

VICTORIA

Victorian
Auditor-General

Audit summary
of
Public Hospitals:
Interim Results of the
2009–10 Audits

Tabled in Parliament
1 September 2010

Audit summary

Background

This report informs Parliament about developments within the public hospital sector and internal control issues arising from our interim financial audit of 109 entities, comprising 87 public hospitals and the 22 entities they control.

All entities operate internal controls to maintain the reliability of their financial reporting, the efficiency and effectiveness of their operations and their compliance with all relevant laws and regulations. In our annual financial audit, we focus on the internal controls that relate to 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.

This report comments on the effectiveness of internal controls supporting the preparation of the financial report and aspects of controls over leave and creditors.

At 24 August 2010, clear audit opinions had been issued on 39 per cent of public hospital and associated entities' financial statements for the financial year 30 June 2010.

Overall conclusion

Overall we found entity internal controls were adequate for financial reporting purposes. Nevertheless opportunities to strengthen internal controls were identified in relation to the preparation and review of key account reconciliations, the existence of core policies and procedures, and the adequacy of reviews for changes made to data on system masterfiles.

Controls over the management of leave were generally adequate, nevertheless there exists a number of opportunities to minimise the risks associated with the accumulation of excess recreation leave, and reduce the financial impact of sick leave absences.

Controls over the management of creditors could be further strengthened at almost all public hospitals, particularly relating to the development of comprehensive creditor management policies, more effective information systems, and enhanced monitoring of compliance and payment performance.

The Department of Health (DH) has not applied the government's fair payment policy to public hospitals. Consequently large metropolitan and regional hospitals are making over a third of their creditor payments outside the 30 day payment terms required under the government's fair payments policy.

Findings

Common internal control weaknesses

Internal control encompasses the policies, systems and behaviours established by entities to reliably and cost effectively meet their accountability and financial reporting objectives. Reliable internal controls are a prerequisite for effective and efficient delivery of reliable, accurate and timely external and internal reporting.

Public hospital internal control structures are adequate for financial reporting purposes, although the strength of these systems varied between public hospitals. We identified instances where important internal control mechanisms commonly needed to be strengthened. The incidence of weaknesses was generally consistent across metropolitan, regional and rural public hospitals.

A significant number of important internal control mechanisms commonly required strengthening:

- 20 per cent (17 of 87) of public hospitals had control weaknesses relating to the upgrade and implementation of new information systems
- information system security strategy, policies and system limitations were inadequate at 11 per cent (10 of 87) of public hospitals
- 34 per cent (30 of 87) of public hospitals were not independently reviewing masterfile standing data changes
- 39 per cent (34 of 87) of public hospitals had deficiencies in the preparation and review of key account reconciliations
- 29 per cent (25 of 87) of public hospitals had instances where core policies and procedures, such as over cash receipting or accounts payable processes, had not been established
- 16 per cent (14 of 87) of public hospitals had control weaknesses over the authorisation of supplier payments
- 23 per cent (20 of 87) of public hospitals had not appropriately addressed the requirements of Financial Reporting Direction 103D *Non-Current Physical Assets* regarding fair value assessments of non-current physical assets
- 31 per cent (27 of 87) of public hospitals had control weaknesses relating to payroll authorisation and management.

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

In response to our 2009 review of investment management practices at public hospitals, DH is expected to promulgate its investment policy guidelines in August 2010.

Controls over leave

A review of the management controls within public hospitals over employee leave processes was undertaken as part of our cyclical assessment of internal controls relating to significant annual financial report balances and disclosures consistent with Australian Auditing Standards.

Total annual salary and related expenses for hospital staff are projected to be around \$6.4 billion for 2009–10 (\$6.0 billion, 2008–09), representing some 65 per cent of total public hospital expenditure. Of this amount, 16 per cent or \$1.04 billion is expended on recreation, sick and long service leave entitlements each year. These costs arise from 74 300 equivalent full time staff employed by public hospitals at 31 March 2010 (71 400 at 30 June 2009).

While there are adequate controls over the management and monitoring of leave at public hospitals, there are a range of opportunities to strengthen controls.

Positive findings from our review included:

- 82 per cent (71 of 87) of public hospitals had an established leave policy which was generally comprehensive and making a positive contribution to leave management controls and arrangements
- 90 per cent of public hospitals had established arrangements to appropriately monitor leave balances to assist staff in complying with leave policies.

Leave management controls should, however, be strengthened in the following respects:

- nine per cent of public hospital employees have recreation leave balances in excess of 40 days at 31 March 2010
- 39 per cent (34 of 87) of public hospitals do not provide their boards with reports on leave management
- 60 per cent (52 of 87) of public hospitals had not included risks associated with the management of leave in the hospital's risk management register
- 89 per cent (48 of 54) of rural hospitals do not benchmark leave trends against external standards
- boards do not periodically perform a review over the adequacy of leave management practices at 76 per cent (66 of 87) of public hospitals
- 69 per cent (60 of 87) of public hospitals had not commissioned any internal audit projects in relation to their leave management practices within the last three years.

Ineffective controls over employee leave arrangements increase the likelihood of poor health and safety outcomes, additional costs associated with unplanned absences, and increased costs resulting from excess recreation leave accumulation.

Controls over creditors

Public hospitals are projected to spend around \$2.6 billion on supplies and services in 2009–10 (\$2.0 billion in 2008–09), representing around 26 per cent of total hospital expenditure. The total outstanding creditor balances were \$209 million at 31 March 2010 (\$246 million at 30 June 2009).

Given the substantial costs associated with creditors, and the considerable impact these payments have on operating cash flows for public hospitals and their creditors, we reviewed controls over creditors, including the effectiveness of established policies and practices, as well as monitoring arrangements.

In February 2006 the government extended its fair payment policy to apply to all major and significant public sector agencies. This requires agencies to pay for purchased goods and services of less than \$3 million, on the lesser of supplier terms or 30 days from the date a correct invoice is received. The aim of this policy is to improve the cash flow certainty for Victorian small and medium sized businesses.

Under DH's funding and service agreements public hospital creditors are required to be paid within 60 days. The department has advised that it was not possible to comply with the government's fair payment policy due to the significant cash flow difficulties it would cause public hospitals. Consequently large metropolitan and regional hospitals are making over a third of their creditor payments outside the 30 day payment terms required under the government's fair payments policy.

The inconsistency between the supplier payment requirements outlined in the department's hospital funding agreements and the government's fair payment policy is yet to be resolved by the department. The government's fair payment policy as the overriding policy has been applied when assessing creditor payment performance.

Positive findings from our review included:

- 84 per cent (73 of 87) of public hospitals are monitoring creditor balances using an automated aged analysis facility
- electronic funds transfer is an effective and common payment method for public hospitals, with 53 per cent of total creditor payments made by this method
- at 49 per cent (43 of 87) of public hospitals where creditor management statistics were reported to the board, they commonly contained average payment terms achieved and, where applicable, comments and recommendations regarding areas of concern
- at 31 March 2010 less than eight per cent of creditor balances at rural public hospitals had been outstanding for more than 30 days, with one per cent outstanding for more than 60 days.

Controls over creditors should however be improved in the following respects:

- over 35 per cent of creditor balances at metropolitan and regional hospitals had been outstanding for more than 30 days, with five per cent outstanding for more than 60 days, at 31 March 2010
- 17 per cent (15 of 87) of public hospitals have experienced instances where creditor payments have been deferred due to cash shortages

- 68 per cent (59 of 87) of hospitals do not have mechanisms in place to capture and report on compliance with terms of trade
- 44 per cent (38 of 87) of public hospitals did not have an established creditor management policy
- 51 per cent of public hospital boards (44 of 87) do not include a supplier payment performance review as part of their regular board reporting
- 84 per cent (73 of 87) of public hospitals did not use external benchmarks to assess their aged creditor balances and payment terms achieved
- 69 per cent (60 of 87) of public hospitals had not included risks associated with the management of creditors and payment processing in the hospital's risk management register
- 61 per cent (53 of 87) of public hospitals had not completed an internal audit review of creditor management within the past three years
- 53 per cent (46 of 87) of public hospitals had not conducted a management review of creditor management practices and processes within the last three years
- 80 per cent (70 of 87) of public hospitals do not have a system in place whereby the board annually reviews the adequacy of creditor management policies.

Most public hospitals still need to develop more comprehensive creditor management policies, more effective management information systems and to enhance the monitoring of payment performance.

Recommendations

Recommendation	Pages
Public hospitals should assess their policies and procedures against the commonly identified internal control weaknesses to confirm they are operating in a reliable, efficient and cost effective manner.	15
Public hospitals should establish comprehensive leave monitoring arrangements, and hospital boards should require comprehensive leave management reports.	24, 25, 27
Public hospitals should improve the level of monitoring, review and oversight of sick leave absences.	33
The Department of Health should expedite resolution of the inconsistency between their service arrangements with public hospitals and the creditor payment terms required under the government's fair payment policy.	38
Public hospital boards should oversee the establishment of comprehensive creditor management policies and procedures, and receive detailed creditor payment and aged analysis reports to acquit their monitoring obligations.	41, 46
Public hospitals should investigate extending the use of computerised applications for processing creditors, establish comprehensive monitoring arrangements, and schedule periodic internal audits of creditor management practices.	46, 48