

Y4
. P 84/10
93-58

1022

93-58
P84/10
Y4

UNRESOLVED AUDIT EXCEPTIONS

GOVERNMENT
Storage

2 1975

THE
KANSAS ST



011600 744049

HEARING
BEFORE THE
SUBCOMMITTEE ON
MENT AND EMPLOYEE BENEFITS
OF THE
COMMITTEE ON
OFFICE AND CIVIL SERVICE

HOUSE OF REPRESENTATIVES

NINETY-THIRD CONGRESS

SECOND SESSION

DECEMBER 17, 1974

Serial No. 93-58

Printed for the use of the
Committee on Post Office and Civil Service



4Y
01/189.
83-28

COMMITTEE ON POST OFFICE AND CIVIL SERVICE

THADDEUS J. DULSKI, New York, *Chairman*

DAVID N. HENDERSON, North Carolina, *Vice Chairman*

MORRIS K. UDALL, Arizona	H. R. GROSS, Iowa
DOMINICK V. DANIELS, New Jersey	EDWARD J. DERWINSKI, Illinois
ROBERT N. C. NIX, Pennsylvania	ALBERT W. JOHNSON, Pennsylvania
JAMES M. HANLEY, New York	LAWRENCE J. HOGAN, Maryland
CHARLES H. WILSON, California	JOHN H. ROUSSELOT, California
JEROME R. WALDIE, California	WALTER E. POWELL, Ohio
RICHARD C. WHITE, Texas	RICHARD W. MALLARY, Vermont
WILLIAM D. FORD, Michigan	ANDREW J. HINSHAW, California
FRANK J. BRASCO, New York	L. A. (SKIP) BAFALIS, Florida
WILLIAM (BILL) CLAY, Missouri	JAMES M. COLLINS, Texas
PATRICIA SCHROEDER, Colorado	GENE TAYLOR, Missouri
JOE MOAKLEY, Massachusetts	
WILLIAM LEHMAN, Florida	
BOB TRAXLER, Michigan	

JOHN H. MARTINY, *Chief Counsel*

VICTOR C. SMIRLODO, *Staff Director and Counsel*

THEODORE J. KAZY, *Assistant Staff Director*

ROBERT E. LOCKHART, *Assistant Counsel*

ROY C. MESKER, *Staff Assistant*

FRANCIS C. FORTUNE, *Coordinator*

SUBCOMMITTEE ON RETIREMENT AND EMPLOYEE BENEFITS

JEROME R. WALDIE, California, *Chairman*

FRANK J. BRASCO, New York	LAWRENCE J. HOGAN, Maryland
DOMINICK V. DANIELS, New Jersey	L. A. (SKIP) BAFALIS, Florida
CHARLES H. WILSON, California	JAMES M. COLLINS, Texas
JOE MOAKLEY, Massachusetts	

Ex Officio Voting Members

THADDEUS J. DULSKI, New York H. R. GROSS, Iowa

DONALD F. TERRY, *Staff Assistant*, Room 406, Cannon Building—Ext. 56831

CONTENTS

	Page
Statement of: Tinsley, Thomas, Director, Bureau of Retirement, Insurance and Occupational Health, U.S. Civil Service Commission, accompanied by Carl Goodman, Assistant to the General Counsel, U.S. Civil Service Commission -----	2
Laur, Robert, vice president, Federal Employees Plan, National Associations of Blue Cross and Blue Shield-----	14

UNRESOLVED AUDIT EXCEPTIONS

TUESDAY, DECEMBER 17, 1974

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON POST OFFICE AND CIVIL SERVICE,
SUBCOMMITTEE ON RETIREMENT AND EMPLOYEE BENEFITS,
Washington, D.C.

The committee met at 10 a.m., in room 210, Cannon House Office Building, Hon. Jerome Waldie (chairman of the subcommittee) presiding.

Mr. WALDIE. The subcommittee will come to order, please.

Today the subcommittee will take up the question of unresolved audit exceptions for the Blue Cross-Blue Shield Federal employees health benefit plan.

According to a General Accounting Office report which was made at the request of the subcommittee, there are unresolved audit exceptions which have been made by the Civil Service Commission dating back to 1971 and which amount to almost \$10 million.

We will be considering the specifics of the GAO report during the course of today's hearing. First of all, I want to make a few observations.

First, I think any objective observer will admit that a system which has allowed audit exceptions to go unresolved for more than 3 years is not adequate. I know that both the Civil Service Commission and Blue Cross-Blue Shield believe that the current system is inadequate. Yet nothing seems to have been done about it. And the question that I and the committee will be asking is why is that?

Second, every nonprepayment health plan which contracts with the Civil Service Commission to provide health insurance to Federal employees concedes that Federal procurement regulations apply to its particular contract with the Civil Service Commission except one, Blue Cross-Blue Shield, and the committee will be interested to know why Blue Cross-Blue Shield seeks this unique situation. It's my understanding that if the "Blues" were under Federal procurement regulations—by the way, not only why Blue Cross-Blue Shield seeks this unique status, but why the Civil Service Commission concedes that unique status to them. It is my understanding that if the "Blues" were under Federal procurement regulations, then there would be appeals boards to resolve any disputes by audit exceptions.

Current procedure amounts to nothing more than letter writing between the Commission and the "Blues" with no resolution of audit exceptions.

The question that readily comes to mind is this: Why should the "Blues" pay up unless the Commission somehow forces payment? Is there no alternative but to bring legal action against the "Blues" in order to assure resolution of audit exceptions?

Finally, let me ask the question, even though Blue Cross-Blue Shield has 60 percent of the business under the Federal employees program, why does it have over 90 percent of the dollar amount of the outstanding audit exceptions and why did the statistics show dramatic increases in unresolved audit exceptions with the "Blues" while indicating, at least on the surface, more compliance by other carriers than the "Blues"?

To help us answer these questions and those questions presented in the GAO report, Mr. Thomas Tinsley, Director of the Bureau of Retirement, Insurance and Occupational Health, U.S. Civil Service Commission; Mr. Carl Goodman, Assistant to the General Counsel of the U.S. Civil Service Commission; and Mr. Robert Laur, vice president, Federal Employees Plan of the National Associations of Blue Cross-Blue Shield will testify today; and our first witness will be Mr. Thomas Tinsley, Director of the Bureau of Retirement, Insurance and Occupational Health of the U.S. Civil Service Commission, accompanied by Mr. Carl Goodman, Assistant General Counsel of the U.S. Civil Service Commission.

Gentlemen, will you come forward, please.

STATEMENT OF THOMAS TINSLEY, DIRECTOR, BUREAU OF RETIREMENT, INSURANCE AND OCCUPATIONAL HEALTH, U.S. CIVIL SERVICE COMMISSION; ACCOMPANIED BY CARL GOODMAN, ASSISTANT TO THE GENERAL COUNSEL, U.S. CIVIL SERVICE COMMISSION

Mr. WALDIE. Gentlemen, do you have any written statements you would desire to have included in the record?

Mr. TINSLEY. No, Mr. Chairman. I have no prepared written statement to place in the record.

Mr. WALDIE. Let me start then asking you a few questions unless you wish to make any statement.

Mr. TINSLEY. No. I might point out that in responding to questions concerning some of these items, depending on the direction the committee takes, I'm going to have to be somewhat careful in view of the fact that several of them have been moved toward litigation.

Mr. WALDIE. Well, I don't know what that means, but if it means that you will feel constraints upon disclosing to the committee information we seek, I will probably find that unacceptable, at least from my particular point of view. So we will probably have to await such an instance happening.

Mr. TINSLEY. Thank you, Mr. Chairman.

Mr. WALDIE. The first question I have to ask is, of unresolved audit exceptions with all the carriers involved in providing services under the Federal employees health benefit program, what are the total amounts of moneys that you have found were improperly taken by the carriers which you have established?

Mr. TINSLEY. They are in excess of \$12 million.

Mr. WALDIE. And of that, over what period of time?

Mr. TINSLEY. Over the period of 1971 to date.

Mr. WALDIE. Does it include 1971 through 1974?

Mr. TINSLEY. That's correct.

Mr. WALDIE. In that 4-year period, what is the pattern of audit exceptions? Did it start low and end high or is it a fairly constant figure on an annual basis?

Mr. TINSLEY. That's extremely difficult to answer, Mr. Chairman, because 4 years ago our audit resources, as you know, were very limited. We have had a rapidly expanding audit staff. As a result, in the past 2 years, the past year particularly, we have devoted a considerable amount of time to the audit of the carriers.

Many of the findings and the exceptions that we pick up today are items that, in terms of the dollars involved, go back a number of years.

Mr. WALDIE. Well, at least the figures I have indicate that there's been an enormous increase in 1973 and 1974 over 1971 and 1972. Is that a fair statement?

Mr. TINSLEY. That's correct, Mr. Chairman.

Mr. WALDIE. And you attribute that to a more effective, intensive audit of the carriers?

Mr. TINSLEY. That is correct, Mr. Chairman.

Mr. WALDIE. Did no audits occur prior to 1971?

Mr. TINSLEY. Yes, Mr. Chairman, they did, but they were very few and very limited.

Mr. WALDIE. Were any exceptions made prior to 1971?

Mr. TINSLEY. Yes, but they were relatively small.

Mr. WALDIE. Can you give me some idea of what that means?

Mr. TINSLEY. Well, certainly not in the magnitude of what we have found in the last 2 years.

Mr. WALDIE. I understand that, but were they so miniscule that they didn't even bear listing in this report?

Mr. TINSLEY. Based upon a very thin memory, I would say, "Yes."

Mr. WALDIE. And how many years prior to 1971 have the plans been in effect?

Mr. TINSLEY. Since 1960.

Mr. WALDIE. 1960?

Mr. TINSLEY. Yes, sir.

Mr. WALDIE. Is it fair to assume that during that 10-year period, 1960 to 1970, there were just as many abuses as we have found from 1971 to 1974 pursuant to the audit?

Mr. TINSLEY. I would be a little reluctant to make that type of assumption without having more information and a more detailed look at what the situation actually was then.

Mr. WALDIE. Why have you not audited that 10-year period?

Mr. TINSLEY. When we go into a plan now our audits do go back all the way. When we make a finding it's not just a finding for one year.

Mr. WALDIE. Did I understand you to say that the audit that transpired in 1971 were miniscule and the amounts excepted to were miniscule?

Mr. TINSLEY. That's correct.

Mr. WALDIE. Have you audited with your new audit group the years 1960 to 1970?

Mr. TINSLEY. In those plans that we have gone into, they do cover items—

Mr. WALDIE. Have you done that with Blue Cross-Blue Shield?

Mr. TINSLEY. Yes, we have.

Mr. WALDIE. And is it my understanding that for the years 1960 to 1970 you found no exceptions that were taken that remain unpaid?

Mr. TINSLEY. I believe that is true, Mr. Chairman.

Mr. WALDIE. Well, I don't want you to believe that. I want a report from you to that effect.

Mr. TINSLEY. The audit was a much narrower type of audit then.

Mr. WALDIE. That's not what I'm asking. I'm asking, since 1971 to 1974 you have found a great number of exceptions where the audit has been expansive and intensive. I'm asking you, have you audited similarly the years 1960 to 1970?

Mr. TINSLEY. Yes, Mr. Chairman.

Mr. WALDIE. All right. And is your answer that in those years you have found no exceptions that have been unpaid?

Mr. TINSLEY. No. We have found exceptions. In fact, the State statutory reserve item is one.

Mr. WALDIE. All right. Will you provide me with a report that might be included in this committee report of the exceptions that precede 1971 through 1960 that you have taken and the amounts of those exceptions that remain unpaid?

Mr. TINSLEY. Yes, Mr. Chairman.

Mr. WALDIE. I gather from the report in my hand that there are no exceptions that remain unpaid prior to 1971.

Mr. TINSLEY. No. Some of these exceptions here do go back prior to 1971. They are over a number of years. It's just that we uncovered them within the past 2 years, but they do apply to years prior.

Mr. WALDIE. Will you give me a report clarifying that so I might understand that, because the GAO report would make it appear that all exceptions prior to 1971, in fact, have been resolved.

Mr. TINSLEY. No, they have not, Mr. Chairman.

Mr. WALDIE. I would like to know, then, in the report what proportions of exceptions of this \$12 million relate back to the period 1960 to 1971.

Mr. TINSLEY. I will be happy to do that.

Mr. WALDIE. What I'm really trying to find out, as you must have discerned, is have you ignored that period pretty much and started auditing from 1971 on?

Mr. TINSLEY. I'll be glad to give you that report, Mr. Chairman.

Mr. WALDIE. All right. Now, of the unresolved audit exceptions of \$12 million, how many audit exceptions were resolved during the period 1971 to 1974? Do you have a total figure that I might compare the exceptions taken with the exceptions resolved?

Mr. TINSLEY. I'll be able to give you the total figure, Mr. Chairman. I don't have it at present, however, by comparison it would be a great deal smaller.

Mr. WALDIE. A great deal smaller than the \$12 million?

Mr. TINSLEY. Yes.

Mr. WALDIE. So there would be very few exceptions that were resolved during that period of time percentage-wise?

Mr. TINSLEY. That is correct.

Mr. WALDIE. Of the total of \$12 million unresolved exceptions of all the carriers, is it my understanding that Blue Cross-Blue Shield has in excess of \$10 million of that outstanding unresolved exception burden?

Mr. TINSLEY. That's the approximate figure, Mr. Chairman.

Mr. WALDIE. And all the rest of the carriers have less than \$2 million?

Mr. TINSLEY. That is correct.

Mr. WALDIE. Now I know part of that figure probably is because of the greater amount of business done by Blue Cross-Blue Shield; 60 percent, I understand, of the Federal employees are insured by them. They still carry, though, about 90 percent of the unresolved exceptions, and so that does not seem to me to be totally explained by the fact that they do more business.

Is there a different manner or a different contract for resolving audit exceptions on the part of the other carriers than there is for Blue Cross?

Mr. TINSLEY. In terms of the other indemnity carriers, no, there is not. However, I believe part of the reason here for the "Blues" exceptions being so high is that fact that we have been concentrating on Blue Cross-Blue Shield.

Mr. WALDIE. Do I gather from that that had you been concentrating on Aetna you would find a similar higher figure of audit exceptions?

Mr. TINSLEY. No, I would not draw that conclusion.

Mr. WALDIE. Why do you say it extends from concentrating on Blue Cross-Blue Shield.

Mr. TINSLEY. In the case of Aetna, we certainly haven't devoted as much staff and resources to audits. If we do, and we will, because now we're on a 3-year audit cycle—I'm not at all sure what we will find. So I'm in no position to say we would find more or less.

Mr. WALDIE. At the present time do you have any audit exceptions outstanding for the other nationwide carrier, Aetna?

Mr. TINSLEY. Yes. There is one item outstanding.

Mr. WALDIE. How much?

Mr. TINSLEY. I believe it's close to \$3 million, however, it involves a question of taxes that's going to have to be resolved by Internal Revenue Service.

Mr. WALDIE. And is there a similar item involved in Blue Cross-Blue Shield?

Mr. TINSLEY. No, Mr. Chairman. There is not because of the different tax situation that Blue Cross-Blue Shield is involved with.

Mr. WALDIE. Have you taken exception to the \$3 million on the part of Aetna?

Mr. TINSLEY. Yes.

Mr. WALDIE. And they have refused to pay it?

Mr. TINSLEY. Pending the resolution of the tax question by the Internal Revenue Service. This has been pending, I believe, prior to 1971.

Mr. WALDIE. Well, then, it's really not outstanding, is it, if it's in the process of being resolved by third parties?

Mr. TINSLEY. That's correct, Mr. Chairman.

Mr. WALDIE. So other than that, there are no outstanding audit exceptions for Aetna?

Mr. TINSLEY. Not insofar as Aetna is concerned, other than probably some minor ones.

Mr. WALDIE. Well, why do they have a picture of no outstanding audit exceptions if the "Blues" have a picture of \$10 million of outstanding audit exception? There has to be a reason for me to understand the distinction. What is that?

Mr. TINSLEY. The settlement of the audit issues in the past few years, at least with the "Blues" since they have become so high and the type of exceptions they are, has made it extremely difficult to resolve the exceptions with the "Blues." With Aetna, many of the exceptions we have taken have been rather easily resolved.

Mr. WALDIE. Why?

Mr. TINSLEY. They weren't of the magnitude of the "Blues" and they did not involve the same issues.

Mr. WALDIE. Why would Aetna not involve the same issues as the "Blues?" Aren't they insuring the same group?

Mr. TINSLEY. They are insuring the same group. The Aetna system is almost a closed system. The Aetna administration controls completely the operations of all their field offices. The control by the home office of Aetna, is much tighter and the responsibility for administration of the contract is placed, insofar as we're concerned, with one man, and they are relatively easy to reach agreement with.

Mr. WALDIE. Let me ask you this, for our record. It's your testimony that you have no complaints other than with Blue Cross-Blue Shield in handling audit exceptions?

Mr. TINSLEY. I'm sorry, Mr. Chairman?

Mr. WALDIE. It's your testimony that you're satisfied with Blue Cross-Blue Shield and the manner by which they have handled audit exceptions, that they are no different in your view than the other carriers in that regard?

Mr. TINSLEY. No; Mr. Chairman, I'm not. They are much different.

Mr. WALDIE. What is the difference and do you have express dissatisfaction with their efforts to resolve audit exceptions?

Mr. TINSLEY. As in many areas, Mr. Chairman, they are extremely difficult to pin down in terms of one individual who can act with authority for the "Blues" in these areas because, as in many other areas, the "Blues" are extremely difficult to deal with because of the makeup of the "Blues" organizations.

Mr. WALDIE. Is it just the makeup or is it a reluctance on the part of the "Blues" to settle audit exceptions when there's no penalty for failure to settle? Is there any penalty for failure to settle audit exceptions?

Mr. TINSLEY. Only the interest.

Mr. WALDIE. How do you collect the interest? You go to court and get a judgment you mean?

Mr. TINSLEY. That's correct.

Mr. WALDIE. Nothing that I see in the contract provides for any interest for audit exceptions agreed to, is there?

Mr. TINSLEY. In the past, any time we have had an audit exception they have agreed to pay interest on the exception.

Mr. WALDIE. Is that the case?

Mr. TINSLEY. Yes, Mr. Chairman.

Mr. WALDIE. And it's your understanding that if they agreed to a payment of \$10 million there would be interest from the dates that the audit exceptions were found?

Mr. TINSLEY. Insofar as I'm concerned, we'd get interest on that money.

Mr. WALDIE. OK, that's encouraging. I must say I did not see that anywhere in the contract. Can you tell me where you have the right to seek interest from them?

Mr. TINSLEY. That is money that should have been earning interest and by virtue of it not—by virtue of it having been used and the exception then taken, we have lost further income on that money by a failure to have it invested.

Mr. WALDIE. I understand that, but I cannot find, counsel, in the contract the authority to impose interest as an incentive to encourage resolution of exceptions. Can you tell me how that comes about?

Mr. GOODMAN. Well, I would think the interest is due to two different theories. One is that the practice of audits in the past, as indicated by Mr. Tinsley, has been that interest has always been paid once these matters have been resolved; and second, I would believe on general principles they would be responsible to pay interest in light of the fact that claim had been made. I would think interest begins to run from the time the exception has been made or at least from that date.

Mr. WALDIE. Well, it surely would if a lawsuit were brought and you received a judgment—I presume it would run from the time the debt was found to have been owed. Well, we'll wait until they appear and ask them on that matter.

Counsel, do the Federal procurement regulations apply to the Blue Cross-Blue Shield contract?

Mr. GOODMAN. In our view, they do.

Mr. WALDIE. They also apply to all the other carriers, do they not?

Mr. GOODMAN. Yes, sir.

Mr. WALDIE. Is there any dispute with the other carriers as to that fact?

Mr. GOODMAN. I don't believe there is.

Mr. WALDIE. Mr. Tinsley, are you aware of any dispute of the other carriers as to the application of the Federal procurement regulations?

Mr. TINSLEY. We have not had a dispute.

Mr. WALDIE. But you do with the Blue Cross-Blue Shield?

Mr. TINSLEY. Yes, we do.

Mr. WALDIE. Do you concur with their view that the Federal procurement regulations do not apply?

Mr. TINSLEY. I do not concur with their view that they do not apply. My view has always been that the question of whether or not they're legally applicable is rather academic, that they are either going to apply by law—and if that's the case I don't need a contract provision; or if they do not apply by law, they are going to apply through a provision in the contract.

Mr. WALDIE. An existing contract?

Mr. TINSLEY. There is a provision in the existing contract.

Mr. WALDIE. I have read it. Is it your view that that provision requires the application of the Federal procurement regulations at this time?

Mr. TINSLEY. It is my view that that does.

Mr. WALDIE. That being the case, why have you permitted a \$10 million that the "Blues" have not paid pursuant to the exceptions under the audit to drag on for at least 4 years in some instances, and in many instances apparently back to the 1960's where the money has been owed? What has caused the Civil Service Commission to be so tolerant of this indebtedness?

Mr. TINSLEY. The bulk of the findings, the exceptions, have been within the past 2 years. We recognized when we were running into these exceptions and had the reaction of the "Blues" and the amounts that were going to be involved, that it was going to be essential to have some manner of bringing these things to a conclusion and settling them.

Certainly, we have increased our own internal time in terms of bringing them to an end as far as we're concerned, and we feel there's a need for somebody to be agreed upon to settle a dispute.

Mr. WALDIE. Do not the Federal procurement regulations provide for resolution?

Mr. TINSLEY. I believe they do.

Mr. GOODMAN. They do have provisions for boards to resolve such matters and I believe one of the matters that have been negotiated between the Commission and the "Blues" is the question of which board should be involved in this.

Mr. WALDIE. Why should that be negotiated? Don't the Federal procurement regulations deal with that?

Mr. GOODMAN. Well, it seems to me that you can have any number of boards to deal with the question through agreement by the parties. I don't think it necessarily has to be the GSA board.

Mr. WALDIE. How long do such negotiations take place? It's been over 2 years, even using your generous figures since 1973 is when it really started. Do you have the authority in your view, counsel, the Civil Service Commission, to designate the board that is to resolve these unresolved disputes?

Mr. GOODMAN. We believe that we could proceed under the FPR's with the board at this time in regard to resolving these disputes. The question is, in part, whether that's the most propitious manner of dealing with it at this particular time.

Mr. WALDIE. Tell me why it would not be propitious. I would assume on that basis that the way you have been dealing with it to have been propitious.

Mr. GOODMAN. Well, I would say, for example, in regard to the State statutory reserves, we would decide it would be more propitious to refer the matter to the Justice Department and perhaps go directly to litigation rather than going through the procedure of a board and so forth.

Mr. WALDIE. I can understand where some of these disputes would have to be resolved by litigation and I want to get into what your litigation calendar is, but those exceptions that you will not take to litigation that will be at least referred to a board for resolution would seem to me to be in our interest, the Government's interest, to have them so referred to begin a resolution of these disputes, and I'm curious as to

why over this long period of time none of these disputes have apparently been resolved anywhere, to either a board for resolution or to a court for litigation.

Has it been because there's been hope and faith that the "Blues" will come across with the settlement?

Mr. GOODMAN. Well, I think part of it has been because there has been active negotiation.

Mr. WALDIE. There's been active negotiation for 1971 through 1974.

Mr. GOODMAN. Well, I believe Mr. Tinsley pointed out and the GAO report indicates that most of these exceptions begin to arise in 1973.

Mr. WALDIE. That was almost \$1 million accumulated prior to 1973; 1971-1972, as you know, is \$800,000 Blue Cross-Blue Shield, and then \$9 million-plus in 1973 and 1974, but not one has been referred anywhere, to my knowledge. Am I incorrect in that regard?

Mr. GOODMAN. Well, as I say, the decision has been made to go forward with regard to the State statutory reserves and the matter has been referred to the Justice Department.

Mr. WALDIE. When was that decision made?

Mr. GOODMAN. That decision was made very recently and that was referred just yesterday.

Mr. WALDIE. All right. And what portion of the disputed claim does that involve, \$3 million-something?

Mr. TINSLEY. That's correct, Mr. Chairman.

Mr. GOODMAN. Yes.

Mr. WALDIE. Just of the "Blues"?

Mr. GOODMAN. Yes.

Mr. WALDIE. And have there been references of any portion of the balance to any other authority, the courts for litigation or to a board?

Mr. GOODMAN. Not that I know of.

Mr. WALDIE. What are the plans in that regard as to the remaining \$7 million?

Mr. TINSLEY. We have been negotiating with the "Blues".

Mr. WALDIE. That's been fruitless, though, hasn't it?

Mr. TINSLEY. Yes, Mr. Chairman. We have also been talking to them in terms of a means to settle disputes short of going to court.

Mr. WALDIE. Would it not be wise to refer them to a board for arbitration under Federal procurement regulations and then seek negotiations?

Mr. TINSLEY. Mr. Chairman, I think I can state that insofar as the Commission is concerned, these 1975 contracts will contain a provision for settlement of dispute.

Mr. WALDIE. I'm not interested in the 1975 contract yet. I'm interested in the \$10 million due and owing. I assume that lessons have been learned for the future, but I'm curious about the errors of the past.

Mr. TINSLEY. I'm assuming that the \$10 million will be subject to that appeals process, regardless of the date.

Mr. WALDIE. Is it my understanding that you do not refer it because you do not feel confident in your assessment that the Federal procurement regulations apply?

Mr. TINSLEY. One of the reasons for the delay was due to the legal question that's been raised by the "Blues," plus the brief from their

attorneys concerning the application of the Federal procurement regulations.

Mr. WALDIE. The fact of the matter is, though, that our attorneys—and I say “ours”—the Civil Service Commission represents the Government—have said the “Blues” are wrong, have they not?

Mr. GOODMAN. Yes.

Mr. WALDIE. Why give them that situation? Do you not rely on our attorneys and pay little attention to their attorneys?

Mr. TINSLEY. I do intend relying on our attorneys.

Mr. WALDIE. Then why do we not refer the \$7 million remaining to an appropriate board for arbitration?

Mr. GOODMAN. Well, there's a question as to whether the \$7 million should go to a board or whether some of that should also go directly into litigation. That is a matter that we do presently have under active consideration.

Mr. WALDIE. Then the question I have is what portion of that do you believe will go into litigation and when do you anticipate it would be referred to litigation?

Mr. GOODMAN. I really couldn't say at this time. It's really a question of what conclusions are drawn on the basis of the review that's going on now. We do have one of these matters under active consideration in the office about going to litigation.

Mr. WALDIE. Perhaps I should just ask this question for the record. Will you provide me with the response to this question? I'm desirous of knowing the amount that has been referred to the Justice Department for litigation of the unresolved exceptions, number one. I'm desirous of knowing the balance of unresolved exceptions, what disposition is anticipated to be made as to how it will be collected, and when it is anticipated that initiatives will be taken other than negotiations to begin the collection of the unresolved balance.

Mr. GOODMAN. We will provide that.

Mr. WALDIE. One of the questions that's apparently still unresolved, too, is the scope of the audit that is permitted under the contract. Counsel, will you address yourself to what you believe to be the scope of that audit?

Mr. GOODMAN. I believe that the scope of the audit is a very broad one, limited solely by the question of whether the matters that are looked into affect the payments under the contract, frankly, and I believe our authority to audit is a very broad authority which finds its roots in 5 U.S.C. 8910.

Mr. WALDIE. You don't happen to have the text of that, do you? Could you just give me the text without reading the whole thing, just the essence?

Mr. GOODMAN. Well, the essence is that the Commission will make a continuing study of operation administration of this chapter, namely, the chapter of the law dealing with these plans, which includes various surveys and reports; and there is within it a requirement that reports be furnished to the Commission to enable it to carry out its functions under this chapter and I believe that's very broad language.

Mr. WALDIE. In your view, does the contract language under article 6, subsection C between the Civil Service Commission and the “Blues”

have any impact upon that statutory authority and, if so, what is the impact? That's subsection C, article 6.

Mr. GOODMAN. Well, I believe that that subsection of the contract has to be read in connection with the authority contained in 8910. I don't think that section of the contract in any way derogates from 8910. I think it's merely stating that you have to read that with 8910 and they have to provide us with all of the records we need to carry out our functions under the chapter.

Mr. WALDIE. They take the contrary position, as I understand the correspondence. What is the mechanism whereby you resolve disputes of that nature?

Mr. GOODMAN. Well, again, I don't think that an impasse has been reached in that regard as yet, but it's the same mechanism question as you asked before. I would think that that would be a matter that could be referred to a board.

Mr. WALDIE. All right. I want to ask you, counsel, another question because the "Blues" will be talking about this, I presume. If not, I will be asking them about it. I wanted to go to the contract language involving the Federal procurement regulations. That's on page 18 of my contract, article 10, subsection E. Do you have that?

Mr. GOODMAN. Yes.

Mr. WALDIE. The last sentence, subpart 1-15.2 to part 1-15 of title 41 of the Federal procurement regulations, "in effect on June 30, preceding the contract year shall be used as a guide in determining said expenses subject to any exceptions agreed to by the corporations and the Commission in writing."

In your view, does that language in any way impact upon your conclusion or Mr. Tinsley's conclusion that the Federal procurement regulations apply to the performance of this contract?

Mr. GOODMAN. Well, it's our view that the regulations apply as a matter of law and I don't think anything in a contract could derogate from that. It seems to me that the FPR's themselves do allow for certain flexibility and, in that sense, they constitute to some extent the guide themselves and they do allow for this flexibility in which case you could have some exceptions. So I don't see anything in that provision which would, in my view, derogate from our position that the FPR's apply.

Mr. WALDIE. Have any exceptions been agreed to in writing between the Commission and the "Blues?"

Mr. GOODMAN. There have been negotiations between the Commission and the "Blues" regarding that.

Mr. TINSLEY. There have been no exceptions made to date.

Mr. WALDIE. Except the agreement to in writing of exceptions and authorities that is granted by statute, the regulations would apply?

Mr. GOODMAN. I think they apply.

Mr. WALDIE. Could parties to a procurement contract waive coverage under the Federal procurement regulations?

Mr. GOODMAN. I think only as far as the regulations themselves allow for some flexibility.

Mr. WALDIE. What is the definition of a procurement contract? Well, let me make it a little more precise. As I understand it, the "Blues"

maintain this is not a procurement contract. Would you address that question?

Mr. GOODMAN. Well, I think the real issue is whether the contract comes within the FPR's. The FPR's apply to contracts. The FPR's apply broadly to contracts and you need not have what one person would consider to be a procurement contract and somebody else considered to be a somewhat different type of contract but where you're getting something.

In other words, I don't think the issue turns on procurement at all because the FPR's do in fact deal with contracts in a much broader sense than a very narrow, technical procurement sense. So I don't find any merit to that argument, frankly.

Mr. WALDIE. Are you familiar with the exceptions that the "Blues" have proposed?

Mr. GOODMAN. I'm not familiar with that.

Mr. WALDIE. Mr. Tinsley, are you familiar with those exceptions?

Mr. TINSLEY. Yes, Mr. Chairman, I am.

Mr. WALDIE. Had those exceptions been in existence in 1960 and thereby applied from 1960 to date, would there be any \$10 million indebtedness existing or would the exceptions have covered all of the disputed amounts?

Mr. TINSLEY. The exceptions would not have covered all the disputed amounts but they would cover some of them. I would have to go to the actual records to give just the amount.

Mr. WALDIE. Will you give me a written report that you might include in this record whereby a determination is made as to how much of this unresolved \$10 million would have been resolved had the exceptions applied from the beginning of the contract?

Mr. TINSLEY. Yes, Mr. Chairman. I'd be glad to.

Mr. WALDIE. For example, would the sum that you're taking to litigation to the Justice Department be due and owing had the "Blues" exceptions been adopted?

Mr. TINSLEY. I don't believe so, Mr. Chairman.

Mr. WALDIE. So we eliminate \$3 million immediately.

Mr. TINSLEY. Yes. I think of the exceptions—

Mr. WALDIE. Is it fair for me to assume that if all their exceptions had been agreed to, they wouldn't owe very much?

Mr. TINSLEY. I don't think it would be a great amount.

Mr. WALDIE. I suspect not.

Mr. TINSLEY. But I think they're looking not just to the present, but to the future, over a long period of time.

Mr. WALDIE. I'm sure they are. But when did they propose the exceptions?

Mr. TINSLEY. I believe they originally proposed the exceptions back in December of 1972.

Mr. WALDIE. Right after the audits began?

Mr. TINSLEY. The intensive audits.

Mr. WALDIE. So am I properly to assume legally they did not seek any exceptions for the first 10 years of the contract?

Mr. TINSLEY. Not to my knowledge, but I don't have personal knowledge of every year of the first 10 years. My knowledge is somewhat limited to the last 4 years.

Mr. WALDIE. So that any exceptions they are now proposing would have no application beyond 1972 in any event, would they, prior to 1972?

Mr. GOODMAN. I certainly think that's correct. If they weren't in the contracts in the past years, I don't see how they could apply.

Mr. WALDIE. And as a matter of fact, no exceptions have been agreed to in writing at all, have they?

Mr. GOODMAN. That's my understanding.

Mr. TINSLEY. They have not, Mr. Chairman.

Mr. WALDIE. So even 1972 to date, since they have not been agreed to in writing, they have no application to this contract?

Mr. GOODMAN. That would be my position.

Mr. WALDIE. Can you have an exception that has retroactive application? If you adopt an exception tomorrow, could you wipe out the \$10 million?

Mr. GOODMAN. I would think—you know, I'd have a real problem with that.

Mr. WALDIE. Legally, could you do that?

Mr. GOODMAN. I would have a real problem legally with that.

Mr. WALDIE. It seems to me it would be a gift of somebody's money that you would not be entitled to make.

Mr. GOODMAN. That's why I would have a problem with that.

Mr. WALDIE. As a policyholder, you might end up with a suit. This is my money they're dealing with, this \$10 million, or is it? Whose money is this \$10 million if it's collected by the Government?

Mr. TINSLEY. It is coming from the employees and from the Government.

Mr. WALDIE. What do you do with it if you get it back? Will you give it back to the employees, their share of it, which was 60 percent?

Mr. TINSLEY. The entire amount would go back into the reserves of the program and be available for the reduction of premiums and the expenses for future years.

Mr. WALDIE. One final question. Of the unresolved amount the "Blues" are claiming, as I gather, they have paid back \$500,000, half a million; is that right? Aren't they claiming some bookkeeping entry; but they've not turned over any money to us?

Mr. TINSLEY. This is another area that at the moment is in the General Counsel's office. Insofar as the problem is concerned, you're correct. The amount of exceptions agreed to at that time amounted to, I believe, a little over \$500,000. The "Blues" in their accounting statement made an adjustment. We were not satisfied with the manner in which they made the adjustment, we did not think it was proper and that brought from the "Blues" the views of their attorneys-advisers. This matter, too, is presently before the General Counsel.

Mr. WALDIE. Then would you give me in your report the disposition that you propose on that controversy, also?

Mr. TINSLEY. I believe we can.

Mr. WALDIE. Thank you, gentlemen. I guess I have no further questions. I'm not sure that I will ever be questioning you again, Mr. Tinsley. I'm sure you regret that.

Mr. TINSLEY. I could say I have mixed emotions, Mr. Chairman.

Mr. WALDIE. But I want to tell you this, the Civil Service Commission under your predecessor and you I think have performed well and ably in attempting to resolve these matters and they are complicated and there's been a pattern I think in the past. There's not been a desirable pattern, but it seems to me it's just remarkably improved and I want to commend you and General Counsel's office, and I'd particularly like to say it's the first time I've had you before the committee, Mr. Goodman, and your responses were to my questions and understandable, which, as an attorney, I can suggest is not always the case.

Mr. GOODMAN. Thank you, Mr. Chairman.

Mr. WALDIE. I appreciate it.

Mr. TINSLEY. Thank you, Mr. Chairman. And let me express the Commission's thanks for the efforts you have exerted on behalf of all Federal employees and certainly the help that you have given to the Commission in the administration of this program. Thank you, Mr. Chairman.

Mr. WALDIE. Take very good care of the monies I have in the retirement fund, will you? I won't be using them for a while, but I want to make sure they're there and under good care.

Mr. TINSLEY. They are earning interest.

Mr. WALDIE. The next witness we'll have is Mr. Robert Laur, vice president of the Federal employees plan, National Association of Blue Cross and Blue Shield, and anybody Mr. Laur desires to accompany him.

STATEMENT OF ROBERT LAUR, VICE PRESIDENT, FEDERAL EMPLOYEES PLAN, NATIONAL ASSOCIATION OF BLUE CROSS AND BLUE SHIELD

Mr. LAUR. Thank you, Mr. Chairman.

I am vice president of the Blue Cross Association and the National Association of Blue Shield plans, and in that capacity I serve as the director of the Federal employee program jointly administered by those two national associations.

Before commenting on the specific issues discussed in the GAO report the committee requested, I would like to make some observations that should serve to place my subsequent testimony in some perspective.

The Blue Cross and Blue Shield plans contract with the U.S. Civil Service Commission is a fixed price contract for health insurance. It is underwritten by 147 Blue Cross and Blue Shield plans across the country in exactly the same manner as contracts for other large groups in private industry.

The contract is subject to such Federal and State statutes as pertain directly to health insurance. As in the case of similar experience-rated contracts for large employers, the Blue Cross and Blue Shield plans' actual expenses incurred in the administration of the contract are chargeable against its experience. In this context, administrative charges have from 1960 to 1972 been defined by contract as the actual necessary expenses incurred in connection with the administration of this contract determined by the corporations—Blue Cross and Blue Shield plans—on an equitable and reasonable basis with proper justification and accounting support.

This practice has been entirely consistent with the intent of Congress. That intent is expressed in House Report 86-957 which states that "any readjustment in rates is required to be consistent with the general practice of carriers which issue group health benefits plans to large employers."

Now the Blue Cross Association and the National Association of Blue Shield plans have resisted incorporation of the cost principles of the federal procurement regulations into their contract. Their concern is that the use of those cost principles may result in the disallowance of actual expenses properly incurred and properly allocable to the contract.

This could occur because the cost principles were developed for application to supply and manufacturing contracts rather than contracts of insurance. In fact, Mr. Chairman, the cost principles never have been applied directly to the purchase of insurance by the Federal Government and, indeed, were not designed to apply to a fixed price contract such as that of Blue Cross and Blue Shield.

In 1973, however, the Commission stated that inclusion of the cost principles in our contract by reference as guidelines for administrative charges was "a condition for continuation of the contract."

As a result, the associations agreed to their inclusion. The parties contemplated that the guidelines would be subject to exceptions agreed to by the associations and the Commission. These exceptions would permit the plans to recover their full administrative expenses properly chargeable against the experience of the contract.

The associations have described for the Commission the exceptions to the cost principles which we desire.

Mr. WALDIE. May I interrupt you there a moment?

Mr. LAUR. Surely.

Mr. WALDIE. Is it your position that until such time as exceptions were agreed to the guidelines didn't apply?

Mr. LAUR. That is correct.

Mr. WALDIE. Why does your language say, then, that the guidelines in effect shall be used as a guide in determining said expenses subject to any exceptions agreed to by the corporations and the Commission in writing? That says to me that if there are no exceptions agreed to, the guidelines apply. The language seems to me to be clear. Where am I misinterpreting that language?

Mr. LAUR. You're not, except that we had the Commission at the time that contract was signed contemplated that there would be exceptions.

Mr. WALDIE. Well, why did you not say, then, that the guidelines shall have no application until the exceptions have been set forth in writing?

Mr. LAUR. Well, perhaps we should have. We just did not. The alternative would have been not to have signed the contract until we agreed to the exceptions. We decided not to do that in the interest of the program.

Mr. WALDIE. And by so deciding, you accepted this language and it was an understandable tradeoff. You accepted the handicap of this language in order to get the benefits of signing the contract. That's called contract negotiations.

Mr. LAUR. Well, I suppose there's another interpretation, Mr. Chairman, which is that we negotiated in good faith with the Commission that there would be some exceptions.

Mr. WALDIE. Well, that's not spelled out very artfully and I presume you had attorneys assisting you in interpreting the contract and drawing up the language, did you not?

Mr. LAUR. Yes, indeed.

Mr. WALDIE. OK. I understand your understanding of the language that was used.

Mr. LAUR. The exceptions which we have requested of the Commission would permit continuation of a number of accepted accounting principles that had been followed by the Blue Cross and Blue Shield plans for many years. The Civil Service Commission has not agreed to these exceptions pending a receipt of an opinion, which they have just received from their General Counsel, on the question of whether or not the Commission has authority to agree to exceptions.

In the meantime, the associations have submitted a memorandum of law in support of our position that the cost principles are not mandatorily applicable.

Next, Mr. Chairman, it should be clear that the \$9.4 million in the GAO report of unresolved audit exceptions does not necessarily represent unallowable charges. In fact, Mr. Chairman, you began your questioning of Mr. Tinsley by talking about costs which were improperly taken and abuses. That is not necessarily the case.

Many of the audit exceptions are simply matters of lack of understanding on the part of one or the other parties.

Mr. WALDIE. But presumption is at this point, since there have been exceptions, that they have to be explained.

Mr. LAUR. Yes, indeed. That is correct.

Mr. WALDIE. And until some time when that presumption is overcome, my description I think is a correct one. Now it may be that the GAO audit is improperly taken and that you will succeed in your assumptions that you do not owe these moneys. But at this point, acting on behalf of the Civil Service Commission, they have claimed that you have improperly taken these sums.

Now, all I'm pressing for is a resolution of this matter. Let me question you on that. Do you concur in their statement that when the matter is ultimately resolved, if you are found to have improperly taken this expense and you must pay it back, is it your agreement that you will pay interest from the date it was improperly taken?

Mr. LAUR. It certainly is not.

Mr. WALDIE. All right. Proceed then. There's a misunderstanding there, too, isn't there? You heard them say that was their belief. Then, is there any incentive for you to ever settle any of these matters? Why should you ever settle a dime, since you can hold this money back, even if you have wrongfully withheld it, invest it, keep the interest, and ultimately pay it maybe when they get to court. Where is the incentive to bring about the resolution of an exception in your interpretation of this contract? How do we resolve exceptions in your interpretation? By going to court? Is that the only way to resolve an exception if you will not agree?

Mr. LAUR. That is the ultimate way to resolve them if we cannot agree.

Mr. WALDIE. Is there another way short of your consent to pay?

Mr. LAUR. Yes. There is a way which—

Mr. WALDIE. Short of your consent to pay, what is that way?

Mr. LAUR. That we and the Commission reach an understanding.

Mr. WALDIE. But that's your consent.

Mr. LAUR. Well, it's the mutual consent. It's not unilateral.

Mr. WALDIE. But it requires your agreement?

Mr. LAUR. Yes.

Mr. WALDIE. If you refuse to agree to move one bit, the only way to resolve it is to go to court?

Mr. LAUR. Which is not necessarily the way we prefer, Mr. Chairman, and we have been arguing for a dispute settlement process and a statute of limitations for some time. The incentive for us to settle these audit disallowances is, first of all, our desire to operate the program properly, and we have no desire to improperly make charges.

Mr. WALDIE. But it would be a greater incentive if the party at fault were required to pay interest?

Mr. LAUR. The alternative is that we would have to fight much more strongly.

Mr. WALDIE. I don't think you could be fighting any more strongly. Where have you ever conceded?

Mr. LAUR. We have made many concessions. These represent only 80 percent of the audit exceptions.

Mr. WALDIE. So you have conceded on maybe 20 percent?

Mr. LAUR. I misstated myself. We have conceded on perhaps 80 percent of the specific issue raised.

Mr. WALDIE. Well, I've asked for a report of that. That was not my understanding of the GAO report. You're talking about 80 percent of the claims or the dollar amounts?

Mr. LAUR. The audit issues. The dollar amounts may be different but I don't know what those are.

Mr. WALDIE. Tell me what you estimate they are.

Mr. LAUR. I would guess it's roughly an equivalent amount to that in question.

Mr. WALDIE. What do you mean by "that in question?"

Mr. LAUR. That has been questioned over the period of the contract.

Mr. WALDIE. You mean 80 percent of the dollar amount you have agreed to?

Mr. LAUR. No. 80 percent of the audit issues totalling amounts roughly equivalent to the amounts now unsettled. That's my estimate. In other words, \$9 million has been settled.

Mr. WALDIE. I see. So that roughly, of the dollar amounts, 50 percent of them have been agreed to.

Mr. LAUR. I would like to make clear again I'm just estimating that. I've asked if we have the figures readily available and we do not have them with us.

Mr. WALDIE. Well, we'll find that out. That's not my understanding, I might tell you. My understanding is that you folks have agreed to a very minimal amount of dollar amount settlements. Now if that is so—and there's no sense in you and I disputing this because neither

of us have these facts—then it is difficult for me to conclude that there's validity in your statement that you have acted in good faith to resolve these disputes and you're interested in a resolution of them. I don't really see any incentive for resolving anything. I'm not blaming you folks. I'm blaming the Civil Service Commission into not forcing you to settle these matters, in taking some steps to resolve them, this \$10 million sitting around for all these years, which is incredible, but it's good business practice for you folks. It's excellent business practice since you incur no liability.

What liability do you incur for letting this go for another 10 years?

MR. LAUR. Two, Mr. Chairman.

MR. WALDIE. What?

MR. LAUR. First of all, we do not wish to build up liabilities which at some point we may be called upon to repay in a short period of time.

MR. WALDIE. Theoretically, you could invest it and draw interest on it.

MR. LAUR. Theoretically, we could. Secondly, Mr. Chairman, if we acted in bad faith—and I would regard the process you have just described as being in bad faith—then I think the Commission would be entitled to ask us for interest, if we were deliberately withholding it, so we could gain interest on it, and we should be charged interest.

MR. WALDIE. If you're found to have unreasonably held it, why wouldn't you be willing to pay interest?

MR. LAUR. I think the question turns on why has the money come under discussion as to whether or not it should be disallowed. If we acted in good faith on the basis of our past experience and past approaches which the Commission never questioned, and then in a subsequent period they decided to go back clear to 1960, it seems to me that does raise a very serious matter of equity as to whether we should be required to pay interest on a sum which we handled in what we believed to be a completely proper way.

And I'm setting aside any issues where we acted improperly with malice aforethought. That would be a different matter.

MR. WALDIE. You think interest is a penalty?

MR. LAUR. I believe it would be when we acted in good faith. When we acted in bad faith, it would be a penalty for that.

MR. WALDIE. Why should the parties not be put in the same position they were, not in the same position if you used our money improperly, even if you acted in good faith? You have to give our money back but you have earned the interest on the money. Why wouldn't you be in precisely the same position if you hadn't acted out of error? Why should you profit out of an error? An interest is a profit, not a penalty.

MR. LAUR. I don't know; if it was a question of error and if it was a substantial error, then I think the interest would be a point worthy of consideration. I really don't know what the answer would be on that. In fact, we have paid interest on some audit disallowances.

MR. WALDIE. I don't see why you're not required to pay interest on every audit disallowance.

MR. LAUR. If we were, Mr. Chairman—

MR. WALDIE. I don't see any disagreement with that. That ought to be clarified in the contract. I understand an audit disallowance attempts to put you in a position where you would have been had there not been a mistake made, and I'm willing to concede any audit

disallowance is not intentionally a rip-off thing; it's a mistake. But mistakes cost me money. If you don't pay me interest that you earned on my money, that is mistakenly appropriated.

Mr. LAUR. It may be another matter entirely. At one point in time there was an interpretation, and a subsequent interpretation is different. Then the question is, it wasn't a mistake. The figures are accurate. We did precisely what we said and everybody agreed to it.

Mr. WALDIE. Agreed to it?

Mr. LAUR. Agreed to it by not taking exception to it.

Mr. WALDIE. If the court so found there's no mistake, or an arbitrator—but if a court or an arbitrator finds that there was not agreement, it's an exception that must be paid. All I'm saying is every exception as to which there is an order to be paid by a third party or an agreement to pay ought to include interest. It's really all I'm saying. The Commission says that they are going to get interest. You say you're not going to pay interest.

Mr. LAUR. In effect, what you're saying, Mr. Chairman, is in the situations I have described where I felt there was no error there would be no exception in your view.

Mr. WALDIE. Exactly.

Mr. LAUR. All right.

Mr. WALDIE. That's exactly what I'm saying. I'm just saying in those exceptions that are found warrant the situations you have described, the exception would not be warranted. Well, you disagree on the interest situation.

Mr. LAUR. Yes, sir.

[The letters follow:]

U.S. CIVIL SERVICE COMMISSION,
BUREAU OF RETIREMENT, INSURANCE, AND OCCUPATIONAL HEALTH,
Washington, D.C., October 10, 1974.

ROBERT J. LAUR,
Vice President, Blue Cross Association, National Association of Blue Shield Plans,
Washington, D.C.

DEAR MR. LAUR: This replies to your letter dated August 27, as amended September 11, concerning scope of audit for the Government-wide Service Benefit plan.

As indicated in previous correspondence, the scope of audit under discussion represents an interim practice pending resolution of the applicability of the Federal Procurement Regulations to contract CS 1039, and resolution of our authority to review contractual relationships between Member Plans and providers vis-a-vis the requirements imposed on the Civil Service Commission by the General Accounting Office.

In our letter of April 26 we outlined our intended scope of financial audit. There have been subsequent exchanges of correspondence for the purpose of clarifying specific audit areas. As a result, we have constructed a scope of audit statement which we believe recognizes the interests and needs of the Civil Service Commission and the Associations. It is as follows:

1. Reconciliation of Plans FEP health benefits payments to the various providers within the provisions of Contract CS 1039.
2. Review of advances in relationship to contractual obligations incurred under Contract CS 1039.
3. Review of administrative expenses to determine whether such expenses are actual and necessary expenses incurred in connection with the administration of the contract.
4. Review of the amount, reasonableness and appropriateness of statutory reserve charges and/or premium rates.
5. Review of claims to determine whether payments are made in accordance with the terms of Contract CS 1039 and applicable brochures.

Our exchange of correspondence also addressed the subject of availability of records and other information necessary to the audit. The materials that are necessary for this purpose are as follows:

1. FEP Administrative Manual.
2. All accounting worksheets supporting the last three cost submissions.
3. Worksheets supporting enrollment and claims statistics, and any other statistics used to allocate charges to FEP.
4. Most recent reports to State regulatory agencies.
5. Most recent GAO audit reports.
6. Basis of provider payments (schedules and formulae).
7. Plan Charter and Enabling Act.
8. Pamphlets and literature describing the Plan.
9. General ledger and journals.
10. FEP Paid Claims Listing (1973, 1974) supporting invoices to the Operations Center.
11. Detail Listing (Check Register) of all disbursements for payment of FEP claims for the period 1-1-73 to 12-31-73.
12. Current Listing of Member Hospitals.
13. Organization Chart.
14. Plans' audited financial statements (last 3 years).
15. FEP CPA reports (last 3 years).
16. BCA and NABSP performance reviews (most current).
17. Current listing of participating physicians and statement of percentage of participating physicians.
18. Internal audit reports when they relate to financial contract compliance situations.
19. General Operating Procedure, flow charts, list of computer generated reports as audit issues necessitate.

Future audits will be carried out within this framework.

Sincerely yours,

THOMAS A. TINSLEY,
Director.

NOVEMBER 18, 1974.

MR. THOMAS A. TINSLEY,
*Director, Bureau of Retirement, Insurance and Occupational Health,
U.S. Civil Service Commission, Washington, D.C.*

DEAR MR. TINSLEY: This is in response to your letter of October 10, 1974 concerning the scope of Civil Service Commission audits (copy attached).

Generally, we are in agreement with the scope of audit statement as outlined in your letter with one possible exception. Specific reference is made to subparagraph four on the first page. Suggest this paragraph be changed to read as follows:

4. Review of statutory reserve charges and/or premium taxes and assessments levied by state and local governments.

The above change is intended to eliminate interpretive misunderstandings and judgemental connotations that could arise in future discussions. The words "taxes and assessments" have been substituted for "rates" as a matter of clarifying and expanding the area of review.

A response recognizing and accepting the change will be appreciated. A revision of your statement, if the change is accepted, is not considered necessary.

Sincerely,

ROBERT J. LAUR,
Vice President.

Mr. WALDIE. You disagree that there is any resolution short of going to court, without your consent.

Mr. LAUR. And we have proposed a dispute settlement process which would solve that problem, we believe.

Mr. WALDIE. And you disagree that the Federal procurement regulations apply to this contract.

Mr. LAUR. Mandatorily, rigidly, yes.

Mr. WALDIE. That you have to consent to them and you draft them in effect by drafting exceptions?

Mr. LAUR. Yes, sir.

Mr. WALDIE. And I presume you disagree, also, on the extent of the audit that was described to us by the Commission.

Mr. LAUR. Well, I found that description rather interesting, since we have a letter from the Commission setting forth an agreed upon scope of audit, and I concur entirely with that scope.

Mr. WALDIE. May I have a copy of that letter?

Mr. LAUR. I'm sure we would be delighted or they would be delighted to provide it to you.

Mr. WALDIE. I have a copy of your letter to Mr. Tinsley dated May 29, 1974, but I don't have a copy of the Commission's letter, that I know of, and perhaps you can—my staff has not provided it to me. If you would provide it to me, I'd appreciate it.

Mr. LAUR. We'd be pleased to.

Mr. WALDIE. I may very well have it here—no. This is all Civil Service. Well, to save my time, would you examine and tell me where there is, in your view, a description of the scope of the audit that's been agreed to by the parties in excess of the language of the contract or adding to the language of the contract interpreting the language of the contract, I guess is what I mean. So the only thing I have is what the contract provides and the statutory authority that counsel for Civil Service Commission read.

I presume your theory is that that statutory authority has either been altered or changed by agreement between the parties.

Mr. LAUR. Well, I think that statutory authority is quite vague and arises, first of all, as a set of guidelines which the Federal agencies should apply. It does not require any particular scope of audit and our theory arises from the fact that the FPR's do not mandatorily apply.

The Congress intended this to be a fixed price contract on the basis of regular insurance industry practices. Nowhere in that arrangement does the audit scope include audit disallowances related to the management responsibilities of the carriers. We are completely willing to be audited in terms of our financial accountability and our compliance with the terms of the contract.

Mr. WALDIE. Do I gather that you're dealing with the terms "necessary and reasonable" there?

Mr. LAUR. No.

Mr. WALDIE. That you have the exclusive right to determine the costs are necessary?

Mr. LAUR. No, sir. We have agreed that the scope of audit would include an examination of whether charges made to the contract were necessary and reasonable. What comes under discussion, however, is the extent to which audit disallowances can be made regarding management decisions within that framework.

In other words, one can become very nitpicking about what is reasonable. We believe that is defeating the purpose of the entire arrangement that the Congress approved with the carriers.

In effect, Mr. Chairman, what is at stake here is that each individual Blue Cross and Blue Shield plan which is a carrier is conducting busi-

ness identical to what we do for the Federal employees with an entire range of other people in their communities, and the issue at stake is: Are they going to have to do something entirely different for the Federal employees than they do for all those others?

Mr. WALDIE. That's entirely possible, isn't it, if we so determine that we, because of premiums we're paying, demand a different sort of treatment of our people?

Mr. LAUR. Mr. Chairman, we have been operating on our understanding of what the intent of Congress was when this program was established and that was not the intent, as we understand it.

Mr. WALDIE. Well, OK. In short, your position is that the scope of the audit should not have the right to go into how these plans operate on the local level.

Mr. LAUR. In relation to their management decision process.

Mr. WALDIE. What other decisions do you permit the audit to go into in your view?

Mr. LAUR. We have stated that they are properly——

Mr. WALDIE. In the local plan?

Mr. LAUR. Yes.

Mr. WALDIE. What can they audit of the local plans?

Mr. LAUR. The financial accountability of that plan, whether the expenditures which the plans said they made and charged to FEP were properly and actually made.

Mr. WALDIE. How do you determine that unless you examine how those expenses were incurred?

Mr. LAUR. They can examine and should examine the accounting worksheets and the accounting records and on that basis determine whether or not expenditures were made.

Mr. WALDIE. But it should not go beyond the records that are kept by the local plan. It should not go to see, if in fact the tonsillectomy was performed?

Mr. LAUR. I would say, and I'm probably treading on accounting ice that I don't even understand, that that represents an auditable issue. In other words, if a provider charged a plan for a service fraudulently, it is——

Mr. WALDIE. They don't know that. They just see Dr. So and So charged \$100 for a tonsillectomy. They've got the right to go to Dr. So and So's office and examine his records and see if, in fact, he performed the tonsillectomy.

Mr. LAUR. I can't speak, Mr. Chairman, as to whether they have the right to go to the physician's office. I think they have a right to demonstrate that that claim is a bona fide claim. There may be other ways to demonstrate it.

Mr. WALDIE. I'm not sure that you and I have much disagreement. I don't understand where you precluded them from——

Mr. LAUR. Perhaps I can give you a specific illustration that's of critical importance to us. We believe it's improper for the Commission to extend the scope of their audit to an examination of the basis upon which we reimburse providers; that is, the amounts. It's one thing to pay for a claim properly submitted. The judgment of how much a physician should be paid for performing that tonsillectomy is an entirely different matter. That is under the scope of the contract in a

service benefit plan such as this. All that is important is that the service we're obligated to provide was provided.

The Commission has many times wished to get into the contractual relationships between the local plan and the hospitals and physicians and providers in the service area of that plan. We have said that represents an incursion into the management responsibilities of the plan outside the scope of the contract.

Mr. WALDIE. AS I understand this case, the issue came about because you objected to an audit that's been taking place in Chicago. Are you familiar with the incident I'm talking about?

Mr. LAUR. At least with the gross details of it.

Mr. WALDIE. Was that short of a decision that they were seeking to determine as to reasonableness and necessity?

Mr. LAUR. Mr. Chairman, I'm too confused on that specific issue to respond.

Mr. WALDIE. I hesitate to press you on it because I don't know enough about that issue either. I'll let that go. I don't understand what you objected to or what they wanted to do. So we'll let that go to another date.

Do I understand you to say that if an audit of 1960 showed a practice that in 1974 has been excepted to, you would not construe that as a proper claim for the Civil Service Commission to make?

Mr. LAUR. If they made that audit disallowance in 1960?

Mr. WALDIE. No. In 1974. They just are now doing the audit of 1960 and in 1974 they go back. There is no statute of limitations, as I gather it.

Mr. LAUR. Yes, sir.

Mr. WALDIE. And there ought to be. I concur with you on that. So in 1960 they find an audit exception. Are they permitted to claim for that?

Mr. LAUR. They are clearly permitted. They have done it all over the place. I'm not an attorney, so I apologize—

Mr. WALDIE. Do you have your attorney with you here?

Mr. LAUR. No, I do not. I would say if they attempted to apply the FPR's prior to the time that we agreed in the contract to apply them; back to 1960—

Mr. WALDIE. When did you ever agree, in your view, to apply them?

Mr. LAUR. I believe it was in the 1973 contract that we agreed to apply them as guidelines with exceptions to be negotiated.

Mr. WALDIE. OK. So is it your view that they did apply to the 1973 contract?

Mr. LAUR. Yes.

Mr. WALDIE. And 1974?

Mr. LAUR. Yes, sir.

Mr. WALDIE. And no exceptions were adopted so they applied?

Mr. LAUR. Now you're raising a point which I wish I had my attorney here to respond because I don't know whether we now have agreed that the entire body applies because no exceptions were agreed to.

Mr. WALDIE. But prior to 1973 that language was never in the contract?

Mr. LAUR. That's correct.

Mr. WALDIE. So therefore, it's your view that that did not apply?

Mr. LAUR. That's correct.

Mr. WALDIE. Are any of the sums to which exceptions were taken by the Commission, did they go back as far as the 1960's?

Mr. LAUR. Yes. I say that rather glibly. It may not go back entirely to 1960, but to some point way back.

Mr. WALDIE. But beyond the years of these audits which began in 1971?

Mr. LAUR. That's correct.

Mr. WALDIE. And it would be your view if they are based upon the Federal procurement regulations that at the most they could go back only to 1973, even if my theory that without exceptions the full regulations apply? They would only apply to 1973 and you don't have to accept that as your view, but the full regulations apply, but Federal procurement regulations, in your view, had no application at all prior to 1973?

Mr. LAUR. As Federal procurement regulations per se. There are many areas where our prior understanding with the Commission is identical to what is found in the FPR's.

Mr. WALDIE. But that was just coincidental.

Mr. LAUR. But as FPR's per se, they would not.

Mr. WALDIE. They claim based upon the application of FPR that went back beyond 1973 would have absolutely no validity at all.

Mr. LAUR. Yes, I would agree.

Mr. WALDIE. And from 1973 on, that invalidity would be dependent upon the resolution of that question of exceptions in writing?

Mr. LAUR. Yes.

Mr. WALDIE. OK. I think that clarifies it. Will you then provide me just with the information that we discussed? I'd like to know the amounts of moneys involved in the 60 percent of the exceptions to which you have acceded.

Mr. LAUR. Fine. I hope it turns out to be something reasonably close to 80 percent, having said so. We'd be glad to provide them.

[The information follows:]

According to our records, out of the \$10.1 million questioned in CSC audits, \$2,507,280 have been resolved. The amount accepted as unallowable charges is \$2,029,509 which represents 81 percent of the total that has been resolved.

Mr. WALDIE. And I'd also like to know, as a matter of fact, if the number that you have agreed to equals 80 percent. You understand I'm asking for two different figures there? Did the number that you have agreed to equal 80 percent of the full amount of exceptions taken? And of the numbers you agreed to, what was the dollar amount of those?

Mr. LAUR. Yes, sir.

[The information follows:]

Including the six National Issues, we have received from CSC 296 audit findings. Our records indicate that a total of 229 of these audit findings have been settled. We have accepted the CSC position on 170 of these findings, with 59 having been resolved in favor of the local Blue Cross and Blue Shield Plans. Accordingly, the number of audit findings that we have settled represents 77 percent.

The 170 findings which we agreed to accept amounted to \$2,029,509, as previously stated. The 59 findings which were resolved in favor of the local Blue Cross and Blue Shield Plans amounted to \$477,771.

Mr. WALDIE. Compared to the \$10 million. You used a figure of \$9 million. I don't want to be confused.

Mr. LAUR. My understanding of the GAO report is \$9.4 million are outstanding audit issues at this time.

Mr. WALDIE. If you'll look on page 5 of the GAO report I might be able to clarify where I'm confused. The top table in the middle of the page, says "amount of audit exceptions local Blue Cross and Blue Shield plans, 1971 through 1974, \$10,133,000," and then you go down the next column and it says "Total amount of unresolved audit exceptions," same period of time, "local Blue Cross and Blue Shield plans, \$9,434,000," which would seem that you only agreed to resolving less than \$1 million worth of value in that period of time.

They claim that you owed \$10 million. You agreed to a million of that 10, but there's \$9 million. So it would seem to me if your total was 80 percent of unresolved claims that represented 10 percent of the dollar amount.

Mr. LAUR. Either I'm wrong or this represents a different period than our total audit experience might. Both are very likely possibilities. But I would think—and this is just speculation, Mr. Chairman, that because of the sixfold increase in audit activities by the Commission in the period represented in those tables, that is a period of time that is somewhat unrepresentative and probably goes way back identifying unresolved audit issues back to 1960 but clearly omitting all the ones that were resolved.

Now, as Mr. Tinsley reported, the audit activities were much less then, so the dollar amounts are probably less.

Mr. WALDIE. He said the amounts prior to 1971 were infinitesimal.

Mr. LAUR. He can regard them as infinitesimal. I'm not so sure our plans did.

Mr. WALDIE. We can get those figures. He's got to provide those figures. And you might provide me your figures to see how they check out. My guess is that you probably have little exceptions prior to 1971 because the Commission didn't have any auditors. All the sudden they got geared up to look at things and we find in a 4-year period \$10 million. What really scares me, if that's what we found in the last 4 years, what did we not find in the 11 years that preceded that? That's why I was probing to see what kind of audits occurred prior to that.

Mr. LAUR. Conversely, Mr. Chairman, I think the big dollar amounts here arise from the extension back to 1960 of some basic issues.

Mr. WALDIE. That could very well be and that's something I did not understand until today. I think in terms of that \$3 million they referred to the Justice Department, that apparently goes all the way back to 1960, and I gather the greatest proportion of that occurred prior to 1971 would be my guess, too, and there may be others in that \$10 million—are there other big claims represented that would be one exception? Wouldn't that be that \$3 million?

Mr. LAUR. Yes, sir.

Mr. WALDIE. Are there others anywhere near a million dollars in exceptions?

Mr. LAUR. No.

Mr. WALDIE. That would be the biggest single exception?

Mr. LARSON. Could I answer that? We do have three issues right now.

Mr. WALDIE. Could you identify yourself for the record?

Mr. LARSON. My name is Keith Larson and I'm the manager of program audits for the FEP program. Now what I started to say, we do have three exceptions with three plans that exceed a million dollars. These are primarily claims dollars.

Mr. WALDIE. Do they go way back?

Mr. LARSON. Some do, yes. Some go back as far as 1968.

Mr. WALDIE. But the biggest one is this insurance?

Mr. LAUR. State mandatory reserves.

Mr. WALDIE. And that clearly goes back to the inception of the plan in 1960?

Mr. LARSON. I would say so.

Mr. WALDIE. OK. Gentlemen, I have no further questions. Do you have any further statements or anything you'd like to submit?

Mr. LAUR. Perhaps I'd like to comment on just one item for clarification, both in the GAO report and in the testimony you have already heard, Mr. Chairman.

That has to do with the final accounting statement for 1973 and the fact that the Commission felt \$500,000-plus of that should have been handled differently. I would like to make it clear to you that the accounting procedures we followed in that year were in accord with the Civil Service Commission instructions to us and they are the same as we have been following for several years in the contract in accord with their instructions. Therefore, we are somewhat at a loss to understand what we did that was improper since we followed their instructions.

Mr. WALDIE. As I understand, what you ended up doing by your accounting procedure, you ended up wiping out an indebtedness without paying it.

Mr. LAUR. That is because there is an imposition in this contract on our administrative expenses and we took a \$5 million loss that year on administrative expenses.

Mr. WALDIE. How did you do that?

Mr. LAUR. Because our actual and reasonable and necessary costs of administering this contract exceeded by \$5 million what the Federal Government was willing to pay.

Mr. WALDIE. And so if you wanted to assume all this \$10 million, you could increase your administrative costs over and above the Federal Government's willingness to pay and simply offset the \$10 million?

Mr. LAUR. No, because those costs are all audited, Mr. Chairman. We cannot charge something that's improper.

Mr. WALDIE. If you can't charge them to us, what do we care about them? If they're in excess of what you can charge to us, you assume them.

Mr. LAUR. Yes, we do, indeed.

Mr. WALDIE. If you assume them, according to your theory from the money you owe us, we assume them, don't we?

Mr. LAUR. Well, the program reserves would in that case, yes.

Mr. WALDIE. Well, that's why they objected to it.

Mr. LAUR. I can understand the objection. The alternative is that you go back and open every book every year in an unending parade

of accounting adjustments, and the Commission wished to avoid that, I think properly so, and so every year instructed us to make accounting adjustments in the year in which the adjustment was made, regardless of what time period the adjustment was related to. That's precisely what we did.

Mr. WALDIE. According to your theory—and I understand their unhappiness with it—you've got great incentives to go out, if it's found that you owe this \$10 million—and it's not found yet—but suppose you owe the \$10 million—you've got great incentives to go out and just load up administrative costs without any regard for the limit that we have set because you can offset this \$10 million against anything over and above the limit.

Mr. LAUR. What you have to understand is that we would also have to take a loss on our administrative expenses during that period of time because the plans have no desire, believe me, to lose money.

Mr. WALDIE. If we have to pay that loss through what you owe us, you're not taking that loss.

Mr. LAUR. That only takes effect when we have reached the ceiling. If we were so adroit as to calculate it so only the disallowances exceeded the ceiling—and you have to understand that we also do this about 6 months after the close of an accounting period when final accounting statements are prepared—there's no way to.

Mr. WALDIE. How unadroit were you when you tried to offset the half million?

Mr. LAUR. It was done in complete conformance with accounting practices.

Mr. WALDIE. How much did you exceed the limits?

Mr. LAUR. \$5 million.

Mr. WALDIE. And you were able to only offset half a million?

Mr. LAUR. That's correct. That doesn't seem to me like a very good return.

Mr. WALDIE. Where did the other \$4.5 million go?

Mr. LAUR. The local plans had to eat it. In effect, non-Federal-employee subscribers in their communities paid more for their health insurance to offset that loss or we dipped into reserves, which in many cases is more likely to be the case. The same circumstance will occur in 1974. It occurred in 1973 and it will occur in 1974.

Mr. WALDIE. Each year will you be exceeding your limit on administrative costs?

Mr. LAUR. Yes, sir. The limit is simply arbitrarily too low.

Mr. WALDIE. But that's important.

Mr. LAUR. In relation to the accounting statement, I didn't think the report was completely clear on it.

Mr. WALDIE. That's the limit we forced upon them because of the belief that there was no ceiling at all on what was described as public service charge, isn't that it?

Mr. LAUR. No, sir. It's a totally different matter.

Mr. WALDIE. Wasn't there always a ceiling on those charges?

Mr. LAUR. The public service charge has been an amount agreed to in the contract and it doesn't fluctuate with plan cost or claims volume or anything else. That's an agreed upon amount.

Mr. WALDIE. I understand. The administrative charge has always had a ceiling, hasn't it?

Mr. LAUR. I don't know that it always has, Mr. Chairman. I understand that for many years one has been imposed.

Mr. WALDIE. 4.5 percent?

Mr. LAUR. Not always 4.5 percent. In recent years 4.5 percent of subscription income.

Mr. WALDIE. Some of them don't even get close to 4.5.

Mr. LAUR. For many years it was much lower. What has happened is that the kind of coverage we're providing and the increase in audit activities and other things have simply raised administrative costs considerably. Principally, it's related to the extent of benefits in the contracts which result in claims which are more costly to administer—claims for ambulatory diagnostic services, as an example. It has become a very serious problem with the plans in the underwriting of this account.

Mr. WALDIE. Then I just want to ask a last question. I think Mr. Tinsley tried to explain it to me and I didn't understand it. Maybe you can help me.

The record of Aetna seems to be better in my terms at least. They seem to have less dispute in resolving exceptions than does your plan. Is there a reason for that that stands out other than the reason I suspect, which is you folks are harder nosed businessmen than Aetna are?

Mr. LAUR. I find it hard to believe that that would account for the difference between us and Aetna, Mr. Chairman. I don't know because I'm totally unfamiliar with the audit process related to Aetna. I do believe that Mr. Tinsley pointed out one probable explanation, and that is we have 147 different plans operating in accord with state requirements and so on involved in the Blue Cross and Blue Shield program, and that makes it more difficult because there's 147 opportunities for different approaches to be taken.

Second, this is a service benefit contract and I believe that in its very nature it is a more complicated approach but a more comprehensive approach to the provision of health services than perhaps one would find in indemnity contracts such as Aetna administers, and that may produce more opportunities for audit disallowance.

Mr. WALDIE. For disagreements?

Mr. LAUR. Then, of course, there is simply the sheer magnitude of the involvement of Blue Cross and Blue Shield and therefore probably more proper target for audit just because of the amount of money that's involved.

Mr. WALDIE. I appreciate that, and, Mr. Laur, I have not had much opportunity to deal with you, but every time I have I have been deeply impressed by your preparation and by your willingness to be forthspoken on the answers you have given the committee, and I appreciate that. Thank you, gentlemen.

Mr. LAUR. Thank you. And we would like to join the Commission in wishing you every possible success in your next ventures. You, too, have made an impression on Blue Cross and Blue Shield, I can assure you. Thank you.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]