



STATE OF WASHINGTON

April 7, 2011

The Honorable Brian Sonntag
Washington State Auditor
P.O. Box 40021
Olympia, WA 98504-0021

Dear Auditor Sonntag:

Thank you for this opportunity to formally respond to the Performance Audit on Prescription Drugs relating to the Department of Labor & Industries' (L&I). Like Governor Gregoire, we support the use of performance audits as an important tool to improve state government, which is why we worked closely and extensively for nearly a year with the Auditor's staff on this audit.

L&I is the seventh largest workers' compensation insurer in the nation, covering 2.3 million workers and 161,000 employers. It pays out \$1.2 billion each year in medical expenses and partial replacement of lost wages for workers who suffer job-related injuries or illnesses.

As part of this function, the department strives to improve injured workers' access to appropriate and quality care while driving down the costs of prescription drugs. These efforts have had the following results:

- L&I has saved millions through its industry-leading, high use rate of generic drugs. Its rate of 88 percent, compared with 54 to 80 percent for other states' workers' compensation programs, generated around \$7.25 million in savings in Fiscal Year 2009. To our disappointment, these savings are not noted in this audit.
- Likewise, although the audit does not include a direct comparison of drug prices for workers' compensation programs, L&I's pharmacy reimbursement rate is lower than the rate in 43 other states.
- The independent Workers' Compensation Research Institute (WCRI) recently identified L&I as having one of the lowest cost prescription drug programs among 17 other states it studied. WCRI will publish its research report in the next few months.
- The gap between drug prices paid by L&I and the Health Care Authority (HCA), which was emphasized in the audit report, has largely been addressed by 2010 changes in L&I's pharmacy fee schedule.

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We are concerned that the audit repeatedly benchmarks L&I to the HCA. Unfortunately, this comparison has limited application because L&I has a different line of business with additional billing workload and risks that make it less attractive to pharmacies. It is also an apples-to-oranges comparison because, unlike L&I, HCA is able to use patient co-payments and deductibles as incentives for choosing lower cost drugs. In addition, the Auditor's estimated cost savings are based on debatable assumptions, and in some cases, depend on legislative policy changes. Therefore, we believe the savings stated in the audit are not attainable.

While we disagree with several conclusions in the audit report, we appreciate the cooperative and respectful interactions between the Auditor's Office and L&I staff in completing this audit. We have enclosed a joint response and will report on our progress on completing these action items.

Sincerely,



Judy Schurke, Director
Department of Labor & Industries



Marty Brown, Director
Office of Financial Management

Enclosure

cc: Jay Manning, Chief of Staff, Governor's Office
Jill Satran, Deputy Chief of Staff, Governor's Office
Wendy Korthuis-Smith, Director, Accountability & Performance, Governor's Office
Kimberly Cregeur, Governor's Liaison on Performance Audits, Accountability & Performance, Governor's Office

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Employees of the Department of Labor & Industries (L&I) and the Office of Financial Management (OFM) have provided a coordinated response for each issue and corresponding recommendation. In addition to the audited agency, OFM jointly responds to performance audits to provide perspective on potential statewide or multi-agency issues, including policy, strategic planning, performance management, budget, accounting, purchasing, human resources, information technology, labor relations, and risk management. We prepared this document in response to the final draft audit report delivered on March 17, 2011.

Issue 1: State law requires, and L&I is using, several leading practices to control prescription drug expenses.

L&I RESPONSE: Washington is the only state that has established therapeutic interchange using an evidence-based state Preferred Drug List. This leading practice requires pharmacists in most cases to substitute a preferred drug alternative when a physician has written a prescription for a non-preferred drug in the same drug class.

As a result of L&I policies and extensive work with other state agencies, L&I has an extremely high rate of use of generic medications. Workers' compensation programs in other states fill prescriptions as generics at a rate of 54 to 80 percent, for an average generic use rate of 70 percent. L&I, meanwhile, fills 88 percent of all prescriptions paid for by the agency with less-expensive generics. Compared to the average for these other states, we estimate that L&I's emphasis on generics saves about \$7.25 million per year.

In addition, among drugs that have a generic equivalent (same active ingredient), L&I's use of generics is 99 percent. A study by the Workers' Compensation Research Institute (*Prescription Benchmarks Study for Michigan, 2010*) found much lower – and costlier – figures for other states. The median for the 16 states studied was an 83 percent use of generics for medications for which generic products were available.

Action Steps and Timeframe:

- L&I will continue to participate in interagency activities to implement leading practices pursuant to laws on prescription drug purchasing for state programs. (*corresponds to Recommendation #1*)

OFM RESPONSE: Washington State has prescription drug purchasing laws for state health care programs that make our state a national leader in innovative practices for controlling prescription costs. For example, L&I, along with the state's Health Care Authority (HCA) and the Medicaid Purchasing Administration, has been a key participant in developing and maintaining the state Preferred Drug List and rules around therapeutic interchange. Their work has resulted in substantial pharmacy savings to the state.

Issue 2: By updating its prescription drug prices, L&I could have saved \$7.1 million in Fiscal Year 2009. It has not followed other practices that could further reduce costs.

L&I RESPONSE: L&I is already using appropriate benchmarks to review program performance and adjust fees based on market rates. Last year, we contracted with the

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Workers' Compensation Research Institute (WCRI) – an independent, nationally recognized research organization – for a benchmarking study to compare L&I's prescription drug costs and use with those of workers' compensation programs in 17 other states. WCRI's preliminary results indicate that, for the most commonly prescribed medications, L&I drug prices were below the median for the other states. Because of L&I's extremely high use of generics, our overall average price per pill for all medications was about 35 percent below the 17-state median. The study did not include L&I's July 2010 reduction in pharmacy fees, which further reduced drug prices.

After the period examined in both the audit and the WCRI study, L&I reduced pharmacy fees in its July 2010 fee schedule update. This is an annual process to review and adjust L&I fee schedules for all provider types. The July 2010 adjustments in pharmacy fees have already closed most of the gap between drug prices paid by L&I and HCA. The remaining gap between L&I and HCA rates equates to about \$1.5 million per year (based on FY 2009 utilization levels) – much less than the \$7.1 million cited by SAO for FY 2009.

We do not agree with the audit conclusion that the HCA drug prices are the most appropriate benchmark for our program. The audit does not consider the significant differences between workers' compensation coverage and other types of health insurance. From the pharmacies' perspective, workers' compensation patients present additional workload and much higher risks. When filling a prescription, the pharmacist needs to determine not only that the patient has an approved L&I claim, but that the particular medication is related to treating the patient's work-related injury. Otherwise, L&I will recoup payments from pharmacies if the bill is retroactively denied. Pharmacies do not have these additional tasks and financial risks for other types of health insurance, so they would be less likely to give L&I the same deep discounts that they accept from HCA or other employee health plans.

We need to find the balance between holding down prescription costs and maintaining access to pharmacies for injured workers statewide. Driving reimbursements too far down could actually drive overall costs up. If small rural pharmacies leave the program due to low reimbursements, savings from lower pharmacy fees could be cancelled out by higher wage-replacement costs because it would likely take injured workers longer to find a pharmacy to fill their prescriptions. We will continue to use appropriate benchmarks to adjust our fee schedule based on changes in market rates. However, it may be unrealistic for L&I to achieve savings by further reducing fees.

Action Steps and Timeframe:

- After the WCRI study is completed in September 2011, L&I will use the results and comparisons with drug prices paid by other health care payers — including workers' compensation programs in other states — to review and adjust our reimbursement levels, if appropriate. We will determine the feasibility of further reducing prescription reimbursement rates as part of our annual provider fee schedule update. (July 2012)

OFM RESPONSE: We are concerned that the audit repeatedly benchmarks L&I to the Health Care Authority (HCA). Although it is tempting to believe that state agencies should or could use the same rates for prescription drugs, this comparison has limited application. L&I has a

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fundamentally different line of business with additional billing workload and risks that make it less attractive to pharmacies. It is an apples-to-oranges comparison because, unlike L&I, HCA is able to use patient co-payments and deductibles as incentives for choosing lower-cost drugs.

The audit appears to disregard how L&I's pharmacy fees compare to fees in workers' compensation programs in other states. For example, L&I's pharmacy fee schedule is lower (as a percentage of Average Wholesale Price) than the pharmacy fee schedules used by 43 other states.

Recommendation 3: Mail order pharmacies.

L&I RESPONSE: Offering financial incentives to encourage injured workers to switch from retail pharmacies to mail order conflicts with our mandate to cover all costs for proper and necessary treatment for injured workers. This change would require statutory authorization. The convenience of receiving a 90-day supply of medication via mail order could prove to be an incentive for some L&I patients. However, offering this option is not likely to save \$107,000 per year as suggested, since the uptake would be lower than that of other programs with financial incentives.

Action Steps and Timeframe:

- Evaluate and determine if mail order could be offered to some pension claims. (January 2012)

OFM RESPONSE: Currently, Washington Administrative Code (WAC) 296-20-03011 limits prescriptions to a 30-day supply, so increasing to a 90-day supply would require rulemaking to amend the WAC. However, under Executive Order 10-06, all non-critical rule development and adoption are currently suspended through December 31, 2011.

Recommendation 4: Pill splitting.

L&I RESPONSE: We disagree with this recommendation. This is a controversial strategy that is opposed by multiple regulatory and professional organizations including the U.S. Food and Drug Administration (FDA), American Medical Association, American Pharmacists Association, and the National Association of Boards of Pharmacy. This is a patient safety issue. Concerns include patient confusion about correct dosages; patients' ability to accurately split the tablet; questionable content uniformity of split tablets; the difficulty of splitting some tablets; and the fact that not all drugs are safe to split.

In addition to patient safety concerns, potential savings to L&I are low for the following reasons:

- Our programs rarely use the more expensive brand name drugs that are typical candidates for pill-splitting initiatives.
- Many medications that physicians are more likely to recommend for pill splitting (i.e., medications to control high blood pressure and high cholesterol) are not routinely covered by workers' compensation.
- Our potential financial liability increases greatly for errors associated with inaccurate pill splitting or other problems caused by injured workers not taking medications correctly.

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OFM RESPONSE: We also disagree with this recommendation. In addition, the HCA (Public Employee Benefits Board) and Medicaid Purchasing Administration share the concerns expressed by L&I. Any potential savings would likely be outweighed by the cost of implementation and medication errors associated with adverse consequences due to inaccurate splitting.

Recommendation 5: Contractual audits.

L&I RESPONSE: L&I will work with the HCA and other contracting agencies to develop a strategy for auditing the pharmacy benefits management (PBM) contractor that will include a coordinated effort involving all participating agencies. This strategy will take into account industry standards and individual agency needs for audits of similar programs. It will allow the department to establish a regular, ongoing audit protocol that is cost-effective and consistent among all participating entities.

Action Steps and Timeframe:

- Collaborate with HCA and other agencies to develop a cost-effective and ongoing audit plan that is consistent among all agencies. (January 2012)

OFM RESPONSE: We would encourage use of this type of audit only if the potential savings exceed the cost of the annual audit. Since this type of specialty audit is expensive and L&I receives less than \$100,000 per year in rebates, any efforts to audit should necessarily be done in collaboration with the other contracting agencies.

Issue 3: L&I has a very high generic drug utilization rate, but changes in the law could further improve that rate.

L&I RESPONSE: Changes in the law would have minimal impact because, among those medications with generic equivalents, 99 percent of prescriptions paid for by L&I are filled as generics. For all types of medications combined, L&I's generic use rate is 88 percent. In contrast, generic use rates for workers' compensation programs in other states range from 54 to 80 percent. As noted under Issue #1, this difference between L&I and the average for other workers' compensation programs generated about \$7.25 million savings in FY 2009.

OFM RESPONSE: Changes in the law would have a much larger impact on other state agency programs, insurers, and health care providers than on L&I. These other payers have much higher use of brand name drugs and greater opportunities for generic savings. The changes would also increase the agencies' administrative costs for handling requests for exceptions.

According to the HCA and Medicaid Purchasing Administration, the current "carve out" provisions and generic substitution laws already allow for generic substitution of preferred brand drugs when a generic is available.

Recommendation 2, associated with this issue, is directed at the Legislature and does not require our response.