part B and DMERC expenses combined)

Fiscal Year	Total Expenses Claimed	Unaccepted	Deferred	Set Aside
			(a)	(b)
2001	\$67,370,223	\$370,602	\$2,237,794	\$6,686,996
2000	64,694,763	-	1,655,341	4,762,625
1999	61,510,797	-	1,504,013	4,877,874
1998	62,701,768	-	1,260,986	5,055,949
1997	58,670,963	-	1,016,277	4,715,952
1996	65,697,323	-	1,104,701	4,591,146
<b>TOTAL</b>	<b>\$380,645,837</b>	<b>\$370,602</b>	<b>\$8,779,112</b>	<b>\$30,690,542</b>

(a) The "Deferred" expenses represent direct pension and 401K.

(b) The "Set Aside" expenses represent indirect

### Unaccepted Expenses By Finding

	Part B	DMERC	Total
Expensing Assets at the Time of Purchase	\$130,658	\$44,303	\$174,961
Expensing of Asset Deposits	33,348	28,253	61,601
Expensing of Prepaid Costs	86,663	16,667	103,330
Medicare Crossover Billings	21,907	8,803	30,710
<b>Total</b>	<b>\$272,576</b>	<b>\$98,026</b>	<b>\$370,602</b>

**John F. Hoey**  
Vice President

November 26, 2003



**CIGNA HealthCare**  
**Medicare Administration**

Charles J. Curtis  
Regional Inspector General for Audits Services, Region IV  
Office of Inspector General  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, GA 30303

RE: A-04-02-02022

Dear Mr. Curtis,

On November 1, 2003, your office released the draft report entitled "Review of CIGNA's Fiscal Year 1996 - 2001 Medicare Final Administrative Cost Proposals". As this draft report pertains to administrative costs incurred to process Part B and DMERC claims by CIGNA HealthCare Medicare Administration (CIGNA), you have requested our views relative to the validity of the facts and reasonableness of the recommendations presented. We thank you for the opportunity to respond.

We have responded to each of the specific findings noted on pages 6 through 9 of the draft audit report as noted below, as well as some general comments pertaining to the audit:

*Expensing Assets at the Time of Purchase*

The items noted by the OIG that should have been capitalized pertain to software costs associated with upgrades to our call management system and phone system in 2001 in the Nashville, Boise and High Point offices. The hardware costs associated with this upgrade were properly capitalized but our corporate policy stated that software costs less than \$5 million should be expensed. The OIG contends that the hardware and software were part of a system upgrade and that the entire system should have been capitalized and that the software should not be treated separately. We concur with the OIG on this matter that the system should be capitalized, and the effect on our fiscal year accounting is noted below:

**Fiscal Year 2001**

Reverse Expense / Capitalize software	\$ (182,798)
Depreciation & ROI in FY 01	<u>7,837</u>
Net Impact for FY 01 (Part B and DMERC combined)	\$ (174,961)

This asset has a five year life, so the un-depreciated amount at the end of fiscal year 2001 would be expensed in fiscal years 2002 through 2006. As a result of capitalizing these software costs, ROI would also be recorded in each year and total approximately \$28,000 for the subsequent five year period. The ROI calculation is based upon the fiscal year 2001 rate of return, and will fluctuate in future years as the rate changes. The table

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below summarizes the results for fiscal years 2002 through 2006. The detailed calculations for the figures below will be made available upon request.

<u>Fiscal Year</u>	<u>Depreciation &amp; ROI*</u>
2002	\$46,815
2003	\$44,630
2004	\$42,154
2005	\$39,667
2006	<u>\$28,661</u>
Total	\$201,937

\* ROI calculation based on the fiscal year 2001 rate of return

We will adjust our FACPs for fiscal years 2002 and 2003 to reflect the depreciation and ROI charges, and include the charges in our ongoing fiscal year 2004 Interim Expenditure Reports.

Expensing of Asset Deposits

The OIG reviewed two invoices pertaining to a new Voice Recognition System in the Provider Enrollment and DMERC areas. They have suggested that these two items be capitalized rather than expensed as incurred, as they are capital items with a useful life greater than one year. The OIG further questioned when these two systems were placed in service, and we noted that the Provider Enrollment system was in place in March 2001, and the DMERC system had not yet been completed and is not in service. They allowed partial depreciation for the Provider Enrollment system beginning in March 2001, when the items were placed in service. They have suggested that the costs incurred for the DMERC services should not be capitalized until placed in service, thus, the expense should be removed from fiscal year 2001. At this point, it is unknown when depreciation would begin, so the impact on future years cannot be determined.

We concur with the OIG that these costs should be capitalized, and the effect on our fiscal year accounting is noted below:

**Fiscal Year 2001 - Part B Provider Enrollment**

Reverse Expense / capitalize software	\$ (46,000)
Depreciation & ROI	<u>12,652</u>
Net Impact (Part B only)	\$ (33,348)

This asset has a 30-month useful life, so the un-depreciated amount at the end of fiscal year 2001 would be expensed in fiscal years 2002 and 2003. As a result of capitalizing these software costs, ROI would also be recorded in each year and total approximately \$2,400 for the subsequent two-year period. The ROI calculation is based upon the fiscal year 2001 rate of return, and will fluctuate in future years as the rate changes. The table

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below summarizes the results for fiscal years 2002 and 2003. The detailed calculations for the figures below will be made available upon request.

<u>Fiscal Year</u>	<u>Depreciation &amp; ROI*</u>
2002	\$20,225
2003	<u>\$18,323</u>
Total	\$38,558

*\* ROI calculation based on the 2001 FY rate of return*

We will adjust our FACPs for fiscal years 2002 and 2003 to reflect the depreciation and ROI charges based on the appropriate rate of return for the respective fiscal year. We will also remove the \$28,253 related to the DMERC system and hold these costs to be capitalized once the system is completed and placed in service.

Expensing of Prepaid Costs

The OIG noted instances where maintenance contracts were fully expensed at the time of invoice rather than being setup as a prepaid expense and amortized over the term of the maintenance contract. In these cases, the maintenance contract covered periods in two different fiscal years, resulting in a misclassification of expense between fiscal years. There were no findings related to unallowable costs, however, the OIG report could be perceived to state that the instances identified represented our normal practice. It should be noted that we indeed have policies and procedures in place to properly account for prepaid expenses, but these particular items were not handled in accordance with those procedures. We agree with the OIG that the items identified in their review should be treated as prepaid items, and will reduce our fiscal year 2001 expenses by \$103,330, and increase our fiscal year 2002 expenses by the same amount.

Expensing of Asset Rebate

The OIG selected a sample of fixed asset purchases and were provided copies of invoices to support the expense amounts. One item selected was for the purchase of a new copier. This particular invoice had a hand-written note suggesting that CIGNA was to receive a \$25,000 rebate for return of the old copier, but the capitalized amount was not reduced for this rebate amount. Upon further research and investigation, including extensive discussions with our corporate purchasing department and with the vendor, we could not determine if CIGNA was actually entitled to a rebate, nor could it be determined that CIGNA had actually received the rebate. The one fact that was determined was that CIGNA did not book a rebate related to this purchase. Thus, the OIG contends that we should reduce the fixed asset amount by \$25,000, thereby reducing our annual depreciation related to this asset. As we could not prove that any rebate was actually due or paid to CIGNA, we do not believe any adjustment should be made to our expenses related to this item.

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Medicare Crossover Billings Allowance for Doubtful Accounts

The OIG selected a sample of our crossover write-offs to review for proper documentation and treatment. For fiscal year 2001, we billed approximately \$10 million for crossover claims and collected \$9.3 million. We had various procedures in place pertaining to our crossover process, however, we agree with the OIG that our controls and procedures were not as strong as they could have been, and that documentation was not always properly maintained. We contend, however, that adequate collection efforts (i.e., follow-up phone calls) were made during that time period, and that CIGNA should not incur a loss on its cost-reimbursement contract for unpaid invoice amounts for crossover claims. As the \$30,710 finding represents monies never collected by CIGNA, we do not feel obligated to reimburse CMS for this amount.

Indirect Costs Claimed From FYs 1996 Through 2001

The OIG did not perform an audit of indirect costs submitted by CIGNA for fiscal years 1996 through 2001. In lieu of this review, the OIG performed a review of an alternative indirect cost allocation methodology developed and proposed by CIGNA, and has determined that the methodology is reasonable. CIGNA and CMS have negotiated a settlement which accepts CIGNA's indirect costs claimed for fiscal years 1996 through 2001.

Now that these matters have been brought to our attention, CIGNA will investigate and implement necessary protocols to ensure that appropriate controls and procedures are put in place to ensure appropriate accounting treatment for fixed assets, maintenance contracts and crossover write-offs. Our proposed specific action steps are as follows:

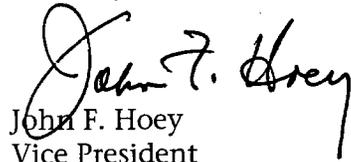
- CIGNA will reduce the cost claim for fiscal year 2001 by \$339,892 and also increase the FACP for fiscal year 2002 by \$170,370 and fiscal year 2003 by \$62,863 to reflect the findings noted above. An additional amount of approximately \$110,500 will be recorded in fiscal years 2004 through 2006 related to the findings noted above.
- CIGNA will perform reviews of expenses charged to all expense accounts to ensure maintenance contracts are properly accounted for as prepaid expenses and amortized over the term of the agreement.
- CIGNA will begin obtaining invoice copies of all fixed assets purchased directly by our corporate office and matching these invoices to our purchase orders, as well as the expense in our general ledger or fixed asset records.
- CIGNA will capitalize costs incurred to place an asset in service using the same criteria as for hardware. This may include such items as software, professional services or other installation costs. We will maintain separate fixed asset listings for items capitalized locally, but expensed in the corporate records.

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- CIGNA will maintain and reconcile fixed asset balance sheet accounts on a monthly basis to ensure all fixed assets are properly recorded.
- CIGNA will maintain appropriate documentation of collection efforts on outstanding crossover claims, as well as documentation of approval of all write-offs.

We thank you for bringing these issues to our attention and hope the action steps we have indicated above will resolve them. If there are any questions related to the above, please contact Linda Potts, Compliance Analyst, at 615.782.4556.

Sincerely,



John F. Hoey  
Vice President  
CIGNA HealthCare Medicare Administration

Enclosures

cc: Tim Romero, OIG  
Kathy Markman, CMS  
Lori Borelli, CMS  
Bruce Coates, CMS  
Jean Rush, CIGNA  
Jeff Chambers, CIGNA  
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# ACKNOWLEDGMENTS

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