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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

September 25, 2002

Mr. Barrett A. Toan
President and Chief Executive Officer
Express Scripts, Incorporated
14000 Riverport Drive
Maryland Heights, MO 63040

Re: New York State Health Insurance Program
Generic Pricing for Drugs from Out-of-State Pharmacies
Report 2001-S-52

Dear Mr. Toan:

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, we audited certain prescription drug claims processed for the New York State Health Insurance Program's Empire Plan. The scope of our financial-related/compliance audit included claims of Empire Plan members for drugs from out-of-state pharmacies for the period January 1, 1999 through March 31, 2001.

A. Background

The New York State Health Insurance Program (Program) provides hospital and surgical services and other medical and drug coverage to more than 790,000 active and retired State employees and their dependents. It also provides coverage for more than 376,000 other individuals, who are either active or retired employees of participating local government units and school districts or dependents of such employees.

The Empire Plan (Plan) is the Program's primary health benefits plan, providing services at a total annual cost exceeding $2.5 billion. The Department of Civil Service (Department) contracts with CIGNA, Inc. (CIGNA) to provide prescription drug coverage under the Plan. CIGNA subcontracts claims processing and vendor payments to Express Scripts, Incorporated (ESI). ESI assumed responsibility for the subcontract when it purchased ValueRx, Incorporated (ValueRx), CIGNA's original subcontractor, in 1998. During the two years ended December 31, 2000, ESI approved over 18.4 million claims totaling almost $1.01 billion and charged the State about $25.6 million for administrative and other related expenses.

The Department's contract with CIGNA establishes reimbursement rates for brand-name and generic drugs. Brand-name drugs are protected by patent to allow the manufacturer to recover research and development costs. Once the patent expires, a generic equivalent may be marketed by any company complying with U.S. Food and Drug Administration regulations. Manufacturers of generic drugs do not incur such research and development costs and, therefore, are able to market their products at a lower cost.

The Department reimburses ESI based on a drug's Average Wholesale Price (AWP) less a discount percentage, adding a dispensing fee and applying the subscriber's co-payment. The discount from AWP is larger for generic drugs than for brand-name drugs. According to the Department's contract with CIGNA, claims for generic drugs from out-of-state pharmacies are reimbursed using a discount from AWP of approximately 39 percent, whereas claims for brand-name drugs are reimbursed using a discount from AWP of approximately 14 percent (different discount rates are applied for drugs from in-state pharmacies). Therefore, it is important that the steeper generic discount rate is applied whenever appropriate.

ESI administers the Plan's Mandatory Generic Substitution Program. When a prescription is written for a brand-name drug that has a generic equivalent, Plan coverage is limited to the cost of the drug's generic equivalent. If a health care provider feels it is medically necessary for a Plan member to receive a brand-name drug when a generic equivalent is available, the Plan member can file a Generic Appeal with ESI. If ESI approves the Generic Appeal, ESI will pay for the brand-name drug.

During our audit period, ESI maintained a Generic Enforcement List (GEL) of generic drugs that are appropriate substitutions for brand-name drugs. The GEL also includes a numeric code (GEL Code) for each listed drug. Equivalent drugs produced by different manufacturers, including the original brand-name manufacturer, share the same GEL Code. ESI was also required to establish a Maximum Allowable Cost (MAC) price for products on the GEL. ESI officials informed us that, to establish a MAC price, they use one of the equivalent generic drugs as a benchmark (based on price, availability, etc.). ESI applies the benchmark price to the equivalent drugs produced by the other manufacturers. ESI established a unique MAC price list (MAC21) for claims generated from out-of-state pharmacies. If ESI does not establish an out-of-state pharmacy generic price for a drug on the GEL, the Department incorrectly reimburses ESI based on the lower discount rate for brand-name drugs.

B. Audit Scope, Objective and Methodology

We audited ESI's out-of-state pharmacy claims for drugs subject to generic enforcement for the period January 1, 1999 through March 31, 2001. The primary objective of our audit was to determine whether ESI applied the appropriate generic drug discount rate.

In selecting claims for audit, we used computer-assisted audit techniques to identify all the out-of-state pharmacy claims processed by ESI during our audit period in which the drugs were listed on the GEL, but were discounted at the lower brand-name rate. We then discussed these claims with ESI officials to determine whether the lower discount rate was appropriate.

We did our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess those Department and ESI operations included in our audit scope. Further, these standards require that we understand the internal control systems of the Department and ESI and that we review these entities' compliance with the laws, rules and regulations that are relevant to the operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions and recommendations.

Our consideration of the internal control structure at ESI focused on the control procedures for applying proper discounts to out-of-state generic drug claims. Our audit identified improvements needed in this area, which we further describe in the "Drugs Subject to Generic Enforcement Paid at the Brand-Name Discount Rate" section of this report.

We use a risk-based approach when selecting activities to be audited. This approach focuses on those operations that we identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. Thus, we devote little audit effort to reviewing operations that may be relatively efficient or effective. As a result, we prepare our audit report on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

C. Results of Audit

We found that ESI was incorrectly reimbursed at the lower brand-name discount rate for 37,498 claims. These claims related to drugs from out-of-state pharmacies that were subject to generic substitution and therefore should have been reimbursed at the higher generic discount rate. We calculated that these claims were overpaid by a total of $613,900.

We provided preliminary reports of our audit findings to ESI officials and considered their comments in preparing this report. ESI officials agree that the claims were overpaid, but disagree with the extent of their liability for the overpayments.

Drugs Subject to Generic Enforcement Paid at the Brand-Name Discount Rate

During our audit period, ESI processed 3.2 million out-of-state pharmacy claims. Using computer-assisted audit techniques, we determined that the drugs in 41,221 of these claims were listed on the GEL, but were discounted at the lower brand-name rate of 14 percent rather than the higher generic rate of 39 percent. We discussed these claims with ESI officials to determine whether the lower brand-name discount rate was appropriate.

We found that, for 3,723 of the claims, the lower brand-name discount rate was appropriate for various reasons beyond the control of ESI. (i.e., Federal Drug Administration drug recalls, etc.). However, for the remaining 37,498 claims, the lower brand-name discount rate was not appropriate. These drugs should have been discounted at the higher generic rate. As a result of these erroneous

discount rates, ESI was overpaid a total of $613,900 on these claims. This overpayment represents the difference between the 39 percent generic discount rate that should have been applied to the claims, and the 14 percent brand-name discount rate that was actually applied to the claims.

We determined that the generic discount rate was not applied to the drugs in these claims because ESI had not established a MAC21 price. We believe this may have been caused, to some extent, by ESI's lack of formal policies and procedures. For example, ESI was not able to document formal policies and procedures for establishing and maintaining the GEL. ESI was able to document MAC pricing policies, but these policies were not effective until October 1, 2000, which was well after the beginning of our audit period. In addition, these policies do not address how MAC prices are to be established for drugs listed on the GEL.

In response to our audit, ESI officials stated it was not their policy to establish a generic discount for all drugs subject to generic enforcement. However, this comment contradicts a statement made to the Department by CIGNA/ValueRx officials during the contract award process. In September 1998, the Department wrote to CIGNA/ValueRx requesting clarification on certain areas of CIGNA's contract proposal. In particular, the Department asked CIGNA/ValueRx officials if they had established a generic price for all drugs subject to generic enforcement, and how those drugs without a generic price were to be reimbursed. In response, CIGNA/ValueRx wrote, "All products that are on our GEL have a corresponding MAC price." Department officials confirmed that, except in certain unusual circumstances, they expect all products on the GEL to have a corresponding MAC price.

ESI officials informed us that the statement by CIGNA/ValueRX officials affirming that all products on the GEL have a corresponding MAC price was erroneous. However, the prescription drug contract for the Plan was awarded to CIGNA/Value Rx with the understanding that statement was true.

ESI officials also stated they believe their liability for the overpayments identified by our audit is only $165,625. The officials based this calculation on the ESI's overall performance in processing out-of-state generic drug claims during the audit period. ESI officials believe that the majority of the out-of–state generic drug claims were processed correctly. The officials, therefore, believe ESI should not be liable for the full amount of the overpayments.

We do not agree. The alternative calculation offered by ESI officials is not relevant. The Plan's prescription drug contract specifically requires ESI to refund the excess cost of each overpaid claim to the State.

Recommendations

1. *Remit the overpayments of $613,900 to the State.*

2. *Ensure that drugs subject to generic enforcement are added to the Plan's generic pricing lists. Regularly monitor these lists to ensure that they are complete and up to date.*

Major contributors to this report were Ronald Pisani, David Fleming, Laura Brown, and Maria Harasimowicz.

We would appreciate receiving your response to the recommendations made in this report within 90 days, indicating any action planned or taken to implement them.

We wish to express our appreciation to the management and staff of ESI for the courtesies and cooperation extended to our auditors during this audit.

Yours truly,

Kevin M. McClune
Audit Director

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