

# CALIFORNIA'S WORKERS' COMPENSATION PROGRAM

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## ***The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care***

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### ***Audit Highlights . . .***

*Our review of the workers' compensation medical payments system revealed that:*

- Rising medical costs are contributing to the increasing costs of the workers' compensation system—costs California's employers are required to pay.*
- Despite numerous warnings from research experts, the Division of Workers' Compensation (division) has done little to respond to the problems in the workers' compensation medical payment system.*
- Fee schedules intended to control the amounts paid for medical services and products are outdated or nonexistent. The medical payment system lacks enforceable treatment guidelines that can help contain medical costs and streamline the delivery of medical care to injured workers. Researchers point to inadequate control over treatment utilization as a primary cause of escalating costs in the workers' compensation system.*

*continued on next page*

**REPORT NUMBER 2003-108.1, AUGUST 2003**

**Division of Workers' Compensation, Department of Industrial Relations' response as of January 2004**

**T**he Joint Legislative Audit Committee requested that we review the medical costs related to the workers' compensation insurance system and the extent to which the payment structure has resulted in unacceptably high reimbursement rates.

### **Finding #1: Workers' compensation medical costs are rising because the medical payment system has not been well maintained or fully developed.**

The costs of the State's workers' compensation program to employers are spiraling upward, and numerous studies point to the rising medical costs of treating injured workers as a major contributor to the problem. The Workers' Compensation Insurance Rating Bureau (rating bureau) reported that the average total estimated medical cost per workers' compensation claim involving lost work time increased by 254 percent from 1992 to 2002. The insurance premiums charged to employers to provide workers' compensation coverage increased from \$5.8 billion to \$14.7 billion between 1995 and 2002.

The medical costs of the workers' compensation system are rising in part because the State has not taken the necessary steps to ensure that the costs of treating injured workers are within reasonable limits. The administrative director of the Department of Industrial Relations' (Industrial Relations) Division of Workers' Compensation (division) is responsible for administering and monitoring the workers' compensation

- ☑ *Although the division could adopt fee schedules developed by other entities, such as Medicare, it would first have to decide on how to adjust those fee schedules to best meet the needs of the workers' compensation system.*
  - ☑ *The division lacks a data collection system that allows it to monitor medical costs and measure the effectiveness of reforms made to the system.*
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system. However, the administrative director has not maintained or fully developed the medical payment system. Despite mandates to biennially update the medical fee schedules for professional services, inpatient hospital facilities, and for medical products—such as pharmaceuticals and durable medical equipment—other than for minor adjustments, these schedules have not been updated since 1999, and they are essentially a patchwork of prior fee schedules.

In addition, costs for services performed at facilities such as outpatient surgical centers and emergency rooms are not covered by fee schedules but are paid on the basis of what are known as usual, customary, and reasonable charges for such services. Health care experts consider this basis for payment to be inflationary, and thus these charges may be contributing to the escalating costs in the workers' compensation system.

Numerous studies have pointed to opportunities to improve cost control in the system; however, the division has not built upon those studies to implement corrective actions. The division's administrative director states that the division has not been able to dedicate more effort to improving the medical payment system due in part to staff reductions, indicating that he has lost almost 17 percent of his authorized positions and 19 percent of his filled positions since fiscal year 1999–2000. He added that when he was appointed in 1999, he was instructed to place a greater priority on improving the workers' compensation judicial process.

Further, the Legislature and administration have sometimes responded to the needs of the system with measures that impede improvement, such as requiring the use of data not currently being collected to develop a new fee schedule for outpatient surgical facility charges and reducing the funding for tasks critical to improving cost control.

Because rising medical costs in workers' compensation contribute to increased costs to California's employers, we recommended that greater importance should be placed on more closely managing the costs of providing medical care to injured workers. As such, the administrative director should take the steps necessary to identify the organization and level of resources needed to effectively administer the workers' compensation medical payment system and should work with the Department of Finance and the Legislature to obtain those resources. In addition, as part of an effort to more closely manage the

medical payment system, the administrative director should more aggressively pursue corrective action needed to address issues identified in research reports, such as those from the Commission on Health and Safety and Workers Compensation (commission), the Industrial Medical Council (medical council), the California Workers' Compensation Institute, and the Workers' Compensation Research Institute, as well as any issues raised by internal studies conducted by Industrial Relations.

We further recommended that to ensure future legislation does not contain any unintended impediments to the improvement of the workers' compensation system, the administrative director should be proactive in working with the Legislature to identify and amend any provisions that would adversely affect the administrative director's ability to effect changes.

***Industrial Relations' Action: Partial corrective action taken.***

Industrial Relations believes that the enactment of Senate Bill 228 (Chapter 639, Statutes of 2003) should reduce the resources needed to adopt fee schedules. It reports that the division is currently reviewing its resources and assessing what specific expertise is needed.

Although Industrial Relations responded that the governor's proposal to further reform the workers' compensation system will address concerns from stakeholder groups and research organizations, its response does not address how it will more aggressively respond to issues raised by researchers and experts in the field that we describe in our report.

Industrial Relations reports that the Labor and Workforce Development Agency (agency) and the division worked very closely with the Legislature and the Governor's Office on the proposals that were included in the 2003 reform and are currently assisting the Governor's Office in developing and reviewing legislative proposals to build on existing reforms.

***Legislative Action: Legislation proposed.***

Conference committee convened.

**Finding #2: A lack of effective utilization controls leads to higher medical costs.**

The workers' compensation payment system lacks a process that would allow doctors to use a uniform set of treatment guidelines as a standard for treating similar workplace injuries and illnesses.

Medical treatment guidelines that provide standards for the treatment reasonably required to relieve the effects of workers' injuries, and that are presumed correct unless medical opinion establishes the need for a departure from those guidelines, can serve to ensure that injured workers receive the care they need to return to work, control medical costs, and increase the efficiency of the delivery of those medical services. Researchers point to inadequate controls over treatment utilization as a primary cause of escalating costs in the workers' compensation system. Overall, they report that in the area of professional medical services, California's average payment amount per claim is typical of other states, but the number of treatments per claim provided to injured workers is far above the average.

Despite the research pointing out the absence of utilization controls, California's system is without an effective process that would make treatment utilization review standards consistent among insurers. As a result, according to a study conducted by the division, there is little consistency in the processes or criteria used by insurers and claims administrators to determine the necessity of treatments proposed by physicians. In fact, one-third of the claims administrators included in the study reported using more than one set of criteria but did not provide a methodology for selecting which one they used for a particular case.

The medical council has developed treatment guidelines and it recently voted to review the medical evidence on treatment and utilization and to update its guidelines. However, the law requires that the medical council be made up of members of the medical community that would be subject to the treatment guidelines and maintain liaisons with the medical, osteopathic, psychological, and podiatric professions. As such, we question whether the medical council is the entity that can most effectively develop treatment guidelines without giving the appearance that it could be influenced by the extent to which the guidelines might adversely affect the financial interests of the medical community.

We recommended that the administrative director, in coordination with the medical council, should adopt a standardized set of treatment utilization guidelines, based on clinical evidence, to deter over- or underutilization of physician services and other professional medical services and products. The administrative director should consider, to the extent possible, adopting treatment guidelines that are developed by independent entities and that are

updated with adequate frequency to reflect advancing technology and changes in professional practice. If the administrative director adopts treatment guidelines developed by the medical council, he should take the steps necessary to ensure that those guidelines are developed without the appearance of undue influence from any group that participates in the State's workers' compensation system.

***Industrial Relations' Action: Partial corrective action taken.***

Industrial Relations points out the reforms in Chapter 639, Statutes of 2003, effective January 1, 2004, requires the division to adopt a medical utilization schedule by December 1, 2004, but did not state when it would update such a schedule. It further states that the new reforms eliminated the medical council, thereby making moot the recommendation to consult with it on treatment utilization guidelines.

Industrial Relations states that the commission (an independent entity) will survey and evaluate existing medical treatment utilization standards and that it expects the commission's findings and recommendations by July 1, 2004. Industrial Relations states that until December 1, 2004, the most recent update of the American College of Occupational and Environmental Medicine Occupational Medical Practice Guidelines are presumed to be correct in determining the extent and scope of medical treatment.

**Finding #3: The current legal and regulatory structure for utilization control is ineffective.**

A primary cause of the lack of effective utilization controls is that under the current law, utilization reviews are usually not admissible as evidence in judicial proceedings to resolve disputes between medical providers and claims administrators. To be admissible as evidence, a decision reached through a utilization review would need to be supported by a report from a physician performing an examination of the injured worker—a level of review not typically used by insurers and claims administrators when approving payment for treatment. Therefore, utilization reviews prepared by claims administrators have no weight in judicial proceedings.

In addition, the law requires that the administrative director adopt model utilization protocols in order to provide utilization review standards and requires insurers and claims administrators

to comply with those protocols. However, the regulations adopted by the former administrative director do not establish utilization review standards based on utilization protocols but instead allow insurers to establish their own unique utilization review plans as long as they meet certain administrative requirements. We believe that the regulations fail to achieve the objective of using utilization reviews to contain medical costs. However, the administrative director stated that he does not believe he has the statutory authority to make utilization reviews mandatory for insurers.

The absence of an effective utilization control process leads to disagreements between medical providers and claims administrators over proposed treatments for injured workers. However, the system does not have an effective process for resolving those disputes. Under the current dispute resolution structure, unresolved disagreements are finally settled by the Workers' Compensation Appeals Board after going through the judicial process within the workers' compensation system. Lacking a more efficient intermediary process, nearly 20 percent of the workers' compensation cases end up going through this judicial process. This lengthy process of resolving disputes can prolong the duration of workers' compensation cases.

To ensure that the treatment guidelines can serve as an authoritative standard for the treatment of workers' injuries, we recommended that the administrative director should seek the changes necessary in the Labor Code to ensure that all insurers and claims administrators are required to follow the standardized treatment guidelines and that treatment guidelines are accepted for use in judicial proceedings.

In addition, after obtaining any needed amendments to the law the administrative director should amend the division's regulations to reflect those changes to the law. Specifically, the division's regulations should require that insurers and claims administrators adhere to the standardized treatment guidelines and should clearly define the role of treatment guidelines in determining treatment and in judicial proceedings.

***Industrial Relations' Action: Pending.***

Industrial Relations stated that the new reforms provide that upon adoption by the administrative director of a medical utilization schedule, the schedule shall be presumptively correct on the issue of extent and scope of medical treatment. According to Industrial Relations, the new law will ensure that insurers and claims administrators follow the treatment guidelines in the schedule, and that the guidelines are accepted in judicial proceedings.

Industrial Relations also states that the division is in the process of drafting new utilization review regulations to implement the new reforms.

***Legislative Action: Legislation proposed.***

Conference committee convened.

**Finding #4: Proposed changes to the medical payment system may control fees for medical services and products but do not ensure lower overall medical costs or access to quality care.**

The administrative director and the commission have presented two different proposals for improving medical cost controls using variations of Medicare-based fee schedules. The Medicare payment system for physician services is founded on a valuation of the resources needed to provide each service. This system is known as the resource-based relative value scale (RBRVS) system.

Basing part or all of the workers' compensation system on the Medicare RBRVS system would have several advantages, among them the values on which payments are based would be derived from the amount of resources needed to perform services, rather than on customary charges. In addition, Medicare updates its schedules regularly, and so the values would remain current. Health policy experts believe resource-based systems to be less inflationary than charge-based ones. However, because the payments are resource based, it is projected that for some medical specialties, such as surgery and anesthesia, the payment amounts would be reduced from the traditional charge-based payments, and payments for evaluation and management services would be increased. This redistributive effect of the RBRVS system is a major point of controversy among providers of these affected medical specialties, in spite of the RBRVS system's ability to contain costs.

More work is needed to ensure that injured workers have access to quality care at reasonable costs to employers. If the State adopts a payment system that is based on indexed values, such as the RBRVS, it will need to determine how to adjust the RBRVS to arrive at payments that will meet this objective. There is no universal way to make these adjustments. Other states that have implemented a payment system based on the RBRVS have used a variety of approaches in adapting the system to fit their needs. Some considerations the State must weigh include the need to balance adequate access to care against overutilization and whether a transition strategy may be needed to mitigate the effects of the payment redistribution that would be caused by an RBRVS payment system.

We recommended that when determining the future structure of the workers' compensation medical payment system, the administrative director should consider the costs and practicalities of maintaining such a complex system and should give consideration to adopting a payment system that is based on models that are maintained by other entities, such as a variation of the RBRVS maintained by the federal Centers for Medicare and Medicaid Services, as he has done with his current proposal for modifying the physician fee schedule. If the administrative director decides to continue modifying the current workers' compensation payment system, he should consider pursuing a variety of activities, including the following:

- Continue his efforts to identify the adjustments needed to ensure that payments for services in the proposed modified physician fee schedule are high enough to encourage participation by physicians and other professionals in order to provide adequate access to care for injured workers.
- Seek the needed resources to develop and maintain fee schedules for the remaining medical services and products, such as outpatient surgical facilities, pharmaceuticals, emergency rooms, durable medical equipment, and home health care.

One proposal to improve California's workers' compensation payment system requires converting the entire system to a combination system that would use a variation of the Medicare payment system for medical services, facilities, and products, and the Medi-Cal payment system for pharmaceuticals. If this proposal is adopted, the administrative director should consider the following steps:



- Develop adjustments to the fee schedule for physician services and other professional services so as to mitigate any effects on access to care caused by adopting a resource-based relative value payment system that results in redistributing payment amounts away from medical specialties, such as surgery, and in increasing payments for evaluation and management services.
- Monitor the medical payment system to determine whether a reasonable standard of care can be achieved at the capped prices for services and products contained in the proposal.
- To fully benefit from adopting the Medi-Cal payment system for pharmaceuticals, in addition to adopting the Medi-Cal fee schedule, the administrative director should also study the feasibility of establishing a process to secure rebates from drug manufacturers like the supplemental rebates enjoyed by the Department of Health Services in its Medi-Cal pharmaceuticals purchase program.

Because there are no universally successful formulas for determining payments for medical services and products, we recommended that the administrative director should consult also with other states that have adopted Medicare-based payment systems and consider any measures they have employed to secure quality care at reasonable prices.

***Industrial Relations' Action: Pending.***

Industrial Relations reports it is taking the following steps to address the recommendations we made above:

- The reforms that took effect on January 1, 2004, revised the existing medical payment system by repealing the existing Official Medical Fee Schedule language and replacing it with provisions that require reimbursement of pharmaceuticals at 100 percent of the Medi-Cal rate; and that inpatient hospital services and outpatient surgeries that occur in either a hospital or ambulatory surgical center be reimbursed at no more than 120 percent of the relevant Medicare rate.
- To gauge access to care, the division's administrative director is preparing to contract with the University of California to conduct a study of injured workers' access to medical treatment. The initial study is to be conducted in 2004 using funding from existing resources.

- Industrial Relations believes that the legislative changes in Chapter 639, Statutes of 2003, should reduce the resources needed to adopt fee schedules. The division is currently reviewing its resources and assessing what specific expertise is needed. Since the hospital, outpatient, and pharmaceutical fee schedules are based on data already compiled by government entities outside the division, the resources required by the division for these fee schedules may be available within existing resources.
- The new reforms require that the existing Official Medical Fee Schedule for physician services be reduced by 5 percent and remain in effect until January 1, 2006, at which time the administrative director has the authority to adopt a new physician fee schedule.
- The reforms require the administrative director to contract for an independent annual study of access to medical treatment for injured workers. If it is found that access to quality health care or products is insufficient, the administrative director may make appropriate adjustments to medical and facilities' fee schedules.
- The division will study the feasibility of securing rebates from drug manufacturers for pharmaceuticals dispensed in workers' compensation cases. However, Industrial Relations notes that because workers' compensation in California is not designed as a single payer system, the division may be limited in its ability to negotiate lower pharmaceutical prices.
- Finally, Industrial Relations states that the division has been in contact with virtually all other states through the International Association of Industrial Accidents Boards and Commissions (IAIABC) and will consult with those states with Medicare-based payment systems.

**Finding #5: The division lacks a data collection system that is adequate to monitor the workers' compensation system.**

The division does not currently have a data collection system that will allow it to perform the necessary research to monitor the effect of policy decisions on the quality and availability of care to injured workers. Although legislation that took effect in 1993 mandated the development of a data collection system,

the Workers' Compensation Information System (WCIS) is still incomplete. According to the division, intense opposition to data collection from insurers, a shortage of knowledgeable and experienced staff, and technical difficulties in installing the proper hardware and software infrastructure have delayed the implementation of the WCIS. The division still has not identified a projected completion date for the system.

The WCIS consists of three components: two are used to collect information on the nature and duration of workplace injuries, and the third collects data on medical treatments and payments. The first two components are complete and operational, but the division is still working to identify the types of medical data it needs to collect to provide useful information for monitoring the performance of the medical payment system. However, the division has not provided us with any assurance that the medical data it collects will generate the information required to meet the statutory objectives for the system. According to the administrative director, identification of the needed medical data has been slow due in part to the effort required to work through the concerns the insurers have about the cost of reporting the data.

Further, the division stated that, if its funding is stabilized by passage of a state budget that includes employer user fees or sufficient General Fund moneys, and if the proposed funding augmentation for Assembly Bill 749 is made, it will identify a timeline for completing the medical data collection module of the WCIS expansion. The 2003–04 Budget Act includes both employer user fees and an augmentation to fund Assembly Bill 749 mandates.

Now that the division's budget contains employer user fees and a spending augmentation the administrative director asserts is needed to complete the division's WCIS, we recommended that the administrative director should place the WCIS implementation project on a timeline to facilitate its completion as quickly as possible. In addition, the administrative director should exercise the authority necessary to ensure that the data collected in the WCIS will provide the information needed to adequately monitor medical costs and services.

***Industrial Relations' Action: Pending.***

Industrial Relations states that division staff is working closely with staff from the Information Systems Unit to design, develop, and implement a prototype model for medical data collection. The division developed a proposed list of medical data elements to be collected, based on IAIABC guidelines. The division plans to reduce the number of data elements, based on an analysis of the ability to collect each data element and its anticipated usefulness.

The major remaining obstacle to the ability of the WCIS to collect medical data elements is the cooperation of claims administrators, who may not be capturing the data elements the division believes necessary to adequately analyze medical treatment. Initial data has been received from the State Compensation Insurance Fund.