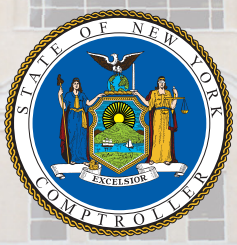
Office of the New York State Comptroller

Division of State Government Accountability

United HealthCare

New York State Health Insurance Program Payments for Repackaged Drugs Dispensed Under the Empire Plan

Report 2010-S-38



Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of State Government Accountability

February 17, 2011

Ms. Paula A. Gazeley-Daily, R.Ph.
Strategic Client Executive, Empire Plan Rx Program
900 Watervliet Shaker Road - Suite 105
Albany, New York 12205

Dear Ms. Gazeley-Daily:

The Office of the State Comptroller is committed to providing accountability for tax dollars spent to support government operations. This fiscal oversight is accomplished, in part, through our audits, which determine whether entities contracting with the State are fulfilling contract responsibilities. Audits can also identify strategies for reducing costs, improving operations and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of United HealthCare entitled New York State Health Insurance Program, Payments for Repackaged Drugs Dispensed Under the Empire Plan. This audit was done according to the provisions of the contract between the Department of Civil Service and United HealthCare and the State Comptroller's authority under Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

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EXECUTIVE SUMMARY

Audit Objective

The objective of our audit was to determine if United HealthCare (United) has established adequate controls to protect the State from excessive costs for repackaged drugs.

Audit Results - Summary

The New York State Health Insurance Program (NYSHIP) provides health insurance coverage to active and retired State, participating local government and school district employees and their dependents. The Empire Plan (Plan) is the primary health benefits plan for NYSHIP and includes prescription drug coverage. The Department of Civil Service (Department) contracts with United to provide prescription drug coverage under the Plan. United subcontracted its claims processing and payment functions for drug coverage to Medco Health Solutions, Incorporated (Medco).

Based on contract provisions, the Department reimburses United for all properly adjudicated claims paid by Medco. In addition, to help limit costs to the Plan, the contract requires a claim payment for a drug to be based on a prescribed discount from the manufacturer's Average Wholesale Price (AWP).

To reduce medication errors, the pharmaceutical industry developed processes for placing drugs into single dose packaging (versus traditional multi-dose bottles). This is commonly known as "repackaging," which can increase the production costs, AWPs, and retail prices for a drug. Generally, the medical necessity for dispensing repackaged drugs at retail pharmacies is limited. Moreover, the contract requires United to have controls in place to protect the State from any inflated costs associated with claims for repackaged drugs. Thus, for purposes of the Plan, the charge for a repackaged drug should be relatively consistent with the charge for the same drug in its original form. For the period January 1, 2008 through July 9, 2010, the State paid United about $3.1 million for 11,015 claims for repackaged drugs.

We found, however, that United/Medco's efforts did not adequately protect the State from excessive costs for repackaged drugs. Although some efforts were made to identify pharmacies that might have improperly dispensed and/or billed for repackaged drugs, there was no meaningful follow-up by United/Medco to address matters. Consequently, we concluded that some pharmacies submitted excessive claims for repackaged drugs. Because the AWPs for most

of the repackaged drugs were usually higher (and often much higher) than the manufacturers' original AWPs, the State incurred as much as $996,751 in excessive costs during our audit period for 8,185 claims for repackaged drugs. The costs for these claims were about 53 percent (or nearly $122 per claim) more than the costs would have been for the same drugs in their original forms.

For one pharmacy, United charged the State almost $429,000 for 1,010 repackaged drugs whose AWPs were higher than the manufacturers' original AWPs. Because the excessive AWPs were applied, the State overpaid about $151,000 for the drugs. Officials from this pharmacy stated that they did not stock repackaged drugs, and therefore, they did not dispense them. However, officials also stated that they sometimes prepared claims to reflect repackaged drugs because it resulted in greater reimbursement from Medco. We believe this practice violates the State's agreement with United and might constitute fraud. Consequently, we referred this matter to law enforcement officials for further investigation and action, as warranted.

Our report contains four recommendations to: improve the controls used by United/Medco to protect the State from excessive costs; formally assess the dispensing and billing practices of the two pharmacies we site visited during the audit; and reimburse the State for overpayments that were made.

This report, dated February 17, 2011, is available on our website at: http://www.osc.state.ny.us. Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
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Introduction

Background

The New York State Health Insurance Program (NYSHIP or Program) provides health insurance coverage to active and retired State, participating local government and school district employees and their dependents. The Empire Plan (Plan) is the primary health benefits plan for NYSHIP. The Department of Civil Service (Department) contracts with United HealthCare (United) to administer the prescription drug benefit portion of the Plan. United subcontracted its claims processing and payment functions for drug coverage to Medco Health Solutions, Incorporated (Medco). Based on the primary contract, the Department reimburses United for all properly adjudicated claims paid by Medco.

The Department's contract with United establishes reimbursement rates for drugs based on a discount from the Average Wholesale Price (AWP). The AWP is commonly used as a price benchmark in the pharmaceutical industry. For most drugs, the AWP is the manufacturer's suggested list price, and it is often significantly higher than the price a wholesaler charges a retailer. Medco uses AWP information purchased from First DataBank, an industry-accepted repository for drug cost and pricing information. The AWP for a particular pharmaceutical is assigned according to its National Drug Code (NDC), an 11-digit number that uniquely identifies the drug by manufacturer, strength, dosage, and package size. Thus, there can be multiple NDC codes for a particular drug, depending upon the strength, dosage, and package size of what is dispensed.

The repackaging industry evolved from efforts to reduce medication errors in institutional settings (such as nursing homes) by placing drugs into sheets of single-dose packaging. Repackaging can increase the production costs and AWPs for a drug. As such, the Food and Drug Administration allows repackaging companies to assign new NDCs to repackaged drugs and to report higher AWPs for them to First DataBank. Further, the retail price of a repackaged drug is usually somewhat higher than the price of the original (non-repackaged) version of the drug. Generally, the medical necessity for dispensing repackaged drugs at retail pharmacies is limited. Also, according to the Department's contract with United, "The Insurer shall administer a control process to protect the Program from any inflated AWP costs associated with repackaged drugs charged to the Program." Thus, for purposes of the Plan, the charge for a repackaged drug should be relatively consistent with the charge for the same drug in its original form.

For the period January 1, 2008 through July 9, 2010, the State paid United about $3.1 million for 11,015 claims for repackaged drugs. In 2008, the State paid about $958,000 (or about $80,000 per month) for repackaged drugs. For the period January 1, 2010 through July 9, 2010, the State paid about $121,000 per month for repackaged drugs, an increase of more than 50 percent from 2008. Thus, the Plan's costs for repackaged drugs have increased considerably during our audit period.

Audit Scope and Methodology

The objective of our audit was to determine if United has established adequate controls to protect the State from excessive costs for repackaged drugs. Our audit covered the period January 1, 2008 through July 9, 2010.

To accomplish our objective, we obtained and analyzed claim payment data provided by United for our audit period. We identified claims for repackaged drugs that were based on AWPs that were higher than the AWPs originally set by manufacturers. We calculated the amounts the Department should have paid for repackaged drugs (based on manufacturers' original AWPs) to the amounts United charged the State (based on the AWPs for repackaged drugs). We then determined the additional costs the State paid for the repackaged drugs in comparison to the costs for the drugs in their original forms. In addition, we interviewed officials at both United and Medco. We also conducted site visits to the two pharmacies that received the highest amounts of payments for repackaged drugs under the Plan during our audit period.

In preparing this report, we excluded certain details relating to the claims we reviewed due to the proprietary nature of United's and Medco's policies and procedures. However, we provided specific details of all the transactions in question to United officials for their review and resolution, as appropriate.

We conducted our performance audit according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting systems; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members (some of whom have minority voting rights) to certain boards, commissions, and public authorities. These duties

may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was done according to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided preliminary copies of the matters contained in this report to United officials for their review and comments. Their comments have been taken into consideration in preparing this report.

Within 90 days of the final release of this report, we request United officials to report to the State Comptroller advising what steps were taken to implement the recommendations included in this report.

Contributors to the Report

Major contributors to this report were Steven Sossei, David Fleming, Wendy Matson, Andrea Dagastine, and Brian Mason.

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Control Weaknesses and Excessive Payments

As previously noted, the pharmacy program contract required United to administer a control process to protect the State from any inflated AWP costs for claims for repackaged drugs. To help avoid excessive costs for repackaged drugs, Medco reviewed Program data and identified some high volume drug repackaging companies. In June 2009, Medco sent letters to three repackaging companies and asked them to stop certain improper practices or to justify the higher amounts they charged for repackaged drugs. Medco also sent letters to several pharmacies that dispensed repackaged drugs. In addition, Medco added language to their pharmacy manual, effective August 2009, informing providers that claims with NDCs that result in significantly higher AWP costs (charges) could be subject to audit recovery.

Nevertheless, we concluded that Medco's efforts did not adequately protect the Program from inflated AWP costs for repackaged drugs, based on the following factors. Medco officials did not follow-up on the letters sent to the drug repackaging companies and selected pharmacies. Consequently, they had little assurance that the repackaging companies and pharmacies took sufficient actions to address any questionable practices. Also, the pharmacies that received letters from Medco submitted relatively lower levels of claims for repackaged drugs under the Plan. Consequently, Medco did not formally contact the Plan's most significant dispensers of repackaged drugs (including the two pharmacies detailed subsequently in our report). Moreover, Medco had not conducted any audits of claim payments for repackaged drugs, and consequently, there were no recoveries of any inflated costs at the time of our review.

Due to the limitations in Medco's controls, we concluded that most of United's charges for Plan-related repackaged drugs were excessive, and therefore, the State incurred excessive costs for them. United charged the State for 11,015 claims for repackaged drugs during our audit period. We determined that 8,185 (74 percent) of these claims, amounting to almost $2.9 million, were billed using AWPs that were higher than the AWPs set by the original manufacturers of the drugs in question. Normally, the State's costs for drugs are based on a pre-determined discount from the drugs' AWPs. However, because the AWPs of repackaged drugs were usually higher (and often much higher) than the manufacturers' AWPs, United's charges to the State were often excessive. We re-priced the 8,185 claims based on the original manufacturers' AWPs and determined that the State overpaid them by as much as $996,751 (about $122 per claim or

nearly 53 percent more than the State would otherwise have paid for the drugs in their original forms).

We also conducted site visits to the two retail pharmacies that received the highest amounts of payments for repackaged drugs to assess the propriety of their dispensing and claiming policies. We identified significant problems at both providers, as follows:

- For pharmacy A, United charged the State $428,562 for 1,010 repackaged drugs whose AWPs were higher than the manufacturers' original AWPs. However, under the agreement, United should have charged the State only $277,871 for the drugs, and consequently, the State overpaid $150,691 for them. For example, United charged the State $2,113 for one particular repackaged drug that was dispensed. However, based on the original manufacturer's AWP, United should have charged the State only $677. Thus, the State overpaid $1,436 (212 percent of the proper amount) for this drug. Officials from pharmacy A stated that they did not stock repackaged drugs, and therefore, they did not use them to fill prescriptions. Officials also stated, however, that they sometimes billed for repackaged drugs (although they were not dispensed) because Medco paid more for them.

- For pharmacy B, United charged the State $181,430 for 557 repackaged drugs whose AWPs were higher than the manufacturers' AWPs. However, United should have charged the State only $121,185, and consequently, the State overpaid $60,245 for the drugs. For example, United charged the State $970 for a particular prescription. However, based the original manufacturer's AWP, United should have charged the State only $327. Thus, the State overpaid $643 (almost 197 percent) for this drug. Officials from Pharmacy B acknowledged that they dispensed repackaged drugs when possible because those drugs yielded higher profits. In fact, this pharmacy maintained a separate inventory of repackaged drugs. When Plan members presented a prescription, the pharmacist checked the inventory of repackaged drugs (before the standard drug supply) to determine if repackaged drugs could be sold. The pharmacist used the standard drug supply to fill a prescription only if a repackaged version of the drug was not in stock.

We concluded that the practices employed by pharmacies A and B resulted in claim payments that were inconsistent with United's agreement with the State. The State paid "inflated" prices attributable to repackaged drugs, and United/Medco should have prevented the excessive payments from occurring. Moreover, we believe the billing practice used by pharmacy A could be illegal. Consequently, we have referred this matter

to law enforcement officials for further investigation and other action, as warranted.

During our audit fieldwork, we shared our preliminary observations (including the details of the excessive payments we identified) and our recommendations with officials from the Department and United. Department officials generally agreed with our findings and recommendations.

Officials from United agreed to investigate the potentially fraudulent claims we identified from pharmacy A. In addition, United officials advised us that Medco developed an edit, for its automated claims processing system, to deny the payment of claims for repackaged drugs with inflated costs. Activated on November 1, 2010, the edit prevents the payment of claims with NDC numbers for certain repackaged drugs with inflated costs, as identified by Medco. We commend United and Medco for the substantive action taken to address this matter. In addition, due to their high risk, we conclude that United should review claim payments for repackaged drugs, made between July 9, 2010 (the end of our audit period) and October 31, 2010, to identify any overpayments made during that period.

Recommendations

1. Reimburse the State for the excessive amounts (as much as $966,751) the State paid for repackaged drugs, as identified by the audit.
2. Review claim payments for repackaged drugs made between July 9, 2010 and October 31, 2010 and identify any excess payments. Reimburse the State for the amounts of the excess payments.
3. Implement and maintain control processes that will sufficiently protect the State from inflated AWP costs associated with repackaged drugs.
4. Investigate the claim payments made to pharmacies A and B for repackaged drugs. Also, formally assess the policies and practices used by these pharmacies to dispense and bill for repackaged drugs. Take actions, as warranted, to remediate any improper practices that are identified.