State of New York
Office of the State Comptroller
Division of Management Audit and State Financial Services

STATE UNIVERSITY OF NEW YORK

STAFF STUDY: SUNY HOSPITALS AND THE COMPETITIVE MANAGED CARE ENVIRONMENT

REPORT 97-D-2

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit and State Financial Services

Report 97-D-2

Dr. John W. Ryan
Chancellor
State University of New York
State University Plaza
Albany, New York 12246

Dear Chancellor Ryan:

The following is our study of the issues to be addressed if State University hospitals are to compete in the growing managed care environment.

We conducted this study pursuant to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. Major contributors to this report are listed in Appendix A.

Office of the State Comptroller
Division of Management Audit
and State Financial Services

July 30, 1998

Executive Summary

State University Of New York
Staff Study: SUNY Hospitals And The Competitive Managed Care Environment

Scope of Study

The State University of New York (SUNY) educates students at 29 colleges and university centers. The university centers at Brooklyn, Syracuse and Stony Brook include academic health science centers which operate hospitals. These SUNY hospitals are government-run facilities which train physicians and other health professionals, conduct medical research and deliver health care services to residents in their regions. Other types of hospitals in New York State are voluntary academic health science centers, teaching hospitals and community hospitals. The three SUNY hospitals serve over 49,000 inpatients and 800,000 outpatients annually, and employed a total of 8,026 people as of December 1997.

Hospitals are now providing services in an environment in which there is an increased demand for managed care. For hospitals, managed care means adapting to increased competition to secure patients. The New York Health Care Reform Act of 1996, which became effective January 1, 1997, makes the health care industry even more competitive since it mandates that reimbursement rates, previously controlled by the New York State Department of Health (DOH), be established through negotiation between the insurers or health care organizations and the hospitals. Managed care has also pressured hospitals to decrease costs and develop relationships with other providers to offer services in a more cost effective manner. However, SUNY officials contend that SUNY hospitals, which must comply with more State laws and regulations than do other kinds of hospitals, face a greater challenge in cutting costs and in developing strategies to compete effectively in the managed care environment.

Our study, which covered the period January 1, 1992 through December 31, 1997, addressed the following questions about the issues to be addressed if SUNY hospitals are to develop strategies to compete in the managed care environment:

- What are factors that affect competitiveness in the managed care environment?
- Are SUNY hospitals able to use these factors to become competitive?

Study Observations and Conclusion

We examined the SUNY hospitals' combined financial statements for the calendar years 1992 through 1996, and found that the hospitals had operating deficits in every year but 1996. State financial support covers the deficits. However, SUNY officials anticipate the reduction, and eventual elimination, of State support and the reduction of the Federal funding hospitals receive for Medicare and Medicaid. Officials say they do not expect future surpluses since, in the new era of negotiated reimbursement rates, SUNY hospitals will be unable to effectively compete. (See pp. 5-8)

Our research of State laws, legislative proposals and industry literature and our interviews with SUNY and DOH officials indicate that certain factors in the areas of governance, workforce management and financial management affect an institution's ability to be competitive in the managed care environment. Because of existing requirements at the time of our study field work, SUNY hospitals were generally unable to use these factors to compete on an equal basis with other hospitals. For example, individual SUNY hospitals lacked the authority to form a local board of trustees, the ability to make investments or the ability to establish capital reserves. State laws or State regulatory agencies either did not permit, or significantly limited, SUNY hospitals' abilities to engage in these and other activities central to developing competitive strategies. SUNY officials have indicated to us that they have not performed an analysis of the specific impact these various constraints have had on the SUNY hospitals. At the time of our study, SUNY and legislative officials had not reached consensus on how much flexibility the hospitals needed. We encouraged SUNY to continue to seek legislation to grant SUNY hospitals the flexibility to develop and use appropriate competitive strategies. We pointed out that; without a legislative solution, the State may be confronted with the difficult budgetary decision regarding whether and how to sustain the level of service the State has come to depend upon from the SUNY hospitals. (See pp. 9-13 and 18)

Legislation was enacted in 1997 to give another government-run hospital in the State greater management autonomy by making it a public benefit corporation. Our survey also found that almost all the 11 other states we contacted have acted to make their state-run university hospitals voluntary not-for-profit corporations or public benefit corporations. (See pp. 15-16)

Auditor Comments: On July 14, 1998, the Governor signed into law legislation granting SUNY hospitals increased flexibility to compete in the managed care environment while remaining a part of SUNY.

Comments of SUNY Officials

SUNY officials agreed with our study conclusions and the issues we raised for their further consideration.

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Introduction

Background

The mission of the State University of New York (SUNY) is to provide the people of New York State with educational services of the highest quality. SUNY strives to ensure that its educational services are fully representative of all segments of the State's population, accessible as broadly as possible, and available in a complete range of academic, professional and vocational post-secondary programs. To accomplish this mission, SUNY educates students at 29 colleges and universities. The university centers at Brooklyn, Syracuse and Stony Brook include academic health science centers which operate hospitals.

These centers and their hospitals educate and train physicians, nurses and other health professionals, conduct medical research and deliver health care services to the New York citizens within their regions. For example, SUNY's biomedical and health-related research is helping the State respond to many of its most complex problems, including AIDS, alcohol and drug abuse and the medical problems of infants and the elderly. Health care services provided at the three SUNY hospitals and clinics benefit hundreds of thousands of patients each year. Not all of the SUNY University Centers involved with training health professionals maintain a hospital, however, to accomplish SUNY's mission. The University Center at Buffalo fulfills its teaching mission through affiliations with private hospitals in Erie County instead of operating its own hospital.

The SUNY hospitals, as well as other public and private hospitals in New York, are confronted with providing services in an environment where there is an increased demand for managed care. The term "managed care" can have different meanings in different contexts, and many types of health care organizations describe themselves as managed care organizations. For the purposes of this report, managed care is defined as a health care plan whose enrollees obtain the care they need from providers selected by the plan, or are given significant financial incentives to use the plan's providers. Prior to managed care, insured patients were not restricted in their choice of doctors or hospitals. The intent of managed care is to improve the quality, appropriateness and cost effectiveness of health care.

The growth of managed care is causing significant changes in the delivery of health care services throughout the country. These changes include emphasizing routine preventive health care services and having primary care physicians serve as gatekeepers to ensure the use of medical services

is appropriate. The changes may be accelerated by the Federal and State actions to control costs (such as cutbacks in the Medicaid and Medicare programs), but they will continue to take place, regardless of governmental action. The essential objective of managed care is to encourage competition among health care providers so they will offer quality health care services at as low a cost as possible. However, competition forces the cost and method of delivering services to be primary considerations. Experts in the health care field estimate that a majority of Americans with health care insurance will be in managed care plans by the turn of the century.

For hospitals, managed care means adapting to increased competition to secure patients and managing excess inpatient capacity. It also means coping with pressure to decrease lengths of stay, using ambulatory services and outpatient clinics and developing relationships with other providers to offer services in a cost effective manner. Before the managed care era, hospitals were reimbursed by commercial and not-for-profit insurers on a fee for service basis (i.e., each procedure or patient service was reimbursed at a specific rate). The New York State Department of Health (DOH) controlled the reimbursement rates insurers would pay for these services. However, services under managed care are now reimbursed at rates of payment negotiated between managed care organizations and hospitals, or other provider organizations. The payments take the form of discounted fee for service, fee schedules or capitation agreements, where services are covered by a flat payment per member per month. Capitation agreements force health care providers to assume some of the financial risk associated with health care.

The pressure on the SUNY hospitals to adapt to the managed care environment increased with passage of the New York Health Care Reform Act of 1996 (NYHCRA), which became effective January 1, 1997. Whereas DOH had previously controlled the reimbursement rates for hospital services, NYHCRA mandated that hospitals negotiate rates with insurance companies. This deregulation of rates has significantly impacted public and private hospitals in the State by increasing the competition for patients. As a result, some hospitals have been downsized, and numerous consolidations and mergers have taken place. For example, in New York City, Columbia Presbyterian Hospital merged with New York Hospital, and Beth Israel and St. Luke's/Roosevelt Hospitals consolidated their operations.

The following are types of hospitals in New York State: government-run academic health science centers, like the SUNY hospitals; voluntary academic health science centers, such as New York University Hospital in New York City; teaching hospitals, like St. Peter's Hospital in Albany; and, community hospitals, such as Saratoga Hospital in Saratoga Springs, New York. Both kinds of health science centers deliver patient care, conduct research, and serve as teaching facilities. Teaching hospitals provide patient care and train physicians after they have completed medical school, but they do not have academic or research functions. Community hospitals fulfill the patient care function only.

While all kinds of hospitals are looking for ways to cut costs in this more competitive environment, the SUNY hospitals face a greater challenge in containing costs than do non-academic hospitals. SUNY hospitals have additional costs associated with academics since they are part of government-owned academic health science centers. In addition, SUNY hospitals must comply with State government regulations and the terms of statewide collective bargaining agreements that do not apply to voluntary academic health science centers. SUNY officials have indicated to us that they have not performed an analysis of the specific impact these various constraints have had on the SUNY hospitals.

Response of SUNY Officials to Study: SUNY officials responded that they provided our staff with an analysis that estimated the fiscal impact of state affiliation and performance of educational and patient care missions for the SUNY hospitals to be about $174 million for fiscal 1998-99.

Auditor Comments: This information was provided subsequent to the completion of our field work.

To meet the challenges of the managed care environment, SUNY hospitals have been taking steps to provide services in a more efficient manner. Generally, these steps include increased use of ambulatory settings for the delivery of care, decreased lengths of stay and redesign and standardization of patient care procedures and protocols. Despite these steps, the SUNY hospitals have generally experienced combined annual losses from operations.

SUNY officials believe that the key for the success of SUNY hospitals is to develop a competitive strategy, and gain the autonomy to use such a strategy to respond quickly and appropriately to capture and maintain market share. SUNY officials believe this will require both comprehensive legislation and a willingness on the part of SUNY System Administra-

tion and the State's control agencies to recognize the special competitive requirements that managed care imposes upon hospitals.

Auditor Comments: On July 14, 1998, the Governor signed into law legislation granting SUNY hospitals increased flexibility to compete in the managed care environment while remaining a part of SUNY.

Scope, Objectives and Methodology

We studied the issues to be addressed if SUNY hospitals are to develop strategies to compete in the managed care environment. The scope period for this study was January 1, 1992 through December 31, 1997. Our objectives were to define factors that affect competitiveness in the managed care environment, and to determine whether SUNY hospitals are able to use these factors to become more competitive. To accomplish these objectives, we interviewed officials from hospitals, from SUNY System Administration and from DOH. We reviewed records, reports, industry studies, laws and legislative proposals. We also contacted officials from New York State county governments that are in the process of divesting their hospitals, and officials from other state universities with academic health science centers. In addition, we contacted officials from 11 other states to find out what they did to help make academic health science center hospitals more competitive. Finally, we contacted officials from national organizations who conduct studies of the health care delivery system. Our study did not examine the quality of patient care in the managed care environment.

Response of SUNY Officials to Study

A draft copy of this report was provided to SUNY officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after the final release of this report, we request that the Chancellor of the State University of New York report to the Governor, the State Comptroller and the leaders of the Legislature and fiscal committees, advising what steps were taken in response to the study conclusions and issues for further consideration.

Profile of SUNY Hospitals and Combined Financial Performance

Each of the three SUNY hospitals is an integral part of its health science center and the community it serves. Each hospital contributes to the education and training of health professionals, conducts medical research and provides patient care to the general population, including the poor and the elderly. The three SUNY hospitals serve over 49,000 inpatients and over 800,000 outpatients per year. In addition, the SUNY hospitals aid their local and regional economies by employing a total of 8,026 people as of December 1997.

The following is a brief history of each of the three SUNY academic health science centers, their relationship to the communities they serve, and their combined financial performance.

Brooklyn Health Science Center

According to information in the annual report of the Health Science Center at Brooklyn (Brooklyn HSC), this facility became part of the SUNY system in 1950. Brooklyn HSC was formerly the Long Island College of Medicine, which was founded in the 1800s. Today, Brooklyn HSC consists of a College of Medicine, School of Graduate Studies, College of Nursing, College of Health Related Professions and a 376-bed hospital. Brooklyn HSC is the focal point of an education and patient care network that serves one of the largest and most diverse urban populations in the country. It is the only academic health science center in the borough of Brooklyn, which has a population of more than two million people. Twenty-three percent of the borough's residents live below the poverty line and 61 percent of the hospital's patients are Medicaid or Medicare recipients. The borough also contains 40 percent of all children living in New York City. Brooklyn HSC serves one in every sixteen pediatric AIDS patients in the country. The annual report also states that most Brooklyn HSC students come from disadvantaged families, most are the first in their families to attend college, and most Brooklyn HSC graduates enter careers within New York State.

According to its certified financial statements, Brooklyn HSC's hospital had a $3.9 million operating surplus in 1996 (without financial support from the State). However, from 1992 through 1995, it incurred losses each year ranging from $28.2 million to $64.3 million.

Syracuse Health Science Center

The annual report for the Health Science Center at Syracuse (Syracuse HSC) also traces this facility's origin to the 1800s. Syracuse HSC also became part of the SUNY system in 1950, when it was transferred from Syracuse University. It became part of the SUNY system because its hospital and medical school were too costly for Syracuse University to continue to operate. Today, Syracuse HSC consists of a College of Medicine, a College of Graduate Studies, a College of Health Related Professions, a College of Nursing and a 350-bed hospital. Its hospital serves the 15 counties comprising central New York State. The hospital has more than 80 clinics including pediatric hematology/oncology, cystic fibrosis, adult hematology, well-baby and scoliosis. It also has a burn treatment unit and a bone marrow transplant unit. Its hospital provides more indigent care than any other provider in the region. Twenty percent of the population in the hospital's patient service area live below the poverty line and fifty-eight percent of its patients are covered by Medicaid or Medicare.

According to its certified financial statements, Syracuse HSC's hospital had a $225,000 operating surplus in 1996 (without financial support from the State). However, from 1992 through 1995, it incurred losses each year ranging from $9.5 million to $29.1 million.

Stony Brook Health Science Center

According to its annual report, the Health Science Center at Stony Brook (Stony Brook HSC) was established in 1972 to address the shortage of health care professionals in Nassau and Suffolk counties. Stony Brook HSC includes five professional schools (Dental, Medicine, Health Technology and Management, Nursing and Social Welfare) and a 504-bed hospital that opened in 1980. Stony Brook HSC is the only academic health science center in Suffolk County. Its hospital serves as a regional center for advanced patient care, education, research and community service. Its hospital includes eight intensive care units dedicated to anesthesia, burn, cardiovascular, coronary, pediatric, medical, surgical and transplant patients. Its hospital also includes a dental care center that serves as a resource for under-served segments of Long Island's population, including low-income and elderly patients and the physically and mentally disabled. Thirty-three percent of SUNY Stony Brook's patients are Medicaid or Medicare recipients.

According to its certified financial statements, Stony Brook HSC's hospital incurred a $2.2 million operating loss in 1996 (without financial support from the State). It had a surplus of $2.5 million in 1993 but it incurred

losses in 1992, 1994 and 1995 of $42.5 million, $37.9 million and $17.5 million, respectively.

Combined Financial Performance

The following chart shows the combined financial performance of the three SUNY hospitals and their respective State support for the calendar years 1992 through 1996.

Combined Financial Performance (In Thousands)

Year	1992	1993	1994	1995	1996
Operating Revenue (Excludes Transfers from NYS)	$513,534	$614,207	$621,149	$675,232	$741,653
Operating Expenses	$619,796	$705,150	$714,861	$734,820	$739,704
Excess of (Deficit) Revenue Over Expenses	($106,262)	($90,943)	($93,712)	($59,588)	$ 1,949
Transfers from NYS	$94,958	$111,229	$88,723	$103,737	$ 15,696

(Source: SUNY hospitals' certified financial statements.)

The first three rows in the above chart represent the results from the hospitals' operations, without any financial support from the State. The fourth row in the chart, "Transfers from NYS," is the net financial support the State provides to the hospitals. This financial support results from the net difference between the State appropriations for hospital employees' fringe benefits and for debt service, and the operating income the hospitals pay back to the State for providing the appropriations. The hospitals have a separate fund to deposit revenue and to pay expenses. Each year, the results from operations are added to the beginning fund balance to arrive at the end of year balance. The fund balance at the end of 1996 was $217.7 million. This balance is available to cover losses the hospitals incur.

Despite their performance in 1996, SUNY officials do not expect the hospitals to earn surpluses in the future under the conditions in which they currently operate. This is because NYHCRA, which became effective on January 1, 1997, mandates hospitals to negotiate rates with health care insurers. The introduction of negotiation promotes competition among all

the affected parties. Thus, NYHCRA made all kinds of hospitals equal with regard to negotiating rates. However, SUNY hospitals do not have the ability their competitors have to control costs. SUNY's competitors have always been better able to control costs because they are not subject to the same rules and regulations as SUNY hospitals. SUNY hospitals must adhere to State government regulations and statewide collective bargaining agreements that do not apply to their competitors. Therefore, NYHCRA places the SUNY hospitals at a competitive disadvantage.

Auditor Comments: The financial statements for the SUNY hospitals for the year ended December 31, 1997 were issued subsequent to the end of our field work. These statements show a combined operating loss of $22.6 million for the hospital (without financial support from the State). These results confirm SUNY expectations about the financial condition of the hospitals. The combined losses include $3.4 million for the Syracuse HSC, $10.6 million for the Stony Brook HSC and $8.6 million for the Brooklyn HSC.

SUNY officials also expect the State to continue to decrease, and eventually eliminate, its financial support to the SUNY hospitals. In addition, they expect the Federal government to cut back on the amount of funding the hospitals receive under the Medicaid and Medicare programs. Therefore, SUNY officials believe it is essential that the State address the various constraints that limit the ability of SUNY hospitals to compete on an equal level with other hospitals.

We believe that there are certain factors that hospitals must be able to use in order to remain competitive in the managed care environment. We also conclude that SUNY hospitals have been precluded from using or have had limited ability to use these factors. These matters are discussed further in the next section of this report.

Competitiveness Issues and Efforts to Address Them

The health care industry is changing rapidly as a result of the growth of the managed care environment with its pressure to control costs. Studies we obtained show that a managed care plan may eventually consist of a network of businesses that will be able to provide all the health care services a person will ever need, from birth to death. To adapt to this changing environment, SUNY officials at the time of our study claimed the hospitals needed the same flexibility that other private hospitals have. However, the efforts made to grant SUNY hospitals such flexibility through legislation had not succeeded as of the time of our study.

Our research of State laws, legislative proposals and industry literature and our interviews of SUNY and DOH officials show that certain factors in the areas of governance, workforce management and financial management enhance an institution's ability to compete in today's health care industry. At the time of our study field work, SUNY hospitals generally did not have access to, or authority to use, the factors listed below. However, their competitors can and do use them. We found no consensus among our research sources regarding which of these issues is most important for achieving competitiveness.

The following lists the specific factors that our research showed as being necessary for hospital competitiveness in managed care at the time of the conclusion of our study field work. Also presented are SUNY officials' explanations about the impact from the lack of these factors for its hospitals.

Governance

- Authority to Form a Local Board of Trustees to Set Policy, etc.

The State Education Law vests authority in the SUNY Board of Trustees to govern all of SUNY's 29 colleges and universities, which have the primary mission of educating students. However, SUNY officials believe it is difficult to expect trustees who serve on a statewide board dedicated to the education mission, to also develop expertise on health policy and on current issues associated with each of the distinct markets the SUNY hospitals serve. In addition, SUNY officials claim that campus presidents will not be able to shoulder the administrative burden created by the recent deregulation of the State's hospitals coupled with the current competitive market forces in the health care industry. According to SUNY officials, having a local board of trustees at each hospital would

help to remedy these problems, since the local board would have a vested interest in the hospital's patient service mission and in the community it serves.

Workforce Management

- The Ability to Develop Flexible Management Workforce Partnerships.

The Civil Service Law and statewide collective bargaining agreements determine the structure for establishing salary parameters, setting fringe benefit rates, acting on personnel matters, deploying staff and determining workforce size. This structure is generally fixed over a period of years and may make it difficult for the SUNY hospitals and the workforce to partner in a timely manner to deal with the demands of a market-driven managed care environment.

SUNY officials point out that, despite advances in technology, the workforce remains the most significant hospital resource, accounting for about 70 percent of the cost of patient care.

One effort to address a similar situation occurred last year when the State turned Roswell Park Cancer Institute into a public benefit corporation, but preserved much of the workforce structure. Roswell Park will continue to receive State support, which will, in part, pay for the costs of preserving the workforce structure.

Undoubtedly, solving the challenges of workforce management will be pivotal in any legislative solution developed for the SUNY hospitals.

Financial Management

- The Ability to Participate in Corporate Structures.

The Public Officers Law restricts the hospitals from participating in corporate structures and from entering into joint ventures and partnerships. Participation in corporate structures would include having a representative serve as a corporate board member, and being able to enter into joint ventures and partnerships, including vertical alliances with other health care providers (like nursing homes, home health care organizations, medical equipment providers and drug and alcohol rehabilitation centers) and horizontal alliances with other hospitals. SUNY officials believe that such participation could help the SUNY hospitals compete more effectively for patients and help cut costs through consolidation of payroll and other administrative functions.

- The Assumption of Business Risk, Including Entering Into Capitation Agreements.

SUNY believes that the Education Law and the Public Health Law give the hospitals authority to assume business risk, but State regulatory agencies do not interpret the laws the same way. The regulatory bodies challenge SUNY's authority as not being specifically cited in statute, while SUNY argues that statutorily they are not specifically denied the authority. The SUNY hospitals, unlike other State agencies, operate in a highly competitive segment of the business community. Therefore, like any business, SUNY officials believe that they must take risks by investing in revenue-enhancing business ventures without constraint. We note that legislative proposals have included provisions to amend the laws to specifically grant the SUNY hospitals authority to enter into capitation agreements. These proposals, as discussed in the next section of our study, have not passed the Legislature.

- The Ability to Effectively Manage Assets.

Asset management practices include projecting future sources of cash, establishing capital reserves, projecting working capital needs, establishing separate funds, investing funds in short-term financial instruments, accessing funds in a timely manner, interfund transfers and carrying funds into future periods. The State Finance Law, the State Education Law and the annual statewide budget and appropriations process restrict SUNY's ability to take action in these areas.

- The Absence of Contractor and Purchase Limitations.

The State Education Law and the State Finance Law stipulate that the State Comptroller's approval is necessary for the hospitals to enter into certain contracts (e.g., service contracts over $35,000 and commodities over $50,000). In addition, the State Comptroller's Office prefers not to approve contracts with terms that extend beyond five years. However, according to SUNY officials, contracts with terms that extend to ten years or more are common in the hospital industry.

- Unrestricted Ability to Acquire and Lease Property.

The State Education Law and the Public Lands Law restrict the ability of the hospitals to acquire or lease property without prior approval from

State regulatory agencies. Therefore, unlike their competitors, SUNY cannot act alone to develop new health care delivery sites.

- Control and Ownership of Assets.

All assets are under the jurisdiction and control of the State University System. However, SUNY officials believe that the hospitals need the ability to own and manage their assets, just like any other business.

- Access to Long-term Bonding.

The SUNY hospitals do not have access to the State Dormitory Authority or the bond market to raise capital independent of the State University as a whole. Therefore, unlike their competitors, SUNY hospitals are restricted in their ability to raise capital to build new health care facilities or renovate old ones.

SUNY officials and industry trends point out that the competitive advantage in the managed care environment lies with the institution that can move quickly and decisively in making decisions and taking action. Managed care fosters the development of both vertical and horizontal delivery systems as necessities for survival.

Legislative Proposals to Address Competitiveness Issues

Under existing law, State University health care services and operations are governed by general provisions of Article 8 of the Education Law, by provisions of the Public Health Law, and by regulations of DOH and other agencies with authority to regulate the State University as a health care provider. SUNY and the State Legislature had made proposals to enact comprehensive legislation to ensure that SUNY hospitals had the ability to compete in the managed care environment, but at the time of our study none of these initiatives had been successful.

The efforts to give the SUNY hospitals a greater ability to compete in the managed care environment began in 1992, and have continued since then. The SUNY Board of Trustees adopted resolutions in 1992 and in 1993 to gain more flexibility for the hospitals, but neither resolution gained a legislative sponsor. From 1993 through 1997, various proposals were introduced each year in both the State Senate and the Assembly. Some of the proposals passed one or the other house, but no one proposal was enacted into law. The reason for the lack of action on this issue was that SUNY officials and members of the Legislature had not been able to reach consensus on how much flexibility the hospitals need.

Auditor Comments: On July 14, 1998, the Governor signed into law legislation grating SUNY hospitals increased flexibility to compete in the managed care environment while remaining a part of SUNY.

Actions Others Have Taken to Address Competitiveness

Legislation was recently enacted to give a number of other government-run hospitals in the State greater freedom to manage their institutions by making them public benefit corporations. Our survey also found that almost all the 11 other states we contacted have acted to make their state-run university hospitals voluntary not-for-profit corporations.

The Experience of Other Government Hospitals in New York State

The difficulties that the SUNY hospitals are encountering in the managed care environment have also affected other government hospitals in New York State. For example, recently, the State enacted legislation to make DOH's Roswell Park Cancer Institute (Roswell) a public benefit corporation. The new legislation will allow Roswell the flexibility that the SUNY hospitals do not have, while protecting the civil service status of Roswell's employees. In addition, the State will continue to provide financial support during Roswell's transition from a State institution to a public benefit corporation. The Roswell legislation required a concerted effort on the part of the Governor, the Legislature and the affected unions, as well as State agency officials. We also learned that Nassau and Westchester Counties are in the process of making their hospitals public benefit corporations to release them from government restrictions. Roswell and the two county hospitals are not part of academic health science centers.

The Experience of Other States

We obtained information during this study that other states have had to grapple with the issue of whether to divest their hospitals from their academic health science centers. Generally, this occurred because restrictions in these states impeded the ability of their hospitals to compete in the managed care environment. In 1988, the University of Colorado conducted a study on hospital reorganizations at seven academic health science centers in different states. Five of the centers were part of state-run university systems like SUNY, and two were associated with private universities.

We followed up on the five state-run university hospitals. Of these, Arizona, Florida, Maryland and West Virginia had made their hospitals voluntary, not-for-profit corporations. Their reasons for doing so were to release the hospitals from state restrictions on purchasing, workforce,

personnel and financial management, and to enable them to enter into joint ventures. Given the new autonomy, all four hospitals report they are doing better financially. They still receive some government funding, but the funding is generally limited to compensation for unreimbursed medical care for the poor and for graduate medical education. The fifth hospital we contacted, located in Connecticut, has remained a state institution. However, Connecticut acted to give this facility more flexibility to compete in the areas of purchasing, contracting, expending funds and entering into joint ventures. Although the hospital had been operating at a surplus for a number of years after it received this new flexibility, it expects to lose money in the current year because of competitive market forces.

During our study, we learned that Colorado, Wisconsin and Oregon have also divested their state university hospitals, that Massachusetts is in the process of divesting, and that South Carolina is considering doing the same. We followed up with Wisconsin officials at the suggestion of a national organization that conducts studies on the health care delivery system. Wisconsin made its hospital a public benefit corporation to release it from government restrictions. The hospital has been earning profits since divestiture. The only government funding this Wisconsin hospital receives is for unreimbursed medical care for the poor and for graduate medical education.

Texas officials we contacted told us that their state is committed to keeping the University of Texas' three hospitals. These hospitals receive general fund appropriations from the state and funds from the Federal government for both graduate medical education and services provided to the medically indigent. According to officials, the managed care environment has impacted patient care at the hospitals, but all three are at least financially breaking even with the state's help. The hospitals have their own accounts and their own reserves. They can purchase equipment, buy buildings and make their own personnel decisions, including classifying jobs and setting salary rates, without prior legislative approval.

As our study shows, other states have acted to release their university hospitals from government regulations. Their experiences provide options New York State can consider pursuing.

Conclusion

Managed care and deregulation of rate setting are forcing all of the State's hospitals to be financially competitive if they are to remain going concerns. However, State laws, rules and regulations did not permit, or significantly limited, the SUNY hospitals' abilities to engage in activities central to developing competitive strategies in this environment. As a result of this inability, SUNY hospitals experienced a trend of significant operating deficits over the last several years. Absent a legislative solution, SUNY must rely on the budgetary process to cope with the deficits by either increasing funding or decreasing services. A legislative solution is a more appropriate and strategic course of action. The legislative options included providing the SUNY hospitals with the ability to pursue competitive strategies within the existing SUNY structure, or divesting the hospitals from SUNY in order to pursue such strategies.

Our research of eleven other states facing similar problems with their university hospitals shows that nine either already had or were planning to divest control of their university hospitals and two granted increased hospital flexibility within their existing university structure. This indicates a general preference for divestiture and is consistent with actions taken by the State last year to make the Department of Health's Roswell Park Cancer Institute into a public benefit corporation. As our report notes, certain counties in the State are also considering divesting from their hospitals. Also, the SUNY approach with the University Center at Buffalo shows that SUNY can accomplish its teaching mission without operating a hospital.

Issues for Further Consideration:

1. An issue to be addressed is whether SUNY should seek legislation to divest control of its hospitals or whether SUNY should seek legislation to afford the hospitals the ability to pursue competitive strategies within the existing organizational framework for SUNY. Another issue is whether a uniform solution is needed or whether unique solutions for each hospital are more desirable.

2. Absent a legislative solution, an issue becomes how SUNY will cope with continuing hospital deficits.

   (SUNY officials concur with the concept of supporting and pursuing a legislative solution that truly provides the hospitals and the faculty with a minimum, but adequate, set of business capabilities, as an initial step forward. They added that subsequent analysis of the local need of each campus should govern future discussion of solutions crafted to support the campus and its regional partners. SUNY officials stated that a solution to the deficit question involves a broader audience than just the University.)

Major Contributors to This Report

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50 YEARS
SERVICE, PRIDE & EXCELLENCE

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University at Buffalo
University at Stony Brook

COLLEGES
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Environmental Science and Forestry
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Fredonia
Geneseo
Institute of Technology at Utica/Rome
Maritime
New Paltz
Old Westbury
Oneonta
Optometry
Oswego
Plattsburgh
Potsdam
Purchase
Ceramics at Alfred University
Agriculture/Life Sciences at Cornell University
Human Ecology at Cornell University
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Tompkins Cortland
Ulster County
Westchester

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June 15, 1998

Mr. Jerry Barber
Audit Director
Office of the State Comptroller
The State Office Building
Albany, New York 12236

Dear Mr. Barber:

In accordance with Section 170 of the Executive Law, we are enclosing our comments regarding the Staff Study on SUNY Hospitals and the Competitive Managed Care Environment (97-D-2).

Sincerely,

Donald G. Dunn

Donald G. Dunn
Executive Vice Chancellor

Enc.

State University of New York
Staff Study: SUNY Hospitals
And The Competitive Managed
Care Environment
97-D-2

Issues for Further Consideration, page 15

State University of New York Comments

State University would like to thank the Office of the State Comptroller for their diligence and efforts to accurately describe environmental pressures placed on the State University's medical education, patient delivery activities and faculty through the deregulation of health care. The draft report provides a concise and accurate depiction of confounding difficulties our present State Agency status creates with regard to finances, governance, mission and business activities in today's highly competitive market. Of significance are the comments on factors such as governance, work force management and financial management and their impact on an institution's ability to compete on an equal basis with other hospitals. Secondly, the report recognizes that in response to environmental challenges spawned by deregulation of the industry the steps taken by hospital management, albeit appropriate, are not adequate to counter the impact of declining revenues.

1. The report suggests that SUNY should pursue a legislative strategy to either divest control of its hospitals or seek adequate flexibility to pursue competitive business strategies within the organizational framework of SUNY. While it is true that both our hospitals and System Administration itself has considered the former, we are supportive of current efforts to statutorily empower the University's hospitals to preserve and enhance market share while fostering an atmosphere which promotes the educational, research and public service missions. Through recent discussions with the Legislature we have attempted to identify why current legislative efforts, while a major step forward, do not permit our hospitals to perfect the networking and other authorities conveyed through bills recently passed by both houses. While it is true that over a longer term individual business relationships developed by each of the Health Science Centers will necessarily be different, they each fundamentally lack basic business capabilities all other hospitals possess.

   Therefore, we concur with the concept that we support and pursue a legislative solution that truly provides the hospitals and faculty with a minimum, but adequate, set of business capabilities, as an initial step forward. Subsequent analysis of each campus' local need should govern

any future discussion of solutions crafted to support the campus and its regional partners.

2. Solution to the deficit question posed in the study involves a broader audience than just the University. Before broaching the issue of the potential for a deficit, should the hospitals not be able to compete, an observation contained in the report needs to be reiterated. While the report cites the success of University Hospitals which have either been relieved of their State affiliation or given the wherewithal to compete, ongoing support of their educational and medically indigent services are essential. The crux of the matter lies in not only restoration of tax levy support previously reduced in SUNY's core operating budget, but to what extent the State is willing to contribute to covering the costs of state affiliation, health professions education and public service in the public hospitals operated by the University. Before issuance of the draft report, field audit staff were provided with an analysis which identified the fiscal impact of state affiliation and performance of educational and patient care missions at each of the University's hospitals. In total, the 1998-99 estimate of these costs is approximately $174 million. To the extent that sponsorship of these institutions remains unchanged this issue has to be addressed at policy levels above that of just State University.