New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Department of Human Services
Division of Medical Assistance and Health Services
Payments for Pharmaceutical Dispensing Fees of Nursing Home Residents

January 1, 2006 to August 31, 2008
The Honorable Jon S. Corzine  
Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Joseph J. Roberts, Jr.  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of Human Services, Division of Medical Assistance and Health Services, Payments for Pharmaceutical Dispensing Fees of Nursing Home Residents for the period of January 1, 2006 to August 31, 2008. If you would like a personal briefing, please call me at (609) 292-3700.

Stephen M. Eells  
Assistant State Auditor  
October 28, 2008
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope</td>
<td>1</td>
</tr>
<tr>
<td>Objectives</td>
<td>1</td>
</tr>
<tr>
<td>Methodology</td>
<td>1</td>
</tr>
<tr>
<td>Background</td>
<td>2</td>
</tr>
<tr>
<td>Conclusions</td>
<td>2</td>
</tr>
<tr>
<td>Findings and Recommendations</td>
<td></td>
</tr>
<tr>
<td>Dispensing Fee Paid to Pharmacies</td>
<td>3</td>
</tr>
<tr>
<td>Auditee Response</td>
<td>5</td>
</tr>
</tbody>
</table>
Department of Human Services
Division of Medical Assistance and Health Services
Payments for Pharmaceutical Dispensing Fees
of Nursing Home Residents

Scope

We have completed an audit of the Department of Human Services, Division of Medical Assistance and Health Services’ (division) payments made to pharmacies for dispensing fees of nursing home residents during the period January 1, 2006 to August 31, 2008. Our audit focused on these Medicaid expenditures accounted for in the state’s General Fund. Medicaid expenditures are funded by the federal government at a 50 percent rate. During our audit period, payments to the 31 contracted pharmacies for dispensing fees totaled $13.8 million.

Objectives

The objective of our audit was to determine the propriety of capitated dispensing fee payments to pharmacies for residents in nursing homes. We also reviewed the effectiveness of the division’s controls to contain these expenditures.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our audit, we studied legislation, administrative code, and policies of the agency. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our analysis of financial transactions. We also reviewed financial trends and interviewed agency personnel to obtain an understanding of the programs and the internal controls. Our analysis of financial transactions was
designed to provide conclusions about the validity of payments as well as internal control and compliance attributes.

**Background**

Nursing homes typically have contracts with pharmacies to ensure the safety and convenient access to drugs for their residents. Historically, the New Jersey Medicaid program paid these pharmacies for the drug costs and dispensing fees of eligible recipients. Pursuant to New Jersey Administrative Code 10:51-2.7, the program pays a capitated payment (a fixed amount) to pharmacy providers for each Medicaid recipient in an approved nursing home for all the dispensing fees, regardless of the number of prescriptions. This capitation payment is calculated based on the total number of Medicaid fee-for-service beneficiary days in the nursing home. Fees range between $15 and $22 per month.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 established the Medicare Prescription Drug Program, known as Medicare Part D. Prior to Medicare Part D, Medicaid paid for most prescription drugs of nursing home recipients enrolled in both Medicare and Medicaid, herein referred to as “dual eligibles”. On January 1, 2006 drug coverage, including dispensing fees; for dual eligibles switched from Medicaid to Medicare.

**Conclusions**

Although capitated dispensing fee payments were made in accordance with regulations, fees were not reduced when prescription costs were shifted to Medicare Part D. We noted the division had considered several cost reduction proposals, but they were never implemented.
Dispensing Fee Paid to Pharmacies

On January 1, 2006 the federal government implemented the Medicare Part D Prescription Drug program. This program ended Medicaid coverage of most prescription drugs for those individuals who are eligible for both Medicaid and Medicare (dual eligibles). Our review found that the division continues to pay pharmacy providers capitated dispensing fees even though most of the prescriptions for dual eligibles in nursing homes are covered by drug plans under the Medicare Part D program. In addition to the drug cost, the Medicare Part D program pays pharmacies a dispensing fee. The estimated average Medicare Part D dispensing fee reimbursement is $2.27 per prescription.

Implementation of the Medicare drug benefit resulted in a major shift of prescription drug spending from Medicaid to Medicare. Our review indicated that the New Jersey Medicaid program experienced a substantial reduction in the number of prescriptions for Medicaid recipients in nursing homes. Medicaid prescription volume and total payments to pharmacies dropped by 82 percent and 79 percent, respectively, between calendar years 2004 and 2007. However, the capitated dispensing fee paid to pharmacies by the division was never adjusted to reflect changes in coverage caused by Medicare Part D.
The division had developed several project proposals to reduce dispensing fee payments to the pharmacies since Medicare Part D was enacted. However, none of the project proposals have been implemented. The New Jersey Medicaid program has continued to pay the same capitated dispensing fee to pharmacies, despite Medicare Part D coverage for most of these prescriptions and dispensing fees. If the capitated dispensing fee had been based on the reduced volume of prescriptions filled, the division could have saved $10.9 million (50 percent federal) since January 1, 2006.

**Recommendation**

The division should modify its regulations and current methodology for computing Medicaid dispensing fees to pharmacies in consideration of the Medicare Part D program.
October 24, 2008

Stephen M. Eells, Assistant State Auditor  
Office of Legislative Services  
Office of the State Auditor  
125 South Warren Street  
P O Box 067  
Trenton, NJ 08625-0067

Dear Mr. Eells:

This is in response to your letter of October 2, 2008 to Commissioner Velez concerning the Office of Legislative Services (OLS) draft audit report entitled "Department of Human Services, Division of Medical Assistance and Health Services, Payments for Pharmaceutical Dispensing Fees of Nursing Home Residents." The letter provides an opportunity to comment on the audit report.

The objective of this audit was to determine the propriety of capitated dispensing fee payments to pharmacies for residents in nursing homes during the period January 1, 2006 to August 31, 2008. Prior to January 1, 2006, the New Jersey Medicaid program paid pharmacies, contracted with nursing homes, for the drug costs and a fixed capitated "dispensing" payment for nursing home recipients enrolled in both Medicaid and Medicare ("dual eligibles"). On January 1, 2006 the majority of drug coverage, including dispensing fees for dual eligibles switched from Medicaid to Medicare (Medicare Part D).

The audit concluded that during the reviewed period, the capitated dispensing fee payments made by the Division were made in accordance with regulations. However, in that these fees were not reduced when prescription costs were shifted to Medicare Part D, the opportunity for gross cost savings of $10.9 million (50% state/50% federal) was missed. Consequently to the shift of dual eligibles to Medicare, Medicaid prescription volume and costs were reduced. The auditors found that the Division continues to pay pharmacy providers a fixed capitated dispensing fees even though most of the prescriptions for dual eligibles in nursing homes are covered by drug plans under the Medicare Part D program.
Finding

The New Jersey Medicaid program has continued to pay the same capitated dispensing fee to pharmacies, despite Medicare Part D coverage for most of these prescriptions and dispensing fees. As a result, if the capitated dispensing fee had been based on the reduced volume of prescriptions filled, the division could have saved $10.9 million since January 1, 2006.

The Division of Medical Assistance and Health Services (DMAHS) concurs with the audit finding and plans to amend its regulations to accommodate this finding.

Recommendations

1. The Division should modify its regulations regarding Medicaid dispensing fees to pharmacies for dual eligibles in consideration of Medicare Part D.

The Division will pursue this recommendation to modify the regulations to properly reflect pharmacy dispensing fees for “dual” eligibles and Medicaid eligibles in nursing homes.

2. The Division should modify its current methodology for computing Medicaid dispensing fees to pharmacies for dual eligibles in consideration of Medicare Part D.

The Division will pursue modifying its current methodology for computing Medicaid dispensing fees to pharmacies for dual eligibles in consideration of Medicare Part D.

The Division continues to follow-up on all of the specific items of concern provided by the auditors. DMAHS has and will take appropriate corrective action on these and any other issues identified. Likewise, DMAHS will further consider corrective action and other enhancements to improve the effectiveness and efficiency of these program activities.

If you have any questions or require additional information, please contact me or David Lowenthal at 609-588-7933.

Sincerely,

John R. Guhl
Director

JRG:L

c: Jennifer Velez
    David Lowenthal