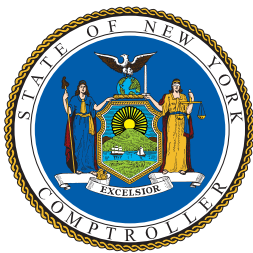


EXHIBIT 7



New York State Office of the State Comptroller
Thomas P. DiNapoli

Division of State Government Accountability

Financial Condition and Outlook

State University of New York Downstate Medical Center University Hospital of Brooklyn



Report 2012-S-72

January 2013

Executive Summary

Purpose

To determine the financial condition of the State University Hospital of Brooklyn (Hospital).

Background

The State University of New York Health Science Center at Brooklyn (also known as SUNY Downstate Medical Center [or Downstate]) includes the College of Medicine, College of Health Related Professions, College of Nursing, School of Graduate Studies, School of Public Health, and the University Hospital of Brooklyn (Hospital). Downstate employs about 8,000 faculty and staff and is the fourth largest employer in Brooklyn. It reported expenses for the year ended June 30, 2012 totaling \$853.2 million.

The University Hospital is a key component of New York City's health care delivery system, providing services to communities with largely uninsured or underinsured minority populations. The Hospital provides services at the following three facilities: University Hospital of Brooklyn located in East Flatbush, Brooklyn; University Hospital at Long Island College Hospital (LICH) located in Cobble Hill, Brooklyn; and SUNY Downstate at Bay Ridge (Bay Ridge), formerly known as Victory Memorial Hospital, located in Bay Ridge, Brooklyn.

Key Findings

- The Hospital is facing potential insolvency within a matter of months. Absent other actions or plans to increase revenue or limit expenses, the Hospital will not have sufficient cash to meet its liabilities, possibly as early as May 2013, and it will be forced to make choices about which financial obligations it will honor.
- The Hospital has experienced cash shortfalls averaging nearly \$3 million each week. Its operating loss for the six months ended June 30, 2012 was \$113.5 million, and its losses for 2012 could exceed \$200 million. The Hospital's aggregate operating and non-operating loss for 2011 was \$275.8 million.
- Present actions and plans to deal with the Hospital's looming insolvency are insufficient to restore financial stability. While the Hospital has hired a consultant to help identify solutions, a full complement of recommendations has not been formulated.
- Primary reasons for the Hospital's financial stress include: the costs associated with the acquisition and operation of the LICH and Bay Ridge facilities amidst an already deteriorating fiscal environment; the failure to take timely actions to address emergency health care issues impacting the Brooklyn community; and weak governance and ineffective financial management.

Key Recommendations

- Work with SUNY System Administration, state policymakers, union officials and the Brooklyn community to identify and implement solutions that balance the Hospital's fiscal stability with health care and economic needs of the community and the strategic goals of Downstate Medical Center.
- Ensure that any decisions to acquire or expand hospital locations are thoroughly supported with documented financial analysis demonstrating the financial viability of such decisions.

- Establish a Finance Committee of senior Downstate officials to periodically to review the financial status of the Hospital and recommend needed steps to improve fiscal stability.
- Continue to monitor overtime and to identify measures to minimize costs.
- Reassess the need to retain the current complement of administrators and reevaluate their salaries.
- Work with the consultant (Pitts Management Associates) to ensure that the patient billing system is working as intended and maximizes revenue.
- Establish a financial plan that charts the time frames and steps for restoring Hospital financial stability. Concurrent with the financial plan, establish ongoing monitoring that tracks the status and impacts of Action Plan steps and affords management the ability to determine the success of those steps and identify whether further steps are necessary.
- Update existing cost analysis to include the costs of employee severance and contracted consulting.

Other Related Audits/Reports of Interest

[SUNY Downstate Medical Center: Allegations of Procurement Fraud, Waste and Abuse \(2010-S-45\)](#)

**State of New York
Office of the State Comptroller**

Division of State Government Accountability

January 17, 2013

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State University of New York
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Albany, NY 12246

John F. Williams, MD, Ph.D.
President
Downstate Medical Center
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Dear Dr. Zimpher and Dr. Williams:

The Office of the State Comptroller is committed to helping State agencies, public authorities, and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities, and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the State University of New York's Downstate Medical Center - University Hospital of Brooklyn entitled *Financial Condition and Outlook*. This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

This audit's results and recommendations are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this draft report, please feel free to contact us.

Respectfully submitted,

*Office of the State Comptroller
Division of State Government Accountability*

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This report is also available on our website at: www.osc.state.ny.us

Background

The State University of New York Health Science Center at Brooklyn (also known as SUNY Downstate Medical Center [or Downstate]) is comprised of the College of Medicine, College of Health Related Professions, College of Nursing, School of Graduate Studies, School of Public Health, and the University Hospital of Brooklyn (Hospital). Downstate employs about 8,000 faculty and staff and is the fourth largest employer in Brooklyn.

Downstate is a key component of New York City's health care delivery system, providing services to communities with largely uninsured or underinsured minority populations. The University Hospital provides services at the following three facilities: University Hospital of Brooklyn located in East Flatbush, Brooklyn; University Hospital at Long Island College Hospital (LICH) located in Cobble Hill, Brooklyn; and SUNY Downstate at Bay Ridge (Bay Ridge), formerly known as Victory Memorial Hospital, located in Bay Ridge, Brooklyn. For the year ended June 30, 2012, the Hospital (including its three component facilities) reported expenses totaling \$853.2 million. The Hospital's financial statements showed a loss totaling \$275.8 million for the year ended December 31, 2011. In fact, the financial condition of the Hospital has been deteriorating appreciably in recent years, resulting in a net accumulated deficit of \$165.6 million as of December 31, 2011.

In June 2011, the State Commissioner of Health appointed the Brooklyn Health System Redesign Work Group (Work Group) to assess the strengths and weaknesses of Brooklyn's hospitals and healthcare system. The Commissioner also directed the Work Group to evaluate the long-term viability of the hospitals as providers of care to Brooklyn residents. The Work Group's report detailed a number of factors, including competition for patients, which contributed to the financial decline of Brooklyn's most troubled hospitals. The report also noted that health care administrators did not effectively respond to the emerging financial challenges they faced.

Although the Hospital has its own management team, Downstate also has senior managers who collectively oversee overall institutional operations. In 2012, a new leadership team was put in place at Downstate to address the institution's broad financial problems. In addition, officials from SUNY System Administration have been monitoring affairs at Downstate and working with Downstate's leadership to address its financial and operational problems. To overcome its deteriorating financial condition, the Hospital has planned and implemented significant layoffs and service cuts. Also, the Hospital has contracted with Pitts Management Associates (Pitts) to provide operational and financial reorganization and restructuring consulting services. Among the services to be provided by Pitts are the following:

- Review and analyze Downstate's Management Action Plan to achieve costs savings, revenue enhancements and operational efficiencies totaling \$200 million over two years;
- Review and improve the monitoring and reporting of financial and operating metrics;
- Analyze supply chain management and make recommendations to increase efficiency;
- Review and improve service charging and billing processes and reconciliations; and
- Analyze professional staffing, productivity, and compensation.

In June 2012, SUNY's Board of Trustees approved a \$75 million line of credit to the Hospital to help ensure it meets its obligations and to support its restructuring efforts. On September 19, 2012, the Hospital accessed the entire \$75 million line of credit. According to the terms of the loan, the Hospital must begin repaying this obligation in October 2015.

On April 9, 2012, our office issued audit report 2010-S-45 entitled State University of New York: Downstate Medical Center - Allegations of Procurement Fraud, Waste and Abuse. The report concluded that Downstate had poor procurement practices that led to fraudulent and uneconomical vendor selection, inefficient implementation of a multimillion dollar software system, and conflicts of interests between an employee and a vendor. These deficiencies likely contributed to the financial distress at the Hospital.

Audit Findings and Recommendations

There is considerable risk that the Hospital will not have sufficient cash to meet its financial obligations and will face insolvency in 2013. This risk arises from a lack of effective governance and financial management, the cost of hospital acquisitions and inadequate planning for external issues impacting health care delivery in the community. In addition, the Hospital's response to its deteriorating financial condition has not been sufficient to put the Hospital on track for long term financial stability. While a consultant has been contracted to help identify ways to better manage Hospital finances and operations, necessary solutions have yet to be formulated. In addition, Downstate did not have a financial plan that clearly demonstrated a time line and all necessary steps for making the Hospital a viable going concern from a financial perspective. We recommend that Downstate work with its consultant, SUNY System Administration, state policymakers, union officials and the Brooklyn Community to identify solutions that balance the Hospital's need for fiscal stability with the strategic goals of Downstate as well as the health care and economic needs of the community.

Possible Insolvency

The Hospital remained solvent in 2012 by drawing upon funds from an account that SUNY established for the maintenance of revenues from SUNY hospitals. This drawdown was discontinued and was replaced by a line of credit loan provided by SUNY. In addition, the Hospital relied on New York State Department of Health special payments that support facilities with large numbers of low income, uninsured patients (referred to as Disproportionate Share Hospital payments or DSH). Despite these resources, we conclude the Hospital will not likely have sufficient cash to cover all expenses beyond July 2013 at the latest. Also, the Hospital has been incurring, and continues to incur, substantial operating and non-operating losses which totaled over \$300 million for the five years ended December 31, 2011. In addition, as of June 30, 2012, the Hospital's current liabilities (obligations due within one year) exceed its current assets (cash and other items that can be freed up within one year) by \$69.5 million. These matters are discussed in detail in the following paragraphs and present a bleak and deteriorating Hospital financial picture with insolvency looming in 2013.

Current Financial Condition

Between May 2012 and September 2012, the Hospital relied on \$65 million that it drew down from the SUNY Hospital Operations Fund (account #34522). In June 2012, the SUNY Board of Trustees authorized a \$75 million line of credit loan to Downstate to replace and repay the draw down from the SUNY account. With the line of credit in place, the Hospital's cash balance on September 20, 2012 was \$27.8 million. Subsequently, during the week of October 12, 2012, the Hospital received a \$64.8 million DSH payment from the New York State Department of Health. As a result of the DSH payment, the Hospital's cash balance was \$73.1 million on November 18, 2012.

While the Hospital has secured a line of credit loan as well as DSH payments to bolster its cash

position, we noted that throughout the period May 2012 through September 2012, weekly expenses on average exceeded operating revenues by nearly \$3 million. Given this trend, the Hospital would likely be insolvent today were it not for outside support from the SUNY loan and the DSH payments. Also, as of September 19, 2012, the Hospital had fully drawn down the \$75 million line of credit. Absent any other actions or plans to increase revenue or limit expenses, by May 2013 the Hospital will no longer have sufficient cash to cover all expenses and will have to begin making decisions about which financial obligations it will pay and which ones it will not pay. If the Hospital receives an anticipated new DSH payment of \$25 to \$30 million by May 2013, the Hospital could have enough cash to meet expenses until July 2013.

To further understand the ability of the Hospital to remain a going concern in 2013, we contacted the Hospital's independent CPA firm to ascertain the firm's view of the Hospital's finances. The CPA firm advised us that it had not reached any conclusions and is seeking a financial plan from the Hospital so that it can assess whether the Hospital will remain a going concern in 2013. In addition, the CPA firm reported that it met with SUNY and Hospital officials in October 2012 to discuss, among other things, the Hospital's financial viability. On November 15, 2012, we asked Hospital officials for minutes and/or supporting documentation regarding the meeting with the CPA firm, but were told that these items were not yet available. We share the CPA's position that a financial plan, demonstrating how the Hospital will remain a going concern in 2013, is essential. As discussed in more detail later in this report, the Hospital has been unable to provide us with documentation that clearly details the time frames and necessary steps to achieve financial stability.

Recent Fiscal Trends

As shown in the table that follows, the Hospital consistently lost money from calendar year 2007 through calendar year 2011. As a result, during the period, the Hospital went from a cumulative surplus (positive net assets) of \$116.2 million to a net deficit of \$165.6 million.

Summary of Financial Results Calendar Years 2007 through 2011 (in Millions)			
Year	Operating Surplus (Loss)	Non-Operating Surplus (Loss)	Aggregate Surplus (Loss)
2007	(\$70.5)	\$68.7	(\$1.8)
2008	(\$75.6)	\$74.3	(\$1.3)
2009	(\$78.8)	\$68.7	(\$10.1)
2010	(\$49.3)	\$34.3	(\$15.0)
2011	(\$117.3)	(\$158.5)	(\$275.8)
Totals	(\$391.5)	\$87.5	(\$304)

As the table shows, over the five calendar years ending in 2011, the hospital incurred aggregate operating and non operating losses totaling \$304 million with \$275.8 million (about 91 percent) of the losses taking place in 2011. The 2011 non-operating loss of \$158.5 million includes a \$140 million liability related to LICH endowment funds that were used to pay professional liability claims. It should also be noted that there is no repayment schedule in place to reimburse the endowment fund and, therefore, the exact timing of the fiscal impact of this liability is not clear. Nevertheless this liability must be recorded for accounting purposes. In addition, of the \$117.3 million operating loss incurred in 2011, \$44 million was attributable to the acquisition of LICH in May 2011, and the remainder was attributable to Hospital operations. Furthermore, operating losses continued to mount in 2012. According to the Hospital's interim (unaudited) financial statements, the operating loss during the six months ended June 30, 2012 was \$113.5 million. If this trend continues, the operating losses for 2012 alone could exceed \$200 million.

Current Liquidity

A key indicator of an entity's ability to pay its bills and remain solvent is referred to as "current ratio." Current ratio is determined by dividing current assets (cash, accounts receivable and other assets that can be turned into cash within one year) by current liabilities (accounts payable, notes payable and other debt that must be paid within one year). The higher the current ratio, the more able an entity is to meet its financial obligations and remain solvent. A current ratio of 1 is generally regarded as indicating an entity is minimally able to meet its obligations. A current ratio of less than 1 indicates an inability to meet current liabilities (those that are due within one year).

The Hospital's current ratio has declined significantly in recent years. In fact, the Hospital's current ratio was .73 as June 30, 2012 (current liabilities were \$256.4 million and its current assets were \$186.9 million). The largest decrease in Hospital current ratio took place during 2011 when the current ratio fell from 1.50 to 1. The following table shows the decline in the Hospital's current ratio from calendar year end 2007 through calendar year end 2012.

Year (See Note)	2007	2008	2009	2010	2011	2012
Current Ratio	1.95	1.94	1.82	1.50	1.00	.73

(Note: With the exception of 2012, the current ratios are as of December 31 of the year referenced. In 2012, the current ratio was as of June 30.)

As of June 30, 2012, the Hospital's current liabilities (\$256.4 million) exceeded current assets (\$186.9 million) by \$69.5 million. Further, the decline in the current ratio also raises considerable doubt the Hospital will remain a going concern.

Factors Contributing to Financial Distress

Competition for patients, reliance on Medicare and Medicaid for revenue, acquisition of fiscally distressed hospitals, and inadequate cost controls coupled with weaknesses in governance and

fiscal management are the primary drivers of the Hospital's current precarious financial condition.

External Forces

The following external forces have adversely impacted the Hospital's finances:

- State mandated personal service costs increased by \$92.2 million (or about \$23 million per year) between fiscal years 2007-08 and 2011-12. This included increases in collectively bargained salaries (\$63.8 million) and fringe benefits (\$28.4 million, which includes Employee Retirement System contributions of \$9.8 million).
- According to the Work Group, about 25 percent of Hospital inpatient beds (excluding LICH and beds available for newborns) were unoccupied during 2010. On average, about 100 beds were unused each day. The Hospital has been absorbing, and continues to absorb, the cost associated with this excess capacity.
- Medicare and Medicaid accounted for 26 percent and 19 percent, respectively of Hospital revenues in 2011. According to Hospital officials, when the State Medicaid program cut reimbursement for psychiatric, acute care and rehabilitation services in 2011, the Hospital had to absorb a \$20 million loss.
- The Hospital had to absorb charity care costs, based on the ratio of Hospital costs to gross charges, of approximately \$2,675,000 and \$1,346,000 for 2011 and 2010, respectively.
- Between 2010 and 2011, direct State tax support from SUNY to the Hospital went from \$36 million to \$27 million; a decline of \$9 million. Moreover, between fiscal years 2007-08 and 2011-12, annual State support decreased by \$23.5 million. (SUNY System Administration helps to make decisions that determine how State support is allocated statewide throughout the SUNY campus system.)
- SUNY support for indirect costs and debt service fell from \$7.7 million in 2010 to about \$1.8 million in 2011; a decline of \$5.9 million.

Acquisition of Other Health Care Facilities

A major cause of the Hospital's fiscal stress is the acquisition of LICH on May 29, 2011. Under the terms of the purchase agreement, the Hospital acquired about \$143 million of assets and nearly \$170 million of liabilities. This resulted in a decline in net assets of about \$27 million for 2011. Also, upon acquisition of the LICH, the Hospital assumed a \$140 million liability related to LICH endowment funds that were used to pay professional liability claims. This liability has no fixed repayment schedule, and no interest will accrue on its unpaid balance, which would be payable to the Health Science Center at Brooklyn Foundation. Nevertheless, in accordance with generally accepted accounting principles, this liability is included on the Hospital's financial statements.

Not only was the cost for LICH a significant drain on Hospital finances, but the acquisition presented the Hospital with the challenge of supporting a facility with a long trend of operating losses. For example, Hospital officials report that LICH generated annual operating losses for seventeen consecutive years dating back to 1994. In fact, for 2009 and 2010, LICH had operating losses of \$39.1 million and \$4.7 million, respectively. Also, according to the Work Group, 55 percent of LICH inpatient beds (excluding beds available for newborns) were unoccupied during 2010 with

an average of 284 beds unused each day. Moreover, LICH's independent auditors reported that LICH's recurring operating losses and working capital deficiencies raised substantial doubts about the ability of LICH to remain a going concern. In short, the Hospital acquired a facility that was in deteriorating fiscal health at the same time that Hospital finances were in decline.

Adding to the dilemma presented by the acquisition of LICH, the Hospital on July 7, 2008 had already acquired lease space at the Victory Memorial Hospital in Bay Ridge, Brooklyn. The Hospital's plans for Victory Memorial included the addition of 100 inpatient beds. However, the Work Group's business plans for Victory Memorial advised that the Hospital should reconsider any planned expansion of beds at this facility to help consolidate services in the Brooklyn community. Nevertheless, the Hospital incurred about \$6 million in leased costs to prepare the Bay Ridge facility for inpatient beds. To date there has been no substantial return on investment in this facility and the Hospital cancelled its plans for the 100 beds.

The acquisitions of LICH and Victory Memorial in the midst of known underutilization and recurring operating losses suggests an overall lack of leadership and governance in planning the future of Downstate. Specifically, Downstate had not prepared comprehensive financial analyses supporting these acquisitions. Instead, current Hospital officials provided consultant studies prepared for and accepted by former Downstate management, indicating that LICH could become financially viable in the future. These studies were flawed, as they were based on business assumptions that were inconsistent with the realities faced by the Hospital and the broader Brooklyn health care community. There were no formal consultant studies pertaining to Victory Memorial. Moreover, it appears that former Downstate management failed to adequately consider pertinent information regarding the financial problems confronting the Brooklyn health care community in general and the particular problems confronting the LICH, Victory Memorial and the Hospital itself.

Weaknesses in Budgetary Oversight and Financial Management

The Work Group concluded that the poor financial condition at the most troubled Brooklyn hospitals resulted from a long history of weak governance and mismanagement. Specifically, the Work Group noted that troubled Brooklyn hospitals failed to effectively respond to economic issues such as declines in discharges and reductions in Medicare and Medicaid and other public funding. These general conclusions apply to the past management of Downstate and the Hospital as well.

For example, large business organizations, such as the Hospital, ought to have an active and effective Finance Committee to help ensure adequate fiscal oversight, particularly in times of financial stress. This committee should be comprised of senior officials and should meet periodically to review the financial status of the institution and to recommend needed actions to sustain and improve fiscal stability. However, the Hospital did not have a Finance Committee.

According to Hospital officials, the former executive leadership team met primarily to discuss patient related issues and did not substantially discuss financial matters. In fact, according to Hospital officials, no financial analysis reports or future financial projections were circulated prior

to the new executive leadership team which was put in place in 2012. Given the lack of an active Finance Committee and absence of detailed fiscal analysis regarding major facility acquisitions, the Hospital's current crisis is troubling yet not surprising.

There were other voids in effective financial management, as follows:

As inpatient utilization was declining from fiscal year 2006-07 through fiscal year 2011-12, Hospital overtime increased nearly \$2.8 million, or more than 50 percent - rising from \$4.6 million to \$7.4 million. Hospital officials explained that requirements for nurse staffing forced use of overtime, particularly when nurses called in for sickness or other absences. It is unclear, however why part-time employees were not used as an alternative to costly overtime in this circumstance. (Hospital officials reported that they are now using pools of per diem nurses to meet staffing requirements.)

- The Hospital has or shares 15 senior administrators who each had annual salaries in excess of \$200,000 for 2011. For 2011, the total annual salary for these administrators was \$4,370,042 or \$291,336 per employee, excluding benefits. The salaries of these employees have remained constant even as the Hospital has sent layoff notices to 469 employees whose average salary is about \$63,000 for the Hospital and \$41,500 for LICH. As a matter of fairness and fiscal responsibility, it would also be appropriate not only to evaluate the salaries paid to administrators, but to also determine if would be feasible to reduce the number of administrative staff.
- The Hospital patient billing system is not as effective as it ought to be. As a result, revenues are not being maximized. According to Hospital officials, the charge master system, which identifies billable services and the related fees, has not been properly maintained with new and revised information. As a result, third party payers such as Medicare, Medicaid and insurance companies have not approved certain Hospital claims for reimbursement. In addition, Hospital officials stated that staff had not properly documented the drugs and supplies ordered for patients. Consequently, the Hospital lost opportunities for reimbursement for these items. Officials added that they expect the recently hired consultant to help them determine necessary steps to address these matters.

Projected Financial Position

In March 2012, the SUNY Chancellor directed SUNY System Administration to analyze and cooperatively manage financial and operational issues confronting the Hospital and to begin to develop an Action Plan to re-establish Hospital financial stability. The Action Plan was developed and identified significant cost reductions and revenue enhancement measures such as staff reductions, service realignment, and improvements in capturing charges for services. In this regard, the Hospital consultant is to develop internal controls, procedures and processes, data sources and the infrastructure necessary to implement the Action Plan components. Hospital officials stated that the Action Plan will drive operational restructuring and work force reductions steps that are necessary for the Hospital's long term viability.

However, there was no concurrent financial analysis that would indicate the time frames for when these steps would restore financial stability for the Hospital or when continued operating losses

would end. Hence, it is important for the Hospital to develop such analysis in order to demonstrate fiscal oversight and the adequacy of the Action Plan. Moreover, the Hospital lacked documentation to demonstrate that it was tracking fiscal outcomes resulting from the Action Plan on an ongoing basis.

Fiscal Improvement Plans and Actions

In 2011, at a cost of \$3.1 million, Downstate engaged a consultant (Pitts) to analyze the Hospital's revenue cycle, physician management, patient billing, clinical programs and alignment of services. In November 2011, Pitts identified several measures that would enhance revenues and save money. According to Pitts, these actions could be undertaken immediately and would result in \$70 million of savings as summarized in the table which follows.

Potential Financial Opportunities	Projected Revenue Enhancements or Cost Savings (in millions of \$)
Reduction in Unbilled Accounts	\$26.2
Reduction in 175 Staff FTE	\$17.15
Cash Collection Enhancements	\$16.1
Charge Description Billing Improvements	\$5 to \$10
Comprehensive Psychiatric Emergency Program Designation at LICH	\$0.77
Pharmacy Clinic Charge Improvements	\$0.48
Total	\$65.7 to \$70.7

At the time of the audit, Hospital officials stated they were in the process of implementing the steps identified by Pitts and that it could take up to another year to fully implement them. Consequently, officials said that, in the short term, the actions taken may not produce the savings identified by Pitts. Although nearly a one year had passed since the action steps were identified, as of October 2012, Hospital officials were unable to provide any documentation and analysis to track the savings achieved on an ongoing basis by implementing the steps identified by Pitts. We believe that it is essential that Hospital management be able to demonstrate the status of all steps recommended by the consultant and the actual and projected short term and long term fiscal impacts accruing from them. In this manner, the Hospital can be best prepared to determine whether the steps are successful, and timely enough to ensure long term financial stability and/or whether additional steps are needed.

Hospital officials advised us that they do have monitoring tools including cash balance reports and a "dashboard report" that shows the status of admissions, census days, discharges and observations for the Hospital. They explained that through these tools, they can assess the financial standing of the Hospital, and determine whether additional corrective actions are necessary. We acknowledge the usefulness of and need for these tools. However, the dashboard report does not include financial analysis and projections based on the actions underway at the Hospital.

The cash balance report is also not a forecasting tool to establish whether cash on hand will be sufficient on a weekly, monthly or annual basis. As the next section of this report indicates, the financial outlook for the Hospital over the next two years appears bleak. Therefore, the ability to forecast the impacts of each action step as well as to show the overall financial status and trends of Hospital finances is critically important.

Financial Outlook

As previously discussed, the Hospital did not have analysis and documentation showing its projected path to solvency - either in terms of its cash position or the adequacy of various action steps underway and planned. The analysis that was provided showed a very bleak financial outlook continuing through fiscal year 2013-2014, the latest year for which projections were available at the time of our review. For example, Hospital reports show projected structural cash deficits totaling \$72.6 million, \$179 million and \$165 million for the 2011-12, 2012-13 and 2013-14 fiscal years, respectively. The Hospital anticipates that the structural cash deficit excluding LICH would increase from \$71.7 million for the 2011-12 fiscal year to \$92.5 million for the 2013-14 fiscal year. The structural cash deficit for LICH would increase from \$0.9 million for the 2011-12 fiscal year to \$72.5 million for the 2013-14 fiscal year. The table that follows shows deteriorating financial condition at Downstate.

Downstate Action Plan For Fiscal Years 2011-12 through 2013-14 (In Millions)									
Category	Hospital 2011-12	LICH 2011-12	Total 2011-12	Hospital 2012-13	LICH 2012-13	Total 2012-13	Hospital 2013-14	LICH 2013-14	Total 2013-14
Structural Deficit/Surplus	<u>(\$71.70)</u>	<u>(\$0.90)</u>	<u>(\$72.60)</u>	<u>(\$111.50)</u>	<u>(\$67.50)</u>	<u>(\$179.00)</u>	<u>(\$92.50)</u>	<u>(\$72.50)</u>	<u>(\$165.00)</u>
Opening Cash	\$37.40	<u>(\$22.70)</u>	\$14.70	<u>(\$34.30)</u>	<u>(\$8.10)</u>	<u>(\$42.40)</u>	<u>(\$42.50)</u>	<u>(\$8.50)</u>	<u>(\$51.00)</u>
Loan Drawdown	-	-	-	\$34.30	\$8.10	\$42.40	\$27.20	\$5.40	\$32.60
Balance After Drawdown	<u>(\$34.30)</u>	<u>(\$23.60)</u>	<u>(\$57.90)</u>	<u>(\$111.50)</u>	<u>(\$67.50)</u>	<u>(\$179.00)</u>	<u>(\$107.80)</u>	<u>(\$75.60)</u>	<u>(\$183.40)</u>
Management Actions	-	-	-	\$36.40	\$42.50	\$78.90	\$62.00	\$58.60	\$120.60
Service Realignment	-	-	-	-	-	-	\$4.00	\$5.20	\$9.20
Other *	-	\$15.50	\$15.50	\$6.00	\$16.50	\$22.50	-	\$8.60	\$8.60
State Support Request	-	-	-	\$26.60	-	\$26.60	\$26.60	-	\$26.60
Sub-Total	-	<u>\$15.50</u>	<u>\$15.50</u>	<u>\$69.00</u>	<u>\$59.00</u>	<u>\$128.00</u>	<u>\$92.60</u>	<u>\$72.40</u>	<u>\$165.00</u>
Ending Cash Balance	<u>(\$34.30)</u>	<u>(\$8.10)</u>	<u>(\$42.40)</u>	<u>(\$42.50)</u>	<u>(\$8.50)</u>	<u>(\$51.00)</u>	<u>(\$15.20)</u>	<u>(\$3.20)</u>	<u>(\$18.40)</u>

* Note: Other includes expected returns from LICH liability fund, estimated IRS refunds of FICA overpayments, and anticipated savings from debt refinancing.

It should also be noted that the table does not reflect necessary severance payments for laid off workers, which will likely increase the projected cash shortfall of \$18.4 million. In addition, Hospital officials anticipate that as much as \$20 million in additional contract payments to Pitts will also increase the structural cash shortfall. In December 2012, the State approved a 9-month contract worth \$5.6 million with Pitts.

Recommendations

1. Work with the consultant, SUNY System Administration, state policymakers, union officials and the Brooklyn community to identify solutions that balance the Hospital's need for fiscal stability with the strategic goals of Downstate as well as the health care and economic needs of the community.
2. Ensure that any decisions to acquire or expand hospital locations are thoroughly supported with documented financial analysis demonstrating the financial viability of such decisions.
3. Establish a Finance Committee of senior Downstate officials to periodically review the financial status of the Hospital and recommend needed steps to improve fiscal stability.
4. Continue to monitor overtime and to identify measures to minimize costs.
5. Reassess the need to retain the current complement of senior administrators and reevaluate their salaries.
6. Work with the consultant to ensure that the patient billing system is working as intended and maximizes revenue.
7. Establish a financial plan that charts the time frames and steps for restoring Hospital financial stability. Concurrent with the financial plan, establish ongoing monitoring that tracks the status and impacts of Action Plan steps and affords management the ability to determine the success of those steps and identify whether further steps are necessary.
8. Update existing cost analysis to include the costs of employee severance and contracted consulting.

Audit Scope and Methodology

We assessed the Hospital's financial condition for the period January 1, 2007 through November 18, 2012. To accomplish our objectives, we reviewed the Hospital's financial records, status and remedial actions planned to improve financial condition, including audit documentation maintained by the Hospital's independent certified public accountants. We also interviewed officials and staff of SUNY, Downstate, and the Hospital to obtain an understanding of their financial and business practices. We also interviewed the Hospital's external independent certified public accountants.

We conducted our compliance audit in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members (some of whom have minority voting right) to certain boards, commissions, and public authorities. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law.

Reporting Requirements

We provided draft copies of this report to Downstate officials for their review and formal comment. We considered Downstate's comments in preparing this report and have included them in their entirety at the end of it. Downstate officials agreed or partially agreed with our report's eight recommendations and indicated that certain actions have been or will be taken to implement them. Our rejoinders to certain Downstate comments are included in the report's State Comptroller's Comments.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chancellor of the State University of New York shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and if the recommendations were not implemented, the reasons why. We also request these officials advise the State Comptroller of actions taken to implement the recommendation addressed to them, and where such recommendation was not implemented the reasons why.

Contributors to This Report

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Vision

A team of accountability experts respected for providing information that decision makers value.

Mission

To improve government operations by conducting independent audits, reviews and evaluations of New York State and New York City taxpayer financed programs.

Agency Comments



SUNY
DOWNSTATE
Medical Center

John F. Williams, Jr., MD, EdD, MPH, FCCM
President

January 14, 2013

Mr. Brian Mason
Audit Director
Division of State Government Accountability
Office of the State Comptroller
110 State Street, 11th Floor
Albany, New York 12236

Dear Mr. Mason:

In accordance with Section 170 of Executive Law, we are providing our comments on the draft report "State University of New York (SUNY) Downstate Medical Center (DMC) University Hospital of Brooklyn (Hospital)" Report 2012-S-72, hereafter the (Draft Report). The University generally agrees with the findings and recommendations in the Draft Report, all of which have already been implemented as part of the University's effort to stabilize the Hospital and the academic programs that it helps to support.

SUNY has since taken substantive key actions, including hiring a new strong and focused senior leadership team who is committed to addressing both the immediate and longer term issues that confront the campus. An Action Plan was initiated in the spring of 2012 that includes, but is not limited to, operational restructuring, work force reductions, cost reductions, debt restructuring and revenue enhancements. University and the new Campus leadership are currently determining what additional steps will be required. Moreover, DMC is working with SUNY System Administration, Department of Health, Division of Budget, the Brooklyn legislators and community, and others in an effort to ascertain a viable solution that will meet the health care and economic needs of the community.

As stated above, SUNY acknowledges and has addressed most of the findings in the OSC's Draft Report. However, we are concerned that the report may not provide certain important details and context for some of the findings. Therefore, the following response will address such concerns.

- A. The first bullet under Key Findings is misleading in its estimate that by July 2013 and as early as May 2013, the Hospital will not have sufficient cash to meet its liabilities. The estimates do not take into account any actions taken or planned by the Hospital to reduce costs and increase revenue. DMC and SUNY anticipate obtaining sufficient funds to meet all necessary expenses.

The Draft Report states that "primary reasons for the Hospital's financial stress include the costs associated with the acquisition and operation of the LICH and Bay Ridge facilities...failure to take timely actions to address emergency health care issues impacting the Brooklyn community, and weak governance and ineffective financial management." SUNY has acknowledged that the acquisitions of LICH and Bay Ridge and the very difficult environment that has emerged for all of Brooklyn's health care providers (graphically described in the Brooklyn MRT Report cited in the audit) have had an impact on the Hospital's financial condition.

SUNY has also attempted to describe, in the course of the audit, how circumstances that are directly and specifically tied to its status as a State entity complicated an already difficult

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Comment

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* See State Comptroller's Comments, Page 22.

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situation, and suggested that these specific circumstances need to be included in the report to understand the set of problems that SUNY and the new campus leadership has been asked to resolve. The Draft Report does touch on the financial stresses related to DMC's status as a State entity in two bullet points in the "External Forces" section in the Draft Report, but SUNY believes it is important to further explain these facts to fully appreciate the fiscal impact.

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In 2007-08, DMC's overall fringe benefit cost was approximately \$65.1M, which it had to pay fully, unlike other State agencies. In 2011-12, the overall fringe benefit cost was \$93.5M accounting for a 43.6 percent increase over the time period. The Employee Retirement System (ERS) contribution alone during this time increased by 100 percent; from \$9.8M in 2007-08 to \$19.6M in 2011-12. In addition, the mandated increases in salaries resulting from collective bargaining agreements signed in 2008 but not negotiated by the SUNY Hospitals, and holding the workforce constant, raised the salaries by approximately \$63.8M over the five years from 2007-08 to 2011-12, with a compounded annual growth rate of 5.4 percent. Together these State-mandated costs increased by \$92.2M over this four-year period.

The SUNY Hospitals receive some limited State support to cover the differential costs associated with their State-sponsored status. During the same time period when fringe benefit costs, especially ERS costs, skyrocketed, State support for DMC which is supposed to assist in covering these costs was decreased from \$41.1M in 2007-08 to \$17.6M in 2011-12 (a 57 percent decrease).

The precipitous decline in State support during the period of time when State-related costs, especially ERS which increased at a rate of 100 percent for the Hospital, was a key reason why DMC's financial decline was so rapid. Further, the job protection provisions in the State-negotiated collective bargaining agreements with the public unions severely restrict the normal set of tools available to a hospital to reduce payroll costs. Labor costs are 70 percent of DMC's cost base, and such provisions severely limit the ability to make necessary changes to that cost structure in a timely way.

Being a State agency, certain expenses are not under management's control and are not reimbursed by the State. In addition, health care providers in general are experiencing a number of fundamental changes including the Federal Accountable Care Act and the State's Medicaid Redesign process that require nimble and responsive decision making. Many private voluntary hospitals, particularly in Brooklyn, are being challenged by these factors and the added responsibilities of being a State facility without commensurate decision making or resource capacity severely limits creative problem solving for DMC.

- B. The Draft Report indicates that the Hospital acquired LICH with assets of about \$143 million and liabilities of nearly \$170 million. SUNY acknowledges that utilizing generally accepted accounting principles (GAAP) the liabilities are greater than the assets. However, as required by GAAP, the Property Plant and Equipment (PPE) are accounted for at book value, which is significantly below market value. DMC does have recent appraisals that show values of the PPE ranging from \$280-\$500 million, which results in assets exceeding liabilities.
- C. The Draft Report indicates that "upon the acquisition of LICH the Hospital incurred a \$140 million liability representing claims for coverage for professional liability. This is not accurate. SUNY did not assume any of LICH's malpractice liability at closing. Rather a Malpractice Trust

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* See State Comptroller's Comments, Page 22.

was established with pre-existing non-SUNY funds to handle those claims, and the Trust was sufficiently funded (according to the actuaries) to pay the outstanding claims.

SUNY did incur \$140M liability for amounts due to a Trust. While any amounts “due to” the Trust are supposed to be repaid if possible, the liability is atypical for the following reasons: (i) the Charities Bureau has agreed that these amounts do not need to be paid back on any particular time schedule and no interest will accrue (SUNY will replenish the Trust only when and if it is able to); and (ii) if and when SUNY does replenish the Trust, it essentially will be repaying the Trust that will be maintained by the SUNY Downstate Foundation and exist for the purpose of benefiting the LICH campus.

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- D. The Final Report should acknowledge that a new leadership team was put in place in 2012 to address the institution’s broad financial problems, and also note that SUNY Administration has, for many months now, been monitoring the situation at DMC very closely (regular, direct contact on a weekly basis) and has worked with the campus leadership to develop and implement an Action Plan to address its financial and operational issues.

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- E. The Draft Report statement that in 2011 the Hospital has 18 senior administrators that had annual salaries in excess of \$200,000 is inaccurate. Only 6 of the 18 administrators are Hospital administrators. Of the remaining 12 administrators, 3 are Deans in the various schools and 9 are administrators in shared service positions with responsibilities across all of the entities on campus including the College of Medicine, College of Health Related Professions, College of Nursing, School of Graduate Studies, School of Public Health, University Hospital at Brooklyn, the Clinical Practice Management Plan and the Research enterprise. Therefore, SUNY believes it is misleading to imply that there are an excessive number of senior administrators in the Hospital, and also asserts that the salaries are in line with the median salary level for like kind positions in the northeast region of the country and the New York Metropolitan area.

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F. Recommendations:

1. Work with the Consultant, SUNY System Administration, State policymakers and the Brooklyn community to identify solutions that balance the Hospital’s need for fiscal stability with the strategic goals of Downstate as well as the health care and economic needs of the community.

SUNY DMC Response: Agree. DMC has been and continues to work with SUNY System, the New York State Department of Health, Division of Budget, and the Brooklyn legislators and community in an effort to identify solutions.

2. Ensure that any decisions to acquire or expand hospital locations are thoroughly supported with documented financial analysis demonstrating the financial viability of such decisions.

SUNY DMC Response: Agree.

3. Establish a Finance Committee of senior Downstate officials which meets periodically to review the financial status of the Hospital and recommends needed steps to improve fiscal stability.

SUNY DMC Response: Agree. Senior DMC officials are meeting routinely and closely monitoring the financial status and determining the necessary steps to improve fiscal

stability. In addition, SUNY System Administration officials, the SUNY Finance and Administration Committee, and the Committee on Academic Medical Centers & Hospitals, have been actively involved in reviewing DMC finances for many months.

4. Continue to monitor overtime and to identify measures to minimize costs.

SUNY DMC Response: Agree. Overtime is being monitored and the costs continue to be reduced. For example, overtime costs for nursing for last month decreased by approximately 40 percent when compared to the same period in the prior year.

5. Reassess the need to retain 18 senior administrators and reevaluate the salaries that are paid to such employees.

SUNY DMC Response: Agree. DMC agrees that all the work force is subject to review and evaluation. However, the number of Hospital administrators cited should be clarified.

6. Work with the consultant to ensure that the patient billing system is working as intended and maximizes revenue.

SUNY DMC Response: Agree. DMC has been and continues to work with the consultant to ensure that the patient billing system is operating as intended and will work towards optimizing revenue.

7. Establish a financial plan that charts the timeframes and steps for restoring Hospital financial stability. Concurrent with the financial plan, establish ongoing monitoring that tracks the status and impacts of Action Plan steps and affords management the ability to determine the success of those steps and identify whether further steps are necessary.

SUNY DMC Response: Agree. DMC is updating its financial plan and will monitor its status. Senior DMC officials are working with SUNY System Administration and external consultants to restructure operations. This includes work force reductions, cost reductions, debt restructuring and revenue enhancements. Moreover, DMC is working with SUNY System Administration, Department of Health, Division of Budget, and the Brooklyn legislators and community in an effort to ascertain a viable solution that will meet the health care and economic needs of the community.

8. Update existing cost analysis to include the costs of employee severance and contracted consulting.

SUNY DMC Response: Partially agree. In the event that severance pay is agreed upon and approved by the appropriate authorities, DMC will update the cost analysis to include such costs.

Thank you for the opportunity to respond to the Draft Report.

Sincerely,



John F. Williams, MD, MPH, EdD, FCCM
President

Copy: Nancy L. Zimpher, Chancellor

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State Comptroller's Comments

1. We acknowledge that the Hospital has taken or plans to take actions to reduce costs or increase revenues. However, at the time of our audit, there was no financial analysis to show when those steps would bring expenses and revenues into balance. Consequently, we are exercising caution and stating a time frame for potential insolvency.
2. We amended our report to include additional details of the circumstances affecting Downstate's efforts to resolve the range of problems it faced.
3. We acknowledge that the market values of LICH's capital assets (property, plant, and equipment) exceed the book values of such assets under Generally Accepted Accounting Principles. However, the market values of LICH's capital assets had little impact on the Hospital's decision to acquire LICH. The Hospital acquired LICH primarily for programmatic (operational) purposes.
4. We amended the report to note that Downstate assumed a liability of \$140 million related to LICH endowment funds that were used to pay professional liability claims. Our report further notes that this liability has no fixed repayment schedule and no interest will accrue on the unpaid balance.
5. On page 5 of the report, we acknowledged that SUNY put a new leadership team in place at Downstate to address the institution's broad financial problems. We also amended the report to note that SUNY System administration has monitored affairs at Downstate and worked with campus officials to develop and implement plans to address financial and operational issues.
6. We amended the report to note that the Hospital had or shared 15 senior administrators with salaries in excess of \$200,000 in 2011. We do not disagree with Downstate officials' statement that all of the institution's workforce should be subject to review and evaluation.