

A Follow-Up Audit Report on  
**The Health and Human Services Commission's  
Administration of the Children's Health Insurance Program**

July 27, 2005

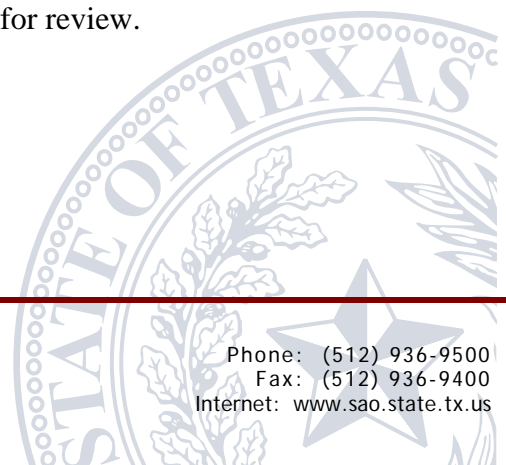
Members of the Legislative Audit Committee:

The Health and Human Services Commission (Commission) has made only limited progress in implementing recommendations for the Children's Health Insurance Program (CHIP) from a March 2003 State Auditor's Office report (*An Audit Report on the Children's Health Insurance Program at the Health and Human Services Commission*, SAO Report No. 03-022).

The Commission has not substantially changed its approach to CHIP drug rebates since our last audit. In 2003, the State Auditor's Office recommended that the Commission require drug manufacturers that provide drugs for the CHIP program to pay the State rebates on those drugs. However, the Commission is still relying on drug manufacturers to voluntarily agree to pay rebates. The Commission has not yet created a preferred drug list (PDL) for the CHIP program, even though House Bill 2292 (78th Legislature, Regular Session) required it to do so by March 1, 2004. Because drugs listed on a PDL are much more likely to be purchased and dispensed, drug manufacturers would have a significant incentive to be listed on a CHIP PDL, which would require them to pay the State rebates.

The Commission also has not strengthened its CHIP contracts by adding provisions the State Auditor's Office recommended in 2003. Specifically:

- The Commission has not yet amended the CHIP contracts to limit the time drug labelers have to adjust drug pricing data. This time limit is important in ensuring that the maximum amount of rebate revenue can be collected. The U.S. Centers for Medicare and Medicaid Services adopted a rule for the Medicaid Vendor Drug Program limiting these adjustments to three years. However, because the Texas CHIP program is not a subset of Medicaid, this rule does not directly apply to CHIP in Texas. Therefore, adding the recommended amendment is still necessary.
- The Commission has not added a provision to its contracts with drug labelers that would allow it to verify the accuracy of the drug labelers' pricing data. In its response to this recommendation in the 2003 audit, the Commission referred to drug labelers' concerns regarding the confidentiality of this pricing data. However, the 78th Legislature addressed those concerns by exempting the pricing data from open records requirements. Despite this protection, the Commission has still not amended its contracts with drug labelers to require that they make their pricing data available for review.



In addition, the Commission has not sufficiently monitored the cost-effectiveness of the CHIP drug benefit. The Commission removed responsibility for the administration of the drug benefit from CHIP health maintenance organizations (HMO) and began managing the drug benefit itself in March 2002. The Commission provided no evidence that it conducted an analysis of the cost-effectiveness of this action. Moreover, it has not complied with requirements in Rider 33 of the General Appropriations Act (78th Legislature) and has not complied with all sections of House Bill 2292 (78th Legislature) to routinely report on the cost-effectiveness of its Vendor Drug Program (through which the Commission manages the CHIP drug benefit).

Although the Commission has not implemented the recommendations discussed above, it has improved its efforts to verify the accuracy of CHIP HMO data used to make program decisions. It also has contracted with outside auditors to verify the integrity of information it receives from contracted CHIP HMOs. Additionally, the Commission has begun to retain supporting documentation for premium rate changes, although it has not documented the retention procedures for this information.

The attachment to this letter contains detailed information regarding the status of the Commission's implementation of each of the recommendations the State Auditor's Office followed up on.

The Commission's responses are in the attachment to this letter. The Commission agrees with most of our findings and recommendations, and we appreciate its cooperation during this audit. We have provided a follow-up comment in the attachment to this letter to help clarify one issue on which the Commission disagrees. If you have any questions, please contact John Young, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA  
State Auditor

Attachment

cc: Mr. Albert Hawkins, Executive Commissioner, Health and Human Services Commission



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# Attachment

## Summary of Follow-Up to Children's Health Insurance Program Audit

### Definitions of Implementation Status

- Fully Implemented: Successful development and use of a process, system, or policy to implement a prior recommendation
- Substantially Implemented: Successful development but inconsistent use of a process, system, or policy to implement a prior recommendation
- Incomplete/Ongoing: Ongoing development of a process, system, or policy to address a prior recommendation
- Not Implemented: Lack of a formal process, system, or policy to address a prior recommendation

As Table 1 shows, of the six recommendations on which auditors followed up, the Health and Human Services Commission (Commission) has substantially implemented two. Its implementation of one recommendation is incomplete or ongoing, and three recommendations have not been implemented. (See text box for definitions of implementation status.)

Table 1

Status of the Commission's Implementation of Prior State Auditor's Office Recommendations		
Recommendation	Implementation Status	Auditor Comments
The Commission should consider establishing a separate formulary for CHIP or seeking legislative change that requires all manufacturers to provide a drug rebate in order to be eligible to participate in CHIP.	Incomplete/Ongoing	The Commission continues to use the Medicaid formulary for CHIP, but for CHIP it generally excludes over-the-counter and contraceptive drugs from this formulary. The Commission is collecting rebates on CHIP drugs through voluntary agreements with some drug manufacturers.  House Bill 2292 (78th Legislature, Regular Session) required the Commission to create preferred drug lists for Medicaid and CHIP. To be on these lists, drug manufacturers or drug labelers would be required to pay supplemental rebates or offer other program benefits. However, while the Commission has established a preferred drug list for Medicaid, it has not done so for CHIP.
The Commission should amend its CHIP contracts with labelers to limit the length of time during which prior-period adjustments can be made to three years.	Not Implemented	The Commission has not amended its CHIP contracts to establish this limit.  In August 2003, the U.S. Centers for Medicare and Medicaid Services adopted a rule limiting prior-period adjustments to three years, and the Commission believes that this rule protects it from the risk of prior-period adjustments being made after three years. However, because the Texas CHIP program is not a subset of Medicaid, this rule does not apply to CHIP in Texas. Therefore, it is still necessary to make these amendments to CHIP contracts.

**Status of the Commission's Implementation of  
Prior State Auditor's Office Recommendations**

Recommendation	Implementation Status	Auditor Comments
<p>The Commission should amend its CHIP contract with drug labelers to include a provision that allows the State to verify the accuracy of drug labeler's pricing data.</p>	<p>Not Implemented</p>	<p>The Commission has not amended CHIP contracts to include a provision that allows for the verification of pricing data. The Commission asserts that CHIP contracts will undergo revision by December 2005.</p> <p>In responding to our 2003 report, the Commission stated that it had omitted such amendments from CHIP contracts because of drug manufacturers' concerns regarding open records issues. However, since then, House Bill 2292 (78th Legislature, Regular Session) enacted a confidentiality clause so that pricing data would not be subject to the Texas Open Records law.</p>
<p>HMO data integrity recommendations:</p> <ul style="list-style-type: none"> <li>▪ The Commission should establish a process to verify whether the HMO data it uses in its decision making are accurate and reliable.</li> <li>▪ The Commission should exercise its authority to audit the data CHIP HMOs provide.</li> </ul>	<p>Substantially Implemented</p>	<p>The Commission documented its desk review process by creating policies and procedures for the review of HMO data and CHIP payments.</p> <p>Audits of CHIP HMOs are in progress and, after these audits are completed, the Commission will begin using audited data in its decision making. The Commission estimates that contracted audit work for all 15 CHIP HMOs will be completed by December 2005.</p>
<p>The Commission should continue to monitor the cost savings achieved from assuming management of the CHIP drug benefit program.</p>	<p>Not Implemented</p>	<p>The Commission's contracted actuary prepared a prescription cost spreadsheet, but the Commission did not analyze the data on that spreadsheet to review cost savings realized from assuming management of the CHIP drug benefit.</p> <p>The Commission also has not fully complied with requirements to submit reports annually to the Legislature regarding the cost-effectiveness of the Vendor Drug Program.</p>
<p>The Commission should establish an organized process for maintaining the supporting documentation for changes in HMOs' premium rates.</p>	<p>Substantially Implemented</p>	<p>The Commission now physically maintains supporting documentation at its office (instead of at the offices of its contracted actuary). However, the Commission has not established policies and procedures regarding where documentation is to be maintained, what sort of documentation is required to be maintained, and who is responsible for maintaining it.</p>

## Management's Responses



### TEXAS HEALTH AND HUMAN SERVICES COMMISSION

ALBERT HAWKINS  
EXECUTIVE COMMISSIONER

July 22, 2005

John Keel, CPA  
State Auditor of Texas  
1501 North Congress Avenue  
Austin, Texas 78701

Dear Mr. Keel:

The Texas Health and Human Services Commission (HHSC) appreciates this opportunity to comment on the State Auditor's Office (SAO) draft "Follow-Up Audit Report on the Health and Human Services Commission's Administration of the Children's Health Insurance Program." As described below, HHSC has initiated significant activity in all areas addressed in the March 2003 "Audit Report on the Children's Health Insurance Program at the Health and Human Services Commission." HHSC is continuing its efforts to fully address these issues.

HHSC has made progress in increasing CHIP drug rebates through the Preferred Drug List (PDL) development process. House Bill 2292 required HHSC to implement PDLs for both Medicaid and CHIP. HHSC requested that the Texas Pharmaceutical and Therapeutics Committee (P&T Committee) focus on the Medicaid PDL during its first year because the Medicaid PDL is expected to generate over 98 percent of Texas' PDL savings. The first phase of the Medicaid PDL was in place before March 1, 2004, and the CHIP PDL was on the P&T Committee's agenda in August 2004 and November 2004. The committee deferred action on the CHIP PDL at these meetings because the members requested further information to support their ability to make the most clinically appropriate PDL recommendations for the unique pediatric population served through CHIP. The committee did not opt to recommend the same drugs for the CHIP PDL that it had for the Medicaid PDL since the Medicaid PDL targets a different population, in which aged and disabled recipients account for the majority of drug expenditures.

Although CHIP rebates from drug manufacturers are still voluntary, prior to the August 2004 P&T Committee meeting, HHSC solicited CHIP rebates from manufacturers who were not yet providing voluntary CHIP rebates. At that time, an additional 42 manufacturers signed CHIP rebate agreements. HHSC has collected over \$650,000 in rebates from these 42 manufacturers. The P&T Committee will review 24 drug classes for inclusion on the CHIP PDL at its next meeting on August 19-20, 2005. As required in House Bill 2292, only drugs with a CHIP rebate agreement will be considered for inclusion on the CHIP PDL.

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HHSC has taken steps to verify the accuracy of drug labelers' pricing data and will amend the CHIP contracts to require verification of pricing information and limit the time drug labelers have to adjust drug pricing data. Due to recent efforts undertaken with the Office of the Attorney General, HHSC is now receiving drug pricing information from most of the participating drug labelers. HHSC's initial response to the SAO audit stated that it would amend the CHIP rebate contracts to include a three-year prior period adjustment limit within three years of the inception of the program. HHSC plans to achieve that goal by December 2005.

HHSC has complied with the requirements in Riders 15 and 34 of the General Appropriations Act from the 78<sup>th</sup> Legislature and House Bill 2292 from the 78<sup>th</sup> Legislature. HHSC has been unable to comply with the reporting requirements of Rider 33 because, until recently, HHSC has received very little average manufacturer price (AMP) data from manufacturers and has still not received wholesale purchase price data from wholesalers. In an effort to address this, HHSC has taken several actions to attempt to obtain AMP information, but with only limited success. In April 2005, the Office of the Attorney General sent notices to manufacturers regarding the AMP reporting requirement. Most manufacturers have provided AMP information since then, and HHSC is currently compiling and evaluating this information.

Finally, HHSC has in place business processes that require and document systematic analysis of major policy changes prior to implementation. This includes cost benefit analyses as appropriate, and the documentation of decisions relating to analysis of cost, quality, and service delivery.

Sincerely,



Albert Hawkins

cc: Charles Bell, M.D., Deputy Executive Commissioner for Health Services  
Chris Traylor, Chief of Staff  
David Balland, Associate Commissioner for Medicaid and CHIP  
David Griffith, Internal Audit Director

## *Auditor's Follow-Up Comment*

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The information the Commission provided to show its compliance with House Bill 2292 does not include evidence that it has performed a review of utilization trends and clinical outcomes, and it does not include a review of the effect of the Commission's managing the CHIP drug benefit.