Public Hospitals: Results of the 2008–09 Audits

Victorian Auditor-General's Report

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Audit summary

This report covers 114 entities, comprising public hospitals, the entities they control and rural health information technology alliances. It is the second of six reports to be presented to Parliament covering the results of our audits of 2008–09 financial reports.

The purpose of this report is to inform Parliament about significant issues arising from the financial audits within the public hospital sector, augmenting the assurance provided through audit opinions issued on financial statements that are included in the respective annual reports. The report also comments on financial management and reporting within the sector and better practice initiatives. It provides recommendations for improving public hospital investment management practices and it assesses the financial sustainability of public hospitals.

The Department of Health (DOH) and public hospital boards share responsibility for financial performance and management within the sector. While they have recognised the need to act on financial challenges, and have done so, there remains the need to expand their current initiatives to establish greater financial sustainability across the sector.

Results of audits

Reporting framework

All public hospitals and associated entities prepare their financial reports in accordance with Australian Accounting Standards, including the Australian Accounting Interpretations. Further, 91 of the 114 public hospitals and associated entities prepare their financial reports in accordance with the *Financial Management Act 1994* and 17 entities prepare their financial reports in accordance with the *Corporations Act 2001* or the *Associations Incorporation Act 1981*. The remaining six do not report under a legislative framework.

Audit opinions issued

At 31 October 2009, clear audit opinions had been issued on all 114 public hospital and associated entities' financial reports for the financial year ended 30 June 2009.

No modified audit opinions have been issued. This continues the positive result from 2007–08, when no modified audit opinions were issued.

Quality of reporting

The timeliness and accuracy of the preparation and finalisation of the financial report is a measure of the quality of financial reporting.

There has been a significant improvement in the quality of financial reporting in 2009, particularly relating to overall timeliness, compared with 2008. This is, in part, a result of DOH requiring earlier preparation of financial statements by public hospital sector entities for the 2008–09 financial year. Specifically:

- 87 per cent (99 of 114) of financial statements were finalised well within 12 weeks, compared with 54 per cent (85 of 156) for 2008
- 91 per cent (104 of 114) of public hospitals and associated entities submitted supporting work-papers and schedules for their financial statements to audit within the agreed time lines
- there was improvement in the level of compliance of draft financial statements, as submitted to audit, with legislative requirements and Accounting Standards compared with 2008.

Despite these significant improvements:

- 69 per cent (79 of 114) of public hospitals did not provide a complete and accounting standard compliant draft of their 2008–09 financial statements for audit within the agreed time line
- 46 material adjustments to the net result or the net asset position reported in the draft financial statements were required in 2009. In addition there were 17 significant classification errors in the draft financial statements.

Improvements notwithstanding, public hospitals and associated entities need to keep planning for and allocating sufficient and appropriate resources to financial report preparation so they can produce a compliant financial report within the legislative time line.

Effectiveness of internal control

Internal control encompasses the systems, policies and behaviours established by public hospitals to reliably and cost effectively meet their objectives.

In undertaking financial audits we assess the effectiveness of internal controls, established by management, over the reliability of financial reporting. While it is not our responsibility to form an opinion on internal controls, we nevertheless raise with management any control weaknesses or breakdowns we identify.

To the extent we examined those controls, the strength of public hospital internal control systems and processes was generally satisfactory, though variable between public hospitals. Specifically a significant number of important internal control mechanisms required strengthening in the following areas:

- information system controls
- preparation and review of key account reconciliations
- compliance with financial delegations
- review of masterfile standing data changes
- revaluations of plant and equipment
- existence of core policies and procedures
- calculation of long-service leave provisions
- management of annual leave entitlements.

These matters, together with other audit findings and recommendations, were reported to the relevant hospital boards and their management teams in audit management letters.

Management of investments in public hospitals

This year as part of our cyclical approach to reviewing significant aspects of corporate governance and financial management, we conducted a review of the investment management practices and outcomes for the public hospital sector.

Public hospital investments and cash holdings respectively totalled $1.2 billion at June 2009, $1.1 billion at June 2008. Public hospitals have broad discretion under the *Health Services Act 1988* to make investment decisions.

During 2008–09, 21 out of 88 public hospitals experienced investment losses totalling $35.3 million ($10.3 million in 2008). This is, in part, a consequence of the global financial crisis.

Our review of public hospital investment management practices found that:

- 80 per cent (70 of 88) had not undertaken benchmarking analysis of their investment performance
- 31 per cent (27 of 88) did not provide regular and sufficiently comprehensive investment reports to their boards
- 83 per cent (73 of 88) had not commissioned internal audits of their investment management practices
- 26 per cent (23 of 88) did not have an approved investment policy
- one-third (21 of 65) had not reviewed their existing investment policy for at least 18 months
- 85 per cent (75 of 88) had not established investment committees.

Financial sustainability

Public hospitals had an annual turnover in excess of $9.3 billion in 2008–09, and managed assets totalling $10.5 billion at June 2009.

Maintaining financially viable public hospitals is a continual challenge for government. Individual public hospital boards and DOH share responsibility for financial performance and management within the sector.

Insight into the financial sustainability of the public hospital sector is obtained from an analysis of financial sustainability indicators over a trend period. These indicators should be considered collectively, and are more useful when assessed over time as part of a trend analysis.

To be financially sustainable, public hospitals need to have the capacity to meet current and future expenditure as it falls due. They should also be able to absorb foreseeable changes and financial risks that materialise.

An analysis of five financial sustainability indicators over a five-year trend period found that the public hospital sector, on average, has an overall medium-risk financial sustainability assessment.

Other key findings from the trend analysis of the financial sustainability indicators include:

- the incidence of individual public hospitals having a high-risk financial sustainability assessment has been relatively constant over the five-year trend period. In 2009, 32 per cent (28 of 88) had a high-risk assessment
- 28 per cent (25 of 88) of the state's public hospitals, including 12 major metropolitan and regional hospitals, had cash holdings at 30 June 2009 equivalent to less than 15 days operating cash outflows
- 81 per cent (71 of 88) of public hospitals had a high-risk self-financing indicator assessment at 30 June 2009
- a worsening trend over the past five years for the capital replacement indicator, with 41 per cent (36 of 88) of public hospitals having a high-risk assessment at 30 June 2009. This outcome is consistent with that for the self-financing indicator, and largely a consequence of the departmental capital funding model
- during 2009, DOH concluded that 31 of 88 public hospitals (35 in 2008) did not technically comply with the going concern test in the Australian Accounting Standards, including 11 of the 21 major metropolitan and regional hospitals, which account for 67 per cent of the total turnover of all Victorian public hospitals.

The financial sustainability indicators highlight trends that need to be monitored arising from the adoption of accrual accounting principles across the public hospital sector. Notwithstanding the application of sector neutral Australian Accounting Standards and accrual accounting by public hospitals, it should be noted that the departmental funding model does not fully provide for depreciation until DOH has determined the capital requirements of individual hospitals.

The departmental funding model, therefore, allocates capital grant funding strategically across the sector rather than progressively to each hospital. However, public hospitals are governed by boards that are accountable for financial management and performance. This situation blurs accountability for the financial performance of the individual hospitals.

Recommendations

Number	Recommendation	Page
1.	Public hospitals, with the assistance and guidance of the Department of Health (DOH), should improve their end-of-year financial reporting processes, including the operation of effective quality assurance processes over draft financial statements.	15
2.	DOH should finalise, promulgate and monitor the application of its investment policy guidelines by public hospitals	26
3.	Public hospital boards should establish a comprehensive investment management policy.	29
4.	Public hospital boards should establish appropriate policies for the appointment, monitoring and management of external fund managers, where applicable.	29
5.	Public hospital boards should have comprehensive investment management practices, including benchmarking investment performance and conducting internal audit reviews of investment practices.	30
6.	Public hospital boards should require comprehensive investment reports.	32
7.	Public hospital boards should review their investment policies at least annually, or more frequently when volatile investment markets are encountered.	32
8.	Given the existing conditions in the financial markets and the economy more generally, public hospital boards that have significant funds available for investment should establish an investment committee to provide a specialised focus on maintaining a robust investment management framework, maximising investment performance and managing risk.	32
9.	DOH and public hospital boards should enhance the monitoring of hospital operating results, and revenue and expenditure trends, in real terms and relative to demand. This process would be assisted by all public hospitals adopting a suite of core financial sustainability indicators.	37
10.	DOH and public hospitals should expand existing budgetary and management initiatives to improve financial sustainability across the sector, while better delineating respective accountabilities. In particular, the department's 2007 decision to extend the explicit legislative responsibilities of boards and chief executive officers applicable to the major metropolitan and regional public hospitals to all other public hospitals should be implemented.	38

General

The total cost of preparing and printing this report was $202 000.