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U.S. DEPARTMENT OF VETERANS AFFAIRS  
BEFORE THE COMMITTEE ON VETERANS' AFFAIRS  
UNITED STATES HOUSE OF REPRESENTATIVES  
HEARING ON  
EXAMINING VA'S PHARMACEUTICAL PRIME VENDOR CONTRACT  
FEBRUARY 1, 2012**

Mr. Chairman and Members of the Committee, thank you for this opportunity to testify on the scope and methodology of the Office of Inspector General's (OIG) ongoing reviews of VA's administration of the Pharmaceutical Prime Vendor (PPV) contract and to also give a historical background on the OIG's work in contracting and open market purchases. I am accompanied by Michael Grivnovics, Director, Federal Supply Service Division, and Mark Myers, Director, Healthcare Resources Division, in the OIG's Office of Contract Review.

**HISTORY**

The OIG's Office of Contract Review (OCR) has conducted pre-award and post-award contract reviews and other pricing reviews of Federal Supply Schedule (FSS) and construction contracts since 1993. These reviews provide both the OIG and VA with unique insight into the commercial marketplace for pharmaceuticals; medical and surgical supplies and equipment; and health care services. In addition, the OIG's Office of Audits and Evaluations has conducted numerous audits addressing purchasing practices at VA medical facilities, with emphasis on open market, or non-contract, purchases. Based on this work, we have advised VA, Congress, and other Government entities on vulnerabilities in the Government's procurement practices and recommended changes needed to protect patients treated at VA and other Government medical facilities as well as the taxpayer.

Open market purchasing is not a new issue; over the past 12 years, the OIG has issued 49 public reports that identified concerns with open market purchases. In May 2001, we issued a report, *Evaluation of the Department of Veterans Affairs Purchasing Practices*, in which we reported that the "effectiveness and integrity of the Federal Supply Schedule (FSS) program has deteriorated." We noted that due to legislative changes requiring acquisition streamlining and reform, the FSS was no longer a mandatory source and there was an increase in open market sales. As a result, a growing number of vendors had cancelled existing contracts, decided not to submit proposals, removed high-dollar sales items from the contract, or simply refused to offer Most Favored Customer pricing. We noted that a "vendor's ability to sell open market in significant volumes effectively eliminates the Government's ability to leverage prices using its aggregate buying power." In response to the report, VA initiated a Procurement Reform Task Force to address the issues. One of the outcomes of the Task Force was to create a purchasing hierarchy that required VA to purchase pharmaceuticals and

medical/surgical supplies and equipment from national contracts first before using alternative buying mechanisms such as local contracts or buying open market.

In the 1990s and since 2008, we have worked with VA, the Department of Justice, the Office of Management and Budget, the General Services Administration (GSA), and the GSA OIG to identify shortcomings in the FSS program that affect the Government's ability to leverage its aggregate buying power and to receive prices that are fair and reasonable at the time of award and remain so during the entire term of the contract.

### **Reporting to Congress**

From 2002-2004 and again from 2008-2010, the OIG worked with staff from this Committee on two legislative initiatives focused on reforming VA's procurement practices. Our recommendations during this process addressed legislative initiatives that would improve VA's ability to get items on contract and thus reduce open market procurements.

In December 2009, in testimony before this Committee's Subcommittee on Oversight and Investigations, we testified about acquisition deficiencies including open market purchasing. At that hearing, we discussed reports issued in 2004, 2007, and 2009, that showed VA facilities were not complying with the purchasing hierarchy and were instead purchasing products open market.

In March 2011, in response to questions during a hearing before the House Committee on Appropriations' Subcommittee on Military Construction, Veterans Affairs, and Related Agencies, we testified about issues facing VA and other Government purchasers on leveraging the Government's buying power when contracting for pharmaceuticals. We recognized that open market purchases were a problem and stated that the causes included the fact that there was no requirement that manufacturers offer generic drugs on contract and that the *Trade Agreements Act* precluded some vendors from offering their products on contract. As a result VA and other Government entities were buying open market and possibly not complying with acquisition laws and regulations.

### **Contract Process**

In 2007, OCR found that VA was purchasing covered or branded pharmaceuticals open market through the PPV even though the products were on FSS contracts at a Federal Ceiling Price (FCP) as mandated by statute. We determined that this occurred because of a loophole that allowed purchasers to buy products through the PPV even though the manufacturer declined to sell their products through the PPV. Because the items were purchased open market, the prices exceeded the contract's FCP. We reported the problem to VA's Pharmacy Benefits Management (PBM) Services, the National Acquisition Center (NAC), and VA's Office of General Counsel. As a result of our discussions, the PPV electronic ordering system was modified to block purchases of items from manufacturers who declined to sell through the PPV. However, in 2011, we found that the modification was ineffective because purchasers were still buying contract items at open market prices through the PPV. We determined that although

the PPV's ordering system did block the purchase, the purchaser had the ability to override the system and make the purchase. We found no controls were in place to hold purchasers accountable. For one vendor's product line, we found \$5.7 million in open market purchases of which \$2.3 million represented overpayments because VA paid more than the FCP. In addition to issuing three letters to the NAC addressing our finding on open market purchases of products from three separate manufacturers, we discussed the issue with PBM, the NAC, and OGC.

Through pre-award and post-award reviews, which include extensive discussions with manufacturers, in 2011 OCR identified a growing number of issues relating to generic drugs including the inability and/or unwillingness of vendors to put these items on contract, sell through the PPV, or offer most favored customer pricing. This work also provided us with insight into contracting and buying practices of private health care providers and institutions. This information was shared with the Office of Acquisitions and Logistics and PBM for the purpose of finding solutions to this growing problem. In May 2011, OCR was invited to participate in a 2-day meeting with PBM, the NAC, and other VA officials to discuss open market purchasing through the PPV and possible solutions. This was the first indication we had that VA had concerns about the level of open market purchasing through the PPV. We attended the meeting, provided our insight, and have been working since October with VA's Integrated Product Team (IPT) to address immediate, short-term, and long-term solutions. Some short-term solutions proposed by the IPT resulted in amendments to the current PPV solicitation to establish negotiated prices for items not on national contracts and a requirement that these products comply with the *Trade Agreement Act*.

### **Long-Term Solutions**

Identifying viable long-term solutions is not an easy task because the causes, which are numerous and often complex, have never been quantified. For example, some products are not available on contract because vendors have chosen not to offer them on contract or cannot offer the products on contract because the products do not comply with the *Trade Agreements Act*. In other cases a non-contract item may be purchased because contract items are unavailable due to shortages. We also know that purchasers will buy open market when the contract price exceeds the price offered by non-contract vendors. This is particularly true when the brand name drug is on contract but the generic equivalents are not. In addition, patient care and safety concerns must be considered. Some solutions can be addressed through contract provisions and internal policies and processes but others may require legislation.

### **OIG'S CURRENT REVIEWS**

At this time, we are conducting a review of PPV purchases for fiscal year 2011 to quantify the extent and cause of the problems. This includes quantifying the actual dollars spent on open market sales; what percentage of these purchases were pharmaceutical items versus medical/surgical items; and identifying patterns and trends of open market purchases of pharmaceuticals. We also will determine and quantify whether the pharmaceutical item purchased open market was on contract and, if so, why the sale was listed as open market. If the item purchased was not on contract, we

will determine whether there was a comparable item on contract. If comparable items were available, we will try to determine why the contract item was not purchased. We also will select a sample to ascertain the extent that purchases may have violated existing procurement laws and regulations. We are attempting to determine whether open market purchases of pharmaceuticals violated the *Trade Agreements Act*. In addition, we are reviewing whether changes made by VA in November 2011 to prevent or limit open market purchasing through the PPV were effective.

We are also conducting a review of the internal controls of VA's Fast Pay System, a system that expedites payments for goods received under contract and makes payments generally within 24 to 48 hours. This internal controls review will identify the risks and vulnerabilities associated with reliance on related payment and processing activities including whether items are received and correctly priced; payment errors are corrected in a timely manner; contract terms are met; and there is a segregation of duties to prevent fraud. The Fast Pay System is unique to the PPV. Under the PPV contract, VA facilities are required to use the Fast Pay process for PPV purchases.

We are conducting tests of sample invoices tracking from time of ordering, payment through the Fast Pay System, and receipt of goods from the ordering location. Further, we are examining the effectiveness of the VA's Financial Services Center's financial controls by comparing the payments made to the invoices at VA facilities. In addition, we are assessing whether VA received correct and timely reimbursements for purchases made on behalf of other Government agencies.

A longer-term review to be conducted by OCR is to review the prices charged for items that were not purchased open market in comparison to the contract price at the time of purchase to ensure that customers were not charged more than the contract price. If this review identifies overcharges, we will recommend that the contracting officer issue a bill of collection and that VA take other action if appropriate. If the current review shows that procurement laws and regulations were violated, the longer term review will determine the frequency and dollar value of such violations and make recommendations for appropriate corrective action.

## **CONCLUSION**

Over the last 12 years, the OIG has continually reported on the issue of open market purchases and our concerns that the Government was not sufficiently aggregating its buying power to obtain fair and reasonable prices comparable to those paid by similar commercial customers for the purchase of pharmaceuticals, medical and surgical supplies, and health care resources. We will provide the Committee the results of our ongoing reviews when they are completed. We will continue to advise VA and Congress on issues related to VA procurement and contracting issues.

Mr. Chairman and other Members of the Committee, this concludes my statement and my colleagues and I would be pleased to answer any questions that you may have.