DEPARTMENT OF HEALTH AND HUMAN SERVICES **Office of Inspector General**
Office of Audit Services

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

JUL 2 8 2003

Report Number: A-04-03-06013

Ms. Aileen Hiramatsu
Division Administrator
Med Quest
601 Kamokila Boulevard, Room 518
Kapolei, Hawaii 96707

Dear Ms. Hiramatsu:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General report providing the results of our ***Audit of the Medicaid Drug Rebate Program in the State of Hawaii.*** The audit objective was to evaluate whether the State had established adequate accountability and internal controls over the Medicaid drug rebate program. Our review covered Medicaid drug rebates through June 30, 2002.

The State has not provided effective control over and accountability for drug rebate collections. Specifically, we found that oversight of their subcontractor was not sufficient, resulting in inaccurate records and reporting. Moreover, interest was not billed or collected. Also, an undetermined amount of accounts receivable were outstanding at the time of transition to their subcontractor and, therefore, may not have been collected.

To correct these weaknesses, we recommend that Med Quest more closely monitor subcontractor activities, accurately report drug rebate activities on the Form CMS 64.9R, and ensure interest on rebates is collected as appropriate. We also recommend that the rebate receivables related to the transition to the subcontractor be determined and disposition made in accordance with the Centers for Medicare and Medicaid Services (CMS) guidelines and proper accounting principles. In written comments, the State concurred with our findings and recommendations. Their comments are included as an Appendix to our report.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise (see 45 Code of Federal Regulations Part 5).

To facilitate identification, please refer to report number A-04-03-06013 in all correspondence relating to this report.

Sincerely,

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

Enclosure – as stated

HHS **Action Official:**
Associate Regional Administrator
Centers for Medicare and Medicaid Services, Region IV
Division of Medicaid and State Operations
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF THE MEDICAID DRUG REBATE PROGRAM IN THE STATE OF HAWAII

JULY 2003
A-04-03-06013

Notices

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OAS FINDINGS AND OPINIONS

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

DEPARTMENT OF HEALTH AND HUMAN SERVICES
Office of Inspector General
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REGION IV
61 Forsyth Street, S.W., Suite 3T41
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JUL 28 2003

Report Number: A-04-03-06013

Ms. Aileen Hiramatsu
Division Administrator
Med Quest
601 Kamokila Boulevard, Room 518
Kapolei, Hawaii 96707

Dear Ms. Hiramatsu:

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services' review entitled, ***Audit of the Medicaid Drug Rebate Program in the State of Hawaii.***

EXECUTIVE SUMMARY

The audit objective was to evaluate whether Med Quest had established adequate accountability and internal controls over the Medicaid drug rebate program. Our review covered Medicaid drug rebates through June 30,2002.

Med Quest has not provided effective control over and accountability for drug rebate collections. We identified weaknesses in Med Quest's management of the drug rebate program. Specifically, we found that oversight of their subcontractor was not sufficient, resulting in inaccurate records and reporting. Moreover, interest was not billed or collected. Also, an undetermined amount of accounts receivable were outstanding at the time of transition to their subcontractor and, therefore, may not have been collected.

In our opinion, the weaknesses occurred because Med Quest did not:

- adequately monitor subcontractor activities;
- retain an adequate record keeping system and audit trail to support the drug rebate activities reported to Centers for Medicaid and Medicare Services (CMS); and
- collect rebate interest in accordance with CMS regulations.

Additionally, the subcontractor had computer system limitations. As a result, there is not sufficient assurance that CMS has been provided with an accurate picture of the drug rebate program, and that all accounts receivable have been pursued with due diligence.

To correct these weaknesses, we recommend that Med Quest more closely monitor subcontractor activities, accurately report drug rebate activities on the Form CMS 64.9R, and ensure interest on rebates is collected as appropriate. We also recommend that the rebate receivables related to the transition to the subcontractor be determined and disposition made in accordance with CMS guidelines and proper accounting principles.

Med Quest responded to our draft report in a letter dated July 1,2003. Their complete response is included in the Appendix. Med Quest officials agreed with our findings and are taking steps to correct the identified weaknesses.

INTRODUCTION

BACKGROUND

On November 5, 1990, Congress enacted the Omnibus Budget Reconciliation Act of 1990, which among other provisions established the Medicaid drug rebate program. Responsibility for the rebate program is shared among the drug manufacturer(s), CMS, and the State(s). The legislation was effective January 1, 1991. CMS also issued release memorandums to State agencies and manufacturers, throughout the history of the rebate program, to give guidance on numerous issues related to the Medicaid drug rebate program.

A drug manufacturer is required to enter into, and have in effect, a rebate agreement with CMS in order to have its products covered under the Medicaid program. After a rebate agreement is signed, the manufacturer is required to submit a listing to CMS of all covered outpatient drugs, and to report to CMS its average manufacturer price and best price information for each covered outpatient drug. Approximately 520 pharmaceutical companies participate in the program.

CMS provides the unit rebate amount (URA) information to the State agency on a quarterly computer tape. However, CMS' tape may contain a $0 URA if the pricing information was not provided timely, or if the pricing information has a 50 percent variance from the previous quarter. In instances of $0 URAs, the State agency is instructed to invoice the units and the manufacturer should pay the rebate based on the manufacturer's information. In addition, the manufacturers often change the URA based on updated pricing information, and submit this information to the State agency in the Prior Quarter Adjustment Statement.

Each State agency is required to maintain the number of units dispensed, by manufacturer, for each covered drug. Approximately 56,000 National Drug Codes (NDC) are available under the program. Each State agency multiplies the URA by the drug utilization for each drug to determine the actual rebate amounts due from the manufacturer. CMS requires each State agency to provide drug utilization data to the manufacturer.

The manufacturer has 38 days from the day a State agency sends an invoice to pay the rebate. The manufacturers submit to the State agency a Reconciliation of State Invoice, by NDC, that details the current quarter's payment.

A manufacturer can dispute utilization data that it believes is erroneous, but the manufacturer is required to pay the undisputed portion by the due date. If the manufacturer and the State agency cannot in good faith resolve the discrepancy, the manufacturer must provide written notification to the State agency by the due date. If the State agency and the manufacturer are not able to resolve the discrepancy within 60 days, the State agency may consider a hearing mechanism available to the manufacturer under the Medicaid program, in order to resolve the dispute.

Each State agency reports, on a quarterly basis, outpatient drug expenditures and rebate collections on the Form CMS 64.9R. This report is part of the Form CMS 64 report, which summarizes actual Medicaid expenditures for each quarter and is used by CMS to reimburse the Federal share of these expenditures. Med Quest reported to CMS approximately $4.4 million in Medicaid drug rebates from drug manufacturers for the 1-year period ending June 30,2002. Med Quest reported $995,607, on the Form CMS 64.9R, as the outstanding balance as of June 30,2002. However, the reported rebates outstanding over 90 days totaled $1,282,478, which exceeds the June 30,2002 balance.

Med Quest contracts with a subcontractor, Affiliated Computer Services, Inc. (ACS), to perform the daily operations of the drug rebate program including billing, collection, accounting, and dispute resolution. Employees in other departments of Med Quest separately performed the functions of overall management and preparation of the CMS 64 reports.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of our audit was to evaluate whether Med Quest had established adequate accountability and internal controls over the Medicaid drug rebate program.

Scope

Our audit was performed in accordance with generally accepted government auditing standards. We reviewed Med Quest and ACS[7] policies, procedures, and controls with regard to manufacturer's drug rebates for the period ending June 30, 2002. Our review of internal controls was limited to the controls concerning drug rebate billing, collection, and dispute resolution. This was accomplished through interviews and testing pertaining exclusively to the drug rebate program. We limited the scope of our review of internal controls because our audit objective did not require a full assessment or understanding of the Med Quest and ACS internal control structure.

Methodology

To accomplish our objective, we obtained the State's Medicaid Drug Rebate Schedule (Form CMS 64.9R) for the 1-year period ending June 30, 2002 and reviewed supporting documentation to assess the reliability of the outpatient drug rebate information reported to CMS. We reviewed accounts receivable and subsidiary records and compared the information with the data presented in the Form CMS 64.9R report. We interviewed Med Quest and ACS staff that performed functions related to the drug rebate program to determine existing policies, procedures, and controls for the period ending June 30,2002.

Fieldwork was performed at the Med Quest office in Kapolei, Hawaii, the ACS office in Atlanta, Georgia, and at o w field offices in Florida, Hawaii, and California from February through April 2003.

FINDINGS AND RECOMMENDATIONS

We identified weaknesses in Med Quest's management of the drug rebate program. Specifically, we found that oversight of their subcontractor was not sufficient, resulting in inaccurate records and reporting. Moreover, interest was not billed or collected. Also, an undetermined amount of accounts receivable were outstanding at the time of transition to the subcontractor and, therefore, may have gone uncollected.

Accurate Records and Reports

We found variances between reports ACS prepared for use in completing the Form CMS 64.9R and the amounts that were reported on the Form CMS 64.9R that Med Quest submitted to CMS. On the June 30,2002, CMS 64.9R report, Med Quest reported $331,397 more in collections than ACS reported, and Med Quest reported a balance of $7,378,314 less than that reported by ACS. We found that ACS does not receive any reports or information from Med Quest to reconcile data reported to CMS.

We also found that Medicaid drug rebate information prepared by ACS is inaccurate except for the amounts invoiced, and cannot be substantiated by ACS. The ACS officials explained that there were limitations to their computer system that will not allow for the retrieval of prior data. They can only access the system on a current basis.

The obvious differences in the various management reports indicate a lack of oversight, checks and balances and documentation retention that lessens Med Quests' ability to accurately report the drug rebate activities to CMS. Med Quest officials stated that they didn't have written policies and procedures for monitoring the rebate program and managing the dispute resolution process.

Collection of Interest

Med Quest did not have adequate controls to verify if rebate interest payments were collected. CMS program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State.

A Med Quest official stated that the ACS Payment Summary Report has a column for interest due, but that it had all zeros. The official also stated that she could not determine the amount of interest due and is working with ACS to obtain this data. Our review of ACS reports indicated minimal voluntary interest received.

Outstanding and Aging Accounts Receivable

We found that drug rebates totaling $2.3 million were reported as over a year old on the June 30, 2002, CMS 64.9R report. In addition, an undetermined amount of accounts receivable that are uncollected related to the subcontractor transition. Med Quest is in the process of determining the amount of the outstanding accounts receivable.

When ACS became the vendor in August 2001, they started with a zero balance for accounts receivable because Med Quest did not have that data. Med Quest has been trying to reconstruct available records to determine the amount manufacturers owed the State since 1991. To date, Med Quest has identified $10 million owed for the period 1991 through 1994. Because of poor management of the receivables over the years, this reconstruction and collection process will require that additional resources be devoted to the drug rebate program. Since their program does not utilize the services of an administrative law judge, Med Quest intends to forward these cases to the State Attorney's office for potential collection. It appears that this process would remove Med Quest from the management of dispute resolution, thereby, potentially allowing rebates to be written off or collected by another agency. Med Quest did not provide a concise plan for these potential collection procedures.

RECOMMENDATIONS

Med Quest has not provided effective control over and accountability for drug rebate collections. To correct these weaknesses, we recommend that Med Quest more closely monitor subcontractor activities, accurately report drug rebate activities on the Form CMS 64.9R, and ensure interest on rebates is collected as appropriate. We also recommend that the rebate receivables related to the transition to ACS be determined and disposition made in accordance with CMS guidelines and proper accounting principles.

MED QUEST RESPONSE AND OIG COMMENTS

Med Quest responded to our draft report in a letter dated Julyl, 2003. Their complete response is included in the Appendix. Med Quest officials agreed with our findings and recommendations. Med Quest's response and OIG's comments are summarized below.

Med Quest Response

Med Quest concurred with the report's findings and recommendations. They stated they are addressing the issues and anticipate all recommendations will be resolved by September 30, 2003.

OIG Comments

We commend Med Quest's efforts to improve their drug rebate program.

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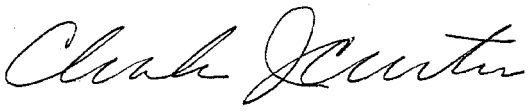
To facilitate identification, please refer to report number A-04-03-06013 in all correspondence relating to this report.

Sincerely,



Charles J. Curtis
Regional Inspector General
for Audit Services

Direct Reply to HHS Action Official:

Associate Regional Administrator
Centers for Medicare and Medicaid Services
Division of Medicaid and State Operations
61 Forsyth Street, S.W., Suite 4T20
Atlanta, Georgia 30303

APPENDIX

LINDA LINGLE
GOVERNOR

LILLIAN B. KOLLER, ESQ.
DIRECTOR

HENRY OLIVA
DEPUTY DIRECTOR

In reply, please refer to:
Governor's Referral No.:

STATE OF **HAWAII**
DEPARTMENT OF HUMAN SERVICES
Med-QUEST Division
Finance Office
1001 Kamokila Boulevard, Suite 317
Kapolei, Hawaii 96707

In reply, please refer to:
DHS No.:
MQD No.:

July 1,2002

Mr. Charles J. Curtis
Regional Inspector General for Audit Services, Region IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

Dear Mr. Curtis:

RE: AUDIT OF THE MEDICAID DRUG REBATE PROGRAM- A-04-03-06013

This is in response to your letter regarding the Audit of the Medicaid Drug Rebate Program in the State of Hawaii dated May 22, 2003.

We concur with your findings and recommendations of the report. The Hawaii Department of Human Services has been addressing the issues raised in the report and has either resolved or is currently in the process of resolving the issues. We are anticipating that all recommendations issued by your office will be resolved by September 30, 2003.

Thank you for the opportunity to comment on the audit. If you have any questions regarding this matter please contact Mr. Brian Pang at (808) 552-7956.

Sincerely,

'Aileen Hirarnatsu
Med-QUEST Division Administrator

ACKNOWLEDGMENTS

This report was prepared under the direction of Charles J. Curtis, Regional Inspector General for Audit Services, Region IV. Other principal Office of Audit Services staff who contributed incIude:

Mary Ann Moreno, *Audit Manager*
Bernard Rach, *Senior Auditor*
Manny Guerrero, *Auditor* in *Charge*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.