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United States Government Accountability Office
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Congressional Committees

Subject: *DOD Pharmacy Benefits Program: Reduced Pharmacy Costs Resulting from the Uniform Formulary and Manufacturer Rebates*

Rising pharmacy costs have been a long-standing issue for the Department of Defense (DOD). In 1998, we reported that DOD's fiscal year 1997 total pharmacy costs were \$1.3 billion—a 13 percent increase from fiscal year 1995.¹ In fiscal year 2006, DOD dispensed 115 million prescriptions to about 6.5 million beneficiaries at a cost of about \$6 billion.

One effort to control pharmacy costs is through the use of a uniform formulary, which is a list of preferred drugs that are generally available to beneficiaries. The National Defense Authorization Act for Fiscal Year 2000 directed DOD to establish a pharmacy benefits program that included a uniform formulary.² DOD implemented the uniform formulary in 2005.³ Drugs on the uniform formulary are generally available at military treatment facilities (MTF), the TRICARE Mail Order Pharmacy (TMOP), and retail pharmacies.⁴ Each quarter, DOD reviews drugs for inclusion on the uniform formulary. DOD's decision to designate a drug as either formulary or nonformulary is based on the drug's clinical and cost-effectiveness relative to the other drugs in its therapeutic class.⁵ In its decision-making process, DOD considers information such as the drug's indications, clinical outcomes, and the price a manufacturer is willing to charge DOD if the drug is selected for placement on the uniform formulary. DOD's costs for a drug may vary depending on whether the drug is dispensed at an MTF, the TMOP, or a retail pharmacy. In exchange for formulary placement, manufacturers can offer DOD prices below those otherwise available through statutory

¹GAO, *Defense Health Care: Fully Integrated Pharmacy System Would Improve Service and Cost-Effectiveness*, [GAO/HEHS-98-176](#) (June 12, 1998).

²See Pub. L. No. 106-65, § 701, 113 Stat. 512, 677-80 (1999) (codified as amended at 10 U.S.C. § 1074g).

³The process DOD uses to develop the uniform formulary was established by the National Defense Authorization Act for Fiscal Year 2000.

⁴DOD contracts with Express Scripts, Inc., a private pharmacy benefits management company, to operate its retail network pharmacy program. The network consists of more than 59,000 retail pharmacies where DOD beneficiaries can pick up prescriptions.

⁵A therapeutic class is a group of drugs that are similar in chemical structure, pharmacological effect, or clinical use.

federal pricing arrangements⁶ for drugs dispensed at MTFs and the TMOP, and voluntary rebates for drugs dispensed at retail network pharmacies.

The John Warner National Defense Authorization Act for Fiscal Year 2007 required that we examine DOD's pharmacy benefits program.⁷ In September 2007, we briefed your staff on the status of our work. This report responds to your request for information specifically on DOD's estimate of reduced pharmacy costs (1) resulting from drug costs avoided through its uniform formulary, and (2) from manufacturer rebates for drugs dispensed at retail network pharmacies. We plan to report more fully on DOD's pharmacy benefits program in a subsequent report.

To obtain this information, we reviewed summary information provided by DOD officials on costs avoided for fiscal years 2006 and 2007. We also obtained data on the amount in rebates DOD collected in fiscal year 2007 and the amount in rebates it expects to collect in fiscal year 2008. Cost avoidance refers to DOD's reduced pharmacy costs at MTFs, the TMOP, and retail network pharmacies resulting from the decision on whether to include a drug on the uniform formulary. Manufacturer rebates that DOD receives for drugs dispensed through retail network pharmacies are in addition to costs avoided. We also interviewed officials from DOD's Pharmacoeconomic Center regarding the methodology used to develop the cost avoidance and rebate estimates and its limitations. Through these interviews we determined that the summary cost avoidance and rebate data provided by DOD were sufficiently reliable for our purposes, but we did not independently verify DOD's data. We conducted our work from April 2007 through October 2007 in accordance with generally accepted government auditing standards.

DOD summary data show that through its uniform formulary DOD avoided about \$447 million in drug costs in fiscal year 2006 and estimated that it would avoid about \$900 million in drug costs in fiscal year 2007. MTFs account for most of DOD's cost avoidance because they are generally required to dispense formulary drugs, which are typically lower cost.⁸ To calculate cost avoidance, DOD determines the costs it incurred at MTFs, the TMOP, and retail network pharmacies for each drug reviewed for the uniform formulary and designated as either formulary or nonformulary. DOD subtracts these incurred costs from the estimated costs it would have incurred at MTFs, the TMOP, and retail network pharmacies if those drugs had not been designated as formulary or nonformulary.

In addition, DOD officials told us that as of fiscal year 2007 DOD has collected about \$28 million in voluntary manufacturer rebates for drugs dispensed at retail pharmacies since the program began in 2006. DOD expects to collect at least \$120 million in fiscal year 2008

⁶Federal pricing arrangements refer to the lower of the Federal Supply Schedule price available generally to federal purchasers or a price available to four large agencies, including DOD. Federal pricing arrangements are not applied to drugs dispensed at retail network pharmacies.

⁷See Pub. L. No. 109-364, § 718, 120 Stat. 2083, 2292-93 (2006).

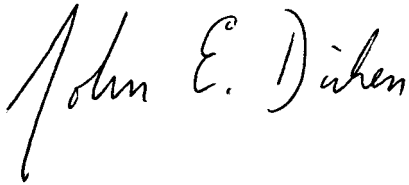
⁸MTFs can dispense nonformulary drugs if medically necessary.

through voluntary rebates.⁹ Because federal pricing arrangements are not applied to drugs dispensed through retail pharmacies, DOD developed the Voluntary Agreements for TRICARE Retail Network Rebates (VARR) in August 2006 to allow manufacturers to offer rebates for these drugs. All of DOD's reduced costs achieved through voluntary rebates as of October 1, 2007, were through VARRs related to the uniform formulary. The uniform formulary VARR is an agreement between DOD and a manufacturer for its drugs selected for the uniform formulary.¹⁰ DOD expects the amount it collects through Uniform Formulary VARRs to increase over time as manufacturers continue to enter into these agreements with DOD for drugs that are selected for the uniform formulary.

We provided a draft of this report to DOD for comment. The department reviewed the draft and determined that comments were not necessary.

We are sending copies of this report to the Secretary of Defense and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff members have any questions, please contact me at (202) 512-7114 or dickenj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report were Bonnie Anderson, Assistant Director; Keyla Lee; Lesia Mandzia; and Tim Walker.



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⁹DOD's estimate of the amount of voluntary rebates for fiscal year 2008 is based on rebates that it collected in fiscal year 2007. It does not account for new rebate agreements that will be implemented for drugs that will be reviewed in fiscal year 2008. DOD officials noted that these rebate projections are contingent on assumptions, for example, about changing market conditions, and the potential for rebate agreements to be terminated.

¹⁰Another type of VARR is the Utilization VARR, which is an agreement between DOD and manufacturers for drugs that have not yet been reviewed for the uniform formulary and for those drugs that have been reviewed and designated nonformulary. As of October 2007, no manufacturers had provided DOD with a Utilization VARR.

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