

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

REVIEW OF
VENDOR REBATES
PAID TO HOSPITALS

OPTION CARE, INC.
BUFFALO GROVE, ILLINOIS



Daniel R. Levinson
Inspector General

AUGUST 2007
A-05-07-00045

Office of Inspector General

<http://oig.hhs.gov>

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The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF AUDIT SERVICES
233 NORTH MICHIGAN AVENUE
CHICAGO, ILLINOIS 60601

REGION V
OFFICE OF
INSPECTOR GENERAL

August 10, 2007

Report Number: A-05-07-00045

Mr. Joseph P. Bonaccorsi
Senior Vice President, Secretary and General Counsel
Option Care, Inc.
485 Half Day Road, Suite 300
Buffalo Grove, Illinois 60089

Dear Mr. Bonaccorsi:

This final report provides the results of our audit of a vendor rebate in the amount of \$173,805 that a drug manufacturer paid to Option Care of Buffalo Grove, Illinois. We identified this rebate through a national statistical sample of rebates.

BACKGROUND

Option Care, Inc.

Option Care, Inc. (the provider) offers home infusion and specialty pharmacy services. The provider operates approximately 50 company-owned pharmacies and maintains a network of approximately 65 independently-owned and operated franchised pharmacies.

Vendor Rebates

A vendor rebate is a retroactive discount, allowance, or refund given to a health care provider after the full list price has been paid for a product or a service. Rebates are usually paid quarterly or annually and are usually dependent on achieving a specific purchasing volume. A rebate is paid directly to a provider (e.g., a hospital) or to a nonprovider (e.g., a group purchasing organization or distributor).

Federal regulations (42 CFR § 413.98) state that rebates are reductions in the cost of goods or services purchased and are not income. The Centers for Medicare & Medicaid Services (CMS) "Provider Reimbursement Manual" (part 1, chapter 8) requires hospitals and other health care providers to report all discounts on their Medicare cost reports.

Medicare Cost Reports

Some types of Medicare-certified providers, such as hospitals, skilled nursing facilities, and home health agencies, must submit an annual Medicare cost report to a fiscal intermediary. The

cost report contains provider information, including facility characteristics, utilization data, costs and charges by cost center (in total and for Medicare), Medicare settlement data, and financial statement data. A cost center is generally an organizational unit having a common functional purpose for which direct and indirect costs are accumulated, allocated, and apportioned. Providers must reduce previously reported Medicare costs when they receive rebates.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the provider reduced costs reported on its 2003 Medicare cost report by the \$173,805 vendor rebate it received.

Scope

As part of a national statistical sample of rebates that a single drug vendor sent directly to providers, we selected a \$173,805 rebate (part of a \$242,555 check) that the provider received during calendar year 2003. We limited our review to identifying the rebate amount and determining whether the provider credited the amount in its accounting records and in its Medicare cost report. We did not perform a detailed review of the provider's internal controls.

We performed our fieldwork at the drug vendor's offices in Deerfield, Illinois. We requested and received information from the provider through phone contacts, mail, and electronic mail.

Methodology

To accomplish our objective, we:

- reviewed Federal regulations and CMS guidance related to rebates,
- obtained a statistical sample of rebates paid by the vendor to identify providers that received the rebates,
- requested documentation from the provider regarding the reporting of the rebate,
- determined whether the provider credited the sampled rebate amount on its Medicare cost report,
- quantified the dollar amount of any rebates not reported and used to reduce previously reported costs, and
- contacted the provider's fiscal intermediary to verify the accounting for the vendor rebate.

We conducted our audit in accordance with generally accepted government auditing standards.

FINDING AND RECOMMENDATIONS

For the \$173,805 rebate reviewed, the provider did not reduce costs reported on its 2003 Medicare cost report by \$43,451, contrary to Federal regulations and CMS guidance. The provider properly reduced its cost of goods sold by 75 percent of the rebate (\$130,354). However, the provider recorded the remaining 25 percent (\$43,451) as revenue, rather than as a credit to reduce its health care costs. The provider stated that this percentage was based on its estimated purchasing volume for its independently-owned franchised pharmacies. Providers must offset costs by rebates to ensure that they report the actual cost of services provided.

We recommend that the provider:

- revise and resubmit its 2003 Medicare cost report, if not already settled, to properly reflect the \$43,451 portion of the rebate as a credit reducing its health care costs; and
- consider performing a self-assessment of its internal controls to ensure that future vendor rebates are properly credited in its Medicare cost reports.

PROVIDER COMMENTS

The provider disagreed with the finding and recommendations. In its written response, the provider stated that only the portion of rebates related to purchases made by company-owned pharmacies should be considered a reduction to its cost of goods. Rebates related to purchases made by independently-owned franchises should be recorded as revenue. The provider stated that it followed the Financial Accounting Standards Board's guidance and generally accepted accounting principles (GAAP) regarding its treatment of the rebate as revenue. The provider believed the guidance required it to include rebates as reductions to the cost of goods to the extent that such rebates are related to its cost of goods and not to services provided to the vendor. To the extent that rebates are related to services provided to the vendor, the rebates are to be recorded as revenue.

OFFICE OF INSPECTOR GENERAL RESPONSE

Federal regulations (42 CFR § 413.98) state that rebates are reductions in the cost of goods or services purchased and are not income. The GAAP guidance cited by the provider allows rebates to be reported as income if the drug vendor received an identifiable benefit (assets or services) in exchange for the rebate. The identifiable benefit must be sufficiently separable from the provider's purchase of the drug vendor's product.

The provider did not provide a benefit to the drug vendor that would trigger treatment of rebates on sales to independently-owned franchises as revenue. The drug vendor sent the rebate to the provider based on purchases made via the provider's contract by both company-owned pharmacies and independently-owned franchises. The provider retained 100 percent of the rebate amount rather than distributing applicable portions to its independently-owned franchises. Since there was no benefit separable from the provider's purchase of the vendor's product, the

rebate should be used to offset the provider's purchases and costs associated with managing the contract with the drug vendor.

We continue to believe that the provider's Medicare cost report should have reflected the entire rebate amount as a credit, including the 25 percent (\$43,451) that the provider recorded as revenue. We have included the complete text of the provider's comments as the Appendix.

* * * * *

A copy of this report will be forwarded to the action official for review and any action deemed necessary. The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please contact Jaime Saucedo at (312) 353-8693. Please refer to report number A-05-07-00045.

Sincerely,



Marc Gustafson
Regional Inspector General
for Audit Services

Direct Reply to HHS Action Official:

Ms. Jackie Garner
Regional Administrator
Centers for Medicare & Medicaid Services
233 N. Michigan Avenue, Suite 600
Chicago, Illinois 60601

APPENDIX

OPTIONcare
Specialty Pharmacy and Infusion Services

485 Half Day Road
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Buffalo Grove, IL 60089
Telephone 847.465.2100
Toll Free 800.879.6137
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May 7, 2007

Via facsimile (312-353-3814) and U.P.S. delivery

Marc Gustafson
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Audit Services
233 North Michigan Avenue
Chicago, IL 60601

Re: Review of Vendor Rebates Paid to Option Care

Dear Mr. Gustafson,

This correspondence shall serve as our comments responsive to the April 5, 2007 draft OIG report concerning your audit of a vendor rebate paid to Option Care during 2003 by one of our vendors.

We recorded 75% of the rebate in question as a reduction to our cost of goods and 25% as revenue. Your conclusion is that the entire rebate should have been recorded as a reduction to cost of goods on our Medicare Cost Report and accordingly, you have recommended that we resubmit our 2003 Medicare Cost Report with the necessary adjustment. While we understand your position and the guidance provided by CMS on this issue, we respectfully disagree with your conclusions.

Specifically, Option Care earns rebates from various vendors, and many such rebates are linked to purchase volume. We provide home infusion and specialty pharmacy services through both company-owned pharmacies *and independently-owned franchises*. In many cases, the rebates we receive are based on the total purchase volume of both our company-owned offices and the independently-owned owned franchised offices. Our financial statements, including our cost of goods, only reflect purchases made by our company-owned offices, and not purchases made by the independent Option Care franchise owners. Therefore, only that portion of our rebates related to purchases made by our company-owned pharmacies should be considered a reduction to our cost of goods. The rebates that relate to purchases made by our independent franchises are not related to our cost of goods and therefore should not be recorded as reductions to our cost of goods. Instead, they rightly are recorded as revenue.

Making healthcare a little easier

Our GAAP accounting for these rebates is governed by guidance published by the Financial Accounting Standards Board's ("FASB") Emerging Issue Task Force ("EITF") in their *Issue 02-16: Consideration Received from a Vendor by a Customer or Reseller*. Essentially, this guidance requires us to record the rebates as a reduction to our cost of goods to the extent that such rebates are related to our cost of goods and not to services we provided to the vendor. To the extent that rebates are related to services provided to the vendor, the rebates are to be recorded as revenue, not as a reduction to cost of goods. In the specific rebate sampled, only the percentage of the rebate that was related to our purchases was recorded as a reduction to our cost of goods. This complies with the GAAP guidance provided above and provides a true matching of rebates to the underlying purchases.

By way of a hypothetical example, if we did not have a franchise network, then we would only have received 75% of the rebate, but would have purchased the same amount of drugs through out company-owned pharmacies. In this case, our net cost of goods would be exactly the same as was presented on our cost report and you would have no question about the correctness of our numbers. Therefore, it would be prejudicial against us to require us to offset 100% of the vendor rebates against our cost of goods since only 75% of the rebate was actually related to our purchases.

Thank you for reviewing and considering our response to your draft report. Should you have any further questions on this matter, you may contact me at (847) 229-7794.

Sincerely,



Joseph P. Bonaccorsi
Senior Vice President,
Secretary and General Counsel