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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

June 17, 2005

Antonia C. Novello, M.D., M.P.H., Dr. P.H.
Commissioner
New York State Department of Health
Corning Tower
Empire State Plaza
Albany, NY 12237

Re: Administration of State Contract
X009512 to Mead Johnson for the WIC
Infant Formula Rebate Program
Report 2004-R-3

Dear Dr. Novello:

According to the State Comptroller's authority set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we audited the New York State Department of Health's (DOH) administration of Contract X009512 with Mead Johnson for the WIC Infant Formula Rebate Program for the period July 1, 2003 through June 30, 2004.

A. Background

The New York State Department of Health contracted with Mead Johnson to administer the Federal and State funded Women, Infants and Children (WIC) infant formula rebate program. The contract specifies that Mead Johnson must pay DOH a rebate based on a percentage of wholesale cost and the number of cans of infant formula sold. It is expected this program will generate \$240 million in rebates. The contract began early July 1, 2003 and will expire on June 30, 2006. The contract includes provisions specifying the responsibilities of both Mead Johnson and the DOH. DOH's Division of Nutrition (Division) is responsible for monitoring the program and ensuring its mission is accomplished.

The New York State WIC program is regulated and funded by the United States Department of Agriculture's (USDA) Food and Nutrition Service and the State of New York and is administered by the Division. The Women, Infants and Children Special Supplemental Nutrition Program began operating nationally in January 1974 with a mission to promote and maintain the health and well-being of nutritionally at-risk women, infants and young children. Federal regulations (7 CFR Ch.11, Section 246.12) Food and Nutrition Service, USDA and State regulations (10NYCRR Part 60-1) govern the actions and dictate the oversight responsibilities of DOH and its local agencies.

Within New York State, the WIC program is approved to serve approximately 485,000 participants (of which approximately 120,000 are infants provided with infant formula) per month through 103 health and human service organizations operating at approximately 565 service sites statewide that employ 1,500 staff. Once they are certified eligible for the program, participants receive vouchers (WIC checks) to take to the 4,600 contracted stores/pharmacies (vendors) to redeem for specific foods. The program distributes over two million food checks monthly, including checks for infant formula. In New York City, most WIC programs operate full time daily sites out of hospitals or health centers. Upstate, most WIC programs are located at county health departments, community health centers or not-for-profit health and human service organizations.

B. Audit Scope, Objectives and Methodology

We audited the Mead Johnson contract for the period July 1, 2003 through June 30, 2004. The objectives of our performance audit were to determine whether Mead Johnson remitted the proper rebates to the Division, to assess compliance with contract requirements, and to assess the extent and effectiveness of the Division's monitoring of the WIC Rebate Program.

To accomplish these objectives, we reviewed Contract X009512 and relevant contract-related documents and discussed contract requirements with both the Division and Mead Johnson officials. We reviewed eight months of vouchers (July 1, 2003 through February 28, 2004) to verify the accuracy of the rebate amount claimed relative to the information shown on the Division's computerized system entitled WIC Statewide Information System (WICSIS) and the support for that information. We reviewed all available months for which there was documentation during our audit period. Toward that end, we verified the number of cans sold, the computation of the national wholesale prices and the computation of the rebate percentages. We verified the accuracy of the rebate claims by testing a randomly selected sample of two months (December 2003 and February 2004) to source data. We also verified that the rebates were remitted to the Division.

We did our audit according to generally accepted government auditing standards. Such standards require we plan and do our audit to adequately assess those Division operations that are within our audit scope. Further, these standards require we understand the Division's internal control structure and compliance with those laws, rules and regulations relevant to 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.

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, several of which are done by the Division of State Services. These include operating the State's accounting system, preparing the State's financial statements, and approving State contracts, refunds and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. 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.

C. Results of Audit

We concluded that Mead Johnson and the Division did a good job in complying with the contractual requirements stipulated in the Mead Johnson contract. We determined that the rebates paid by Mead Johnson to DOH was the correct amount and were paid timely. We also concluded that the contractual standard for conducting compliance buys of authorized WIC vendors was met. However, we suggest that the Division increase its compliance buys in the five boroughs of New York City and Long Island since the majority of vendors are located in these areas.

1. Remittance of Proper Rebates to the New York State Department of Health

Mead Johnson is required by the contract to pay a monthly rebate to the Division based on the number of cans of infant formula sold, multiplied by the lowest national wholesale price for the unit of formula. Any manufacturer increases to the national wholesale price automatically increase the rebate cent-for-cent for each can of formula sold. The infant formula rebate contract between Mead Johnson and the DOH took effect on July 1, 2003 and provided for a rebate on standard formulas of 65 percent of the wholesale cost. The percentage of the rebate was increased to 75 percent effective January 1, 2004.

In order to compute the rebate owed, the Division extracts information from WICSIS on all checks redeemed each month that qualify for the rebate. To determine if Mead Johnson remitted the proper rebate amount to the Department, we randomly selected two months (December 2003 and February 2004) of claimed vouchers from our audit period and reviewed WICSIS' supporting documentation including the number of cans sold and the unit price. As a part of this test, we also verified the computation of the unit prices used. For each month we multiplied the number of cans sold by the unit price (adjusted for any price increases) and applied the rebate percentage. The rebate amounts were accurate.

We also verified rebate billings to Mead Johnson agreed with the information on WICSIS for the first eight months of the contract period (July 2003 through February 2004). We traced the units sold and unit price information as indicated on the Division's vouchers to the information shown on WICSIS to determine whether they agreed. No exceptions were found.

We also determined that Mead Johnson made the required monthly payments based on the documented purchases submitted by the State. The contract requires that monthly payments be forwarded via wire transfer within 30 days of the post marked/faxed date of the invoice. We verified that Mead Johnson made the rebate payments within the required timeframe.

2. Mead Johnson's Compliance With Relevant Contract Terms

Mead Johnson is required by the contract to perform certain functions i.e., providing infant formula in sufficient supply to meet WIC requirements; guarantee availability of infant formula to all of the program's authorized retailers; notify New York State of any wholesale price changes; provide pamphlets and WIC shopping guides to participants; and, to meet with the Department

biennially to discuss the program. We determined each of these requirements was met by Mead Johnson.

3. Compliance Buys of Authorized WIC Vendors

The contract requires that the Division conduct compliance buys of authorized WIC vendors to ensure that prescribed formula types are purchased. The annual total number of buys shall equal ten percent (10 %) of the average number of vendors authorized in the annual period. Vendors who are determined to have substituted, without just cause, a non-authorized product for the manufacturer's product will be subject to enforcement action deemed appropriate by the state. The compliance buys are conducted by the Division's Investigative Services Unit (ISU). We verified whether the ISU conducted the required number of compliance buys of authorized WIC vendors. We determined that the ISU complied with the required number of compliance buys, as called for in the contract.

Although compliance buys are conducted statewide, in the Metropolitan region which consists of the counties of Sullivan, Ulster, Dutchess, Orange, Putnam, Rockland, Westchester, Nassau, Suffolk and the five boroughs of New York City, most of the infant formula compliance buys were conducted in localities north of New York City. DOH officials explained that infant formula compliance buys are targeted at those stores located predominantly north of New York City, where the greater potential of inappropriately redeeming WIC checks for non-contract formula exists. During the audit, we judgmentally selected a sample of 25 stores of the 3,324 WIC vendors located in New York City that we considered to be "large" stores based on the store name. We contacted the stores by telephone and 23 stores told us that they also stocked non-contract formula products. While we did not confirm the actual size of the store or verify if the information provided to us was correct, we believe the survey results may indicate a potential risk in New York City and Long Island. Therefore, we suggest that ISU increase its infant formula compliance buys in the five boroughs in New York City and Long Island.

Recommendation

To improve internal controls related to compliance testing, the Department should consider increasing the number of infant formula compliance buys in the five boroughs of New York City and Long Island.

We provided a draft copy of this report to Department officials for their review and comments. Their comments have been considered in preparing this report, and are included as Appendix A.

In response to our draft audit report, DOH stated that its Investigative Services Unit will review the methodology for conducting compliance buys in New York City and Long Island, and consider the suggestion in the audit report.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Commissioner of the New York State Department of Health shall report to the Governor, the State Comptroller, and the leaders of the legislature and its fiscal committees, advising what

steps were taken to address the conclusion contained herein, and where the conclusion was not addressed, the reasons therefor.

Major contributors to this report were Albert Kee, Allen Cohen, Charles Johnson, John Ames and Unal Sumerkan.

We wish to thank DOH management and staff for the courtesies and cooperation extended to our auditors during this audit.

Yours truly,

David R. Hancox
Director
State Audit Bureau

cc: Robert Barnes, Division of the Budget



STATE OF NEW YORK DEPARTMENT OF HEALTH

Corning Tower The Governor Nelson A. Rockefeller Empire State Plaza Albany, New York 12237

Antonia C. Novello, M.D., M.P.H., Dr.P.H.
Commissioner

Dennis P. Whalen
Executive Deputy Commissioner

May 5, 2005

David R. Hancox
Audit Director
Office of the State Comptroller
110 State Street
Albany, NY 12236

Dear Mr. Hancox:

Enclosed are the Department of Health's comments on the Office of the State Comptroller's (OSC) revised draft audit report (2004-R-3) entitled "Administration of Contract X009512 with Mead Johnson for Infant Formula Rebate".

Thank you for the opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis P. Whalen".

Dennis P. Whalen
Executive Deputy Commissioner

cc: Mr. Coleman
 Ms. Cowans
 Mr. Griffin
 Ms. Hathaway
 Ms. Hayward
 Ms. Hess
 Mr. Howe
 Mr. Reed
 Mr. Van Slyke

Department of Health
Comments on the
Office of the State Comptroller's
Revised Draft Audit Report 2004-R-3
Entitled "Administration of Contract X009512 with
Mead Johnson for Infant Formula Rebate"

The following are the Department of Health's (DOH) comments concerning the conclusions contained in the Office of the State Comptroller's (OSC) revised draft audit report (2004-R-3) entitled "Administration of Contract X009512 with Mead Johnson for Infant Formula Rebate".

OSC Conclusion:

To improve internal controls related to compliance testing, the Department should consider increasing the number of infant formula compliance buys in the five boroughs of New York City and Long Island.

DOH Response:

The Department's Investigative Services Unit will review the methodology for conducting compliance buys in New York City and Long Island, and consider the suggestions made in the audit report.