

NEW JERSEY
INDIVIDUAL HEALTH BENEFITS PROGRAM

20 West State Street, 10th Floor

P.O. Box 325

Trenton, New Jersey 08625

Phone: (609) 633-1887

Fax: (609) 633-2030

OAL DKT NO. IHC 2864-97

AGENCY DKT NO. 96-21

IN THE MATTER OF THE)
INDIVIDUAL HEALTH COVERAGE)
PROGRAM BOARD'S ADJUSTMENT)
OF BLUE CROSS AND BLUE SHIELD)
OF NEW JERSEY'S REQUESTS)
FOR REIMBURSEMENT OF LOSSES)
FOR CALENDAR YEARS 1993)
AND 1994)

FINAL DECISION

The Initial Decision in this matter was issued on November 4, 1998, by the Honorable Bruce R. Campbell, A.L.J. (the "A.L.J."), and copies were mailed to counsel for the parties, Horizon Healthcare Services, Inc. (d/b/a Horizon Blue Cross Blue Shield of New Jersey) ("Horizon")* and the Individual Health Coverage Program (the "IHC"). In the Initial Decision, A.L.J. Campbell determined that Horizon had not presented any evidence in support of its claim that the accounting firm of Deloitte and

* On August 18, 1998, Blue Cross and Blue Shield of New Jersey changed its name to Horizon Healthcare Services, Inc.

Touche ("D&T") had used an inappropriate methodology when auditing Horizon's net paid loss for calendar years 1993 and 1994 (Initial Decision at 20) and that in any event, because Horizon had formally accepted D&T's proposed adjustments, its objections to D&T's audit methodology were not relevant. (Id. at 19). The A.L.J. determined further that the documents comprising the record before him produced no evidence indicating that a reversal or modification of D&T's proposed adjustments was required. (Id. at 20).

In the Initial Decision, A.L.J. Campbell made substantial findings of fact, including the following enumerated findings:

1. D&T was engaged by the IHC Board to conduct an independent audit of Horizon's net paid losses for the years 1993 and 1994.
2. The D&T audit was consistent with what the Board's Request for Proposal specified.
3. The audit was done in accordance with generally accepted auditing standards ("GAAS").
4. Horizon accepted all adjustments proposed by D&T and made those adjustments a part of Horizon's financial statements.
5. Horizon represented that its adjusted financial statements were a fair presentation of Horizon's net paid losses on individual business for 1993 and 1994.
6. Horizon signed a management representation letter stating that they agreed with the

adjustments and the presentation of the financial statements.

[Initial Decision, at 15.]

Both Horizon and the IHC filed written exceptions to the Initial Decision in a timely manner. Horizon's exceptions allege that the A.L.J. had: (1) ignored the uncontroverted evidence that D&T violated its own materiality standards; (2) ignored the undisputed fact that D&T insisted on using an inappropriate automated audit approach; (3) ignored the undisputed fact that Horizon only accepted the adjustments proposed by D&T as a whole; (4) erred by preventing Horizon from introducing evidence to show that the IHC Board's instructions to D&T in the initial request for proposal were inappropriate; (5) erred by preventing Horizon from introducing evidence to show that the IHC Board's failure to advise D&T of the potential for the IHC Board's post-audit "waiver" finding was inappropriate and fatally contaminated the audit; (6) erred by rejecting Horizon's expert's testimony; (7) erred by giving weight to the IHC Board's expert testimony; and (8) erred, in its order dated December 2, 1997, by refusing to allow Horizon to introduce any evidence concerning the IHC Board's post-audit "waiver" finding.

The IHC's exceptions, although not disagreeing with the Initial Decision, requested that it be modified by setting forth additional reasons for the decision that reference certain specified exhibits and by identifying them as they appear on lists provided in the exception document. The IHC also requested that a list of stipulated facts (with appended exhibits) be incorporated as additional findings of fact to further support the decision.

For the reasons stated infra, the IHC Board of Directors ("IHC Board" or "Board") finds that the A.L.J.'s factual findings are supported by substantial evidence in the record, and adopts the Initial Decision.

Horizon appeals from an audit of its net paid losses for calendar years 1993 and 1994. The IHC contracted with the accounting firm of D&T, pursuant to N.J.S.A. 17B:27A-11m and N.J.A.C. 11:20-8.8(b), in order to determine the amount of reimbursement of net paid loss that was due to Horizon, pursuant to N.J.S.A. 17B:27A-12a(1)(b).^{*} As required by statute and regulation, Horizon had submitted information regarding its net

^{*} After the activities that form the basis for this litigation, both the IHC Act and the IHC's regulations were amended. See L. 1997, c. 146, §§ 1-6; 30 N.J.R. 3289(a) (Sept. 8, 1998). Citations in this opinion refer to the pre-amendment versions of the statute and regulations, which were in effect at all times relevant to this case.

paid loss as part of an annual filing known as "Exhibit K." See N.J.S.A. 17B:27A-12a(1); N.J.A.C. 11:20-8. Before reimbursing a carrier for its losses, the IHC may conduct an independent audit of the carrier's net paid loss. See N.J.A.C. 11:20-8.8(b).

The IHC Board engaged D&T to audit Horizon's net paid losses for 1993 and 1994. D&T, after reviewing Horizon's records, proposed certain adjustments in net paid loss, and Horizon accepted those adjustments.

When Horizon filed its Exhibit Ks for 1993 and 1994, it attached to each a certification stating that Horizon had chosen not to include certain amounts, representing expenses for employee incentives and amortization of deferred system development costs, in the net paid loss that it reported in that year's Exhibit K. After receiving D&T's report of Horizon's adjusted net paid loss figures, the Board determined that those statements constituted a binding waiver by Horizon of those amounts and accordingly, further reduced Horizon's net paid loss by those amounts. IHC Administrative Order No. 96-21.

Horizon requested a hearing, alleging that D&T's audit methodology had been improper and that the Board's conclusion on waiver was incorrect. The Board determined that Horizon's allegation concerning D&T's audit methodology involved disputed

issues of fact requiring transmittal to the Office of Administrative Law ("OAL") as a contested case. Administrative Order No. 96-23. It also determined that with regard to the waiver issue, Horizon had not raised a genuine issue of material fact, and therefore denied, as a matter of law, Horizon's appeal with regard to all issues other than methodology. Ibid. Therefore, the IHC's transmittal to OAL included only the issue of Horizon's challenge of D&T's audit methodology.

The IHC transmitted the case to OAL, where it was filed on April 22, 1997. On November 20, 1997, Horizon filed a motion to expand the scope of the OAL hearing to include the waiver issue. A.L.J. Campbell denied the motion on December 2, 1997.

The hearing took place on December 17, 1997; March 30, 1998; and April 8, 1998. Horizon offered fact testimony from William Frantel and Dennis Kant of Horizon and expert testimony from Thomas Martin Mulhare of the accounting firm of Arthur Andersen. The IHC offered testimony from Scott Sanders of D&T, who had overseen the audit on a day-to-day basis. It also submitted in evidence a report by Samuel Gunther, its expert on independent audits. However, because Horizon waived cross-examination of the IHC's expert, Mr Gunther was not asked to testify. In addition,

the record includes pre-filed testimony, several documentary exhibits, and a list of 42 facts to which both parties stipulated.*

After a review of the record in this matter, the IHC Board adopts the A.L.J.'s findings of fact and conclusions of law. The A.L.J.'s findings of fact are amply supported by sufficient credible evidence in the record as a whole, as described above. Brady v. Board of Review, 152 N.J. 197, 210 (1997).

The A.L.J.'s first finding -- that D&T was engaged to perform an independent audit of Horizon's net paid losses for 1993 and 1994 -- is stipulated by both parties. See Stipulated Facts, ¶¶ 14, 15. Furthermore, the Request for Proposal ("RFP") soliciting bids for the project expressly contemplates an audit of net paid losses, RFP ¶ 1.01(b), as does D&T's proposal in response to the RFP, Letter from Deloitte and Touche, LLP, to IHC Board of Directors (April. 12, 1995).

The second finding -- that D&T's audit was consistent with the work specified in the RFP -- also finds support in the record. The report of Mr. Gunther, the IHC's expert, as well as the testimony of both Mr. Sanders and Mr. Mulhare (Horizon's

* The stipulated facts "shall be regarded as evidence," N.J.A.C. 1:1-15.11, and as such are part of the record in this matter.

expert), all support that finding. See Report of Samuel Gunther, at 1-2; T-2 at 102-10 to -14 (Sanders testimony); T-1 at 187-21 to 188-4; 203-9 to -21 (Mulhare testimony).*

Finding No. 3 -- that the audit was performed in accordance with GAAS -- finds support in both the report of the IHC's expert and the testimony of Scott Sanders, of D&T. Gunther Report, at 1; T-2 at 19-3 to -8; 26-3 to -6; 95-24 to 96-19; 97-12 to -19.

The A.L.J.'s enumerated findings numbered 4, 5, and 6, which address Horizon's acceptance of D&T's proposed adjustments, are also supported by substantial evidence in the record. That Horizon signed a management-representation letter in which it accepted D&T's adjustments is beyond dispute; that letter is part of the record. T-2 25-19 to -20 (introducing into evidence a letter from Robert J. Pures and Robert E. Meehan to Deloitte and Touche (Jan. 5, 1996) (the "management-representation letter")).

At this time we also address Horizon's assertion that the A.L.J. erred by not excluding the IHC expert's report on the

* Citations to "T-1," T-2," and "T-3" refer to transcripts of the three hearing dates, as follows:

T-1 refers to the proceedings of December 17, 1997;
T-2 refers to the proceedings of March 30, 1998; and
T-3 refers to the proceedings of April 8, 1998.

grounds that it was a "net opinion," Horizon Exception No. 7, at 40-42. The "net opinion" rule provides that "an expert's bare conclusions, unsupported by factual evidence, [are] inadmissible." Buckelew v. Grossbard, 87 N.J. 512, 524 (1981).

Horizon's assertion is erroneous. Expert testimony in an administrative hearing is governed by the New Jersey Uniform Administrative Procedure Rules, N.J.A.C. 1:1-1 et seq., which specify that expert testimony must present an opinion that is "[b]ased on facts and data perceived by or made known to the witness at or before the hearing * * *." N.J.A.C. 1:1-15.9(b)1. Mr. Gunther's report expressly states that his conclusion that the audit complied with GAAS is based on "D&T's audit workpapers (documents prepared by and accumulated by D&T to support D&T's audit conclusions)," as well as discussions with Mr. Sanders. Gunther Report, at 1. The report also lists the specific documents that Mr. Gunther reviewed. Id. at 2. The basis for the report is unmistakable.

Horizon also faults Mr. Gunther's report because it did not address a series of issues that Horizon contends were relevant to his finding. Horizon Exceptions, at 42. However, the fact that the report fails to take into account factors that Horizon deems to be important does not render it inadmissible. See State v.

Freeman, 223 N.J. Super. 92, 116 (App. Div. 1988) (concluding that medical expert testimony "is not inadmissible merely because it fails to account for some particular condition or fact which the adversary considers relevant.").

The court in Freeman further noted that "[t]he adversary may on cross-examination supply the omitted conditions or facts and then ask the expert if his opinion would be changed or modified by them." Ibid. Horizon, however, waived cross-examination of Mr. Gunther. IHC Response to Horizon Exceptions, at 21 (November 30, 1998). Mr. Gunther was available to testify and be cross-examined, at which time Horizon could have taken advantage of the opportunity to question Mr. Gunther more closely on the aspects of his report that Horizon believes are lacking. Ibid. Therefore, Horizon is unable to establish that Mr. Gunther's opinion was not supported by facts and data, including his review of D&T's workpapers.

Horizon's contention that A.L.J. Campbell had not given appropriate weight to the testimony of Horizon's expert, Horizon Exception No. 6, at 34-40, is also rejected. A.L.J. Campbell considered Mr. Mulhare's testimony, and made a finding that their expert never stated that D&T violated GAAS. Initial Decision, at 18. The A.L.J. also correctly found that Horizon made no showing

that the results would have been different had any other methodology been used. Id. at 17.

Horizon's Exceptions No. 1 and 2 -- that D&T violated its own materiality standards and used an inappropriate audit methodology, respectively -- are both rendered moot by the fact that it accepted the adjustments that D&T proposed after conducting the audit, and thereby accepted D&T's methodology. With regard to the audit methodology, Horizon's contends that D&T was required to mold its audit methodology to Horizon's accounting system. Horizon records transactions on the "New Membership System" ("NMS"), a "real-time," computerized database that is constantly updated and therefore is not "capable of providing a retrospective, year-end snapshot of the figures D&T was seeking to audit." Horizon Exceptions, at 13. In his testimony, however, D&T's Scott Sanders, who supervised the audit on a day-to-day basis, testified that "[i]t is management's responsibility to provide the evidence to support management's Financial Statements. * * *. Management provides the information, the Auditor audits the information." T-1, at 19-23 to 20-6.

Horizon contends that even if D&T did adhere to GAAS, its methodology was inappropriate and required invalidation because instead of using the NMS, D&T should have based its audit on

Horizon's cash books, "which are the original sources of entry, much like a checking account balance sheet." Horizon Exceptions, at 14. Mr. Sanders, however, testified that that was not feasible. The cash books are so voluminous that to use them as the basis for the audit would have been unreasonably burdensome. Each day's book is approximately three inches thick; two years' books would have measured approximately 120 feet. In addition, the listings in the cash books are not segregated by line of business. Thus, Horizon's suggested methodology would have required that D&T wade through data relating to all of Horizon's lines so that it could audit Horizon's net paid loss for individual coverage. Finally, the cash books list disbursements to providers, without identifying the cash disbursement by claim or the line of business behind the cash disbursement. T-3, 103-9 to -19.

In conducting the audit, D&T did not ask that information be provided in a specific format. It specified the information that it needed, but it left up to Horizon the choice of how to present that data to D&T. T-3 124-1 to -22. Horizon provided D&T with no information that would warrant any adjustments beyond those that D&T recommended. T-1, 144-3 to 145-8; T-2, 51-23 to 54-7; T-3, 106-5 to 107-6. Indeed, after the audit was complete, Horizon signed a management-representation letter addressed to D&T. See

management-representation letter. The A.L.J. correctly found that this acceptance by Horizon should have ended this matter. Initial Decision, at 19.

Among Horizon's representations in the management-representation letter was the statement that "[Horizon is] responsible for the fair presentation in the combined financial statements of net paid losses for individual business in conformity with accounting practices prescribed or permitted by the State of New Jersey Department of Insurance as set forth in the N.J.A.C. 11:20-8.1-6." That provision recognizes that the responsibility for providing the necessary data to D&T was Horizon's. It was up to Horizon to provide the information in a manner that D&T could use in conducting the audit. The need for the information should not have come as a surprise to Horizon; the regulation authorizing an audit of net paid loss has existed since the inception of the IHC Program. Surely Horizon knew that its net paid loss for 1993 and 1994 was subject to audit and that Horizon would be required to provide the data necessary to conduct the audit. As the A.L.J. noted, "[b]y its own testimony, [Horizon] had the ability on December 31 of each year of the pertinent years to generate an accurate report -- a snapshot, in [Horizon's] words -- of their revenues." Initial Decision, at 20. In fact, that ability is

demonstrated by the fact that to ensure that the problem would not recur with a 1995 audit, Horizon froze its tape as of December 31, 1995. Minutes of IHC Board Meeting of March 12, 1996, at 7.

With regard to Horizon's Exception No. 1, regarding D&T's materiality standard, D&T's Scott Sanders testified that D&T analyzed the adjustments to the net paid loss as a whole, T-2, 54-55, and we find that was the appropriate analysis. In any event, we note once again that Horizon, by accepting D&T's proposed adjustments, cannot now contend that they should be stricken as immaterial.

In addition to the management-representation letter that Horizon signed, the audited financial statement also represents the adjustments, which Horizon accepted. Horizon even stipulated that it had accepted the audit results. Stipulation of Facts, ¶ 23; See also T-1 91-25 to 92-11 (testimony of William Frantel, Assistant Vice President and Comptroller of Horizon); 147-14 to -21 (testimony of Dennis Kant, Assistant Comptroller of Horizon); 200-15 to -24 (testimony of Thomas Mulhare, Horizon's expert). That was consistent with Mr. Sanders's testimony, T-3 18:16 to 19-2. The record as a whole, the management-representation letter, the audited financial statement, and the stipulation of facts provide a strong foundation for the A.L.J.'s findings of fact and

conclusions of law. Horizon's contention in Exception No. 3 -- that it accepted the proposed adjustments only as a whole -- ignores the fact that nevertheless, Horizon did accept the adjustments. Initial Decision, at 17; Horizon Exception No. 3, at 23-28. The A.L.J. also properly observed that Horizon's expert conceded that D&T was engaged to opine on the financial statements as a whole, not on discrete items therein. Initial Decision, at 17.

In addition, Horizon raises several exceptions relating to issues that are extrinsic to the IHC's transmittal of this matter to OAL. Specifically, Horizon's exceptions number 4 and 5 assert that:

- * the A.L.J. erred by preventing Horizon from introducing evidence to show that the IHC Board's instructions to D&T in the initial request for proposal were inappropriate (Exception No. 4); and
- * by preventing Horizon from introducing evidence to show that the IHC Board's failure to advise D&T of the potential for the IHC Board's post-audit "waiver" finding was inappropriate and fatally contaminated the audit (Exception No. 5).

Both of those exceptions are outside the scope of the matter that the IHC transmitted to OAL.

An administrative agency has the authority to determine whether a matter is a contested case, warranting transmittal to the

OAL. In re Uniform Administrative Procedure Rules, 90 N.J. 85 (1982). The decision is for the agency head, and not for the A.L.J. The scope of the hearing is thus limited to that which the agency transmits.


The IHC's Notice of Transmittal in this case describes the issue as follows:

Blue Cross appeals the validity of an independent audit of Blue Cross's losses reported on individual health insurance for calendar years 1993 and 1994 conducted by Deloitte and Touche, LLP, at the direction of the IHC Board. The portion of the appeal referred for hearing is limited to Blue Cross's challenge of the audit methodology [(emphasis added)].

Any contention regarding instructions that the IHC allegedly should have given to D&T exceed the scope of this decision. The OAL's charge was to consider Horizon's allegation that D&T employed an inappropriate methodology when conducting the audit. The IHC's decision to adjust Horizon's net paid loss for 1993 and 1994 arose from statements by Horizon in certifications accompanying its Exhibit Ks for 1993 and 1994, and not from the audit methodology. The A.L.J. was not charged with considering them. Therefore, his so-called "failure" to admit evidence concerning the adjustments was not error.

For the same reason, Horizon's contention that "the A.L.J. erred, in its order dated December 2, 1997, by refusing to allow Horizon to introduce any evidence concerning the IHC Board's post-audit 'waiver' finding," Horizon Exception No. 8, at 43-46, is also mistaken. Again, once the IHC had transmitted the matter to OAL, the A.L.J. properly considered only the issue as stated in the transmittal notice.

Based on the foregoing, the IHC Board concludes that Horizon has not met its burden of demonstrating that D&T's audit methodology was inappropriate. Accordingly, the Initial Decision of the OAL is adopted for the reasons stated herein.



Rebecca Smart, Esq., Chair
Individual Health Coverage Program Board

Date: February 9, 1999

c: The Honorable Barbara A. Harned, Director and Chief
Administrative Law Judge, Office of Administrative Law