Queensland Audit Office
better public services

Health: 2016–17 results of financial audits

Report 7: 2017–18

Contact details

The Financial Audit Division of the Queensland Audit Office is the custodian of this report. All comments and enquiries should be directed to:

Location	Level 14, 53 Albert Street, Brisbane Qld 4000
PO Box	15396, City East Qld 4002
Telephone	(07) 3149 6000
Email	qao@qao.qld.gov.au
Online	www.qao.qld.gov.au

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Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009,* we provided a copy of this report to all health sector entities. In reaching our audit conclusions, we have considered their views and represented them to the extent we deemed relevant and warranted in preparing this report.

A response was received from the Department of Health. It is in Appendix A.

Report cost

This audit report cost $187 000 to produce.

Your ref:
Our ref: 11635

Queensland Audit Office
better public services

15 February 2018

The Honourable C Pitt MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Mr Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Health: 2016–17 results of financial audits* (Report 7: 2017–18).

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Brendan Worrall
Auditor-General

Queensland Audit Office
Level 14, 53 Albert Street, Brisbane Qld 4000
PO Box 15396, City East Qld 4002

Phone 07 3149 6000
Email qao@qao.qld.gov.au
Web www.qao.qld.gov.au

Report structure

CHAPTER 1

Provides a sector overview to assist readers in understanding the audit findings and conclusions.

CHAPTER 2

Delivers the audit opinion results and evaluates the timeliness and quality of reporting.

CHAPTER 3

Analyses the financial performance, position, and sustainability of the entities.

CHAPTER 4

Assesses the strength of the internal controls designed, implemented, and maintained by entities in the health sector.

Contents

Summary

This report summarises the results of our financial audits of the entities in the Queensland public health sector.

This includes entities within the Minister for Health and Minister for Ambulance Services' portfolio of responsibility, being:

- the Department of Health (DoH) and 16 hospital and health services (HHSs) (referred to collectively in this report as Queensland Health entities)
- three health statutory bodies and their controlled entities
- 13 hospital foundations.

This report also includes three primary health networks that are outside the minister's portfolio but are public sector entities within the auditor-general's mandate.

Appendix C lists the Queensland public health sector entities and their responsibilities.

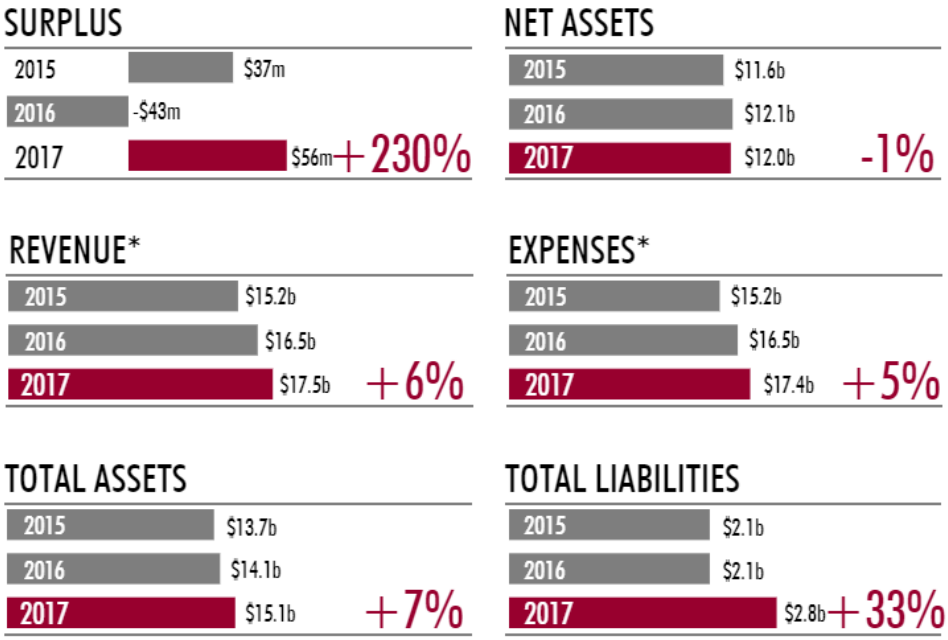
Results of our audits

We issued unmodified audit opinions on all financial statements this year within the statutory deadlines of 31 August 2017 (and 31 December 2017 for primary health networks). We do this when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards. In doing so, we confirm that readers can rely upon the audited financial statements.

For Queensland Health entities, we evaluated the processes that support accurate and timely preparation of draft financial statements. We found that they have improved in terms of timeliness but reduced marginally in terms of quality, with one additional HHS making adjustments prior to certifying their final financial statements this year.

Financial performance, position, and sustainability

Figure A
Queensland Health entities—2016–17 financial snapshot



* Revenue and expenses exclude transactions between DoH and HHSs.

Source: Queensland Audit Office.

Understanding financial performance

The collective performance of the health sector has improved over the last year. The result for Queensland Health entities was a surplus of $56 million in 2016–17 (2016: $43 million deficit). They have achieved these improved results by containing expense growth below that of the growth in revenue. At the same time, they have become more efficient by delivering more clinical activity at a lower average cost.

The increase in Queensland Health entities' revenue is due to the Queensland Government increasing appropriation and the HHSs delivering eight per cent more clinical activity this year, resulting in additional funding from the Australian Government. HHSs also increased their own source revenue from hospital fees and Pharmaceutical Benefits Scheme reimbursements.

Providing more clinical services has increased HHSs staff costs and spending in areas like clinical supplies and pharmaceuticals. However, this year, Queensland Health entities have contained the growth in expenses to five per cent, which is lower than the growth in revenue.

A future risk for Queensland Health entities is the introduction the national cap on growth funding in 2017–18. The Australian Government will cap the funding it will pay for increases in clinical activity at 6.5 per cent of 2016–17 activity levels. If growth exceeds the national cap in future years, Queensland Health entities will need to find alternate sources of funding to cover any shortfall.

Understanding financial position

The net asset position for Queensland Health entities is stable.

This year, the $1.3 billion Sunshine Coast University Hospital opened. This state-of-the-art hospital was built under a public–private partnership with Exemplar Health. The opening of the hospital triggered an interest-bearing liability of $500 million, increasing the sector liabilities by more than 30 per cent. Sunshine Coast Hospital and Health Service will repay this debt to Exemplar Health over the next 25 years.

The health sector is making significant investments in information technology systems, including replacing their current (SAP) financial solution and continuing the investment in digital hospitals, with 24 hospitals expected to be digital by 2020. (Digital hospitals use electronic rather than paper records that integrate with digital medical devices to enable clinicians to easily review and update patient information.)

Successful implementation of these major projects will be critical to maintaining and advancing the delivery of quality health care to Queenslanders.

Internal controls

We identified two significant deficiencies in information and communication controls at the Central Queensland Hospital and Health Service. We found that it did not have the capability to manage the complex process of valuing land and buildings.

Queensland Health entities are not resolving internal control deficiencies within agreed timeframes. Fifty-six per cent of internal control deficiencies we reported this year were also reported in the prior year. Queensland Health entities need to resolve these issues more promptly, as delays may expose them to increased risk of fraud or error.

Recommendations

As part of each audit we make recommendations to individual entities in the Queensland public health sector about how to improve their financial management.

We recommend these Queensland Health entities take prompt action to address individual recommendations and resolve internal control deficiencies, with a particular focus on those outstanding since prior years, to help mitigate the risk of fraud or error. We also expect that audit and risk committees will take an active role in monitoring the resolution of internal control deficiencies.

1. Sector overview

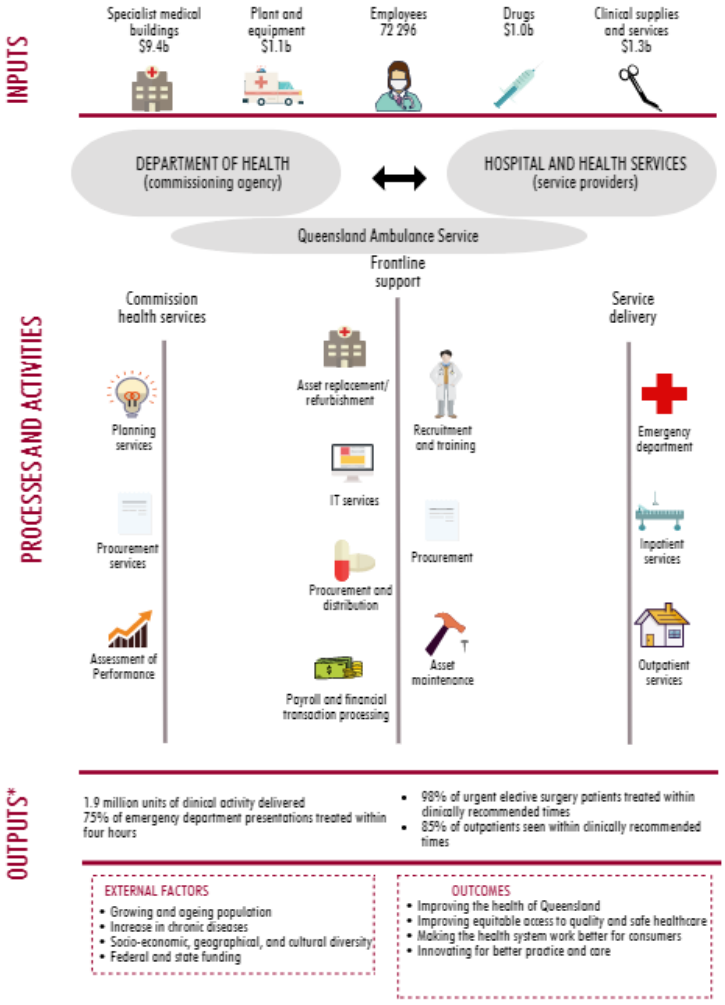
The Department of Health (DoH) and the 16 hospital and health services (HHSs) (referred to collectively in this report as the Queensland Health entities) work as a system to deliver health services to Queenslanders. The *Hospital and Health Boards Act 2011* establishes DoH's responsibility for the overall management of the public health system in Queensland. It purchases public hospital and health services from the HHSs.

Each HHS has a governing board that is accountable to the Minister for Health and Minister for Ambulance Services. Appendix D shows each HHS's health facilities across Queensland.

DoH negotiates service agreements annually with each HHS. These agreements outline the services that DoH purchases from the HHS and how much it will pay for those services. DoH has established a performance framework that outlines how the department monitors and assesses the performance of HHSs in delivering public health services in Queensland.

The supply chain for Queensland Health entities is made up of a wide range of services and uses a significant amount of resources. Figure 1A details the main inputs, activities, outputs and outcomes for Queensland Health entities.

Figure 1A
Supply chain for Queensland Health entities



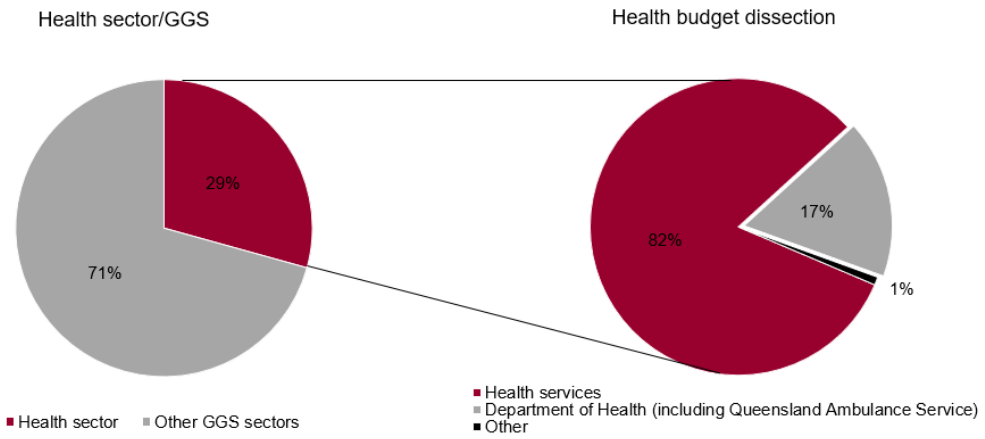
* Output measures as reported by the Department of Health.

Source: Queensland Audit Office.

Health budget

In 2016–17, the expenses of Queensland Health entities and the three health statutory entities (Office of the Health Ombudsman, Queensland Mental Health Commission and The Council of the QIMR Berghofer Medical Research Institute) accounted for 28.7 per cent of the budgeted expenses for the Queensland Government's general government sector (GGS). Approximately $12.6 billion or 82 per cent of the Queensland Health entities' budget funds the provision of health services by HHSs and other organisations, including Mater Health Services and St Vincent's Health Australia. In addition to its role as the system manager, the Department of Health also provides a number of statewide services including the planning and delivery of major infrastructure, providing ICT systems and support, and providing services such as pathology and ambulance. Figure 1B shows the significance of the health budget to the Queensland state budget, and the dissection of health spending.

Figure 1B
Significance of health budget to the Queensland budget



Source: Queensland Audit Office.

This report focuses on our audits of Queensland Health entities, as they represent 99 per cent of total sector expenses.

2. Results of our audits

Introduction

This chapter examines the reliability of information reported by entities that were subjected to audit. We also analyse the quality and timeliness of financial reporting.

Conclusion

We issued unmodified audit opinions for the financial statements of each of the health sector entities. Readers can rely on the results in the financial statements. All audits were completed within legislative deadlines.

Most Queensland Health entities (which, for this report, include the Department of Health (DoH) and the hospital and health services (HHSs)) have improved the robustness of their year end close processes, allowing them to produce high quality financial statements in a timely manner. This year, more Queensland Health entities met their time frames for completing year end processes, including complex asset valuations, and prepared their draft financial statements by the dates they agreed with us.

Most Queensland Health entities provided financial statements to us that required no amendments to the values reported.

Audit opinion results

For the 2016–17 financial year, we issued unmodified audit opinions for all entities within legislative deadlines. Appendix F lists these entities and the opinions issued on their financial statements.

Emphasis of matter

In 2016–17, we included an emphasis of matter paragraph with two unmodified audit opinions to draw attention to the following issues:

- the ability of Q-Pharm Pty Ltd to continue as a going concern. This is dependent on continuing support from its parent entity (The Council of the QIMR Berghofer Medical Research Institute) and the generation of future profits by the business
- the future de-registration and dissolution of the HIV Foundation Queensland (subject to Governor in Council approval) because of the expiry of its service agreement with the DoH.

Emphasis of matter: a paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

Health entities exempted from audit

The auditor-general may exempt a public sector entity from audit by the auditor-general for a financial year. Exempt entities are still required to engage an appropriately qualified person to conduct an audit of their financial statements.

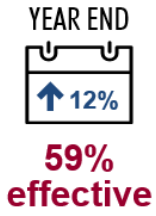
Nine health entities were exempted from audit by the auditor-general in 2016–17 due to their small size and low risk. Appendix G provides details on the results of these audits.

Financial statement preparation

Queensland Health entities prepared more timely financial statements than in prior years. This improvement is attributable to the prompt completion of year end processes. However, the quality of financial statements can still improve, with four Queensland Health entities (three last year) adjusting the numbers they included in their draft financial statements.

Appendix H lists our assessment criteria and our detailed assessment of each entity.

Year end close process

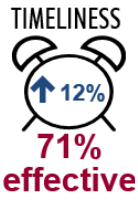


This year we found that 10 of the 17 Queensland Health entities completed important year end close processes by the target date (59 per cent). This was an improvement from eight entities in 2015–16.

Six of the 17 Queensland Health entities performing asset valuations did not meet the target date of 31 May 2017. Contributing factors were the refinement of valuation approaches this year and the use of the same expert to perform valuations for most Queensland Health entities, straining the resources available to perform timely valuations.

Property, plant, and equipment represents the largest single item in Queensland Health entities' financial statements. Valuing it requires the most judgement and estimation. The early completion of revaluations allows more time for internal and external review of valuation results, and reduces the potential for adjustments to draft financial statements.

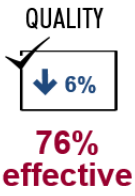
Timeliness of draft financial statements



This year, 12 out of 17 Queensland Health entities (71 per cent) completed draft financial statements on time, compared to 10 entities (59 per cent) in the previous year.

This indicates that some Queensland Health entities have improved the effectiveness of their year end processes to produce timely financial information.

Quality of draft financial statements



Of the 17 Queensland Health entities, 13 did not adjust their draft financial statements (76 per cent). Last year, we reported that 14 entities did not make any adjustments (82 per cent).

Two of the four Queensland Health entities adjusted their asset values, demonstrating the impact of the late completion of asset valuations on the quality of draft financial statements.

Three of the four entities made adjustments of less than five per cent to their draft financial statements. While the dollar value of these adjustments was not significant, these entities should continue to focus on reducing the number of changes.

Key audit matters

The Australian Auditing and Assurance Standards Board has adopted the international standard *ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report* for audits of listed entities.

Key audit matters are those areas that, in our professional judgement, pose a higher risk of material misstatement. A misstatement is material if it has the potential to influence the decisions made by users of the financial statements. These matters mostly relate to major events and transactions that occur during the period, and those areas requiring significant application of judgement and estimation.

We included key audit matters in our independent auditor's reports for Queensland Health entities on:

- valuation of property, plant, and equipment at the HHSs
- accounting for the Sunshine Coast University Hospital (constructed under a public–private partnership arrangement between the government and Exemplar Health).

We described in our reports the key audit matters and the procedures we performed to address the matters.

3. Financial position, performance, and sustainability

Introduction

The information in an entity's financial statements describes its main transactions and events for the year. Over time, financial statements also help users to understand the sustainability of the entity and the sector.

Our analysis helps users understand and use the financial statements by clarifying the financial effects of significant transactions and events in 2016–17. We also analyse important financial ratios to highlight organisational performance issues.

Additionally, our analysis alerts users to future challenges, including existing and emerging risks the entities face.

Conclusion

The overall financial performance of Queensland Health entities (which, for this report, include the Department of Health (DoH) and the hospital and health services (HHS)) improved in 2016–17. All but two entities achieved surpluses this year. Mackay HHS budgeted for a one-off deficit this year, using surpluses from prior years to deliver more clinical activity than the funding they received. Cairns and Hinterland HHS recorded another deficit this year, but this was less than originally forecast as it implemented strategies to manage increased activity and contain costs.

Demand for health services continues to increase across the health system, with HHSs delivering eight per cent more clinical activity than last year. While expenses associated with delivering the additional activity have also grown, the rate of growth has been contained to five per cent. This is a substantial improvement on last year's results where we reported expense growth was one per cent higher than revenue growth.

Thirteen HHSs receive activity-based funding from DoH. This year, 11 HHSs—one more than last year—achieved an average cost per activity that was equivalent to or lower than the price DoH paid for the activity. This improvement is due to the HHSs exercising fiscal restraint and/or increasing efficiency in delivering health services.

In 2017–18, the Australian Government will change the activity-based funding arrangements by implementing a 6.5 per cent cap on funding. This means that HHSs may not receive government funding if they deliver activity above the cap.

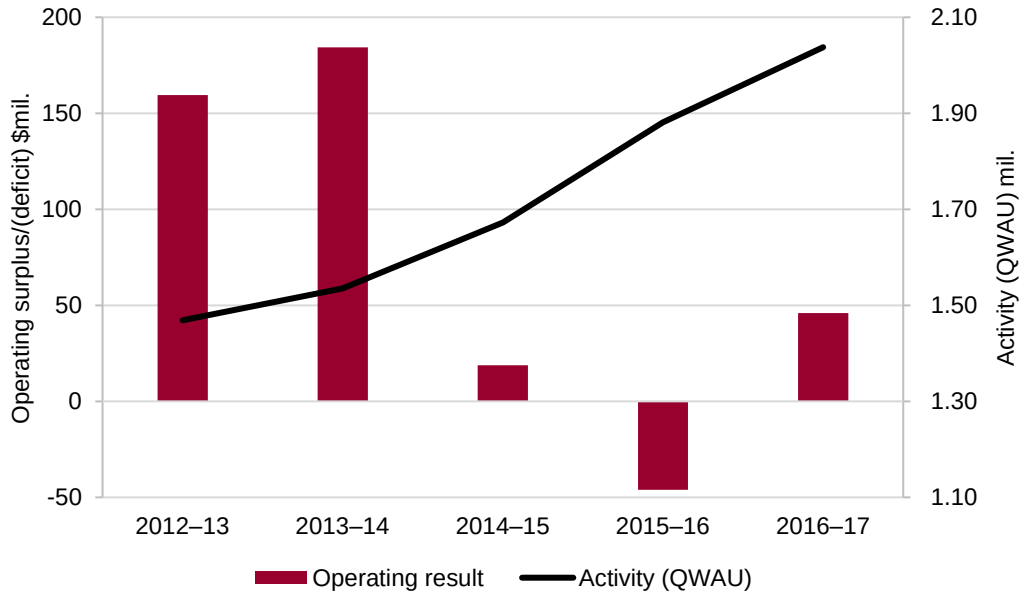
Understanding financial performance

The financial performance of Queensland Health entities improved in 2016–17. The collective result was a surplus of $56.2 million (2016: $43.3 million deficit).

In 2016–17, HHSs returned to a more balanced result, achieving a surplus of $45.9 million compared to a deficit of $46.1 million in the prior year.

Figure 3A shows the growth in clinical activity over the last five years, measured in Queensland weighted activity units (QWAU—refer to glossary) and the HHSs' operating results. From 2014–15 additional Australian Government funding was available to states and territories where they delivered clinical activity greater than the previous year. Over the last three years, HHSs have reduced their surpluses, but delivered more activity. In 2016–17 HHSs delivered over 2 million QWAU—an increase of eight per cent compared to the prior year. At the same time, the HHSs have improved their underlying financial result through prudent management of their resources. The ongoing challenge for the sector is to find efficiencies to meet the increasing demand without compromising on quality of care.

Figure 3A
HHSs' operating result and clinical activity



Notes: Clinical activity in 2015–16 included the administrative discharge of long-term mental health patients, which had not previously been counted. As a result, 2015–16 activity was approximately 3.8 per cent higher.

Source: Queensland Audit Office.

Figure 3A shows the activity delivered by HHSs. It represents 96 per cent of total services purchased through activity-based funding by DoH in 2016–17, with the remaining four per cent of activity being delivered by Mater Health Service.

Short-term financial sustainability

We assess Queensland Health entities against three short-term financial sustainability measures:

- operating result (which compares revenue and expenses)
- current ratio (which is the ability to pay existing short-term debts with current assets. A ratio of one or more indicates a HHS has sufficient current assets to meet its short-term debts as they fall due.)
- cash available (days) ratio (which measures the number of days a HHS has cash available to cover cash outflows. The desired benchmark is 14 days in line with the timing of funding payments from DoH).

Figure 3B shows the number of Queensland Health entities achieving the preferred benchmark for each of these short-term measures.

Figure 3B
Queensland Health entities' short-term financial sustainability ratios

Short-term financial sustainability measures	Benchmark	Number of entities above benchmark 2017	Number of entities above benchmark 2016
Operating result	Balanced or in surplus	15	9
Current ratio	Greater than 1	15	14
Cash available (days) ratio	Greater than 14 days	12	8

Source: Queensland Audit Office.

The results show that Queensland Health entities have improved their performance and reduced the risk of financial issues in the short term. Last year, we reported that three HHSs (Cairns and Hinterland HHS, North West HHS and Wide Bay HHS) were under-performing against all three financial sustainability ratios. This year, North West and Wide Bay HHSs met or exceeded the benchmarks for two out of three ratios. In particular, Wide Bay HHS achieved their best operating result in five years with a surplus of $10.8 million. North West HHS achieved a balanced operating result after two deficit years.

Only Cairns and Hinterland HHS is below each of these benchmarks and continues to face financial challenges in the next 12 months.

Cairns and Hinterland HHS

In 2016–17, Cairns and Hinterland HHS reported an operating deficit of $32.1 million. (In 2015–16, the deficit was $20 million.) This result was better than the forecast deficit of $39.9 million.

A key contributor to the deficit was the growth in employee expenses, which increased by $35.6 million (six per cent) compared to the prior year. This increase reflects the full year effect of the additional staff who were employed in the latter part of 2015–16 to deliver new or expanded clinical services and for the digital hospitals program. Digital hospitals use electronic rather than paper records that integrate with digital medical devices to enable clinicians to easily review and update patient information.

In terms of the other sustainability ratios—current and cash available—both improved this year, but are still below their respective benchmarks at 30 June 2017. An additional $40 million in cash funding from DoH provided via equity transfer (meaning it did not increase the HHS's revenue), has aided these improved sustainability ratios.

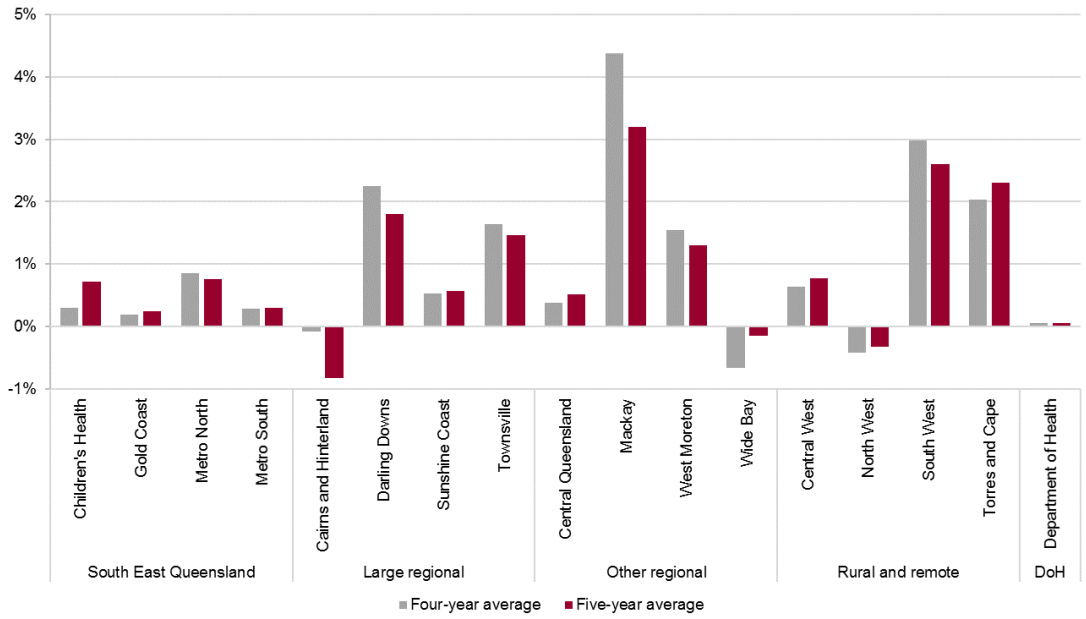
The HHS improved their operating deficit position in 2016–17 year by implementing its Operational Sustainability Plan. In 2017–18, the HHS expects to deliver a better result than the forecast operating deficit of $30 million as it continues to realise cost savings from the sustainability plan.

Long-term financial sustainability

To assess the long-term financial sustainability of Queensland Health entities, we calculate their operating surplus ratio as an average over time. This ratio measures the extent to which revenue covers operational expenses. A positive ratio indicates an entity's revenues have consistently exceeded its expenses.

Figure 3C shows Queensland Health entities' four-year and five-year average operating surplus ratio calculated from 2012–13. We found that HHSs with strong positive four-year averages typically fell in year five, as most invested some of their surpluses in more clinical services. Most others either maintained their average or improved their five-year average. However, the ratio for Cairns and Hinterland HHS has deteriorated, with two consecutive years of deficit.

Figure 3C
Queensland Health entities' average operating surplus ratio



Source: Queensland Audit Office.

Revenue

In 2016–17, Queensland Health entities reported total revenue of $17.5 billion. DoH receives most of its funding in the form of an appropriation from Queensland Treasury and grants from the Australian Government. HHSs receive health service funding from:

- DoH
- user charges from patients, private health insurers, and other entities
- Pharmaceutical Benefits Scheme reimbursements.

Figure 3D
Major revenue for Queensland Health entities by type in 2016–17

* Includes Queensland Government funding of $8.5 billion for health services.

Includes Australian Government funding of $4 billion for health services.

Source: Queensland Audit Office.

Health funding arrangements

HHSs must ensure they operate in accordance with the requirements of various agreements between the Australian and Queensland governments. These agreements include the *National Health Reform Agreement*, which has provided joint funding of public hospital services since July 2012.

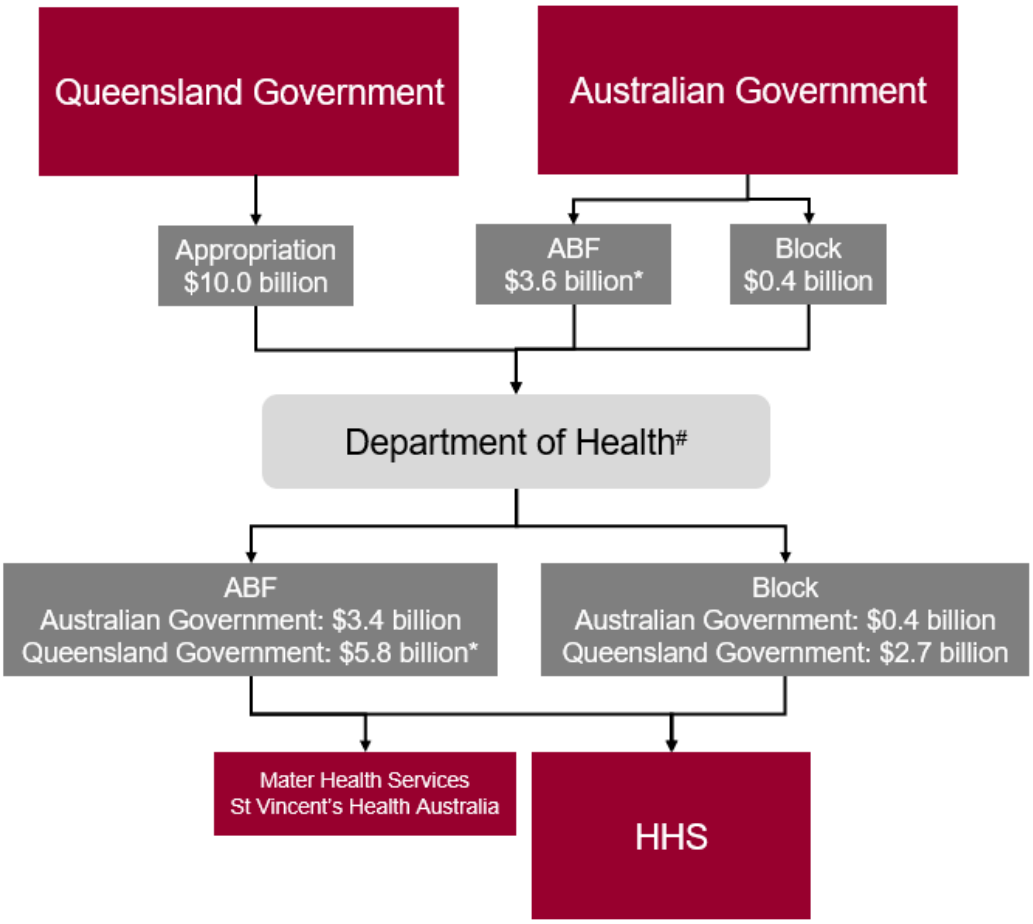
The *National Health Reform Agreement* outlines the responsibilities for public hospitals. It establishes a national framework for funding public hospitals using an activity-based funding model. This is a system of funding based on the number of services provided to patients and the amount to be paid for delivering those services.

The amount of activity-based funding a HHS receives is a combination of:

- the volume of clinical activity purchased by DoH, measured by the number of Queensland weighted activity units (QWAU) and the price paid for each WAU—called the Queensland efficient price (QEP)
- the volume of clinical activity delivered by the HHS above the target activity agreed with DoH, measured by the number of national weighted activity units (NWAU) and the QEP. This is called growth funding. A QWAU is an NWAU adjusted for local factors.

The Australian and Queensland governments also provide block funding for services delivered by hospitals that may not be practicable to fund through activity-based funding. Block funding is provided to rural and remote hospitals, and for teaching, training, and research. Figure 3E provides a conceptual diagram of the funding flow from the Queensland Government and Australian Government to the DoH and then to the HHSs and private health service providers. Values shown are for 2016–17.

Figure 3E
Queensland Health entities funding flow



* DoH accrued $0.2 billion of activity-based funding (ABF) from the Australian Government based on activity delivered by HHSs. DoH has already paid HHSs for this activity.

DoH retains $1.7 billion of appropriation funding for its own activities.

Source: Queensland Audit Office.

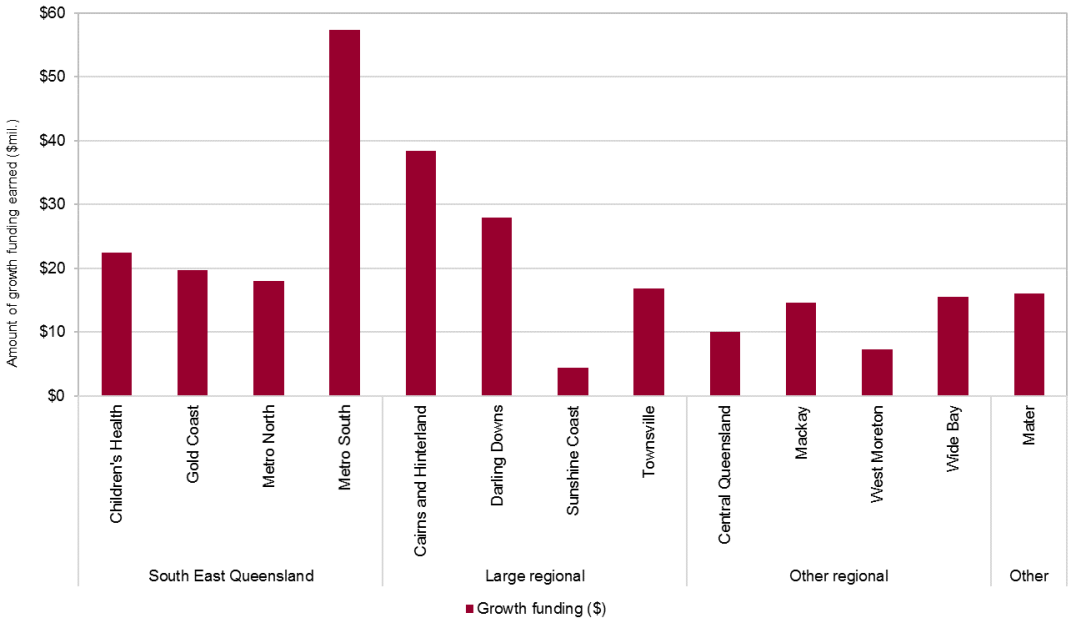
Events and transactions affecting revenue this year

Growth in services delivered

In 2016–17, DoH set a target of approximately 1.56 million NWAU from HHSs that receive activity-based funding and the Mater Health Services. In 2016–17, these entities delivered approximately 1.69 million NWAU, an increase of eight per cent above the target. All entities exceeded their activity target for 2016–17.

The increase in clinical activity earned these entities growth funding of $268.5 million from the Australian Government, an increase of $69.8 million or 35 per cent compared to the amount of growth funding in 2015–16. Figure 3F shows the amount of growth funding earned by each entity. For each NWAU delivered above the target, these entities receive funding of only 45 per cent of the QEP. There is a risk that the funding earned may not cover the cost of these additional services, meaning these entities will need to identify alternate revenue sources to fund any shortfall.

Figure 3F
2016–17 growth funding earned by each HHS and Mater Health Services



Note: Growth funding earned may differ from the amounts recognised by each HHS at 30 June 2017 as activity volumes are determined later in the year.

Source: Department of Health.

Future challenges and emerging risks

Queensland Health entities are acutely aware of the challenges presented by the rising demand for their services. All are looking for ways to increase capacity in public hospitals, while also improving the quality of care. Since their establishment in 2012–13, HHSs have collectively increased the volume of clinical activity they deliver by 40 per cent. However, funding for health services has only increased by 28.5 per cent. This means that HHSs are delivering more services for less money. This growth in health services is not sustainable in the long term.

Changes in public hospital funding from the Australian Government

From 1 July 2017 until 30 June 2020, the Australian Government will fund 45 per cent of efficient growth in public hospitals, subject to a new national cap of 6.5 per cent growth per year.

An addendum to the *National Health Reform Agreement* sets out the terms for implementing the national cap. The administrator of the National Health Funding Pool will reconcile the actual activity delivered by each state against the baseline amount from the prior year. Where one state delivers activity above the national cap, but the national total does not exceed 6.5 per cent growth, the Australian Government will proportionally redistribute the remaining available funding to the states who had activity above the national cap once final activity numbers for the year are known.

Queensland Health entities' growth in activity has exceeded 6.5 per cent each year over the last two financial years. If growth exceeds the national cap in future years, these entities will need to find alternate sources of funding to cover any shortfall in the cost of delivering activity above the cap.

The Australian Government funding was previously provided by DoH to HHSs at 45 per cent of the QEP for all activity delivered above the agreed activity target. In 2017–18, DoH has already included all available growth funding up to the funding cap in the HHS's service agreements. DoH will monitor the performance of each HHS and reallocate funding between HHSs that are above or below their activity target.

Also starting from 1 July 2017, the Australian Government will adjust its level of funding to reflect the safety and quality of hospital services provided. This comes from an April 2016 agreement signed by the Australian Government and all state and territory governments. Under these revised arrangements, the Australian Government will:

- not fund any adverse events that result in death or serious harm to patients ('sentinel events')—effective 1 July 2017
- reduce the level of funding for specified complications that occur during a hospital stay, that should have been mitigated by clinical risk management strategies ('hospital acquired complications')—effective 1 July 2018
- develop a framework to adjust the level of funding for situations where a patient is treated for a particular condition and needs to be readmitted to hospital for that same condition ('avoidable readmission'). The effective date is still to be determined, as the states and territories need to agree on the conditions that are avoidable readmissions.

New revenue accounting standards

From 1 January 2019, the new Australian accounting standard (AASB) 15 *Revenue Contracts with Customers* will affect the revenue and income of health entities. This standard is more complex and includes more judgements than the current equivalent standards.

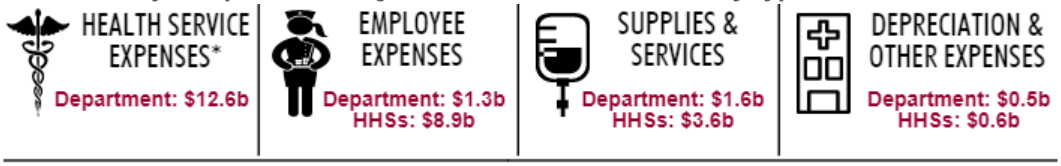
Queensland Health entities have various sources of revenue and income. These mainly include health service funding from the Queensland and Australian governments, fees and charges, and grants and contributions. Entities will need to analyse each of these sources to determine what changes will be required.

Given the variety of sources of revenue and income, the large number of contracts, and the complexity of the new standards, Queensland Health entities should not underestimate the effort required to prepare themselves. It may require changes in systems, processes, accounting policies, and in some instances, contracts.

Expenses

In 2016–17, Queensland Health entities spent $17.4 billion purchasing goods and services and employing people to provide health services to Queenslanders. Expenses included $12.6 billion spent by the DoH purchasing health services from the HHSs and other organisations, including Mater Health Services and St Vincent's Health Australia.

Figure 3G
Major expenses for Queensland Health entities by type in 2016–17



* Health service expenses includes DoH payments of $11.7 billion to HHSs.

Source: Queensland Audit Office.

Events and transactions affecting expenses this year

Cost of HHS activity

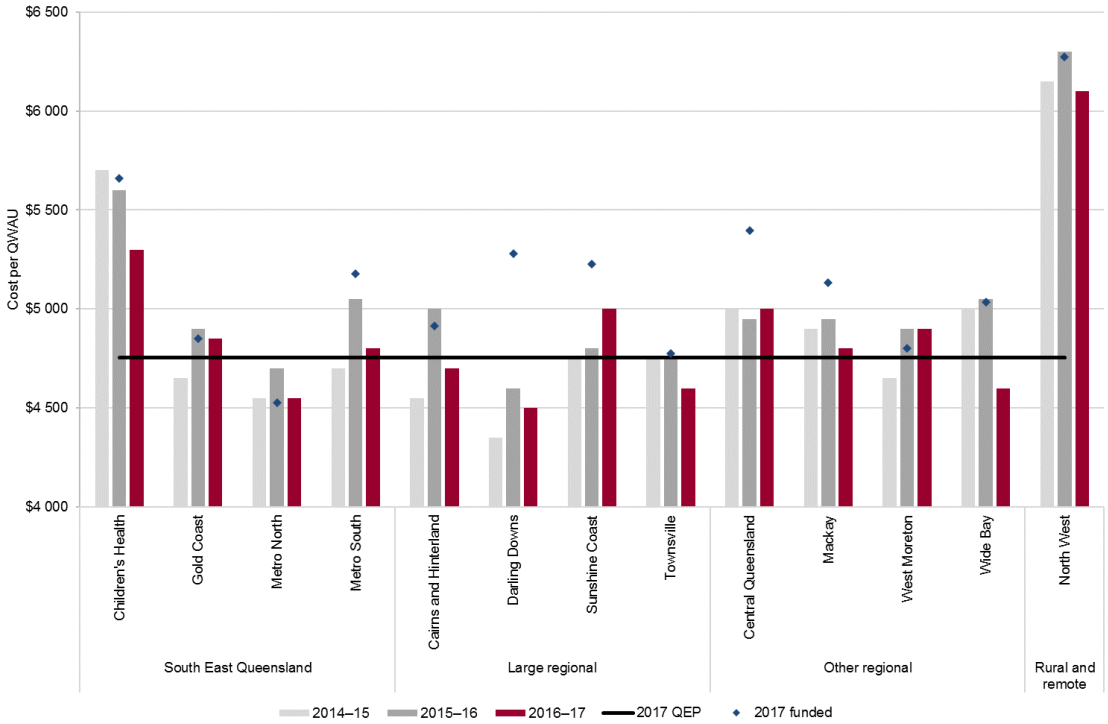
DoH measures HHSs that receive activity-based funding against the average cost of delivering one unit of clinical activity (Queensland weighted activity unit or QWAU).

The Queensland efficient price (QEP) is a benchmark of the efficient cost of providing public hospital services, excluding the cost of teaching and training. The average QWAU cost of an efficient HHS should be at or below the QEP.

Health Services are funded based on the activity they deliver and as the mix of services vary across HHS, the QWAU cost varies across Health Services. When DoH assesses a HHS's cost per QWAU performance, it uses the QEP plus any additional funding received by the HHS (the funded rate).

Figure 3H shows the actual average QWAU cost for each activity-based funded HHS over the last three years, compared to the 2016–17 QEP and the funded rate. In 2016–17, the QEP was set at $4 755 per WAU (2016: $4 579).

Figure 3H
Cost per QWAU for activity-based funded HHSs



Note: The 2016–17 figures are based on HHS QWAU activity data compiled in August 2017 and cost data compiled in September 2017. For comparative purposes, the 2016–17 model has been applied to prior year figures.

Source: Queensland Audit Office.

In 2016–17, there was an average decrease of three per cent in the cost per QWAU across the sector. Ten HHSs achieved decreases of between one per cent and nine per cent, while two HHSs had increases of lesser amounts. These results are in contrast to our previous report *Hospital and Health Services: 2015–16 results of financial audits* (Report 9: 2016–17), where we noted that in 2015–16, most HHSs had increased their cost per QWAU compared to the prior year. HHSs employed more people in 2016–17, but the cost of additional employees was outweighed by the increase in activity. This brought down the average cost per QWAU.

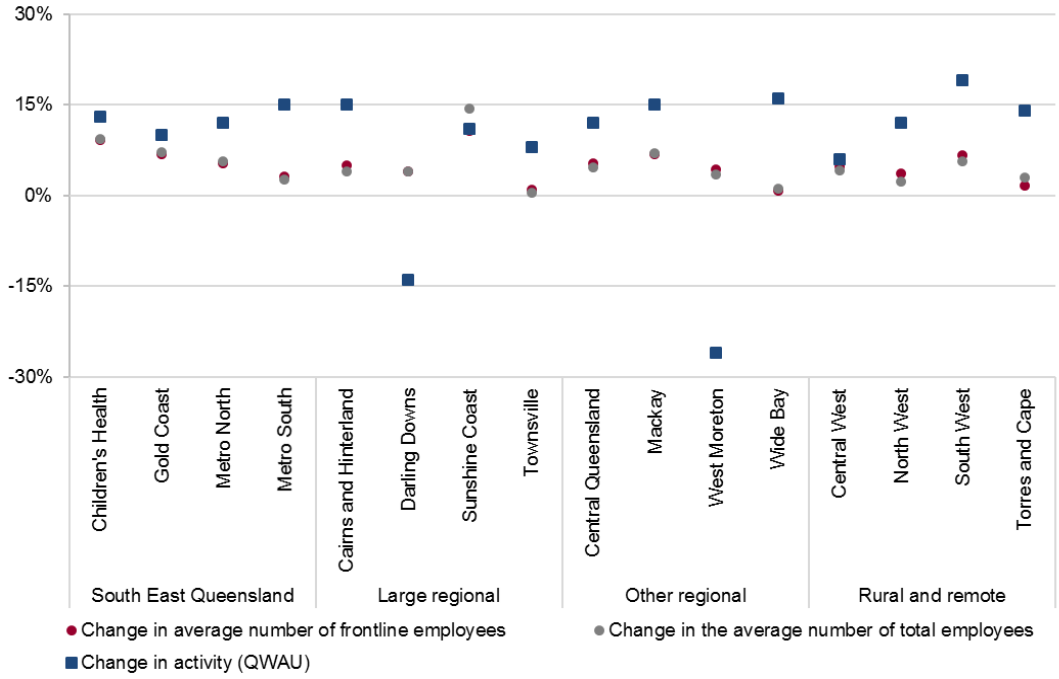
Five HHSs achieved an average cost per activity below the Queensland efficient price in 2016–17, compared to one in 2015–16. This further demonstrates the efficiency improvements they have made.

Two HHSs, Children's Health Queensland HHS and North West HHS, have the highest average cost per activity in the sector. Children's Health Queensland HHS delivers care in a specialised paediatric hospital with increased supervision, with children needing more support for interventions, family support and lower economies of scale. North West HHS services patients in a remote location with a proportionally high indigenous population. These circumstances increase the cost of care.

Employee expenses

HHSs employed an average of 70 000 employees in 2016–17, an increase of five per cent compared to the prior year. Employee expenses represent approximately 70 per cent of HHSs' total expenses. HHSs employed 82 per cent in front line positions, with the remaining 18 per cent providing operational and administrative support. Figure 3I compares the average change in employee numbers (front line employees and total) to the change in QWAU activity between 2016–17 and 2015–16.

Figure 3I
Change in activity compared to change in employees



Source: Queensland Audit Office.

Most HHSs show a growth in activity that has exceeded the growth in average number of employees. Sunshine Coast HHS did not achieve growth in activity above employee growth as it brought additional employees online for the opening of the Sunshine Coast University Hospital in March 2017.

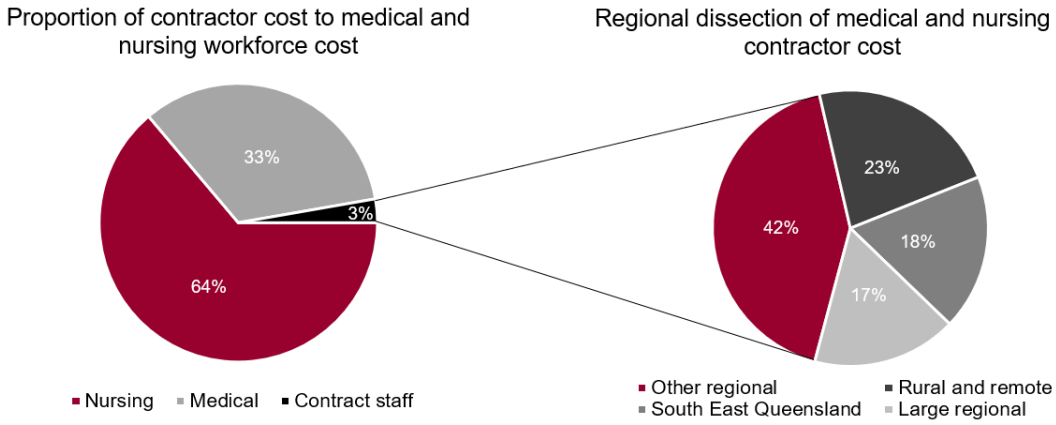
The change in activity for West Moreton HHS and Darling Downs HHS is distorted by the administrative discharge of long-term mental health patients in 2015–16. Statewide, these HHSs have the highest proportion of long-term mental health patients. As clinical activity is counted on the discharge of a patient, these long-term patients had not previously been included in activity counts. The effect of administratively discharging these patients was to increase the 2015–16 activity (by several years of activity for some patients) which gives the appearance of negative growth in 2016–17.

Medical and nursing contractors

HHSs supplement their established workforce with contractors to meet demand for health services. Because contractors are not part of the established workforce, the actual number of people used by HHSs is not visible to the users of their financial statements. This year we looked at the cost of medical and nursing contractors to assess their significance to the HHSs.

In 2016–17, HHSs spent $194.3 million on medical and nursing contractors. This expense represents 2.8 per cent of the HHSs' employee expenses. Figure 3J shows the proportion of medical and nurse contractors compared to the cost of the HHSs' established medical and nursing workforce.

Figure 3J
Cost of medical and nursing contractors by HHS regions



Source: Queensland Audit Office.

The regions with the highest expense on medical and nursing contractors are the rural and remote and other regional HHSs. HHSs in these areas often find it difficult to attract and retain permanent staff and are forced to engage contractors. Due to the higher costs involved with contracted staff, some HHSs like Central West are making concerted efforts to engage staff on a permanent basis.

Understanding financial position

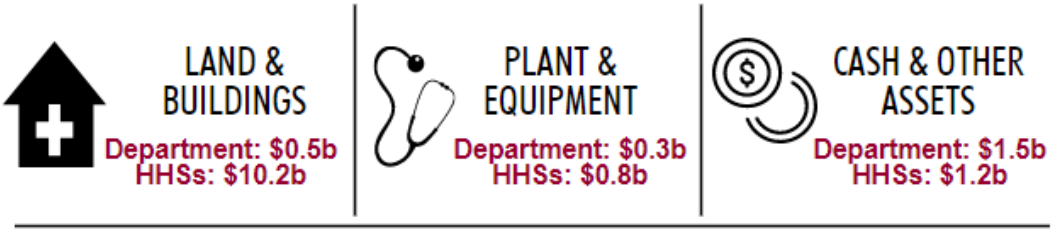
The financial position of Queensland Health entities is measured by their net assets—the difference between total assets and total liabilities. Over time, financial position can indicate whether financial health is improving or deteriorating. A growing positive net asset position indicates that a Queensland Health entity has greater capacity to meet an increase in future service demands. As at 30 June 2017, the combined net asset position totalled $12 billion, which is similar to the result achieved in 2015–16.

Queensland Health entities do not hold any liabilities, apart from short-term debts to suppliers and the interest-bearing liability arising from the public–private partnership arrangement for the Sunshine Coast University Hospital. (A public–private partnership is when a government service is funded and operated by government and a private sector body.)

Assets

In 2016–17, Queensland Health entities reported total assets of $15.2 billion, of which 70.4 per cent is property, plant, and equipment.

Figure 3K
Total assets for Queensland Health entities by type for 2016–17



Source: Queensland Audit Office.

Events and transactions affecting assets this year

Measuring the value of assets

Queensland Health entities must ensure that the carrying value of their assets (the value at acquisition less accumulated depreciation) reported in their financial statements reflects their fair value. Queensland Health entities measure the fair value of assets in two ways—market value or current replacement cost. Using the market value approach, fair value is determined by what a buyer would be willing to pay for an asset. This approach is used for valuing land and non-specialised buildings, such as residential properties. Current replacement cost is used to measure the fair value of specialised buildings such as hospitals, because there is no active market to buy and sell such assets.

Queensland Health entities reported $1.2 billion in land at 30 June 2017, which is similar to the prior year. The value of buildings increased by $1.5 billion to $9.4 billion. This includes the Sunshine Coast University Hospital and the impact of asset revaluations (of $300 million).

Sunshine Coast University Hospital

The Sunshine Coast University Hospital opened in 2016–17 with approximately 450 beds. This will expand to approximately 738 beds by 2021.

The Sunshine Coast University Hospital was built through a public–private partnership arrangement with Exemplar Health; a consortium of Lendlease, Siemens, and Capella Capital with partners Spotless Facilities Services. Exemplar Health's role was to design, construct, partially finance, and commission the hospital.

The total cost of construction of the Sunshine Coast University Hospital was approximately $1.35 billion. The Queensland Government contributed $820 million during construction with the remaining $534 million (plus interest of $730 million) to be paid to Exemplar Health over the next 25 years.

Over the next 25 years, Exemplar Health will also:

- maintain the buildings and grounds in return for agreed life cycle payments. They bear the risk that the costs to repair, maintain, and refurbish the facility exceeds these contractual payments
- operate two car parks it built and gifted to the Sunshine Coast HHS. They lease the car parks from the HHS for no cost and collect the revenue.

Maintaining buildings

Last year we reported that HHSs were in their third year of their four-year backlog maintenance remediation program (the program). At the completion of the program this year, we asked the HHSs about its impact on their list of backlog maintenance items.

Seven HHSs indicated that backlog maintenance has reduced. However, the remaining HHSs indicated that backlog maintenance has either not changed or has increased. When the program finishes, HHSs' expenditure on regular maintenance may need to be increased to minimise the build-up of backlog maintenance.

Future challenges and emerging risks

Queensland Health entities are investing in modern information systems and digital hospitals. Investment in information technology (IT) systems carries both financial and operational risk, and planned benefits may not be fully realised if these risks are not managed. The Queensland Health *eHealth Investment Strategy* released in 2015 identified over $1 billion in IT priorities over 20 years.

Integrating electronic medical records and digitising hospitals

DoH is implementing integrated electronic medical records progressively across Queensland hospitals, replacing existing paper-based systems, and implementing additional functionality to 'digitise' hospitals. The total amount spent on the program since September 2011 is $321 million.

During 2016–17, the Princess Alexandra Hospital received the Medications, Anaesthetics and Research Support (MARS) module. It was the first public hospital to do so in Queensland. The department expects that 24 hospitals will have implemented the full suite of digital hospital modules by the end of 2020.

The Queensland Audit Office is conducting a performance audit during 2017–18 to examine how well Queensland Health entities have planned and are delivering its digital hospitals program, and whether they are realising the intended information sharing and patient benefits.

Patient administration system replacement program

DoH operates the patient administration system for all the Queensland Health entities. This system is used to capture and manage both admitted and non-admitted patient, clinical and administrative data. The current system is over 25 years old. The department is in the preliminary stages of developing a business case for the replacement of this system with a modern solution.

Laboratory information system renewal program

DoH operates the laboratory information system for all Queensland Health entities. This system is used for all public pathology services and the current system is over 15 years old. DoH has begun a renewal program to deliver a modern, efficient, and cost-effective system at a budgeted cost of $60.9 million.

DoH is working with the preferred supplier to develop a prototype to evaluate the new system's capability and ability to integrate with existing Queensland Health systems.

Financial system renewal project

The financial system renewal project will replace the 20-year-old SAP product currently used by Queensland Health entities. The new system will provide DoH and the HHSs with a contemporary SAP finance solution (SAP S/4HANA) and an integrated strategic sourcing program (SAP Ariba). The project is co-sponsored by DoH, Metro North HHS, and Metro South HHS. It has a budget of $105 million over three years and had incurred $15.3 million to 30 June 2017.

Recognising the significant change for people and the business, the project has engaged an external change management partner to assist. More than half of the budget is allocated to testing and validating the system, including change management. The project will use built-in best practice processes to limit the modifications to the system.

The implementation plan for the project is currently being determined. It is likely to go live in late 2018.

New lease accounting standard

The introduction of the new accounting standard AASB 16 *Leases*, for reporting periods beginning on or after 1 January 2019, will introduce a single lease accounting model for lessees. This will result in almost all leases being recognised in the statement of financial position, as the distinction between operating and finance leases will be removed. Under the new standard, most leases previously not reported as assets and liabilities will be included in the future. The timing of recognition of expenses will also change.

In 2016–17, Queensland Health entities collectively reported operating lease commitments of approximately $1 billion in their future commitments as lessee. Some of this will be brought onto the statement of financial position as an asset (right of use) upon implementation of the new standard.

4. Internal controls

Introduction

This chapter evaluates the effectiveness of internal controls as they relate to our audit.

The Department of Health (DoH) is responsible for processing the payroll and accounts payable financial transactions of the hospital and health services (HHSs), and for managing the financial information systems that HHSs use. HHSs rely on their own controls and those of DoH to minimise the risk of fraud or error in their financial statements. In assessing the effectiveness of the controls of the Queensland Health entities (DoH and the HHSs), we consider the controls of DoH (the service provider) as well.

Through our analysis, we aim to promote stronger internal control frameworks and to mitigate financial losses and damage to public sector reputation by initiating effective responses to identified control weaknesses.

Conclusion

We concluded the control environment was suitably designed and implemented for all Queensland Health entities. As a result, we relied on the internal control systems of the entities.

We identified two significant deficiencies in information and communication controls at Central Queensland HHS, but this did not result in a material error in their financial statements.

Of the 107 internal control deficiencies reported this year, 60 were unresolved deficiencies from the prior year. By not addressing internal control deficiencies within agreed timeframes, the entities expose themselves to a higher risk of fraud or error.

Internal controls at HHSs complement the internal controls at DoH—their service provider—as they relate to the HHSs' financial transactions. While there were some weaknesses in DoH's general information technology controls and internal controls over accounts payable processing, these weaknesses did not affect the reliability of reported financial results for Queensland Health entities.

Our audit of internal controls

We assess internal controls to ensure they are suitably designed to prevent, or detect and correct, material misstatements in the financial report. We also assess whether they achieve compliance with legislative requirements and make appropriate use of public resources. Where we identify controls that we plan to rely on, we test how effectively these controls are operating to ensure they are functioning as intended.

We are required to communicate deficiencies in internal controls to management.

Our rating of internal control deficiencies

Deficiency: arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.

Significant deficiency (high risk matters): a deficiency, or combination of deficiencies, in internal control that requires immediate remedial action.

Our rating of internal control deficiencies allows management to gauge relative importance and prioritise remedial actions.

We increase the rating from a deficiency to a significant deficiency when:

- we consider immediate remedial action is required
- there is a risk of material misstatement in the financial statements
- there is a risk to reputation
- the non-compliance with policies and applicable laws and regulations is significant
- there is potential to cause financial loss including fraud

Where management has not taken appropriate timely action to resolve a deficiency we may increase the rating to a significant deficiency from 2017–18.

Control deficiencies categorised by COSO component

We categorise internal controls using the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components that need to be present and operating together for a successful internal control system. These components are explained in more detail in Appendix I.

Figure 4A shows control deficiencies categorised by COSO component reported to management at 31 August 2017.

This year, we identified two significant deficiencies in information and communication.

Figure 4A
Number and category of internal control deficiencies for Queensland Health entities

 **Control environment** *Structures, policies, attitudes, and values that influence daily operations*	 **Risk assessment** *Processes for identifying, assessing, and managing risk*	 **Control activities** *Implementation of policies and procedures to prevent or detect errors and safeguard assets*	 **Information & communication** *Systems to capture and communicate information to achieve reliable financial reporting*	 **Monitoring activities** *Oversight of internal controls for existence and effectiveness*
24 deficiencies	Five deficiencies	60 deficiencies	Two significant deficiencies and 14 deficiencies	Two deficiencies

Source: Queensland Audit Office adapted from Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework.

Control environment

We found that four HHSs have not formally accepted their payroll service agreements with DoH. This is because DoH and the HHSs are negotiating terms as they transition from an annual to a three-year agreement. These agreements detail the service level and reporting requirements for DoH-provided services.

The absence of tailored practice manuals for financial management continues to be an unresolved matter for five HHSs. The manual describes the policies and procedures that relate to the financial management of the respective HHS, including internal controls. This means that internal controls at these HHSs may not be consistently applied, increasing the risk of fraud or error. All five HHSs report that they are in the process of preparing their draft manual for board endorsement within the next 12 months.

Risk assessment

In the prior year, we assessed the information technology disaster recovery plans (IT DRPs) for four HHSs and concluded that their IT DRP processes were immature. We found that these HHSs did not have comprehensive IT DRPs that are reviewed and tested annually. Further, these HHSs had not undertaken business impact assessments of disasters on their IT environment. This year, three of the four HHSs have not resolved these issues. Delays in implementing remedial action means that the IT environment for these HHSs may not be robust, impacting on their ability to recover critical systems within an acceptable time frame in the event of a disaster.

Control activities

Across HHSs, more than half of deficiencies identified were procurement-related issues, including non-compliance with procurement policies, inadequate processes for assessing contractors' performance, and insufficient monitoring of actual expenditure against contract values. The existence of these deficiencies makes it difficult for HHSs to demonstrate that they have achieved value for money in their procurement activities. It also increases the risk of fraud or error.

Service provider

DoH is a service provider, delivering a range of services to the HHSs. These services include accounts payable, payroll, and information system services. Service providers can deliver cost efficiencies and provide an effective layer of control. They also present risks to the participating entities due to the lack of visibility over controls at the service provider.

DoH engage us to prepare two assurance reports on their controls. Figure 4B shows the scope of these reports and their period of coverage.

Figure 4B
Service provider assurance reports

Scope of Report	Coverage period	Opinion
Assurance over the design, implementation, and operating effectiveness of controls. It highlights the rate of deviations in the transactions tested. (Type 2)	01.07.16 to 31.03.17	Modified
Assurance over the design and implementation of controls. It highlights matters identified through observation and inquiry. (Type 1)	As at 30.06.17	Unmodified

Source: Queensland Audit Office.

Our modified audit opinion on the Type 2 report related to:

- SAP HR and Workbrain application and security management. We found that DoH had not adequately secured SAP HR for system changes. This resulted in an inappropriate change to settings within SAP HR that was not identified in a timely manner. We performed additional testing and did not identify any instances of fraud or error resulting from this deficiency
- deficiencies in validating the appropriate approval of vendor invoices at one service centre. We performed testing over complementary controls at two affected HHSs and did not identify any instances of fraud or error resulting from these deficiencies.

The Type 1 report was unmodified, meaning that we were able to confirm, by observation and inspection of documents, that DoH controls were implemented at 30 June, including the resolution of control deficiencies identified in the Type 2 report.

HHSs cannot solely rely on these assurance reports for the adequacy of their internal controls. Typically, HHSs need controls:

- when the transaction is initiated—such as approval by a HHS officer with the appropriate financial authority
- after transactions are processed—such as reviewing cost centre reports.

These complementary HHS controls are required to monitor performance of the service provider and ensure the overall internal control strength is maintained.

Information and communication

Last year, we reported an issue about DoH's ageing SAP financial system, which is no longer supported by the vendor. The system is used to process transactions and produce financial statements for Queensland Health entities. DoH has put in place mitigating action to maintain system performance and stability until the financial system is replaced. The financial system replacement project will provide Queensland Health entities with a modern SAP solution in 2018–19.

This year, we identified two significant deficiencies at Central Queensland HHS. We found a lack of capability at the HHS that resulted in two significant deficiencies in the complex process of revaluing land and buildings. As a consequence, the HHS made material adjustments to its financial statements.

Similarly, we found that Queensland Health entities, particularly small regional, and rural and remote HHSs, do not have strong processes for assessing the inputs, assumptions, and judgements used to calculate the fair value of assets and determine their remaining useful lives. These HHSs struggle to find people with the appropriate expertise to manage the asset valuation process and ensure that the valuations satisfy financial reporting requirements.

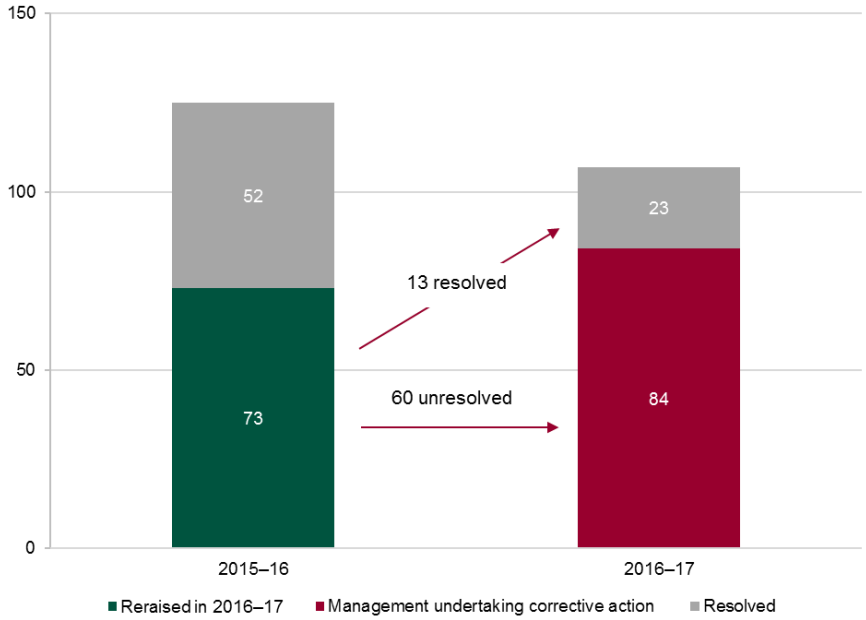
Queensland Health entities carry $10.7 billion of land and buildings, representing more than 70 per cent of their total assets. Robust critical review of asset valuations is necessary to ensure that asset values are reasonable and depreciation reflects the consumption of the asset.

Status of internal control deficiencies

Management, and those charged with governance, are responsible for the efficient and effective operation of internal controls. All Queensland Health entities have an audit committee to assist those charged with governance to obtain assurance over internal control systems. An audit committee is responsible for considering audit findings, management responses to those findings, and monitoring remedial action for resolving audit findings within agreed timeframes.

We have analysed the appropriateness and timeliness of remedial action undertaken to resolve any audit matters we identified. Figure 4C shows the total internal control deficiencies in the current year and prior year, and their status at 31 August 2017.

Figure 4C
Status of internal control deficiencies at 31 August 2017



Source: Queensland Audit Office.

Of the deficiencies raised this year, 60 (56 per cent) were deficiencies raised in the previous year but not resolved by Queensland Health entities by 31 August 2017. Some of the unresolved deficiencies were originally reported in 2013–14. This means that some Queensland Health entities are taking more than 12 months and up to three years to implement action to address their internal control weaknesses. The lack of timely action on internal control deficiencies exposes Queensland Health entities to an increased risk of error or fraud.

Long outstanding deficiencies at Queensland Health entities include:

- the absence of tailored financial management practice manuals for current financial practices
- poor contract management processes, non-compliant expense approvals, and poor expense monitoring processes.

The delay in implementing remedial action is primarily due to the lack of availability of resources with the appropriate skill and capability.

Case study 1 identifies good practice by the Department of Health for monitoring recommendations.

Case study 1

Monitoring the implementation of recommendations

For many years the Department of Health's Audit and Risk Committee has monitored the resolution of audit issues. Internal audit tracks, and the committee monitors, the resolution of issues raised by internal audit, and QAO financial, compliance and performance audits. Even where the department is not directly subjected to a performance audit, any recommendations that apply to all agencies are identified and monitored.

The committee considers the remedial action and timeframe proposed by management and then monitors the resolution of issues. It will also invite officers responsible for addressing issues to brief the committee where implementation of action is taking longer than anticipated and to get first-hand information about the action proposed.

In June 2017 the committee extended its monitoring to recommendations raised by external regulatory agencies for improving internal controls, which includes reports issued by two Queensland integrity agencies—the Crime and Corruption Commission and the Queensland Ombudsman.

This means that the committee is informed of the department's progress on implementing agreed actions to mitigate the risk of missing or ineffective internal controls.

Appendices

Appendix A—Full responses from agencies

As mandated in Section 64 of the *Auditor-General Act 2009*, the Queensland Audit Office gave a copy of this report with a request for comments to all health sector entities.

The heads of these agencies are responsible for the accuracy, fairness and balance of their comments.

This appendix contains their detailed responses to our audit recommendations.

Comments received from Director-General, Department of Health

Queensland Government

Enquiries to: Mr Alistair Luckas
Senior Director
Statutory and Advisory Services
Finance Branch
Corporate Services Division
Telephone: 3199 3494
File Ref: C-ECTF-17/9096-002

Mr Brendan Worrall
Auditor-General
Queensland Audit Office
Level 14, 53 Albert Street
BRISBANE QLD 4000

Email: qao@qao.qld.gov.au

Dear Mr Worrall

Thank you for your letter dated 15 December 2017 regarding the Queensland Audit Office's (QAO) proposed report to Parliament titled *Health: 2016-17 results of financial audits*.

I acknowledge receipt of the report and the contents proposed to be included in this report. I am responding on behalf of the Department of Health (the Department) and the 16 Hospital and Health Services (HHSs) – referred to as Queensland Health entities in the report.

It is pleasing to note that all Queensland Health entities received an unmodified audit opinion on their financial statements for 2016-17 within the statutory deadline of 31 August 2017. I note that Queensland Health entities have implemented more robust financial year-end processes with the Department and a number of HHSs receiving green lights on all assessment criteria in relation to the financial statement preparation process.

2016-17 Financial Results

This year, our system reported a combined surplus of $56.2 million. In particular, HHSs achieved a surplus of $45.9 million. This is a significant improvement compared to a deficit of $46.1 million in the prior year. This outcome reflects HHSs' continuous effort in cost management and efficiency improvement.

In 2015-16, four HHSs indicated to the Department they were facing financial challenges and reported deficits in their financial statements. This year, three of them – Central Queensland, North West and Wide Bay – have made a significant turnaround and achieved surplus operating positions. Whilst Cairns and Hinterland is still facing financial challenges, their financial remediation initiative has gained traction and delivered cost savings and revenue improvements. The Department is working closely with Cairns and Hinterland to ensure its long-term financial sustainability.

Office
Level 37
1 William Street
BRISBANE QLD 4000

Postal
GPO Box 48
BRISBANE QLD 4001

2016-17 Activity and Operating Performance

HHSs demonstrated improvements in operating efficiency in three aspects:

- HHSs delivered more clinical activity in 2016-17 than the previous year. This was achieved with a lower expenditure growth which is a significant improvement compared to last year where the expenditure growth was one per cent higher than the revenue growth.
- HHSs delivered more clinical activity at a lower average cost. This is in contrast to 2015-16 when most HHSs experienced an increase in the cost per Queensland Weighted Activity Unit compared to the prior year.
- Five HHSs achieved an average cost per activity below the Queensland Efficient Price (QEP) compared to one in 2015-16.

Changes in public hospital funding from the Australian Government

The Department and HHSs are fully aware of the 6.5 per cent cap on activity growth introduced by the Commonwealth Government in 2017-18. We are closely following developments in this matter and waiting on the Commonwealth to advise the final 2016-17 activity data which serves as the baseline for the funding in 2017-18. The Department will work closely with HHSs and the Commonwealth to address funding issues as a result of this change.

Maintenance of buildings

Upon completion of their current building maintenance program, seven HHSs advised a decrease in items needed to be maintained, whilst the remaining HHSs still face challenges in this regard. The Department will continue to work with HHSs to ensure the buildings are properly maintained to achieve full service potential.

Significant internal control deficiencies

I note that QAO identified two significant deficiencies in information and communication controls in Central Queensland HHS in relation to the capability to manage the asset valuations process.

Central Queensland is working on these issues as a matter of priority. They will be performing a full land and building valuation for the 2017-18 financial year and have engaged an external specialist to assist with the analysis of the valuation results. The HHS is also developing a detailed training plan for internal asset staff to bridge the knowledge gaps.

Information technology disaster recovery plans (IT DRPs)

Whilst noting the delays in HHSs to implement IT DRPs, I am pleased to advise that, of the three HHSs that did not have mature IT DRPs at the end of 2016-17, two have since established their IT DRPs in 2017-18 and the remaining HHS expects to finalise its plan later this financial year. eHealth has provided input and assisted reviews of the IT DRPs and continues to provide support to HHSs in this regard.

Control activities at service provider

The Department is a service provider delivering a range of services to HHSs including accounts payable, payroll and information systems. I note the reference to the QAO Type 2 Assurance Report and QAO's confirmation that in subsequent Type 1 testing it was noted that the Department had resolved the identified deficiency in SAP HR and Workbrain application and security management. I can advise that the Department has implemented a range of ongoing measures to prevent a reoccurrence of this issue.

2

Delay in resolving internal control deficiencies

Although some HHSs, especially the rural and remote ones, have experienced delays due to lack of capacity, there has been consistent focus on the closure of open QAO recommendations, and the Audit and Risk Committees in HHSs will continue to play an active role in this regard.

I note that, of the 60 deficiencies that were raised in prior years, the report cites the following long outstanding deficiencies in particular:

- Tailored Financial Management Practice Manuals (FMPMs) - most HHSs have a tailored FMPM in place to guide financial practices and mitigate risks. Other HHSs are on track to implement tailored FMPMs in 2017-18.

- Weakness in contract management processes - addressing procurement-related deficiencies has been high on HHSs' agenda. Some HHSs have a robust contract management framework in place whilst others are working towards this goal.

Should you or officers of your Department require further information, the Department of Health's contact is Mr Alistair Luckas, Senior Director, Statutory and Advisory Services, Finance Branch, Corporate Services, on telephone

Yours sincerely

Michael Walsh
Director-General
Department of Health
23/01/2018

3

Appendix B—The Queensland Audit Office

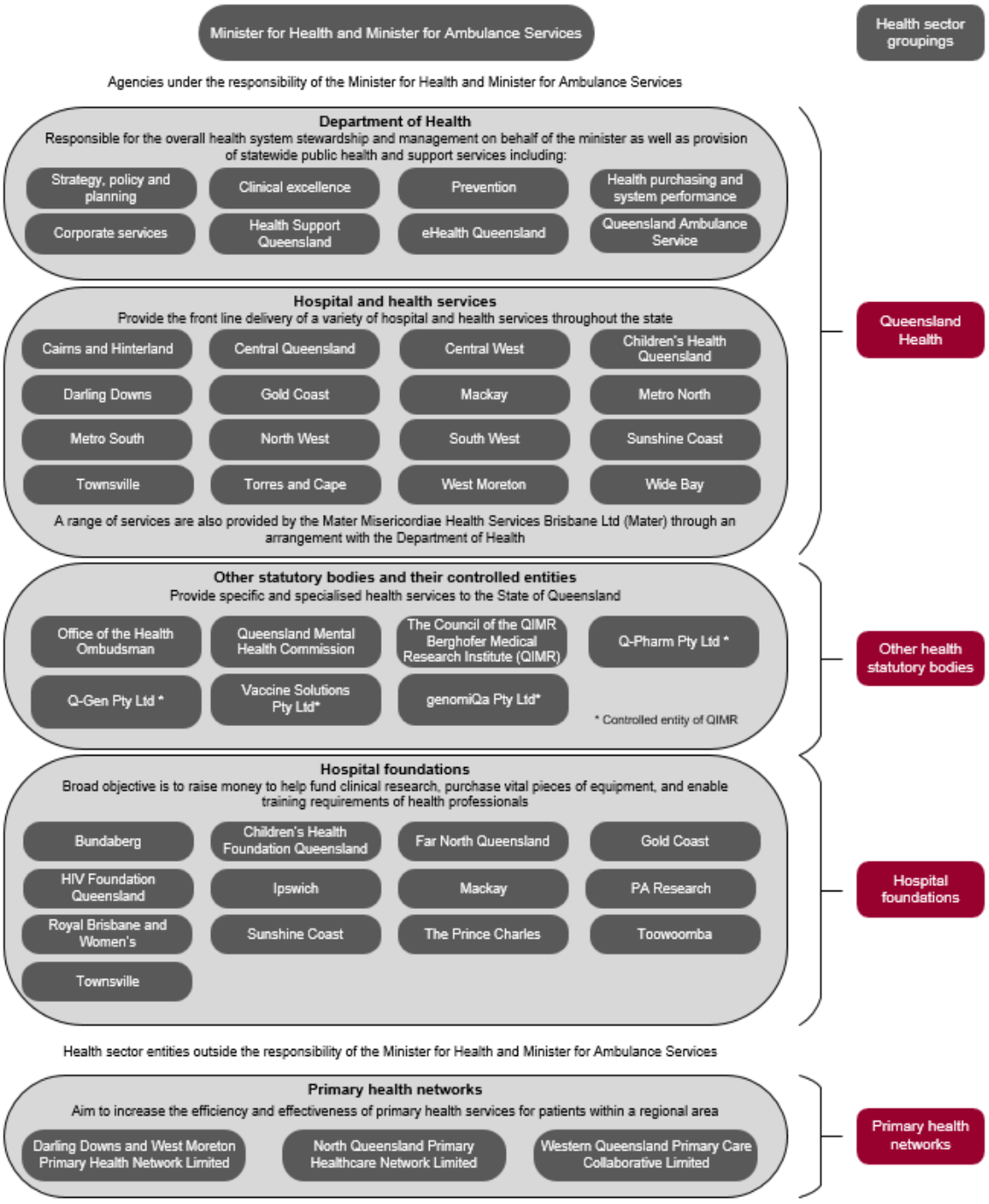
The auditor-general, supported by the Queensland Audit Office, is the external auditor of the state's public sector. Each year, through our financial audit program, we form independent audit opinions about the reliability of financial statements produced by state and local government entities.

We provide independent assurance directly to parliament about public sector finances. We also help the public sector meet its accountability obligations. Our role and the work we do is critical to the integrity of our system of government.

The auditor-general must prepare reports to parliament on each audit conducted. These reports must state whether the financial statements of a public sector entity have been audited. They may also draw attention to significant breakdowns in the financial management functions. This report satisfies these requirements.

Appendix C—Queensland public health sector

Figure C1
Queensland public health sector



Source: Queensland Audit Office.

Appendix D—Queensland HHS areas

Health and hospital services (HHSs) provide health services across metropolitan, regional, and rural areas of Queensland. We group HHSs into the following regions:

South East Queensland	Large regional	Other regional	Rural and remote
Children's Health Services HHS	Cairns and Hinterland HHS	Central Queensland HHS	Central West HHS
Gold Coast HHS	Darling Downs HHS	Mackay HHS	North West HHS
Metro North HHS	Sunshine Coast HHS	West Moreton HHS	South West HHS
Metro South HHS	Townsville HHS	Wide Bay HHS	Torres and Cape HHS

Appendix E—Legislative context

Framework

The health sector entities prepared their financial statements in accordance with the relevant legislative framework.

For the health sector entities listed below, the financial statements certification deadline is 31 August 2017 except for the primary health networks. The networks are required to provide their financial statements to the Australian Charities and Not-for-profits Commissioner by 31 December 2017.

Figure E1
Legislative framework

Entity type	Entity	Legislative framework
Department	Department of Health	*Financial Accountability Act 2009* Financial and Performance Management Standard 2009
Statutory body	Cairns and Hinterland Central Queensland Central West Children's Health Queensland Darling Downs Gold Coast Mackay Metro North Metro South North West Sunshine Coast Torres and Cape Townsville West Moreton Wide Bay Office of Health Ombudsman Queensland Mental Health Commission The Council of the Queensland Institute of Medical Research (trading as QIMR Berghofer) Bundaberg Health Services Foundation Children's Hospital Foundation Queensland Far North Queensland Hospital Foundation Gold Coast Hospital Foundation HIV Foundation Queensland Ipswich Hospital Foundation Mackay Hospital Foundation PA Research Foundation Prince Charles Hospital Foundation Royal Brisbane and Women's Hospital Foundation Sunshine Coast Health Foundation Toowoomba Hospital Foundation Townsville Hospital Foundation	
Controlled entities of statutory body	genomiQa Pty Ltd Q-Pharm Pty Ltd Q-Gen Pty Ltd Vaccine Solutions Pty Ltd	*Corporations Act 2001* Corporations Regulation 2001

Entity type	Entity	Legislative framework
Primary Health Networks	North QLD Primary Healthcare Network Ltd Darling Downs and West Moreton Primary Health Network Ltd Western QLD Primary Care Collaborative Ltd	*Australian Charities and Not-for-profits Commission Act 2012* Australian Charities and Not-for-profits Commission Regulation 2013

Source: Queensland Audit Office.

Other health statutory bodies and their controlled entities

There are three statutory bodies within the health sector established by their own enabling legislation. Figure E2 identifies the enabling legislation and the controlled entities for each of these bodies.

Figure E2
Health statutory bodies

Entity name	Enabling legislation	Controlled entities
Queensland Mental Health Commission (QMHC)	*Queensland Mental Health Commission Act 2013*	—
Office of the Health Ombudsman (OHO)	*Health Ombudsman Act 2013*	—
The Council of the QIMR Berghofer Medical Research Centre (QIMR)	*Queensland Medical Research Institute Act 1945*	genomiQa Pty Ltd* Q-Pharm Pty Ltd Q-Gen Pty Ltd* Vaccine Solutions Pty Ltd*

* These entities did not prepare financial statements for the 2016–17 financial year for the following reasons:

- genomiQa Pty Ltd—no transactions in 2016–17
- Q-Gen Pty Ltd—dormant entity
- Vaccine Solutions Pty Ltd—board of directors' determination.

Source: Queensland Audit Office.

Hospital foundations

There are 13 hospital foundations established under the *Hospital Foundations Act 1982*. Hospital foundations raise revenue through fundraising activities and investment activities. Some foundations receive research grants from the Australian Government or Queensland Government. Monies are spent on hospital research programs and equipment purchases.

Four hospital foundations are audited by the Queensland Audit Office. The remaining nine hospital foundations are exempted from audit by the auditor-general under the *Auditor-General Act 2009* but must appoint an appropriately qualified person to undertake their audit. Details of when the audit of all hospital foundations was completed are included in Appendix F.

Primary health networks

There are seven primary health networks (PHNs) established in Queensland. PHNs are incorporated under the *Corporations Act 2001* as companies limited by guarantee. They are also registered charities under the *Australian Charities and Not-for-profit Commission Act 2012*. PHNs receive funding from the Australian Government and commission primary health care projects from private and public health entities.

Three of the seven PHNs are considered controlled or jointly controlled Queensland public sector entities because collectively, the HHSs hold the majority of membership in these entities. PHNs are reconsidering their membership composition for 2017–18, which may mean they are no longer considered Queensland public sector entities subject to audit by the auditor-general. Figure E3 identifies the HHS membership of the three PHNs included in this report.

Figure E3
PHN membership

PHN name	HHS membership of PHN	HHS
Darling Downs and West Moreton Primary Health Network Limited	50 per cent	Darling Downs HHS
Western Queensland Primary Care Collaborative Limited	100 per cent	Central West HHS North West HHS South West HHS
North Queensland Primary Healthcare Network Limited	67 per cent	Townsville HHS Mackay HHS Cairns and Hinterland HHS Torres and Cape HHS

Source: Queensland Audit Office.

Accountability requirements

The *Financial Accountability Act 2009* applicable to the health sector entities requires these entities to:

- achieve reasonable value for money by ensuring the operations of the statutory body are carried out efficiently, effectively, and economically
- establish and maintain appropriate systems of internal control and risk management
- establish and keep funds and accounts that comply with the relevant legislation, including Australian accounting standards.

Queensland state government financial statements

Each year, Queensland state public sector entities must table their audited financial statements in parliament.

These financial statements are used by a broad range of parties including parliamentarians, taxpayers, employees, and users of government services. For these statements to be useful, the information reported must be relevant and accurate.

The auditor-general's audit opinion on these entities' financial statements assures users that the statements are accurate and in accordance with relevant legislative requirements.

We express an *unmodified opinion* when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards. We *modify* our audit opinion where financial statements do not comply with the relevant legislative requirements and Australian accounting standards, and are not accurate and reliable.

Sometimes we include an *emphasis of matter* in our audit reports to highlight an issue that will help users better understand the financial statements. These do not change the audit opinion.

Appendix F—Audit opinions

Entity	Date audit opinion issued	Type of audit opinion issued
Queensland Health entities		
Department of Health	30.08.2017	Unmodified
Cairns and Hinterland HHS	29.08.2017	Unmodified
Central Queensland HHS	31.08.2017	Unmodified
Central West HHS	31.08.2017	Unmodified
Children's Health Queensland HHS	30.08.2017	Unmodified
Darling Downs HHS	31.08.2017	Unmodified
Gold Coast HHS	23.08.2017	Unmodified
Mackay HHS	30.08.2017	Unmodified
Metro North HHS	31.08.2017	Unmodified
Metro South HHS	25.08.2017	Unmodified
North West HHS	31.08.2017	Unmodified
South West HHS	31.08.2017	Unmodified
Sunshine Coast HHS	30.08.2017	Unmodified
Torres and Cape HHS	25.08.2017	Unmodified
Townsville HHS	29.08.2017	Unmodified
West Moreton HHS	28.08.2017	Unmodified
Wide Bay HHS	30.08.2017	Unmodified
Other health statutory bodies and controlled entities		
Office of the Health Ombudsman	30.08.2017	Unmodified
Queensland Mental Health Commission	17.08.2017	Unmodified
The Council of the Queensland Institute of Medical Research (trading as QIMR Berghofer)	31.08.2017	Unmodified
Q-Pharm Pty Ltd (controlled entity of QIMR)	31.08.2017	Unmodified—Emphasis of matter

Entity	Date audit opinion issued	Type of audit opinion issued
Hospital foundations		
Children's Hospital Foundation Queensland	31.08.2017	Unmodified
HIV Foundation Queensland	17.08.2017	Unmodified—Emphasis of matter
Royal Brisbane and Women's Hospital Foundation	31.08.2017	Unmodified
The Prince Charles Hospital Foundation	31.08.2017	Unmodified
Primary health networks		
North Queensland Primary Healthcare Network Ltd	13.10.2017	Unmodified
Darling Downs and West Moreton Primary Health Network Ltd	27.10.2017	Unmodified
Western Queensland Primary Care Collaborative Ltd	03.10.2017	Unmodified

Appendix G—Entities exempt from audit by the auditor-general

Audit	Audit Firm	Date audit opinion issued	Type of audit opinion issued
Bundaberg Health Services Foundation	Levert Audit Services	06.09.2017	Unmodified
Far North Queensland Hospital Foundation	BDO Audit Pty Ltd	29.08.2017	Unmodified
Gold Coast Hospital Foundation	Dickfos Dunn Adam, Audit & Assurance	23.08.2017	Modified
Ipswich Hospital Foundation	Ramsay & Associates	21.08.2017	Unmodified
Mackay Hospital Foundation	Brown & Bird	15.08.2017	Unmodified
PA Research Foundation	KPMG	31.08.2017	Unmodified
Sunshine Coast Health Foundation	Focus Professional Group, AH Pty Ltd	29.08.2017	Unmodified
Toowoomba Hospital Foundation	Horizon Accounting Group	29.08.2017	Unmodified
Townsville Hospital Foundation	Crowe Horwath	05.09.2017	Unmodified

Appendix H—Our assessment of financial statement preparation

Our assessment of the effectiveness of financial statement preparation processes involved considering three components—the year end close process, the timeliness of financial statements, and the quality of financial statements.

Result summary

This table summarises our assessment of the financial statement preparation processes for Queensland Health entities and other health statutory bodies producing a financial report. The assessment colours are explained in the following pages.

Queensland Health entities

Entity	Financial statement preparation		
	Year end close process	Timeliness of draft financial statements	Quality of draft financial statements
Department of Health	●	●	●
Cairns and Hinterland HHS	●	●	●
Central Queensland HHS	●	●	●
Central West HHS	●	●	●
Children's Health Queensland HHS	●	●	●
Darling Downs HHS	●	●	●
Gold Coast HHS	●	●	●
Mackay HHS	●	●	●
Metro North HHS	●	●	●
Metro South HHS	●	●	●
North West HHS	●	●	●
South West HHS	●	●	●
Sunshine Coast HHS	●	●	●
Torres and Cape HHS	●	●	●
Townsville HHS	●	●	●
West Moreton HHS	●	●	●
Wide Bay HHS	●	●	●

Source: Queensland Audit Office.

We assess financial statement preparation processes under the following criteria.

Year end close process

State public sector entities should have a robust year end close process to enhance the quality and timeliness of the financial reporting processes. This year we assessed processes for year end financial statement preparation against the following key targets:

- prepare pro-forma financial statements by 30 April
- resolve known accounting issues by 30 April
- complete non-current asset valuations by 31 May
- complete early close processes
- conclude all asset stocktakes by 30 June.

These targets were developed based on advice previously issued by the Under Treasurer in 2014, and on better practice identified in other jurisdictions.

Rating scale	Assessment criteria—year end close process
● Fully implemented	All key processes completed by the target date
● Partially implemented	Three key processes completed within two weeks of the target date
● Not implemented	Less than two key processes completed within two weeks of the target date

Timeliness of draft financial statements

We assessed the timeliness of draft financial statements by considering whether entities prepared financial statements according to the timetables set by management. This includes providing auditors with the first complete draft of financial statements by the agreed date. A complete draft is one that management is ready to sign and where no material errors or adjustments are expected.

Rating scale	Assessment criteria—timeliness of draft financial statements
● Timely	Acceptable draft financial statements received on or prior to the planned date
● Generally timely	Acceptable draft financial statements received within two days after the planned date
● Not timely	Acceptable draft financial statements received greater than two days after the planned date

Quality of draft financial statements

We calculated the difference between the first draft financial statements submitted to audit and the final audited financial statements for the components of total revenue, total expenses, and net assets. Our quality assessment is based on the percentage of adjustments across each of these components.

Rating scale	Assessment criteria—quality of draft financial statements
● No adjustments	No adjustments were required
● No significant adjustments	Adjustments for any of the components of total revenue, total expenses, and net assets were less than five per cent
● Significant adjustments	Adjustments for any of the components of total revenue, total expenses, and net assets were greater than five per cent

Appendix I—Our audit of internal controls

Internal controls are designed, implemented, and maintained by entities to mitigate risks that may prevent them from achieving reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations.

In undertaking our audit, we are required under the Australian auditing standards to obtain an understanding of an entity's internal controls relevant to the preparation of the financial report.

We assess internal controls to ensure they are designed to prevent, or detect and correct, material misstatements in the financial report, and achieve compliance with legislative requirements and appropriate use of public resources.

Our assessment determines the nature, timing, and extent of testing we perform to address the management assertions at risk of material misstatement in the financial statements.

Where we believe the design and implementation of controls is effective, we select the controls we intend to test further by considering a balance of factors including:

- significance of the related risks
- characteristics of balances, transactions, or disclosures (volume, value, and complexity)
- nature and complexity of the entity's information systems
- whether the design of the controls addresses the management assertions at risk and facilitates an efficient audit.

Where we identify deficiencies in internal controls, we determine the impact on our audit approach, considering whether additional audit procedures are necessary to address the risk of material misstatement in the financial statements.

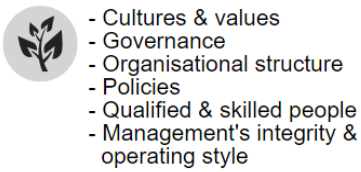
Our audit procedures are designed to address the risk of material misstatement, so we can express an opinion on the financial report. We do not express an opinion on the effectiveness of internal controls.

Internal controls framework

We categorise internal controls using the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components for a successful internal control system. These components are explained in the following paragraphs.

Control environment



The control environment is defined as the structures, policies, attitudes, and values that influence day-to-day operations. As the control environment is closely linked to an entity's overarching governance and culture, it is important that the control environment provides a strong foundation for the other components of internal control.

In assessing the design and implementation of the control environment we consider whether:

- those charged with governance are independent, appropriately qualified, experienced, and active in challenging management, ensuring it receives the right information at the right time to enable informed decision-making
- policies and procedures are established and communicated so people with the right qualifications and experiences are recruited, they understand their role in the organisation, and they also understand management's expectations regarding internal controls, financial reporting, and misconduct, including fraud.

Risk assessment

- Strategic risk assessment
- Financial risk assessment
- Operational risk assessment

Risk assessment relates to management's processes for considering risks that may prevent an entity from achieving its objectives, and how management agrees risks should be identified, assessed, and managed.

To achieve appropriate management of business risks, management can either accept the risk if it is minor, or mitigate the risk to an acceptable level by implementing appropriately designed controls. Risks can also be eliminated entirely by choosing to exit from a risky business venture.

Control activities

- General information technology controls
- Automated controls
- Manual controls

Control activities are the actions taken to implement policies and procedures in accordance with management directives and to ensure identified risks are addressed. These activities operate at all levels and in all functions, and can be designed to prevent or detect errors entering financial systems.

The mix of control activities can be categorised into general information technology controls, automated controls, and manual controls.

General information technology controls

General information technology controls form the basis of the automated systems control environment. They include controls over information systems security, user access, and system changes. These controls address the risk of unauthorised access and changes to systems and data.

Automated control activities

Automated controls are embedded within information technology systems. These controls can improve timeliness, availability, and accuracy of information by consistently applying predefined business rules. They enable entities to perform complex calculations in processing large volumes of transactions, and improve the effectiveness of financial delegations and segregation of duties.

Manual control activities

Manual controls contain a human element, which can provide the opportunity to assess the reasonableness and appropriateness of transactions. However, these controls may be less reliable than automated elements as they can be more easily bypassed or overridden. They include activities such as approvals, authorisations, verifications, reconciliations, reviews of operating performance, and segregation of incompatible duties. Manual controls may be performed with the aid of information technology systems.

Information and communication

- Non-financial systems
- Financial systems
- Reporting systems

Information and communication controls are the systems used to provide information to employees, and the processes used to control how responsibilities are communicated.

This aspect of internal control also considers how management generates financial reports, and how these reports are communicated to internal and external parties to support the functioning of internal controls.

Monitoring activities

- Management supervision
- Self-assessment
- Internal audit

Monitoring activities are the methods management uses to oversee and assess whether internal controls are present and operating effectively. This may be achieved through ongoing supervision, periodic self-assessments, and separate evaluations.

They also concern the evaluation and communication of control deficiencies in a timely manner to effect corrective action.

Typically, the internal audit function and an independent audit and risk committee are responsible for implementing controls and resolving control deficiencies. These two functions work together to ensure that internal control deficiencies are identified and then resolved in a timely manner.

Appendix J—Glossary

Term	Definition
Accountability	Responsibility of public sector entities to achieve their objectives in reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties.
Auditor-General Act 2009	An Act of the State of Queensland that establishes the responsibilities of the Queensland Auditor-General, the operation of the Queensland Audit Office, the nature and scope of audits to be conducted, and the relationship of the auditor-general with parliament.
Australian accounting standards	The rules by which financial statements are prepared in Australia. These standards ensure consistency in measuring and reporting on similar transactions.
Australian accounting standards board (AASB)	An Australian Government agency that develops and maintains accounting standards applicable to entities in the private and public sectors of the Australian economy.
Cash available (days) ratio	The number of days available to cover cash outflows.
Current ratio	The ability to pay existing short-term debts with current assets.
Depreciation	The systematic allocation of a fixed asset's capital value as an expense over its expected useful life, taking account of normal usage, obsolescence, or the passage of time.
Emphasis of matter	A paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Financial sustainability	The ability to meet current and future expenditures as they arise and capacity to absorb foreseeable changes and emerging risks.
General government sector	The group of legal entities established by political processes that have legislative, judicial, or executive authority over other institutional units within a given area. The primary function of these agencies is to provide public services that: ▪ are non-trading in nature and that are for the collective benefit of the community; ▪ are largely financed by way of taxes, fees and other compulsory charges; and ▪ involve the transfer or redistribution of income.
Going concern	Means an entity is expected to be able to pay its debts as and when they fall due, and to continue to operate without any intention or necessity to liquidate or wind up its operations.

Term	Definition
Material misstatement	A misstatement is material if it has the potential to influence the decisions made by users of the financial statements.
Misstatement	A difference between what is reported and what is required to be reported in accordance with the applicable financial reporting framework. These differences can be in the amount, classification, presentation, or disclosure of a reported financial report item and can arise from error or fraud.
Modified audit opinion	A modified opinion is expressed when: ▪ financial statements do not comply with the relevant legislative requirements and Australian accounting standards, and are not accurate and reliable ▪ service provider's system descriptions do not represent the system as designed and implemented, controls are not suitably designed, or controls did not operate effectively.
Net assets	Total assets less total liabilities.
Operating result	Revenue less operational expenses.
Operating surplus ratio	The extent to which revenue covers operational expenses.
Public private partnership	Cooperative agreements generally entered into with private sector entities for the delivery of government services.
Queensland efficient price (QEP)	The price paid by the Department of Health for each unit of activity purchased from HHSs.
Useful life	The number of years an entity expects to use an asset (not the maximum period possible for the asset to exist).
Weighted activity unit (WAU)	A unit of measure used to compare different health services based on the level of resource use. The Independent Hospital Pricing Authority (IHPA), an Australian Government body, determines the value of a national weighted activity unit (NWAU). The Queensland Department of Health determines the value of a Queensland weighted activity unit (QWAU).

Auditor-General reports to parliament

Reports tabled in 2017–18

Number	Title	Date tabled in Legislative Assembly
1.	Follow-up of Report 15: 2013–14 Environmental regulation of the resources and waste industries	September 2017
2.	Managing the mental health of Queensland Police employees	October 2017
3.	Rail and ports: 2016–17 results of financial audits	December 2017
4.	Integrated transport planning	December 2017
5.	Water: 2016–17 results of financial audits	December 2017
6.	Fraud risk management	February 2018
7.	Health: 2016–17 results of financial audits	February 2018

Contact the Queensland Audit Office