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# **RIDER 40 REPORT**

## **Update on the SAO's 2003 Audit of the Prescription Drug Rebate Program**

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**Submitted by the  
Health and Human Services Commission  
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**As Required by  
Rider 40, S.B. 1  
79<sup>th</sup> Legislature, Regular Session, 2005**

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## Executive Summary

The *Update on SAO's 2003 Audit of the Prescription Drug Rebate Program* report is required pursuant to the 2006-07 General Appropriations Act (Article II, Health and Human Services Commission, Rider, Rider 40, S.B. 1, 79th Legislature, Regular Session, 2005). Rider 40 requires the Health and Human Services Commission (HHSC) to provide a report to the Legislative Budget Board, the State Auditor's office (SAO), and the Governor's office that details the outstanding Medicaid prescription drug rebates and interest balances for 1991 through the second quarter of calendar year 1995. The report addresses data integrity issues related to the calculation of outstanding balances.

SAO Audit 03-029 concluded that HHSC could not account for all the outstanding prescription drug rebate revenue owed to the State. The audit focused on the rebate period from calendar year 1991 through the second quarter of 1995, which pre-dated automation of the rebate process through the Pharmacy Rebate Information Management System (PRIMS). PRIMS was the system of record for HHSC's Prescription Drug Rebate Program from the third quarter of calendar year 1995 through calendar year 2005.

In 2004, HHSC loaded into PRIMS the previously non-automated original invoice data for calendar year 1991 through the second quarter of 1995 period obtained from the Centers for Medicare and Medicaid Services (CMS). To further address data integrity issues, HHSC initiated the Payment Posting Project (PPP), which posted all of the paper copy payment records into the automated system. This addressed the SAO concern regarding the availability of all rebate data in one system of record.

On December 31, 2005, First Health Services Corporation (FHSC) assumed contractual responsibility for HHSC's Pharmacy Claims and Rebate Administration (PCRA). The FHSC FirstRebate™ system replaced the PRIMS system. As the PCRA vendor, FHSC assumed responsibility for data integrity and rebate collection for HHSC. Their responsibility includes correction of previous data entry errors and reconciliation.

Outstanding rebate balances, which are based on data that may include incorrect product package sizes and conversions, will be reconciled. This reconciliation will require additional manual review and adjustment by FHSC. Because of the unit of measure issues remaining in the FirstRebate™ system, the current outstanding principal balance is \$81 million (Column N in Appendix A), and the outstanding interest balance on that amount is an additional \$39 million (Column O in Appendix A) as of August 22, 2006.

HHSC anticipates that after FHSC corrects the data errors, reconciles the units of measure, and recalculates the principal balance, manufacturers may have actually overpaid the state during this period. Although the State may still be due rebate amounts that were originally uncollected from some manufacturers, overall, instead of being owed approximately \$81 million plus interest as the system currently indicates, the estimated net result is that the State may have to repay manufacturers as much as \$44 million. FHSC's reconciliation progress will be documented in subsequent Rider 40 reports as systems issues are corrected.

## Background

The 2006-07 General Appropriations Act (Article II, Health and Human Services Commission, Rider, Rider 40, S.B. 1, 79th Legislature, Regular Session, 2005), required that the Health and Human Services Commission (HHSC) provide, no later than August 31, 2006, a report to the Legislative Budget Board, the State Auditor's office (SAO), and the Governor's office detailing the outstanding Medicaid prescription drug rebates and interest balances for 1991 through the second quarter of calendar year 1995. Rider 40 further required HHSC to address the data integrity issues related to the calculation of outstanding balances, as cited in the State Auditor's office report, Number 03-029, *An Audit Report on the Health and Human Services Commission Prescription Drug Rebate Program*.

### SAO Audit 03-029

SAO Audit 03-029 concluded that HHSC could not account for all the outstanding prescription drug rebate revenue owed to the State. The audit focused on the rebate period from calendar year 1991 through the second quarter of 1995, which pre-dated automation of the rebate process through the Pharmacy Rebate Information Management System (PRIMS). PRIMS was the system of record for HHSC's Prescription Drug Rebate Program from the third quarter of calendar year 1995 through calendar year 2005.

In 2004, HHSC loaded into PRIMS the previously non-automated original invoice data for calendar year 1991 through the second quarter of 1995 period obtained from the Centers for Medicare and Medicaid Services (CMS). To further address data integrity issues, HHSC initiated the Payment Posting Project (PPP), which posted all of the paper copy payment records into the automated system. This addressed the SAO concern regarding the availability of all rebate data in one system of record.

### Pharmacy Claims and Rebate Administration Contractor

On December 31, 2005, First Health Services Corporation (FHSC) assumed contractual responsibility for HHSC's Pharmacy Claims and Rebate Administration (PCRA). The FHSC FirstRebate™ system replaced the PRIMS system, and the data formerly in PRIMS was transferred to the FirstRebate™ system. As the PCRA vendor, FHSC assumed responsibility for data integrity and rebate collections for HHSC. Those responsibilities include correction of previous data entry (key punch) errors and the reconciliation of rebate data from the previously non-automated period.

## Data Integrity Issues

### Units Versus Rates

The Medicaid rebate program is unique because the State only controls half of the invoice equation – the number of units. The manufacturers control the other half – the rebate rate, which is based on package size/unit of measure. The rebate rate, calculated by the manufacturers, is dictated by federal law. Until January 2004, federal law allowed manufacturers to retroactively modify their rebate rates. As a result, many manufacturers restated rebate rates back to 1991, and in many cases, changed the package size on which they were paying rebates.

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Because the pre-PRIMS invoices were not automated, the system was unable to make revisions to previously billed amounts when a manufacturer changed the rebate rate or corresponding package size/unit of measure. This inability to update the system caused erroneous outstanding balance calculations.

**Package Size/Unit of Measure Issues**

During the early years of the rebate program, the unit of measure for creams, liquids, and reconstituted vials changed often. In many cases, the units used to invoice were changed subsequent to the invoice, resulting in different units of measure being used for rebate calculations. For example, a manufacturer may have been invoiced for the number of ounces in a tube. When the manufacturer paid the rebate, however, the payment was based on the number of tubes rather than the number of ounces. A more detailed example of the impact of this issue follows.

**Example of Package Size/Unit of Measure Issue**

The Texas Medicaid program reimburses pharmacies for drugs based on the most commonly dispensed package size. Each quarter, HHSC accumulates the paid claims data and submits an invoice to drug manufacturers listing the quantity of each product, matched with the rebate rate set by the manufacturer. If the package size used to reimburse the pharmacies is different than the package size dictated by the manufacturer for rebate purposes, HHSC does a unit type conversion. Over time, a manufacturer can change the unit type and the resulting rebate amount.

The following example reflects the significant variance in the actual rebates amounts due compared to the reported outstanding rebate balances as a result of the system limitations. In 1991, the State paid pharmacies for 33,000 10-ounce bottles of Product A (330,000 ounces). The manufacturer set the rebate rate at \$0.02 an ounce (\$0.20 per bottle), resulting in a rebate amount of \$760 paid for Product A.

Four years later, the manufacturer revised the rebate amount and reported the rebate as \$3.00 per bottle (no longer using ounces as the unit of measure for this product). Although the automated pharmacy rebate system can update the unit price (from \$0.20 a bottle to \$3.00 per bottle), it cannot change the unit of measure (ounces to bottles) without manual intervention. In this case, the system calculated the rebate due as \$3.00 per ounce rather than \$3.00 per bottle.

The table below shows how the system overstates the outstanding rebate balances. In the case of Product A, the system shows that the manufacturer should pay \$990,000, when in fact he really owes \$99,000 at the new rate. Until a manual entry is made to correct the units from 330,000 ounces, back to 33,000 bottles, the outstanding balance appears to be \$891,000 more than the actual amount.

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| <b>Product A Rebate Calculation Example</b> |                  |                      |                       |
|---|------------------|----------------------|-----------------------|
|   | <b>Quantity</b>  | <b>Rate</b>          | <b>Owed</b>           |
| 1991  | 330,000 ounces   | \$0.02/ounce         | \$760.00              |
| After the 1994 Change                       | 330,000 ounces   | \$3.00/bottle        | \$990,000.00          |
| What it Should be                           | 33,000 bottles   | \$3.00/bottle        | \$99,000.00           |
| <b>Difference</b>                           | <b>(297,000)</b> | <b>\$3.00/bottle</b> | <b>(\$891,000.00)</b> |

It is estimated that unit type differences between quantity and rate account for approximately 80 percent of the apparent outstanding balances for the rebates due to the State for calendar years 1992 through 1993.

## Historic Trends

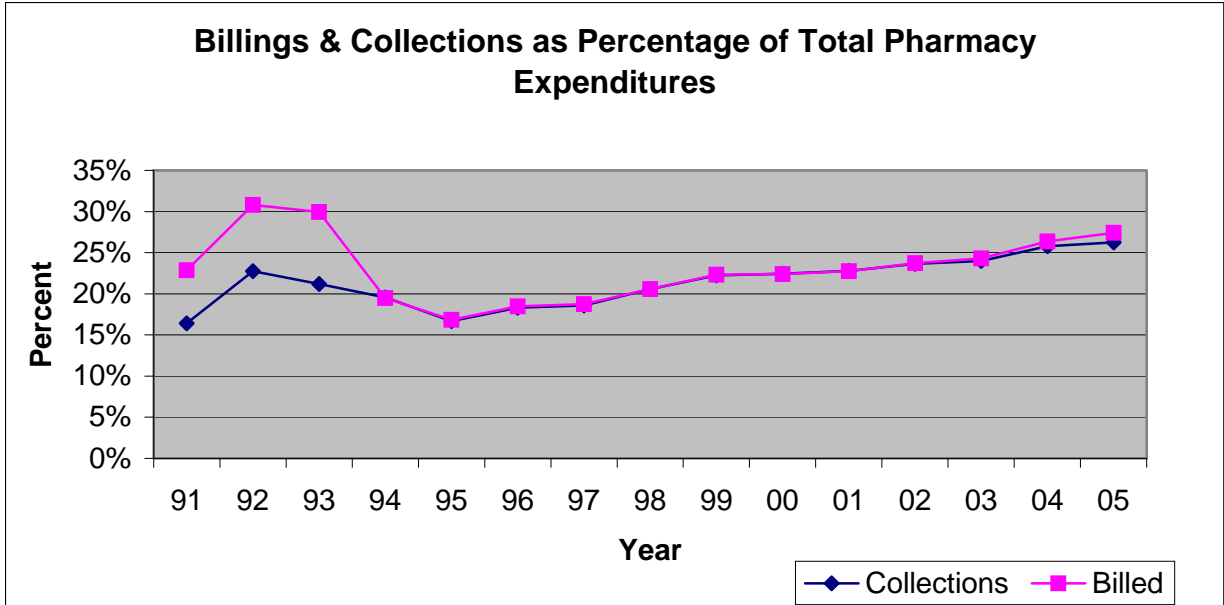
### Appendix A Description

Appendix A contains more detailed rebate billing and collection history for calendar year 1991 through the second quarter of calendar year 1995, as well as an analysis of anticipated revenue based on historic trends versus what the system currently indicates before the unit of measure corrections are made. The rebate data in Appendix A is based on calendar years, and contains the detailed rebate billing and collection history for federal Medicaid rebates for the period required by Rider 40. The Aged Receivables (Column M) are current as of May 31, 2006, and Outstanding Principal and Interest (Columns N and O) are current as of August 22, 2006, and reflect invoice and payment activity since the end of the fiscal quarter.

### Billings and Collections as a Percentage of Expenditures

The chart that follows shows the historic trends for (1) rebate collections and (2) rebate amounts billed as a percent of the total reimbursement to the pharmacies for the traditional Medicaid program over the past fifteen years. During 1994 through 1997, rebate collected and billed amounts averaged between 17 and 18 percent of total pharmacy expenditures. However, rebates collection and billed over the pre-PRIMS period (1992 and 1993), without the completion of unit of measure and other data integrity corrections, both significantly exceed that trend (see columns H and AI in Appendix A).

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The higher than expected rates indicate that the data used to estimate the rebate principal amount for the pre-PRIMS period includes errors or requires unit of measure adjustments. This also explains why both (1) billing, at about 23 percent for 1992 and 1993 (see column AH in Appendix A), and (2) collections, at above 30 percent for 1992 and 1993 (see column AI in Appendix A), are well above the 17 to 18 percent overall average for 1994 through 1997. When the data is corrected, it is anticipated that the resulting calculations will show that the amounts billed and collected for the pre-PRIMS period were too high. As a result, manufacturers may be entitled to recover overpayments and seek reimbursement. As an alternative to direct reimbursement, these manufacturers may request to apply the credit to current quarter liabilities, thereby reducing the expected rebate revenue.

**Outstanding Balances**

Currently, pending reconciliation and correction of the data in the system, the outstanding principal balance is approximately \$81 million (see Column N of Appendix A), and the outstanding interest balance is an additional \$39 million (see Column O of Appendix A) as of August 22, 2006.

However, based on the information presented above, HHSC anticipates that after FHSC corrects the data errors, reconciles the units of measure, and recalculates the principal balance, manufactures may have actually overpaid the state during this period. Although the State may still be due rebate amounts that were originally uncollected from some manufacturers, overall, instead of being owed approximately \$81 million plus interest as the system currently shows, the estimated net result is that the State may have to repay manufacturers as much as \$44 million.

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## **Work Plan**

FHSC, under HHSC's guidance, will address the unit of measure and other data integrity issues in the coming months. In addition, FHSC will work with manufacturers to resolve outstanding disputes, refund overpaid rebates, and reconcile outstanding balances. HHSC will document the status of the reconciliation progress in subsequent Rider 40 reports as Unit Adjustments and Billed Amount values are updated.



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**Appendix A**

**APPENDIX A**  
**Rider 40 State Auditors Office's 1993 Audit of the Prescription Drug Rebate Program**  
**As of 5/31/2006**

| Year          | Amounts Billed        |   |   |                   |   | Collections  |                                  |                             |                             |                             | Total Receivables (Aged) as of 5/31/06 # | Outstanding Value as of 8/22/06 + |                            | Annual Collections Rate<br>P=L/(M+L) |                      |            |
|---------------|-----------------------|---|---|-------------------|---|--|----------------------------------|-----------------------------|-----------------------------|-----------------------------|--|-----------------------------------|----------------------------|--------------------------------------|----------------------|------------|
|               | Original              | Total Dollar Value of Pricing Adjustments since billing (1) | Total Dollar Value of Utilization Adjustments since billing (2) | Other Adjustments | Total Billed =A+B+C+D (Current Value of Invoices) | Value of changes (billings and adjustments) during SFY | Collections Prior to Current SFY | Qtr 1 SFY<br>Sep 1 - Nov 30 | Qtr 2 SFY<br>Dec 1 - Feb 28 | Qtr 3 SFY<br>Mar 1 - May 31 |  | Qtr 4 SFY<br>Jun 1 - Aug 31       | Total Collected =G+H+I+J+K |                                      | Principal            | Interest   |
| 1991          | \$ 176,775,165        | \$ (4,014,759)  | \$ (116,358,631)  | \$ -              | \$ 56,401,776                                     | \$ 0   | \$ 40,427,878                    | \$ 1                        | \$ -                        | \$ -                        | \$ -                                     | \$ 40,427,879                     | \$ 15,973,896              | \$ 15,714,777                        | \$ 6,441,824         | 72%        |
| 1992          | \$ 517,815,512        | \$ 16,687,546   | \$ (429,260,105)  | \$ -              | \$ 105,242,952                                    | \$ (931,644)   | \$ 77,685,095                    | \$ 0                        | \$ -                        | \$ -                        | \$ -                                     | \$ 77,685,096                     | \$ 27,557,856              | \$ 26,858,705                        | \$ 3,321,661         | 74%        |
| 1993          | \$ 145,029,864        | \$ (11,561,279)   | \$ (2,828,912)  | \$ -              | \$ 130,639,672                                    | \$ 4,028   | \$ 92,497,667                    | \$ -                        | \$ -                        | \$ -                        | \$ -                                     | \$ 92,497,667                     | \$ 38,142,005              | \$ 38,120,115                        | \$ 27,162,980        | 71%        |
| 1994          | \$ 101,659,769        | \$ 667,931  | \$ (1,999,511)  | \$ -              | \$ 100,328,189                                    | \$ (1,541,517)   | \$ 100,045,214                   | \$ -                        | \$ -                        | \$ 550,349                  | \$ -                                     | \$ 100,595,564                    | \$ (267,375)               | \$ (233,605)                         | \$ 1,666,313         | 100%       |
| 1995Q1 & 2    | \$ 53,739,577         | \$ (35,531)   | \$ (155,386)  | \$ -              | \$ 53,548,660                                     | \$ 4,932   | \$ 52,420,196                    | \$ -                        | \$ -                        | \$ 187,189                  | \$ -                                     | \$ 52,607,384                     | \$ 941,276                 | \$ 452,056                           | \$ 657,255           | 98%        |
| <b>TOTALS</b> | <b>\$ 995,019,888</b> | <b>\$ 1,743,908</b>   | <b>\$ (550,602,546)</b>   | <b>\$ -</b>       | <b>\$ 446,161,249</b>                             | <b>\$ (2,464,200)</b>                                  | <b>\$ 363,076,051</b>            | <b>\$ 2</b>                 | <b>\$ -</b>                 | <b>\$ 737,538</b>           | <b>\$ -</b>                              | <b>\$ 363,813,590</b>             | <b>\$ 82,347,659</b>       | <b>\$ 80,912,049</b>                 | <b>\$ 39,250,034</b> | <b>82%</b> |

**Analysis:**

| CY            | Amounts Billed        |   |   |  | Collections<br>Thru May 31, 2006 | Total Receivables<br>value of invoice less collections = AD-AE as of 5/31/06 | VDP Expenditures<br>Money paid to pharmacies | Billing Rate<br>Total Billed as % of Expenditures =AD/GH | Collection based on Expenditure<br>Actual Collections as % of Expenditures =AE/AG |
|---------------|-----------------------|---|---|--|----------------------------------|--|--|--|---|
|               | Original              | Total Dollar Value of Pricing Adjustments since billing | Total Dollar Value of Utilization Adjustments since billing | =Total Bill AA+AB+AC as of 5/31/06 (Current Value of Invoices) |                                  |  |  |  |   |
| 1991          | \$ 176,775,165        | \$ (4,014,759)  | \$ (116,358,631)  | \$ 56,401,776  | \$ 40,427,879                    | \$ 15,973,896  | 240,628,967                                  | 23.4%  | 16.8%   |
| 1992          | \$ 517,815,512        | \$ 16,687,546   | \$ (429,260,105)  | \$ 105,242,952   | \$ 77,685,096                    | \$ 27,557,856  | 304,822,946                                  | 34.5%  | 25.5%   |
| 1993          | \$ 145,029,864        | \$ (11,561,279)   | \$ (2,828,912)  | \$ 130,639,673   | \$ 92,497,667                    | \$ 38,142,006  | 393,595,151                                  | 33.2%  | 23.5%   |
| 1994          | \$ 101,659,769        | \$ 667,931  | \$ (1,999,511)  | \$ 100,328,189   | \$ 100,595,564                   | \$ (267,375)   | 532,130,737                                  | 18.9%  | 18.9%   |
| 1995Q1 & 2*   | \$ 53,739,577         | \$ (35,531)   | \$ (155,386)  | \$ 53,548,660  | \$ 52,607,384                    | \$ 941,276   | 300,445,365                                  | 17.8%  | 17.5%   |
| <b>TOTALS</b> | <b>\$ 995,019,888</b> | <b>\$ 1,743,908</b>                                     | <b>\$ (550,602,546)</b>                                     | <b>\$ 446,161,250</b>  | <b>\$ 363,813,590</b>            | <b>\$ 82,347,660</b>   | <b>1,771,623,166</b>                         | <b>25.2%</b>   | <b>20.5%</b>  |

| EXPECTED      | EA | EB | EC | ED                    | EE                    | EF                     | EG                   | EH           | EI |
|---------------|----|----|----|-----------------------|-----------------------|------------------------|----------------------|--------------|----|
|               |    |    |    |                       |                       |                        |                      |              |    |
| 1991          |    |    |    | \$ 43,313,214         | \$ 40,427,879         | \$ 2,885,335           | 240,628,967          | 18.0%        |    |
| 1992          |    |    |    | \$ 54,868,130         | \$ 77,685,096         | \$ (22,816,966)        | 304,822,946          | 18.0%        |    |
| 1993          |    |    |    | \$ 70,847,127         | \$ 92,497,667         | \$ (21,650,540)        | 393,595,151          | 18.0%        |    |
| 1994          |    |    |    | \$ 95,783,533         | \$ 100,595,564        | \$ (4,812,031)         | 532,130,737          | 18.0%        |    |
| 1995Q1 & 2*   |    |    |    | \$ 54,080,166         | \$ 52,607,384         | \$ 1,472,781           | 300,445,365          | 18.0%        |    |
| <b>TOTALS</b> |    |    |    | <b>\$ 318,892,170</b> | <b>\$ 363,813,590</b> | <b>\$ (44,921,420)</b> | <b>1,771,623,166</b> | <b>18.0%</b> |    |

| DIFFERENCE between Actual and Expected | Diff between Actual and Expected Billed Amount | Diff in Collections thru May 31, 2006 | Diff between Actual and Expected Receivables |
|--|--|---------------------------------------|--|
| 1991                                   | \$ 13,088,562                                  | \$ 0                                  | \$ 13,088,562                                |
| 1992                                   | \$ 50,374,822                                  | \$ 0                                  | \$ 50,374,822                                |
| 1993                                   | \$ 59,792,546                                  | \$ 0                                  | \$ 59,792,546                                |
| 1994                                   | \$ 4,544,656                                   | \$ 0                                  | \$ 4,544,656                                 |
| 1995Q1 & 2*                            | \$ (531,506)                                   | \$ 0                                  | \$ (531,506)                                 |
| <b>TOTALS DIFF</b>                     | <b>\$ 127,269,080</b>                          | <b>\$ 0</b>                           | <b>\$ 127,269,080</b>                        |

# End of the last complete state fiscal quarter  
+ The date the report was run.  
\* Total Expenditures - amounts paid to pharmacies - is only available for the whole year. The total amount was divided in half for estimation purposes

Areas of concern. These percentages are too high given historic trends.