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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

February 14, 2018

Kristina M. Johnson
Chancellor
The State University of New York
State University Plaza
353 Broadway
Albany, NY 12246

Re: Report 2017-BSE01-01

Dear Chancellor Johnson:

We examined[1] SUNY Downstate Medical Center (Downstate) contracts CM00939 and TQ00002 with Pitts Management Associates, Inc. (PMA). Under these contracts, Downstate paid PMA $34 million for consultant services to implement a Restructuring Action Plan (RAP) that would help Downstate achieve financial stability. In the contract, the RAP was projected to result in $134 million in savings and cash flow improvements (savings) for Downstate by the end of November 2014.

This is the second report related to these contracts. The first report (PMA Travel Expenses – Final Report, issued August 8, 2016) detailed the results of our examination of PMA consultants' travel-related expenses for the period March through August, 2014. At this time, we are reporting the results of our examination of PMA's final claim that the RAP saved Downstate $138 million for the period December 1, 2012 through November 30, 2014. At the end of the contract period, Downstate officials certified in writing to PMA that PMA met the deliverables in the contract and that the operating and financial metrics were completed. The objective of our examination was to determine whether PMA's implementation of the RAP achieved the claimed savings.

A. Results of Examination

We found that Downstate officials did not properly monitor and assess PMA's performance under the contracts, including PMA's implementation of the cost-saving improvements identified in the RAP. We also found that for select areas, PMA did not use sound methodologies, or even follow its own methodologies, to calculate the savings achieved during the RAP period. Moreover, we found that Downstate's weak control environment and poorly written contracts exacerbated these conditions. As a result, we question the accuracy of $74,674,978 of $85,455,000 in PMA-claimed

[1]We performed our examination in accordance with the State Comptroller's authority set forth in Article V, Section 1 of the State Constitution, as well as Article II, Section 8(1) and (7), and Article VII, Section 111 of the State Finance Law.

savings we reviewed as part of this examination. This does not include the $349,627 in understated savings we found when reviewing PMA's calculations.

Specifically, we could not verify the accuracy of $65,442,000 in savings PMA claimed for labor reductions because PMA's methodology was flawed and Downstate could not provide sufficient information so we could calculate and independently confirm the actual savings. While our independent review did indicate some savings likely occurred, it is unclear how much of this was attributable to PMA. In addition, neither PMA nor Downstate could provide sufficient support that would enable us to verify the accuracy of $4,964,000 in savings PMA reported for a claimed reduction in inpatient length of stay. In fact, we found that inpatient length of stay actually increased during the examination period. We also found that PMA took credit for $2,505,000 in savings for reducing the cost of cardiac rhythm management (CRM) supplies from St. Jude Medical, even though Downstate negotiated those savings before entering into the PMA contracts we examined. Finally, we found PMA overstated savings by $1,763,978 for reducing guaranteed payments to physicians, and understated savings by $349,627 that resulted from actions such as extending operating hours at 21 Downstate ambulatory clinics. We found the $6,762,000 in savings PMA claimed for improvements to reduce accounts receivable was correct in all material respects.

Based on PMA's failure to follow its own methodologies to determine savings and Downstate's failure to properly monitor and approve PMA's methodologies for calculating claimed savings, we question PMA's claim that it saved Downstate $138 million.

We shared a draft report with SUNY and considered their comments (Attachment A) in preparing the final report. The State Comptroller's Office comments on SUNY's response are included in Attachment B. SUNY officials generally agreed with our recommendations, however, they are concerned that certain details related to PMA work at Downstate has been omitted and therefore does not provide for full disclosure.

B. Background and Methodology

Downstate originally entered into contract CM00939 with PMA for consulting services for the period December 3, 2012 through September 3, 2013. That contract was later extended for three months through December 2, 2013. The contract and the extension were subject to approval by the Office of the State Comptroller (OSC).

Chapter 56 (Part Q) of the Laws of 2013 authorized Downstate to obtain services and commodities related to its restructuring without following certain State procurement requirements, including executing contracts without prior approval from OSC. In December 2013, Downstate replaced contract CM00939 with contract TQ00002, which was not subject to OSC approval. Collectively, Downstate paid PMA $34 million under these two contracts. In December 2015, PMA reported cumulative savings of $138 million for Downstate under both contracts.

To accomplish our examination objective, we analyzed the terms and conditions of contracts CM00939 and TQ00002, interviewed Downstate officials, evaluated the savings PMA claimed resulted from the implementation of the RAP, and reviewed other pertinent documentation, including Part Q of Chapter 56 of the Laws of 2013.

We judgmentally selected the following savings categories from the RAP to examine, for which PMA claimed savings of $85,455,000: (i) Labor Reductions, (ii) Inpatient Length of Stay Improvement, (iii) Physician Clinical Guarantees, (iv) Ambulatory Access, (v) St. Jude Cardiac Rhythm Management, and (vi) Reduction of Billed Accounts Receivable. For each category, we attempted to verify the accuracy of the claimed savings using PMA's methodologies. Where we were unable to do so, we attempted to determine actual amounts using appropriate alternate methodologies.

C. Details of Findings

Labor Reductions

PMA claimed savings of $65,442,000 for labor reductions over four phases during the two-year examination period, including $20,627,000 in savings for the first phase. PMA developed a plan that would decrease labor costs in the first phase by reducing the number of full-time equivalent employees (FTEs). PMA calculated the $20,627,000 in savings by multiplying the net reduction in FTEs over a specific period of time by an average salary amount. However, when we attempted to verify the accuracy of the claimed savings for the first phase, we found the methodology PMA used was flawed.

Specifically, PMA used a base period of January 2012 through April 2012 and compared it to the period of May 2012 through December 2012 to determine the net reduction in FTEs, which was used to project the savings during the RAP period. However, PMA should have used the year before the RAP (December 2011 through November 2012) and compared it to the actual RAP period (December 2012 through November 2014) to determine a more accurate reduction in labor during the two year period. In addition, PMA: (i) used an average salary to calculate savings instead of using actual salaries of the positions Downstate eliminated as a result of the RAP; (ii) added an arbitrary and unsupported amount of 15 percent to the average salary for fringe benefits; and (iii) performed a series of adjustments, including increasing the fringe benefit amount to 35 percent and adjusting the average salary by 50 percent and subsequently 75 percent. PMA did not provide justification or explanation for the adjustments, which substantially increased claimed savings. Downstate officials were unable to provide documentation to support the appropriateness of PMA's calculation.

Furthermore, when calculating the first phase savings, PMA included the salaries of Downstate employees: (i) whose positions were not eliminated, (ii) whose positions were refilled at a later date, (iii) who remained employed at Downstate in positions reclassified as non-hospital, resulting in no savings to Downstate as a whole, and/or (iv) who were counted in more than one savings phase.

Because we could not verify the claimed savings of $20,627,000 for the first phase, we expanded our scope to include all four phases to attempt to verify the entire $65,442,000 in claimed savings. We compared Downstate's total Hospital salary expenses for the one-year period prior to the RAP to the total salary expenses at the end of years one and two of the RAP. Downstate officials could not provide the corresponding fringe benefit expenses incurred during these periods. Without fringe benefit data, we could not complete the calculation to verify the actual savings for labor reductions.

SUNY requested we report net salary expense reductions as minimum savings, absent fringe benefit data. Our analysis showed Downstate's hospital salary expenses were reduced by $16 million by the end of year one. Downstate sustained this reduction in year two, and also realized an additional $16 million reduction. However, we caution against characterizing the total amounts as savings because they include the salary expenses for employees who:

- remained employed at Downstate in positions reclassified as non-hospital.
- left Downstate for reasons other than efforts related to the RAP. PMA should claim savings attributable only to the positions they targeted under the RAP.

Inpatient Length of Stay Improvement

PMA claimed savings of $4,964,000 for reducing the length of stay (LOS) for inpatients who receive treatment based on the top 25 diagnosis related groups (DRGs). DRGs are used to reimburse a hospital a fixed fee based on the patient's diagnosis, regardless of the actual costs the hospital incurred to treat the inpatient. Therefore, the shorter the LOS, the lower the actual costs, and the higher the savings.

We found neither PMA nor Downstate could provide sufficient support that would allow us to verify the accuracy of $4,964,000 in claimed savings. Neither entity could regenerate the original report used to calculate that savings amount. We also found that when PMA calculated the savings, it included savings attributed to more than 500 DRGs, not just the top 25 DRGs, as described in its stated methodology.

Moreover, when we recalculated the LOS based on a regenerated report of more than 500 DRGs that Downstate provided to us, we found LOS was not reduced, as PMA claimed. Instead, the LOS actually increased from 6.10 days in 2012 to 6.28 days in 2014. Therefore, not only do we question whether Downstate achieved any savings, we find LOS costs may have actually increased.

Physician Clinical Guarantees

PMA claimed savings of $4,563,000 for working with Downstate to identify and discontinue 27 physicians' Clinical Guarantees that Downstate continued to pay after they expired. Clinical Guarantees are a financial incentive Downstate provides to a newly hired physician for a fixed period of time to help the physician build his or her practice.

We found PMA incorrectly claimed savings for 15 of the 27 physicians, resulting in $1,763,978 in net overstated savings. PMA's calculation incorrectly included savings for: (i) three physicians whose payments were never discontinued after the guarantee period, (ii) five physicians for whom PMA calculated incorrect savings, (iii) three physicians for whom Downstate discontinued guaranteed payments prior to the start of both PMA contracts, (iv) two physicians whose guaranteed payments stopped when they resigned prior to the start of both PMA contracts, and (v) two physicians whose guaranteed payments stopped when they resigned during the contract period, and for whom Downstate could not provide support to show the resignations resulted from the efforts of PMA.

Ambulatory Access

PMA claimed $1,219,000 in savings by taking such actions as decreasing the length of patients' appointments and extending the hours of operation for 21 Downstate ambulatory clinics. However, we found that in calculating the savings, PMA included time periods and clinics inconsistent with its stated methodology.

We recalculated the savings using the correct time periods and clinics identified in PMA's methodology and determined the correct savings amount was $1,568,627. As a result, we found PMA understated the savings by $349,627. Although an increase in savings is a desirable outcome, Downstate did not verify the accuracy of the amounts claimed by PMA.

St. Jude Cardiac Rhythm Management

PMA claimed savings of $2,505,000 for reducing the cost of cardiac rhythm management (CRM) supplies from St. Jude Medical. However, we found Downstate negotiated and executed agreements for the reduced prices prior to the start of both PMA contracts. Therefore PMA should not have attributed these savings to the RAP. Also, while PMA's only role on the St. Jude CRM project was to calculate the savings Downstate achieved, we found PMA's calculations were inaccurate, overstating the savings by $77,015.

Reduction of Billed Accounts Receivable

PMA claimed their officials worked with Downstate to improve the billing and collection processes to reduce patient accounts receivable (AR), and developed a methodology to quantify and track

Downstate's progress to reduce patient AR. In the RAP, PMA claimed this resulted in saving $6,762,000. We were able to verify the accuracy of this amount in all material respects.

Control Environment

In our initial report on Downstate's contracts with PMA (PMA Travel Expenses – Final Report issued August 8, 2016) we raised concerns about Downstate's internal controls and questioned whether these exacerbated a poor control environment that already existed within the Finance Department. These included several instances where the then-President of Downstate did not act in the best interest of the State when dealing with PMA and administering the PMA contract. The New York State Joint Commission on Public Ethics subsequently found the then-President had violated the Public Officers Law by using his official position to secure unwarranted privileges.

We question whether the poor control environment established by the former President and evidenced by his own actions had an effect on the Downstate staff responsible for monitoring PMA. The lack of internal controls related to this vendor was also evident in our prior audit.

Given the discrepancies in savings we found and that Downstate officials could not explain all of PMA's methodologies and/or recreate them, we question how Downstate could certify to PMA that PMA completed, delivered and communicated all relevant work plans, deliverables, staff accountability, budgets, and staff training for a seamless sustained operation. Downstate officials should have: validated PMA's methodologies prior to their use, and verified claimed savings prior to certifying that PMA met the contract deliverables and completed operating and financial metrics.

In addition, we found that poorly written contracts added to the problems. The PMA contracts did not: clearly define how PMA would measure savings; set forth the duties and responsibilities of PMA versus those of Downstate; or specify milestones PMA must meet in order to claim savings. The contracts also lacked specific remedies in the event Downstate determined PMA's plan failed to yield the projected savings and cash flow improvements.

PMA's failure to follow its own methodologies or, in certain cases, sound methodologies to determine savings calls into question the reliability of the remaining $52,621,000 in PMA-claimed savings. While Downstate officials continue working to ensure financial stability for the Hospital, accurate information is critical to affect positive changes.

Recommendations

Management at Downstate Medical Center should:

1. *Establish and promote a control environment that sets the foundation for proper internal controls.*
2. *Establish clear agreements and contracts with vendors that:*

   a. *Require specific and measurable deliverables.*

   b. *Delineate the specific duties and responsibilities of the vendor versus those of Downstate.*

   c. *Contain specific remedies in the event Downstate determines the vendor fails to provide deliverables.*

3. *Establish controls to properly administer future contracts to:*

   a. *Effectively monitor contractor progress.*

   b. *Verify whether deliverables are in compliance with contract terms prior to certifying the work was completed.*

   c. *Safeguard against a contractor's failure to meet contract requirements, such as monetary retainage, until the contractor meets the terms and conditions.*

4. *Review the clinical guarantees that were not stopped and recover as appropriate.*

We thank the management and staff of SUNY Central Administration and SUNY Downstate Medical Center for the courtesies and cooperation extended to our auditors. Since your response to the draft report is generally in agreement with this report, there is no need for a further response unless you feel otherwise. If you choose to provide a response, we would appreciate it by March 14, 2018.

Sincerely,

Bernard J. McHugh
Director of State Expenditures

Encl: Attachment A
Attachment B

cc: Dr. Wayne J. Riley
Michael Abbott
Renee Poncet

SUNY The State University of New York

Office of the Chief Financial Officer

State University Plaza
Albany, New York 12246

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September 13, 2017

Mr. Bernard J. McHugh
Director of State Expenditures
Office of the State Comptroller
110 State Street
Albany, New York 12236

Dear Mr. McHugh:

In accordance with Section 170 of Executive Law, we are providing our comments on the draft report 2017 BSE01-01 "State University of New York (SUNY) Downstate Medical Center (DMC) University Hospital of Brooklyn (UHB)" Report, Pitts Management Associates, Inc. (PMA) Professional Fees, hereafter the (Draft Report). SUNY generally agrees with the recommendations; though we are concerned that certain details related to PMA work at DMC has been omitted and therefore does not provide for full disclosure.

OSC's audit focus was on two contracts, CM00939 (12-1-2012 through 11-30-2013) and TQ00002 (12/1/2013 through 11/30/2014), between PMA and DMC. However prior to the start of the CM00939 contract, PMA had a continuous two year working history at DMC. PMA was engaged by DMC in September 2011 to conduct assessments in focused areas of process and financial improvements and began implementation of approved recommendations during the 2012 period. The outcome of PMA's work during this period led to the contract CM00939 (12-1-2012 through 11-30-2013) and TQ00002 (12/1/2013 through 11/30/2014) at which time PMA developed and implemented a restructuring action plan (RAP) with a financial goal of achieving $134M in cash flow improvements by the end of 2014. Therefore, concerns raised by the OSC as to who should take credit for the improvements; PMA or DMC, may be misplaced. Certainly, PMA participated in the work that led to the RAP and thus had influence on the outcomes via their assessments, recommendations, coordination, and facilitation of much of the work that occurred. More importantly, in general the cash flow improvements were realized. *Comment 1

With regard to your findings related to the labor reduction savings, the average salary and fringe benefit mark-up utilized by PMA is common practice for estimating the impact for salary reductions. Therefore, DMC is comfortable with the method and we believe significant savings occurred that approximate the amounts reported by PMA. With regard to the inpatient length of stay improvement, we concur with the OSC that this RAP was miscalculated. *Comment 2

We duly note your concerns regarding the control environment under the previous President's leadership. However, the work conducted by PMA was monitored by and reported up to a restructuring committee with membership from SUNY System and DMC. PMA routinely delivered and discussed methodologies, progress, and estimated improvement and savings with the restructuring committee. *Comment 3

OSC Recommendations and DMC Responses:

OSC Recommendation #1:
Establish and promote a control environment that sets the foundation for proper internal controls

DMC Response #1:
Agree. DMC is committed to ensuring that the Campus has appropriate controls and processes in place and acknowledges that improvements are necessary. SUNY has appointed new presidential leadership to DMC who is committed to creating a strong internal control environment that minimizes risk, promotes efficiency and effectiveness, and strengthens accountability.

OSC Recommendation #2:
Establish clear agreements and contracts with vendors that:

a. Require specific and measurable deliverables.
b. Delineates the specific duties of the vendor versus those of DMC.
c. Contain specific remedies in the event DMC determines the contract fails to yield deliverables.

DMC Response #2:
Agree. DMC will establish agreements and contracts that delineate the deliverables and responsibilities of the vendor and contain remedies, where applicable, in the event a vendor does not deliver.

OSC Recommendation #3:
Establish controls to properly administer future contracts to:

a. Effectively monitor contractor progress.
b. Verify whether deliverables are in compliance with contract terms prior to certifying the work was completed.
c. Safeguard against a contractor's failure to meet contract requirements such as monetary retainage until the contractor meets the terms and conditions.

DMC Response #3:
Agree. However, as stated above, the work that was conducted by PMA was monitored by and reported up to a restructuring committee with membership from SUNY System and DMC. PMA routinely delivered and discussed methodologies, progress and estimated improvement and savings with the restructuring committee.

* Comment 3

OSC Recommendation #4:
Review the clinical guarantees that were not stopped and recover as appropriate.

DMC Response #4:
Agree. DMC is evaluating the cases where PMA reported that the underlying guarantee should have stopped and will handle as appropriate.

*See State Comptroller's Office Comments

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

Sincerely,

Eileen McLoughlin
Senior Vice Chancellor for Finance and Chief Financial Officer

Copy: President Riley
Mr. Porter
Dr. Azziz
Mr. McGrath
Ms. Fargnoli
Mr. Matthews
Mr. Abbott
Ms. Poncet/Downstate

State Comptroller's Office Comments on Auditee Response

1. We acknowledge that Pitts Management Associates, Inc. (PMA) performed work prior to contracts CM00939 and TQ00002. However, under these contracts, Downstate paid PMA $34 million to implement a Restructuring Action Plan that was projected to result in $134 million in cash flow improvements for Downstate. SUNY responded that, "in general the cash flow improvements were realized." However, as detailed in this report, we could not always reproduce the savings because of PMA's failure to follow its own methodologies to determine savings and Downstate's failure to properly monitor and approve those methodologies, or verify the savings claimed by PMA. As a result, SUNY cannot rely on the amount of savings PMA claimed.

2. We continue to note PMA: (i) used an incorrect base period to determine the net reduction in FTEs, and (ii) deviated from its initial methodology by making arbitrary adjustments to the calculation, without justification or explanation, to substantially increase the claimed savings.

3. The restructuring committee did not identify that PMA (i) incorrectly calculated inpatient length of stay, physician clinical guarantees, and ambulatory access, (ii) used a flawed methodology to calculate labor reductions, and (iii) claimed savings for reducing the cost of cardiac rhythm management supplies that was 100 percent attributable to the efforts of Downstate, not PMA.