

SOUTH AUSTRALIA

Report

of the

Auditor-General

for the

Year ended 30 June 2003

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Supplementary Report

**Department of Human Services: Some Matters of
Importance to the Government and the Parliament**

By Authority: J. D. Ferguson, Government Printer, South Australia



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Gentlemen,

**AUDITOR-GENERAL'S SUPPLEMENTARY REPORT: DEPARTMENT OF HUMAN SERVICES:
SOME MATTERS OF IMPORTANCE TO THE GOVERNMENT AND THE PARLIAMENT**

Pursuant to section 36(3) of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my Supplementary Report 'Department of Human Services: Some Matters of Importance to the Government and the Parliament'.

Yours sincerely,

K I MacPherson
AUDITOR-GENERAL

Report of the Auditor-General 2002-03
Supplementary Report: Department of Human Services: Some Matters
of Importance to the Government and the Parliament

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DEPARTMENT OF HUMAN SERVICES: SOME MATTERS OF IMPORTANCE TO THE GOVERNMENT AND THE PARLIAMENT

INTRODUCTION

On 19 December 2003, the Hon K Foley MP, the Treasurer, released a press statement titled: "*Govt Moves to Fix 'Robbing Peter to Pay Paul' Budget Chaos*". The Treasurer's press statement was made following a review of budgetary/accounting/managerial arrangements within the Department of Human Services (DHS). The concerns raised by the Treasurer are, in my opinion, well founded, and in many cases reflect concerns raised by Audit over a period of years.

In my opinion, several of the issues that have been publicly raised following the issue of the Treasurer's press statement,¹ apart from being factually incorrect, have the tendency to undermine public confidence in the governmental audit processes of this State. Parliament and the community have the right to expect that the audit of government in this State is both competent and thorough and that this be demonstrably established where necessary. Accordingly, these issues cannot, and must not, remain unanswered.²

Having regard to the extent of the matters that have been published following the Treasurer's press statement, and the harmful and false innuendos that, in my opinion, tend to undermine public confidence in the audit processes of the State, there are some matters of importance that should be drawn to the attention of the Government and the Parliament.³

In his press statement, the Treasurer commented, inter alia, as follows:

Cabinet has made a decision to call in independent accountants, with the knowledge of the Auditor-General, to not only check over what has been unearthed, but to help us to set up a proper sustainable accounting system for the future.

The results will be made available to the Auditor-General.

As a matter of record, the Treasurer did discuss this matter with me with a view to exploring the possible involvement of my office in a proposed review. The Treasurer has not at any time raised any matters of concern regarding the discharge of the audit. The Treasurer's concerns, as outlined in his press statement, deal with matters of budgetary processes and also with matters concerning the accounting treatment accorded to certain arrangements over previous years. The Treasurer was also concerned to understand the reason for certain management decisions that were taken during the relevant period.

¹ It is to be emphasised that there is nothing in the statement by the Treasurer that gives rise to the concerns that are addressed in this Report regarding the discharge of Audit responsibilities.

² The Auditor-General's reporting relationship under the *Public Finance and Audit Act 1987* is to the Parliament. This Report is being presented to Parliament at the first available opportunity following the raising of the issues that have given rise to the need to respond to this matter.

³ *Public Finance and Audit Act 1987*; sections 36(3) and 36(1)(b). It is also my respectful suggestion that there are limitations in the Parliamentary processes that inhibit Parliament in the discharge of its constitutional responsibilities in ensuring the accountability of the Executive Government. This matter is discussed in this Report under the heading 'Parliamentary Review of the Annual Reports of the Auditor-General to Parliament'.

It was my opinion, and I so indicated to the Treasurer, having regard to the issues involved, ie the need to establish a proper and sustainable accounting system, a process for sound budgetary processes involving coordination between DHS (and successor departments)⁴ and the Department of Treasury and Finance (DTF), and advice on managerial arrangements, that independent experts be engaged to develop an appropriate accounting and budgetary model. This is the course that the Government would appear to have adopted.

It would, in my opinion, be incompatible with the statutory independence of the role of Auditor-General to be involved in the formulation of the structure of management and/or accounting arrangements within an agency that the Auditor-General audits. DHS and DTF are both agencies audited by the Auditor-General.

PUBLIC COMMENT SUBSEQUENT TO THE TREASURER'S PRESS STATEMENT

In late December 2003/early January 2004, following the Treasurer's press statement, public comment has taken place regarding financial management and budgetary processes in DHS over the past several years. Certain matters included in this public comment have given rise to the inference of a failure by the Auditor-General to adequately discharge the statutory responsibilities mandated under the *Public Finance and Audit Act 1987*.

In essence, the inference is of audit failure to draw attention to several matters of concern in the public financial administrative arrangements in DHS. In the light of the extensive public reporting by Audit on a range of legal, financial management, and other issues concerning matters associated with DHS, the tenor of much of this comment being significant and/or adverse in nature, such inferences are not tenable as they completely disregard the public record of published annual Reports of the Auditor-General to Parliament.

This Report restates and provides further details for the information of the Parliament regarding matters associated with the audit of DHS and the South Australian Health Commission (SAHC) over the relevant period.

Lest it be misunderstood, there is no suggestion that it is not the right of any person to be critical of the discharge by any statutory officer of his/her statutory responsibilities. However, criticism and inferences of professional incompetence that deliberately ignore the fact of, or, are recklessly indifferent to the existence of, a series of already published reports that extensively deal with matters that have already been brought to notice and that, it is wrongly inferred have been overlooked, can be evidence that raises the probability of malice and is more consistent with its existence than its non-existence.

A MATTER OF EMPHASIS — BUDGETARY FUNDING AND MANAGEMENT

Certain issues that are of concern to the Treasurer relate, in the main, to the matter of budget management. Budget management is primarily a matter to be dealt with between DTF and relevant agencies, ie in this case DHS.⁵

⁴ It has been announced by the Government that DHS will be split into two separate departments, one focused on health and the other on social justice and housing.

⁵ Budgetary management is a matter for 'daily attention' for Ministers and departmental managers. It can, and often does, involve the adjustment of policy settings and associated adjustments to agency/program funding to accommodate issues that arise and that must be addressed as a matter of urgency.

The Supply Act, the Appropriation Act, the *Public Finance and Audit Act 1987*, and the Treasurer's Instructions, establish the overarching legal framework for funding of operations of government agencies, account operations of agencies, and aspects of management and reporting on funds and financial resources of agencies. The Treasurer, Ministers and agencies are required by law to comply with this framework.

The day to day administration of budgetary funding arrangements, following appropriation by the Parliament, are principally the responsibility of the DTF and agencies in association with their respective responsible Ministers. The various processes that operate in this regard relate to important matters of detailed budget formulation, budget revision and variation, budget management and monitoring. The processes involve meetings between the parties, interaction by DTF and agency officers, and information and documentation flows between the parties and agencies.

The abovementioned processes and practices are not prescribed as a matter of law, ie they are not dealt with in the Supply Act, Appropriation Act, the *Public Finance and Audit Act 1987*, or Treasurer's Instructions. In short, the law allows for a degree of flexibility within government regarding these matters. Nonetheless, these practices and processes should be executed consistent with good standards of public financial administration. In annual Reports of the Auditor-General to Parliament over many years the importance of proper budgetary control and monitoring has been emphasised.

DEPARTMENT OF HUMAN SERVICES

Its Establishment and Relationship with the South Australian Health Commission

In October 1997, the former Government decided to restructure the Public Service. Amongst other steps, it abolished a number of administrative units under the *Public Sector Management Act 1995*, and established ten new 'portfolio' based agencies. The then Government's stated strategy was to align key government administrative units with Ministerial portfolios and streamline those portfolios.

On its establishment in October 1997, the new DHS took control of certain staff, functions, and the assets and liabilities of the abolished agencies, ie the Department of Family and Community Services and the Department of Housing and Urban Development.

In April 1998, the then Government also transferred a number of other public sector employees into DHS. They included certain employees of the SAHC, South Australian Housing Trust and South Australian Community Housing Authority. Following their transfer into DHS they were assigned back to the abovementioned entities to continue to undertake the functions and operations of those entities.

In 2000, significant amendments were made to the *South Australian Health Commission Act 1976*. The operational effect of the amendments resulted in DHS assuming from the SAHC, both the day-to-day administrative responsibilities and the annual financial reporting obligations associated with the funding and delivery of the State's health services.

The SAHC's main functions now involve provision of advice and assistance to the Minister, inter alia, in the areas of promotion, support and investigation of matters relating to public and environmental health or health services within the State. The SAHC must, in the exercise of its functions, seek to coordinate its activities with DHS.

DHS is a High Risk Audit

DHS has been, and continues to be, a high risk audit. There are several reasons that underlie this assessment of audit risk. These include the:

- high degree of inherent risk in health and community service administration;
- significant public monies involved in this portfolio and the broad range of services and programs across which these monies are expended;
- large number, varied nature, and geographical dispersion of service delivery units for which the Department has funding and administrative responsibility (that is, hospitals, health centres, community centres);
- diversity of administrative and financial management and accounting systems within the Department and service delivery units;

The audit of the Department has, over a number of years, resulted in a range of unsatisfactory findings. Audit has identified and reported upon instances of inadequate financial management and inadequate internal control practices within DHS. In my opinion, the response by management in certain instances to the rectification of these matters was neither timely nor adequate. In one particular matter, concerning 'advance payments' of more than \$20 million by DHS in 1999-2000, the failure to comply with the spirit and intent of the Treasurer's Instructions required those Instructions to be redrafted.

Of particular relevance to the matters discussed in this Report is the potential for a conflict in the management of the budgeting processes concerning amounts to be allocated to the several functional areas and service entities within the Human Services portfolio to discharge their separate statutory obligations. This potential risk was highlighted by Audit in 1997-98 following a specific audit review of the implementation of the DHS portfolio, including a focus on the establishment of DHS and its association with the SAHC.⁶

Arrangements for management of funding to Health Services is an area of specific risk which reflects the:

- challenges faced by the Health Services themselves in managing their budgets;
- need for the Department and the Minister, as funding provider, to manage their relationships with Health Services to support the effective management of the Health Services' budgets;
- relationship between the Department as the manager of the Health Budget and DTF as manager of the overall State budget.

These factors have been considered in the context of a model for funding Health Services which provided for them to 'borrow' from the Department to fund past budget over-runs when it was unlikely the Health Services could repay amounts owed. This matter was noted by Audit in annual Reports of the Auditor-General to Parliament. Refer to Appendix A to this Report under the heading 'Health Service Budget Over-runs'.

It is now clear that this was a recipe for 'budget stress' within Health Services and did not provide a realistic exit strategy.

⁶ Refer to annual Report of the Auditor-General to Parliament for the year ended 30 June 1998; Part A; Audit Overview; pages A4-8 to A4-24.

DHS and the SAHC has been the Subject of Previous Published Adverse Audit Comment

The language of the annual Reports of the Auditor-General to Parliament over the period 1997-98 to 2002-03 is, notwithstanding comments to the contrary, clear and unambiguous in terms of reporting on matters of importance and concern regarding financial management and adequacy of controls within DHS and the SAHC during this period.

Any suggestion that there has not been appropriate Audit comment regarding the financial management and reporting on the operations of these entities is simply wrong. Appendix A to this Report refers to annual Reports of the Auditor-General to Parliament over the period 1997-98 to 2002-03. These references clearly indicate the matters of risk and concern to Audit with regard to the financial management processes and controls and operations within DHS and the SAHC during this time.

Parliamentary Review of the Annual Report of the Auditor-General to Parliament

Preparing this Report has highlighted the range of matters arising from the audits of DHS and SAHC which have been reported upon to the Parliament in my Annual Reports.

Current legislation does not provide for the specific review of matters included in the Auditor-General's Report to Parliament. Prior to its repeal in 1992 the *Public Accounts Committee Act 1972* required the then Public Accounts Committee to review the Auditor-General's Report and to provide its own report on matters raised therein. I respectfully suggest that under the existing arrangements there is a lacuna in the control framework. It may be appropriate to revisit the earlier legislative arrangements to deal with this matter.

Any issues that are referred to in this Report and/or any other matter associated with the audit of DHS and/or any other department in previous years can, of course, be raised with me by the Economic and Finance Committee and any other Parliamentary Committee acting within statutory authority and/or Terms of Reference that provide for its review of these matters.

CONTEXT OF MATTERS RAISED BY THE TREASURER IN HIS PRESS STATEMENT OF 19 DECEMBER 2003

The matters raised by the Treasurer in his press statement, in most part, relate to budgetary and associated financial accounting and management practices of DHS over a number of years.

This section of this Report includes comment with respect to certain issues that I consider are relevant to an informed understanding of the Treasurer's press statement, and my Department's statutory audit of DHS and the SAHC over the past years.

Role and Function of DHS

Understanding the matters raised by the Treasurer requires some understanding of DHS and its functions. The Department is charged with broad ranging policy and administrative responsibilities associated with health, housing, and the support and protection of people as members of families and communities.

The Department carries out its administrative responsibilities in conjunction with the following entities:

- the South Australian Health Commission and Incorporated Health Services established under the *South Australian Health Commission Act 1976*;
- Statutory Authorities established under specific legislation including the South Australian Housing Trust and the South Australian Community Housing Authority;
- Statutory corporations established under the *Housing and Urban Development (Administrative Arrangements) Act 1995* including HomeStart Finance and the South Australian Aboriginal Housing Authority;
- other independent service providers.

The Department's role includes that as funder or service purchaser, policy setter, strategic planner, and provider of services. The Department's role as service provider includes its role as the employer of staff who are assigned to statutory authorities and corporations, as the provider of risk management services, internal audit, insurance services, and management of portfolio information systems.

Context of the Proposed Review of DHS Financial Management Practices

The Treasurer's press statement makes it clear that it is the Government's intention to engage independent accountants to undertake a review of certain aspects of past financial management practices of DHS and to advise and assist in establishing a sustainable accounting system for the future.

In the past two years the Government has conducted major reviews of two significant policy areas within the Department's responsibilities. The Generational Health Review has sought to set a blueprint for reform for the next twenty years and has recommended fundamental changes to Government Health Services. The review of Child Protection, which is directly relevant to the Family and Youth Services provided by the Department, has similarly made significant recommendations for change. At the same time DTF in conjunction with DHS has been undertaking an expenditure review associated with the functions and operations of DHS.

These reviews have required a focus on how the Department uses its resources and an assessment of how they may be deployed more effectively, particularly to support the reform agenda.

Fund Account Operations and the Financial Position of DHS

The Departmental Operating Account

The Department funds and controls its operations through the Department's Operating Account. This account is an authorised Special Deposit Account with the Treasurer.

The purposes for which the Departmental Operating Account may be used were determined by the Treasurer on its establishment and are reflected in Statement F of the Treasurer's Statements:⁷

***Human Services
Operating Account***

To record all of the activities of the Department (including those formerly carried on by the Department for Family and Community Services, and the Department of Housing and Urban Development other than the Planning Division) including recurrent and capital expenditures, revenue from various activities, injections of funds provided from the Consolidated Account and borrowings.

The Operating Account is used to received and disburse grant funds from the Commonwealth Government and State Government appropriations. In short, the Operating Account receives recurrent and capital monies to fund the Department's operations. These monies are expended for a range of purposes including Health, Housing, and Home and Community Care programs.

The arrangements for provision of funding to the Department from both Commonwealth and State sources involve receipt by the Department of monies in advance of the expenditure of those monies. Consequently, the Department will hold in its Operating Account balances of funds which it has not been required to disburse for funded purposes.

It is the Department's authorised practice to manage the cash-flows through this account, rather than operating separate authorised special deposit accounts for specific programs and agreements. The emphasis of the Department's cash management has been on ensuring funds are available to ensure all liabilities and commitments can be met as they are due, and that the Department's Operating Account is not overdrawn in accordance with Treasurer's Instruction 6.7.

It has also been Audit's understanding that the Department has had access to support from DTF in managing the DHS Operating Account. Correspondence from DHS to Audit in 2002 indicated the Department had received:

An undertaking by the Treasurer to provide advanced appropriations to the Department at any time if the Department's cash position is likely to overdraw at the Reserve Bank.⁸

In addition, Audit has sighted correspondence between the Minister for Human Services and the Treasurer in December 2001 which recorded an understanding by the Minister for Human Services that officers of DTF would ensure DHS's Operating Account was not overdrawn.

⁷ The purpose of the Special Deposit Account was approved by the Treasurer on 22 February 1998 and has been incorporated in Statement F of the Treasurer's Statements as published in the annual Reports of the Auditor-General to Parliament.

⁸ Refer to Appendix C to this Report.

Application and Monitoring of Cash Balances

Budget over-runs by Health Services have been funded by the Department using the balance of cash associated with unexpended funding from all sources. The use of funds held in the DHS Operating Account to meet expenses incurred by the Department in exercising its functions and powers is, in my view, consistent with the authorised purposes of the Operating Account.

Audit has monitored the adequacy of cash balances held by DHS to meet its cash-flow requirements including those arising under the Commonwealth State Housing Agreement. When completing the audit of the Commonwealth State Housing Agreement financial statements for the year ended 30 June 2001, my officers noted that the balance of the Department's Operating Account was \$36.7 million. This amount was less than the balance of cash nominally held for housing programs which amounted to \$49 million. As mentioned above, this reflected the use of unexpended monies on hand and not immediately required for other purposes (including housing monies) to fund other Departmental operations including Health Service budget over-runs.

This matter was communicated to DHS management who were asked to advise of action being taken.⁹ The Department subsequently advised of a number of measures to address the Department's cash position including, as discussed previously, that the Treasurer had undertaken to provide funds required to ensure the Department's Operating Account was not overdrawn.¹⁰

The timing of the Audit communication with respect to this matter is significant as 30 June 2001 was the first balance date at which Departmental financial statements reflected the provision of funding to Health Services and the associated receivables from Health Services for budget over-runs.

The balances of the Department's Operating Account at 30 June 2002 and 2003 indicate that the matters raised by Audit had been substantially addressed. Specifically, the Operating Account balance was greater than cash nominally held for housing purposes as recognised in the Commonwealth State Housing Agreement financial statements for each balance date.

Documentation reviewed by Audit in preparing this Report indicates that the Department had independently identified the matter raised by Audit and was reviewing its options for addressing them. Audit was aware in 2002 that the use of funds held within the Department Operating Account to meet Health Service budget over-runs was understood by officers of DTF who were participating in the review of the Department's expenditure on behalf of the Expenditure Review and Budget Cabinet Committee.

Disclosure of Commitments

The consideration by Audit of the adequacy of the Department's cash balance as at 30 June 2001 to meet its cash flow requirements brought into focus the Department's commitments under the Commonwealth State Housing Agreement and other programs. Audit recommended, and the Department accepted, that additional disclosures should be made in the Department's financial statements with respect to the value and nature of the Department's funding commitments. These additional disclosures were included in the Department's financial statements as Note 20 for both the 2001-02 and the 2002-03 financial years.

⁹ Refer to Appendix B to this Report.

¹⁰ Refer to Appendix C to this Report.

Analysis by Audit of the Department's financial statements included in my Annual Reports for the year ended 2002 and 2003 included specific reference to these funding commitments and their relationship with the Department's cash balance.

The Financial Position of DHS and the SAHC

This section of the Report reflects upon the financial position of DHS and the SAHC. The audited financial statements of each entity have been incorporated in my Annual Reports to Parliament.

The audited financial statements of the SAHC for the year ended 30 June 2000, the last year material financial activity was undertaken by the SAHC, disclose a net asset deficiency of \$41 million. This financial position was largely attributable to the accrued provision for public liability indemnities provided, at that time, by the SAHC to health services. Following a restructure of insurance arrangements implemented by the South Australian Government Captive Insurance Corporation (SAICORP) and the SAHC, the SAHC assumed substantial responsibility for these obligations which were previously insured by SAICORP.

The restructure of public liability arrangements and the financial position of the SAHC were specifically commented upon in the section of the annual Report of the Auditor-General to Parliament for the year ended 30 June 2000 which reported upon the SAHC.¹¹

The audited financial statements of the Department for the year ended 30 June 2002 record:

- a Deficit from Ordinary Activities of \$24.1 million;
- a Net Asset deficiency of \$13.0 million.

Both the Operating Deficit and the Net Asset deficiency reflects the role that the Department had assumed from the SAHC in indemnifying Health Services against public liability claims.

Similarly, the audited financial statements for the year ended 30 June 2003 record:

- a Deficit from Ordinary Activities of \$108.8 million;
- a Net Asset deficiency of \$1.3 million.

The Department recorded a net asset deficiency for both the 2002 and 2003 years notwithstanding equity contributions were received from the State Government amounting to \$60 million and \$28 million respectively.

The material reflected above demonstrates that information published in the annual Report of the Auditor-General to Parliament has conveyed a clear picture of the financial performance and position of the SAHC and the Department and has been supported by appropriate audit analysis and commentary. Importantly, the financial position analysis and the audited financial statements of the two entities reflects the reality that both the SAHC and the Department have depended upon the continuing support of funding from the Government to meet their obligations as and when they became due and payable.

¹¹ The changed insurance arrangements for public liability indemnities by the SAHC to Health Services are fully discussed in the Auditor-General's Report to Parliament for the year ended 30 June 2000. In essence, the changes provided for the level of deductibles, which is the amount of any claim to be met by the SAHC before SAICORP meets the cost of claims, to be increased from \$50 000 to \$1 million. Refer to annual Report of the Auditor-General to Parliament; Part B; South Australian Health Commission; pages 357 to 358.

Health Service Funding and Budget Over-runs

Formalised Arrangements

The funding arrangements governing Health Services were initially implemented by the SAHC and became the responsibility of DHS following amendments to the *South Australian Health Commission Act 1976* in July 2000.

DHS administers the funding arrangements under delegation from the responsible Minister who has responsibility for exercising the powers and functions provided by section 15 of the Act. The functions administered by the Minister pursuant to section 15 (1) include requirements:

(g) to act to ensure that hospitals, health centres and health services incorporated under this Act or established, maintained or operated by or with the assistance of the Government of the State are operated in an efficient and economical manner; and

(h) to ensure the proper allocation of resources between hospitals, health centres or health services incorporated under this Act or established, maintained or operated by or with the assistance of the Government of the State;

The Minister has broad powers to perform the functions provided by the Act and is empowered to delegate powers and functions.

The provision of funding to Health Services is governed by Funding Agreements between the Department and the Health Services. The Funding Agreements incorporate provisions for setting of approved funding levels, target activity levels for the Health Services and arrangements for the draw down of cash from DHS to meet the Health Services' expenditure. Specific provision has been made within the Funding Agreements for circumstances where a Health Service has needed to draw more or less cash from DHS than the approved funding level and where a Health Service does not meet targeted activity levels. These arrangements require Health Services to submit business cases to the Department's financial services division to justify any budget over-run and to indicate how these monies drawn down to meet budget over-runs will be repaid.

Where cash is drawn down in excess of the approved funding levels, or the activity targets are not met, the Funding Agreements provide for repayment of monies to the Department by the Health Service.

Accounting for Amounts Due to DHS by Health Services

The right of the Department, and, prior to amendments to the *South Australian Health Commission Act 1976*, the SAHC, to recover cash draw downs in excess of funding allocations from Health Services, and the obligations of the Health Services to repay these amounts, have been recognised in the financial statements of each of, the Department, the SAHC, and the Health Services. The Department has implemented processes for reconciling the amounts between the Department and Health Services' financial records and to reconcile approved funding allocations, cash draw downs and balances payable to or from the Department by the Health Services.

The likelihood that some Health Services may not be able to repay amounts owed to the Department or the SAHC have been assessed at each balance date and provisions for doubtful debts have been recognised in the Department's and the SAHC's audited

financial statements. The Department's financial statements for the year ended 30 June 2003 include, at Note 2(g), a description of the basis for accounting for receivables and at Note 9 detail the extent of amounts due to the Department for Health Service budget over-runs and the extent of provisions for doubtful debts. Equivalent disclosures from 1999-2000 were included in prior years' financial statements for the Department or the SAHC.

Commentary on the Department's and the SAHC's financial statements included in Part B of my Annual Reports to Parliament have discussed the amounts receivable from Health Services and associated provisions.

Specifically, in 2000, the section of Part B of my Report for the SAHC recorded that:

As part of the Casemix funding arrangements between the Commission and Health Units budget over-runs by Health Units have been funded by the Commission but recognised as amounts owed to the Commission by the Health Units in accordance with relevant funding agreements. The value of the receivables at 30 June 2000, before provisioning was \$39.6 million. The Commission has provided an amount of \$34.6 million against receivables due to the Commission from incorporated Health Units.

The recognition of the provision reflects an acknowledgement that while the Commission is entitled to receive the monies they are unlikely to be repaid in full by Health Units. The provision was approved by the Chairperson of the Commission. [emphasis for this Report]

Similarly in 2001, when reporting on the Department, I recorded that:

Amounts due to the Department include \$61.1 million with respect to Health Service budget over-runs which increased by \$21.4 million compared to the amount due to the Commission at 30 June 2000 and against which the Department had made a provision for doubtful debts of \$49.2 million. This is an increase of \$14.6 million over the provision recognised by the Commission at 30 June 2000.

In 2002, the report on the Department recorded that:

Amounts due to the Department of \$57.3 million with respect to Health Service budget over-runs has decreased by \$3.8 million compared to previous years.

However the Department has increased the provision for doubtful debts by \$6 million to \$55.2 million against the budget over-runs even though the total budget over-run has reduced.

Discussion of Funding Arrangements by Estimates Committees

Review of the Parliamentary Hansard of the Estimates Committees by Audit has highlighted that the arrangements implemented by the Department and the SAHC have been the subject of specific questions and explanations.

The record of the Estimates Committee B on 26 June 2001 incorporates explanations by the then Minister for Human Services of the circumstances in which the amounts due to

the Department by Health Services with respect to budget over-runs by Health Services have arisen. The explanations responded to specific questions from a member of the Committee.

The Estimates Committee A on 8 August 2002 heard an explanation from the Minister for Health of the financial position of the Department which reflected upon the extent and impact of the amounts due to the Department from Health Services with respect to budget over-runs.

A review of the records of the Estimates Committees evidences that the arrangements implemented by the SAHC and continued by the Department to manage Health Service budget over-runs were communicated to the Parliament. Consideration has been given to the proceedings of the Estimates Committees by Audit in determining the matters which have been communicated to the Department and to the Parliament in my Annual Reports.

Budget Management within DHS

The Treasurer has made comment on matters associated with DHS's budget management. Budget management involves arrangements including budget setting, monitoring and reporting. The specific matters include:

- the re-allocation of funds from other Departmental programs to the FAYS program;
- an unplanned increase in actual costs associated with the FAYS programs over the budget agreed with DTF;
- the use of 'virtual budgets' which is understood to mean the allocation of budgets to the Department's divisions which, in aggregate, exceed the budget agreed with DTF.¹²

The Treasurer also noted that errors in the Department's budget estimates would result in a \$26 million deficiency in the budget for next year (ie 2004-05). Audit understands the errors reflect variances between the Department's original forward estimates and revised estimates of the costs based on actual outcomes.

Responsibility for budget formulation and management is a core responsibility of Agency executives and finance managers and officers of DTF. Significant elements of budget formulation and management, and particularly budget forward estimate setting and approved changes to program allocations, are matters of Government policy and are appropriately areas within the policy discretion of Ministers and their respective agencies, the Treasurer and Cabinet. Audit does not audit forward estimates.

A further matter to mention is that budget management involves negotiation between agencies and DTF. Audit understands the requirement to maintain appropriate independence and to avoid acting as agent or advocate for either agencies or DTF.

¹² The Department's budget, as reflected in Treasurer's Budget Papers under the Portfolio Statements reflects revenue from both State Appropriations and other sources including grants and payments from the Commonwealth. While compliance with Appropriation Acts is clearly within the Auditor-General's mandate pursuant to the *Public Finance and Audit Act 1987* the management within agencies of the arrangements implemented by the Treasurer for setting and managing the budget is a policy matter for Executive Government in its management of the day-to-day requirements of government. The management arrangements may vary from time to time at the direction of Government, DTF and agencies.

With respect to the errors in the Department's budget estimates, Audit understands that the Treasurer, not unreasonably, requires assurance that budget estimates are soundly formulated and, within reasonable bounds are reliable. Any serious aberrations in the estimates will impact on the Treasurer's capacity to manage the budget effectively. Audit also understands that assurance as to the accuracy of estimates will come from confirmation that:

- the methodology used to prepare the estimates is sound;
- assumptions used are appropriate;
- historical data supporting estimates is reliable.

Treasurer's Instruction 19.11 provides an authoritative framework for DTF to request specific budgetary and other information from agencies. This mechanism together with the normal interaction between DTF and agencies on budget matters should result in assurance as to the integrity of the budget preparation and monitoring process.

Expectations of Assurance from External Audit

Reliance upon the work of External Audit to provide assurance as to the integrity of agency and DTF budget formulation and management arrangements is not appropriate for reasons as discussed above. Another point of consideration, is that by its nature, the audit reporting process is a snapshot of arrangements at a point in time which can not give assurance that agency budgetary position arrangements agreed with DTF continue to operate at all other times.

The concerns raised by the Treasurer with respect to the emerging unbudgeted costs of FAYS illustrate this point. These matters have been identified by DHS, are reflected upon in management reports prepared for the financial year ended 30 June 2004, and I understand, have been communicated to the Treasurer.

Audit's Review of the Department's Budget Management

The primary focus of Audit's consideration of budget management by the Treasurer and agencies is on obtaining assurance that there is compliance with the provisions of the *Public Finance and Audit Act 1986* and Appropriation Acts. The Appropriation Acts have, in recent years, appropriated funds by portfolio at an aggregate level and are not dissected by program. Audit have gained assurance as to compliance with Appropriation Acts by agreeing, in aggregate, the funds paid by the Treasurer to the Department.

In the first years of the establishment of the Department the provision of budgets to Departmental divisions received some review focus regarding the basis of their preparation. My 1998-99 Annual Report to Parliament included discussion of this matter.

As referred to earlier in this Report, over the past two years, officers of DTF have reviewed budget and expenditure matters of DHS on behalf of the Expenditure Review and Budget Cabinet Committee.

Compliance with the Commonwealth State Housing Agreement

The Agreement

The agreement between the Commonwealth and State, operative to 30 June 2003, contains no express provision that requires funds received by the Department pursuant to that Agreement to be held in a separate account(s). The Agreement is silent with

respect to how funds which are not immediately required to meet expenditure for approved purposes may be invested. The Agreement also reflects a guiding principal that:

Funding arrangements should promote efficiency and cost-effective management, including longer term planning and alternative methods of housing provision.

In my opinion, the arrangements implemented by the Department to administer and control Commonwealth State Housing Agreement funds through the Department's Operating Account and to manage cash flows through this account were consistent with the provisions of the Agreement and its guiding principles.

As I have mentioned earlier in this Report, in 2002 Audit observed that the level of cash held by the Department at 30 June 2001 was at a level which was not sufficient to meet the full extent of funding obligations under the Agreement. Again, as discussed earlier, the Department responded to Audit concerns by outlining action taken to address the concerns raised. The balance of cash held at subsequent balance dates was at a level consistent with the Department meeting its funding obligations as they fell due.

It is also relevant to mention that the Department has maintained detailed records of:

- all funds received from Commonwealth and State sources under the Commonwealth State Housing Agreement;
- how Commonwealth State Housing Agreement funds have been applied.

These records have been used by my officers to confirm the balances of funding provided by the Department to the other state housing agencies for approved purposes pursuant to the Commonwealth State Housing Agreement.

Provision of Certificates to the Commonwealth

The Commonwealth State Housing Agreement includes specific requirements that the State provide information to the Commonwealth with respect to its performance under the Agreement. The Agreement requires the State to provide independently audited financial reports to the Commonwealth and requires the reports to be prepared in accordance with national financial reporting frameworks and accounting practices. In essence the reporting framework requires preparation of a special purpose financial report which consolidates the financial statements of each of the state housing agencies and that part of the Department's operations and balance sheet which relates to housing activities funded pursuant to the Agreement.

Financial reports as required by the Agreement have been prepared for each financial year and audited by my officers.

The Agreement also requires, the Chief Executive of the Department to provide the Commonwealth with a certificate that assets and available funds were used only for purposes approved by the Agreement. The Agreement does not require Audit review of this certificate and no such review has occurred.

I have received a letter from the Federal Minister for Family and Community Services, responding to the Treasurer's public statements, seeking advice whether there were errors in audited financial statements. I have responded to that letter by indicating,

inter alia, that I am not aware of any evidence of error in the audited financial statements prepared by DHS and audited by my officers for the purposes of the Commonwealth State Housing Agreement. Copies of the letter from the Federal Minister and my response are attached.¹³

MATTERS OF A SIGNIFICANT/ADVERSE NATURE RAISED BY AUDIT CONCERNING DHS AND THE SAHC IN PREVIOUS REPORTS TO PARLIAMENT

My Annual Reports to Parliament have included comments on a range of matters arising from the audits of DHS and the SAHC. A comprehensive summary of some of the significant issues and comments presented in the Annual Reports to Parliament from 1997-98 to 2002-03 is presented in Appendix A to this Report.

In presenting Appendix A, it is considered important to make the following salient observations in relation to the issues that have been raised in those Annual Reports to Parliament.

Audit Identified Risks — Establishment of DHS

It was conveyed earlier in this Report that DHS was established as a new administrative unit in 1997 as part of the former Government's restructure of the public service.

The establishment of DHS and its proposed role and function in relation to the established statutory authorities operating within the Human Services portfolio (particularly, the SAHC and South Australian Housing Trust), was regarded by Audit as a significant administrative and accountability restructure of Government.

In recognition of the significance of the restructure, Audit undertook a specific review of the accountability and legal issues of importance associated with this particular restructure.

The Audit review resulted in a comprehensive commentary in Part A of the 1997-98 annual Report of the Auditor-General to Parliament. The commentary raised certain issues and risks, including the potential risk of the administrative intermingling of the Department's resources with those from the statutory authorities.

Since that focused reporting at the time of the establishment of DHS, Audit has continued to meet its statutory and professional audit responsibilities in respect of DHS and the SAHC. The consequence of the execution of these responsibilities has been the continued communication of matters of a diverse and significant nature in subsequent Annual Reports to Parliament.

Diversity and Significance of Matters Raised

The matters that have been raised in connection with DHS and the SAHC in the Annual Reports to Parliament over the years, ie 1997-98 to 2002-03, have covered areas of administrative, financial accounting and management, and internal control systems and processes of DHS and the SAHC.

¹³ Refer to Appendices D and E of this Report.

The areas that have involved comment of a significant or adverse nature include:

- Human Service portfolio restructure;
- cash balances and funding commitments;
- Health Service budget over-runs;
- funding to Health Services and Non-Government Organisations;
- managing performance and budgetary monitoring;
- advance payments;
- financial accounting systems and procedures.

As mentioned previously, Appendix A to this Report presents a summary of matters that have been raised in the previous Annual Reports to Parliament.

Appendix A identifies those matters/issues that have been the subject of comment; the particular year of the Annual Report in which the matters/issues received comment; a brief description summarising the commentary concerning the matters/issues that were included in the Annual Report; and a specific reference to the page(s) of the particular Annual Report where the full context of the commentary concerning the matters/issues are presented.

CONCLUSION

It is important that public confidence in the audit process of the State not be undermined. When there is the tendency for this situation to arise through inaccurate comments and false innuendoes, the public interest requires that a detailed response be made to the Parliament. This Report addresses the matters/issues involved. Any further information can be provided to the Economic and Finance Committee of the Parliament (and to any other relevant Committee) should this be required.

With respect, it is my suggestion that there be a revisit of the arrangements that applied prior to the 1993 amendments to the Parliamentary Committees Act that allowed for the annual Report of the Auditor-General to be examined by the present Economic and Finance Committee (as the successor of the earlier Public Accounts Committee).

LIST OF APPENDICES

Appendix	Description
A	Summary of Significant Issues and Comments Presented in Previous Annual Reports of the Auditor-General to Parliament — 1997-98 to 2002-03.
B	Copy of the audit management letter dated 29 April 2002 from the Principal Audit Manager, Auditor-General's Department to the Director of Financial Services, DHS.
C	Copy of the response dated 4 September 2002 from the Director of Financial Services, DHS to the audit management letter dated 29 April 2002.
D	Copy of the letter received by facsimile by the Auditor-General on 23 December 2003 from the Federal Minister for Family and Community Services.
E	Copy of the response dated 9 January 2004 from the Auditor-General to the letter from the Federal Minister for Family and Community Services.

**SUMMARY OF SIGNIFICANT ISSUES AND COMMENTS PRESENTED
IN PREVIOUS ANNUAL REPORTS OF THE AUDITOR-GENERAL TO
PARLIAMENT**

1997-98 to 2002-03

**HUMAN SERVICES PORTFOLIO RESTRUCTURE — ACCOUNTABILITY AND LEGAL
ISSUES OF IMPORTANCE**

1997-98

***Government Administration Reform: Public Sector Agency Restructuring —
Human Services Portfolio — Accountability and Legal Issues of Importance***

Part A of the annual Report of the Auditor-General to Parliament for the financial year ended 30 June 1998 included commentary regarding certain accountability and legal issues arising from the administrative restructure undertaken by the Government in the Human Services Portfolio. One of the matters considered by Audit was the appointment of Ms C Charles as Chairperson and Chief Executive Officer of the SAHC. In the Report, Audit drew attention to concerns regarding Ms C Charles being both Chief Executive of the Department of Human Services and acting as Chief Executive Officer of the SAHC.

Part A: Audit Overview, pages A4-8 to A4-24.

1998-99

***The Appointment of Ms Charles as Chief Executive of the South Australian
Health Commission***

Part A of the annual Report of the Auditor-General to Parliament for the financial year ended 30 June 1999 included commentary regarding the appointment of the Chief Executive Officer pursuant to section 68 of the *Constitution Act 1934* and section 19(A) of the *South Australian Health Commission Act 1976*. Audit expressed the opinion that the appointment of Ms C Charles to the position of the Chief Executive Officer of the SAHC was unlawful and that the appointment had no effect.

Part A: Audit Overview, pages A3-65 to A3-76.

CASH BALANCES AND FUNDING COMMITMENTS

2000-01

Interpretation and Analysis of Financial Statements

Audit reported that the Statement of Cash Flows highlighted that the Net Cash Flow used in Operating Activities was \$19.1 million and the net outflow was drawn from cash on hand at the beginning of the financial year of \$29.9 million and cash transferred to the Department from the SAHC of \$30.1 million. The net outflow of cash was attributable to the Department funding Health Service draw downs in excess of the Health Service's initial budget allocations.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 347.

2001-02

Interpretation and Analysis of Financial Statements

Audit highlighted that the Department's Cash at 30 June 2002 was \$61.3 million and that the Department at that date had outstanding commitments of \$59.9 million in relation to a number of funding programs.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 295.

2002-03

Interpretation and Analysis of Financial Statements

Audit provided an analysis of the Department's cash flows which showed that the Department's sources of funds were insufficient to meet the Department's operating cash requirements for 2003 resulting in it having to use \$7.6 million of its cash reserves on hand at the beginning of the year.

Furthermore, Audit reported that the Department's cash as at 30 June 2003 was \$53.7 million. Audit also noted that the Department was engaged in a number of programs involving the receipt of funds from State and Commonwealth sources who provided funds on the basis that they would be expended in a manner consistent with the terms of the program. As at 30 June 2003 the value of unexpended funding commitments totalled \$89.7 million.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 556.

HEALTH SERVICE BUDGET OVER-RUNS

1999-2000

Provision for Bad and Doubtful Debts

Audit highlighted that as part of the Casemix funding arrangements between the SAHC and Health Units, budget over-runs by Health Units were funded by the SAHC but recognised as amounts owed to the SAHC by the Health Units in accordance with relevant funding agreements.

The value of these receivables at 30 June 2000, before provisioning was \$39.6 million. The SAHC provided an amount of \$34.6 million against receivables due to the SAHC from incorporated Health Units. Also, Audit noted that the recognition of the provision reflected an acknowledgement that while the SAHC was entitled to receive the monies they were unlikely to be repaid in full by the Health Units. The provision was approved by the Chairperson of the SAHC.

Part B: Agency Audit Reports, Volume I, South Australian Health Commission, page 358.

2000-01

Interpretation and Analysis of Financial Statements

Audit highlighted that amounts due to the Department included \$61.1 million with respect to Health Service budget over-runs which increased by \$21.4 million compared

to the amount due to the SAHC at 30 June 2000 and against which the Department had made a provision for doubtful debts of \$49.2 million. This was an increase of \$14.6 million over the provision recognised by the SAHC at 30 June 2000.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 347.

2001-02

Interpretation and Analysis of Financial Statements

Audit reported that amounts due to the Department of \$57.3 million with respect to Health Service budget over-runs decreased by \$3.8 million compared to previous years. It was noted, however, that the Department increased the provision for doubtful debts by \$6 million to \$55.2 million against the budget over-runs even though the total budget over-run was reduced.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 295.

FUNDING TO HEALTH SERVICES AND NON-GOVERNMENT ORGANISATIONS

2000-01

Review of Funding to Health Services and Non-Government Organisations

Health Services

An Audit review of funding to Health Services focused on evaluating the consistency of legislative and administrative arrangements implemented between the Minister for Human Services, the Department and Health Services and on assessing compliance with established administrative and funding policy and procedure. Audit noted that there was some inconsistency between the provisions of the funding agreements between the Department and Health Services and the provisions of the revised *South Australian Health Commission Act 1976* as they related to the Department's capacity to direct Health Services. Audit also noted that the Department, and the SAHC before it, had not consistently sought independent verification of Health Service activity data relevant to assess whether case-mix funded activity levels were achieved by Health Services. Further, instances were noted of administrative non-compliance concerning service (funding) agreement completion and sign off.

Non-Government Organisations

The review of arrangements implemented by the Department for the administration of grants to Non-Government Organisations revealed that the management of this activity occurred across a number of the Department's Divisions in line with the policy areas managed by each Division. Also, Audit noted:

- Arrangements had not been implemented to share best practice across divisions or to develop and implement common policies, procedures and systems for management of grants.
- Funding was provided to a number of organisations notwithstanding that formal funding agreements defining each parties' responsibilities had not been concluded.

- Funding arrangements did not consistently require the evaluation of outcomes for programs funded by the Department.

Part B: Agency Audit Reports, Volume I, Department for Human Services, page 344.

2001-02

Review of Funding to Health Services and Non-Government Organisations

The audit of the Department for the year ended 30 June 2002 included follow up of matters arising from reviews finalised in the latter part of the previous financial year.

Health Services

The audit of the Department for the previous year included review of the arrangements for providing funding to Health Services. Funding is provided to Health Services pursuant to funding agreements which require Health Services to manage their operations within funding levels reflected in the agreements while achieving specified activity levels. The funding agreements provide for financial penalties where agreed activity levels are not achieved by Health Services. A key finding of the 2000-01 review was that neither the Department or the SAHC before it had consistently undertaken audits of activity data reported by funded Health Services to meet their obligations under case mix funding arrangements. Follow up by Audit in 2001-02 indicated a contractor had been engaged to undertake the activity audits and a program had been established for performance of the audits.

Non-Government Organisations

The review of arrangements for managing funding to Non-Government Organisations in 2000-01 revealed that there was scope to improve practices relating to the administration of the grants. Audit review in 2001-02 of the Department's progress in addressing the matters raised by Audit in the previous year noted that, generally, the administration of individual grants was satisfactory. Audit noted, however, that progress by the Department in improving coordination between divisions was limited and funding agreements had not been amended to provide for evaluation of funded outcomes.

Part B: Agency Audit Reports, Volume I, Department of Human Services, pages 291 to 292.

2002-03

Case Mix Audit

Audit review included examination of the arrangements in place for providing funding to Health Services including the processes implemented to ensure Health Services achieve agreed activity levels as provided for in Funding Agreements with the Department. Prior year audits found that the Department had not consistently undertaken audits of activity data reported by Health Services to meet their obligations under casemix funding arrangements. Audit review in 2002-03 found that the Department implemented an audit of external clinical coding and short stay admissions at eight metropolitan hospitals. The coding audit found higher than anticipated coding error and evidence of admissions which did not meet DHS admission criteria. The audit also identified the need to develop strategies for improving the quality of coding by addressing factors affecting accuracy including; coder education, clinical education and guidelines.

Part B: Agency Audit Reports, Volume II, Department for Human Services, pages 547 to 548.

MANAGING PERFORMANCE AND BUDGET MONITORING

1998-99

Budget Preparation and Monitoring

Audit review found that the process of preparing the Departmental budget for the 1998-99 year and for allocating budgets to operational units was inconsistent with prescribed elements of the FMF. Finalisation of the budgets for operational units was delayed pending the finalisation of the Australian Health Care Agreement and the appointment of Departmental Executive Directors. As a consequence the final Departmental budget against which outcomes were evaluated varied from the budget reflected in the Treasurer's budget papers.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 371.

2002-03

Part A of my Annual Report to Parliament for the financial year ended 30 June 2003 included a summary of audit observations and conclusions resulting from discussion and analysis of the State's finances. In the report, Audit highlighted the need to manage actual performance against budget. Specifically, Audit reported:

The characteristics of the 2003-04 Budget are in line with the previous year, particularly in respect to the projection of restraint in relation to expenses over the forward period, and when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending. This is particularly an issue for agencies that have identified and submitted savings targets.

Part A: Audit Overview, page 55.

Similar commentary highlighting the need to manage actual performance against budget was reported in the annual Reports of the Auditor-General to Parliament for the two prior years. Specific references to the commentary reported in prior year reports are provided below.

- 2001-02 — Part A: Audit Overview, page 14.
- 2000-01 — Part A: Audit Overview, page 23.

ADVANCE PAYMENTS

1999-2000

Advance Payments-Capital Program

The audit of DHS for the year ended 30 June 2000 included a review of large payments processed in May and June 2000 by the Department on its own behalf and that of other agencies within the Human Services portfolio. The review identified payments amounting to more than \$20 million where payments were made in advance of the Department, the SAHC, or Health Units, receiving relevant goods or services. The payments were in two broad categories:

- payments to suppliers in advance of receipt of goods or services where the supplier provided unconditional bank guarantees in exchange for payment from the Department. Payments were with respect to contracts for the supply of medical equipment;

- payments to Health Units with respect to Information Systems projects where costs associated with the projects were not due and payable at the time funds were advanced to the Health Units.

Audit wrote to the Chief Executive of the Department in relation to these payments and noted that the procedures adopted had the potential to misrepresent the outcomes achieved by the portfolio in implementing its capital program. The Department, following communication of this matter, addressed this concern through proper financial statement reporting presentation of the payments.

Nonetheless, the letter to the Chief Executive expressed concern that the Department had compromised fundamental control processes which required that payment was only made where goods and services had been received. In addition, the advanced funding measures involved additional and avoidable costs.

Part B: Agency Audit Reports, Volume I, Department of Human Services, pages 302 and 303.

Part A: Audit Overview, pages 186 to 187.

2000-01

Advance Payments-Capital Program

The 1999-2000 audit identified what Audit considered to be advance payments. Specifically, Audit noted payments which were made to suppliers of medical equipment where the suppliers' performance was secured by Bank guarantees obtained by the suppliers. Audit also noted payments were also made to Health Services for planned work which had not been completed at the time of the payment.

In relation to the payments associated with Bank Guarantees, Audit noted that the Treasurer's Instructions were amended in January 2001 to specifically prohibit making such advance payments, without the prior approval of the Treasurer. With respect to the second type of payment the Department indicated that these payments were of the nature of grant funding and it was within the Department's authority to determine how it funded these projects. While the Department's position with respect to its authority to make these payments was understood by Audit, it was noted that of the \$11 million paid to Health Services from the 1999-2000 Capital Program, a significant amount (ie \$1.4 million) had not been spent by the Health Services in May 2001 and was required to be repaid to the Department.

Part B: Agency Audit Reports, Volume I, Department of Human Services, pages 344 to 345.

CAPITAL WORKS

1997-98

Capital Works

Audit identified issues relating to the SAHC's capital asset management policy and processes, which Audit considered were in need of review and/or remedial action. This matter was commented on in Part A of my Annual Report to Parliament.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 361.

Capital Works Projects-Hospital Developments

Audit undertook a review of hospital developments for the Mount Gambier Hospital and Port Augusta Hospital. Audit review identified issues associated with capital asset management policy and processes, which Audit considered needed to be reviewed. Audit reported that these issues contributed to additional funding requirements for both hospital development projects. Shortcomings identified by Audit included inadequate definition of project management responsibilities, unsatisfactory cost planning and control, and the absence of routine project review processes.

Part A: Audit Overview, pages A4-108 to A4-110.

ADMINISTRATION OF CONCESSIONS

1998-99

Administration of Concession Payments

Audit reported that the Department's Internal Auditors reviewed aspects of the control and administration of concession payments by the Department. The Internal Audit review identified a number of significant weaknesses in control arrangements and provided recommendations for improvements to Departmental procedures. Audit reported on measures proposed to be taken by the Department to resolve the issues. Furthermore, Audit reported that some advantage may be gained by establishing a central unit to coordinate data matching processes with respect to all State Government agencies.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 372.

2000-01

Administration of Concession Payments

The Department's Internal Audit program included a review of arrangements for the reimbursement of concessions. The review noted that arrangements with the party providing concessions for electricity charges were not governed by a service level agreement with the Department. In reviewing the Internal Audit findings, External Audit noted that whereas the service provider receiving reimbursement was previously a statutory authority it was now a private sector service provider which reflected a significant change in the risk profile to be managed by the Department. External Audit recommended that the Department negotiate formal contractual arrangements with the private sector service provider and identified a number of matters which were considered needed to be addressed.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 346.

2001-02

Administration of Concession Payments

Previous audits of concessions payments highlighted that the Department had not implemented appropriate documented agreements with the parties providing concessions. The need to develop and implement appropriate documented agreements between the Department and parties providing concessions was communicated by Audit to the Department in 1999-2000. Follow up of this matter in 2001-02 indicated that, limited progress had been achieved in addressing the matter. The audit for 2001-02 also highlighted that the Department's processes for assessing claimants entitlement to concessions was essentially a paper based process and that automation of these

processes may support increased efficiency and improved automated checking of entitlements. Audit noted the Department had prepared scoping documents for automated systems but, at the time of the audit, it had not committed to their development and implementation.

Part B: Agency Audit Reports, Volume I, Department of Human Services, pages 290 and 291.

2002-03

Administration of Concession Payments

Audit of concession payments for a number of years highlighted that the Department had not implemented appropriate documented agreements with the parties providing concessions detailing the respective roles, responsibilities and terms of arrangements. The audits also highlighted that concession assessment processes were essentially paper based and that automation of these processes could achieve increased efficiencies. A follow-up of these matters undertaken in 2002-03 found that the Department continued work in establishing agreements, however, formal agreements had yet to be executed. Also, Audit found that work had been undertaken with Centerlink to purchase a product to enhance the Department's capacity to facilitate data matches, however, the purchase of the product was delayed due to legal considerations regarding some of the proposed conditions of the contract.

Part B: Agency Audit Reports, Volume II, Department of Human Services, pages 548 to 549.

LEGAL COMPLIANCE

2002-03

Legal Compliance

Audit review included examination of the arrangements implemented by the Department to ensure the requirements of all legislation applicable to the Department were complied with. The review did not find a formal, structured and robust compliance framework. Review by Audit did find the following:

- Reliance on institutional knowledge rather than formal structures.
- Key provisions and requirements of legislation had not been documented.
- No systematic reporting of compliance matters.
- Legal compliance were yet to be integrated with risk management processes.

Part B: Agency Audit Reports, Volume II, Department for Human Services, page 547.

ADEQUACY OF FINANCIAL ACCOUNTING SYSTEMS AND PROCEDURES

Expenditure — Payroll

1997-98

Salary Payments

Audit review of the calculation of employee termination payments revealed no evidence that calculations were being reviewed by an officer independent of the preparer. Audit testing of termination payments identified some under and overpayments.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 316.

Payroll

Audit identified the need to ensure there was greater emphasis on the independent review of key documentation, in particular, employee masterfile amendments and bona fide reports. Also, Audit noted the SAHC continued to experience difficulty with respect to the reconciliation of payroll transaction data to the general ledger.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 356.

1998-99

Payroll

Audit review revealed that issues raised in previous years relating to employee masterfile changes, bona fide reports and reconciliation of payroll transaction data continued to remain relevant issues to be satisfactorily addressed by the SAHC.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 414.

2000-01

Payroll Processing and Human Resource Management

Audit review of payroll processing identified certain matters of a management control nature which were in need of attention. Matters noted included the provision of information to departmental and agency managers with respect to their employees and to related costs and the breakdown of certain payroll processing controls. A key factor identified by Audit which contributed to the findings was the continued use by the Department of three installations of the system software to process payroll transactions.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 345.

2001-02

Payroll Processing

Prior year audits identified aspects of controls exercised by the Department which needed to improve. These aspects were the focus of the 2001-02 audit. Audit review found that the documentation of policies and procedures continued to be an ongoing process by the Department. Furthermore, Audit testing of payroll processing by the Department noted the breakdown of the performance of key reconciliations and effective maintenance of clearing accounts. While the Department advised of strategies implemented to address these areas they remained unsatisfactory at year end.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 290.

2002-03

Payroll

Audit review undertaken by Internal Audit in 2002-03 and review performed by External Audit in prior years identified control weaknesses relating to the processing of the Department's (and other portfolio agencies) payroll transactions. Audit review undertaken by External Audit in 2002-03 found that the Department had made some

progress in addressing the control weaknesses raised by Internal Audit and External Audit. The External Audit review found, however, that for the majority of the 2002-03 financial year internal controls did not provide an adequate control framework for the processing of the Department's payroll transactions. The more significant areas of concern included:

- Bona Fide Certification Processes;
- Leave Recording and Management Processes;
- Payroll Reconciliation Processes;
- Documentation of Policies and Procedures.

Audit considered a formal project management framework was required to respond to the issues raised.

Part B: Agency Audit Reports, Volume II, Department of Human Services, pages 546 to 547.

Expenditure — Payment of Accounts

1997-98

Payment of Accounts

Audit review revealed that there was generally no review and authorisation of accounts payable batches by an officer independent of the preparer. Audit reported that the absence of such a review increased the risk that incorrect or unauthorised transactions are processed.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 316.

Accounts Payable

Audit review identified matters mainly related to the requirement to improve segregation of duties, independent verification and record keeping processes with respect to some aspects of the purchasing and the accounts payable functions.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 356.

1998-99

Accounts Payable

Audit identified the need to review control procedures over computer masterfile data; the need to review processes relating to Advance Account and Workers Compensation payments; and improvements required in respect of record keeping processes.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 414.

1999-2000

Review of Accounts Payable Processing

The audit of the accounts payable function revealed a number of weaknesses in control including:

- Policies, procedures and control arrangements were not documented in a manual which was available to all system users.

- Utilisation of the On-Line Purchase Order function of the system, which in Audit's view incorporated strong system based controls, had not been maximised; instead use was made of manual payment vouchers.
- Control over the vendor masterfile was inadequate.
- Systems controls were, at times, not followed for payment processes.

The report to the Department acknowledged that the Department's Financial Services Division was reliant on staff at the work sites who initiate payments, located both within the Department and at the South Australian Housing Trust, for performance of key control procedures. It was also acknowledged that achieving improvement in controls would require effective collaboration between the Financial Services Division and the work sites.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 302.

2000-01

Review of Accounts Payable Processing

Audit review of Accounts Payable processes identified a number of findings including:

- Policies, procedures and control arrangements were not documented in a manual which was available to all system users.
- Utilisation of the On-Line Purchase Order function of the system, which in Audit's view incorporated system based controls, had not been maximised; instead use was made of manual payment vouchers.
- Control over the vendor masterfile was inadequate.
- System controls were, at times, not followed for payment processes.

Also, Audit's review of the extent to which the Department's Accounts Payable system matched relevant prescribed elements of the Financial Management Framework revealed there were a number of gaps between the prescribed elements requirements and the controls implemented by the Department.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 345.

2001-02

Accounts Payable

Audit review for the year ended 30 June 2002 included follow up of progress by the Department in addressing matters arising from prior years. Prior year audits noted the Department had not prepared documented policies and procedures relevant to Accounts Payable processing. Follow up in 2001-02 indicated work had been undertaken in preparing draft documented policies and procedures however the draft had not been finalised or formally adopted. Also, prior year audits found the Department only made limited use of its accounts payable system's on-line purchasing facility. The 2001-02 audit indicated that the extent of use of the on-line system was still limited. This facility was considered by Audit to incorporate sound system controls for verifying the

authorisation of payments, the receipting of goods or services supplied and that the amount invoiced by suppliers was consistent with that agreed when the order for supply was placed.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 289.

Expenditure — Grant Payments

1997-98

Grant Payments

Audit review of the Department and the Office of the Ageing revealed that:

- a proportion of grants were being paid without supporting service agreements, setting out the terms and conditions of the grant payments and the responsibility of the parties, or were based on service agreements that were still in draft form;
- instances of non-compliance with the financial and reporting requirements established by those service agreements that were in existence;
- some service agreements did not include specific program outputs;
- non-conformity with Treasurer's Instructions which requires any grant monies unexpended at the end of the financial year or at the completion of the grant period to be repaid to the Minister unless specific approval is given by the Minister to retain funds. Financial returns from the previous financial year indicate that some grant recipients could be retaining material excess funds without specific approval.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 316.

Grants

Audit identified matters concerning centralisation of record keeping processes in relation to grant revenues, including procedures associated with their collection and recording. Also, Audit made comment regarding the importance of ensuring that such revenues are appropriately accounted for in accordance with accounting standards.

Part B: Agency Audit Reports, Volume II, South Australian Health Commission, page 357.

INTERNAL AUDIT

1998-99

Internal Audit

Audit noted a number of factors which reduced the effectiveness of the Internal Audit function within the Department. The Departmental Audit Committee had not finalised Charters for either Internal Audit or the Audit Committee. Furthermore, Audit noted that no comprehensive Audit Universe and Audit Plan had been prepared for the Department. Audit reported that Internal Audit can play an important role within an agency by evaluating the effectiveness of specific controls and operating activities and in monitoring compliance by agency staff with approved policies and procedures. Audit

considered that while Internal Audit undertook some important and valuable work in 1998-99, the absence of a comprehensive Audit Universe and associated risk evaluation gives rise to a concern that areas of material risk to the Department may not be appropriately reviewed.

Part B: Agency Audit Reports, Volume II, Department of Human Services, page 370.

1999-2000

Internal Audit

Audit noted that the Department facilitated an independent review of Internal Audit services. The review outlined a range of areas where the internal audit service provided to the Department needed to improve to meet the needs of the Department and the portfolio. Audit assessed the Review's findings and considered implementation of the recommendations would enable the Department, and the broader portfolio, to address the diverse and complex activities undertaken and would provide assurance that the Department's objectives were being effectively met.

Review of work performed by Internal Audit during the year indicated that limited work had been completed with respect to the Department's operations. It was also noted that development of a whole of Department strategic audit plan, which was a recommendation of the Review of Internal Audit function, had not occurred at the time of the External Audit review.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 301.

2000-01

Internal Audit

Previous audits reflected upon the effectiveness of the Internal Audit function both within the Department and across the portfolio. In the previous year's Report, reference was made to an independent review of the function in the Department and to limited progress in implementing the recommendations of the review with respect to staffing the function. Audit noted that in the past year, the Department implemented certain interim staffing arrangements but had yet to finalise and implement an approved staffing structure.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 343.

2001-02

The Audit Committee and Internal Audit

Audit noted the new Department Chief Executive reviewed the composition of the Audit Committee and became chair of the Committee. Also, Audit noted during the year the Department finalised an approved organisation structure for Internal Audit and appointed staff to the Internal Audit group to fill the positions reflected in the structure. This process was not finalised until the later part of the 2001-02 year which had some impact on the completion of planned audit activities. Following the appointment of new staff, Internal Audit foreshadowed the need to review and update both the planning methodology used and the specific planned audit assignments.

Part B: Agency Audit Reports, Volume I, Department of Human Services, page 289.



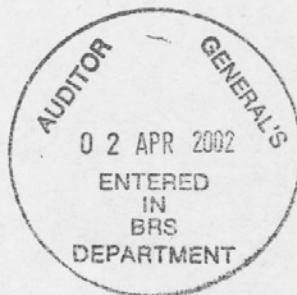
Auditor-General's
Department

9th Floor State Administration Centre
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A02/078

29 April 2002

Mr F Turner
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Dear Frank

Cash Balances

Introduction

The Department's arrangements for managing its cash position and the level of cash held at 30 June 2001 has been the subject of some informal discussion in the past. Following the recent change of Government, the re-allocation of portfolio responsibilities and review by the Government of organisation arrangements it is considered appropriate to document relevant issues and for Audit to seek advice of measures being considered or pursued by the Department.

Banking arrangements

The arrangements implemented by the Department from its establishment, and following the transfer of activities previously controlled by the South Australian Health Commission to the Department, have provided for the Department to control all its financial transactions, across the range of policy areas, through a single Departmental bank account. This arrangement has enabled efficient and reliable processing of financial transactions.

Audit is not aware of any legislative or administrative requirements which would preclude the Department from consolidating its activities in this way, notwithstanding that funding has been received by the Department from a number of funding sources and subject to provisions with respect to how these funds may be applied.

The balance of cash held by the Department is a matter which is closely monitored by the Department, reflecting the relatively low balance held in relation to its cash flow requirements and the obligation to maintain a positive balance at all times. From our discussions I understand that the monitoring arrangements include daily reporting to you of the actual and the expected overnight balances and the inclusion in the Corporate Performance report of a section which highlights projected and actual balances. These arrangements are understood by Audit to be appropriate to ensure the Department's cash management objectives are met.

Financial position

A number of factors have been identified which support a view that the Department's balance at 30 June 2001 of cash at bank was relatively low:

- The Department's cash at bank balance as at 30 June 2001 was \$36.7 million reflecting a reduction of \$23.3 million from the combined balance of the Department and the South Australian Health Commission as at 1 July 2000.
- The balance of cash held by the Department compares to an amount of \$ 49 million notionally held by the Department with respect to housing funding as reflected in the Commonwealth State Housing Agreement audited financial statements as at 30 June 2001.

The balance of cash held by the Department can be directly linked to the amounts owed to it, in accordance with relevant funding agreements, by funded Health Services. The Department has provided funding to Health Services for their over budget expenditure without receiving substantial funding from the Treasurer through Appropriation. Consequently this over budget expenditure by the Health Services has been largely funded from the Department's cash reserves.

The Department's financial statements for the past two years have reflected an assessment, which has been supported by Audit, that there is no reasonable expectation that Health Services will be able to repay the monies owed with respect to over budget expenditure. Consequently the provisions for doubtful debts have been made against these balances.

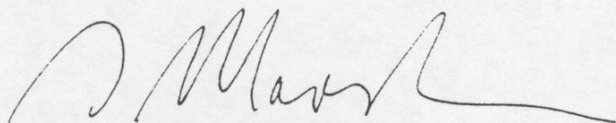
It is evident from review of Parliamentary Papers that the Department's funding of Health Service over budget expenditure has been understood by the Minister of Human Services, the Government and by the Parliament.

It is not clear to Audit what measures are being considered by the Department and the Government to address the extent of the Department's support of the Health Services and the impact upon its cash position, particularly in the context of reliance on Commonwealth State Housing monies for that Health Service funding support.

I would be grateful for your advice of what options or measures the Department is considering regarding this important budgetary and cash position matter.

If you would like to discuss this request please contact me on 8226 9643 at your convenience. I would be grateful if you would respond to this request by 30 May 2002.

Yours faithfully



Simon Marsh
Principal Audit Manager

DEPARTMENT OF HUMAN SERVICES



Financial Services

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4 September 2002

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Dear Simon,

CASH BALANCES

I refer to your letter of 29 April 2002 regarding cash balances held by the Department and apologise for the lateness of my reply.

As you are aware the Department has shared your concerns in relation to its low cash balances and as a consequence has implemented tight controls and reporting mechanisms to ensure that it manages its cash position in order to maintain a positive balance in its Departmental Deposit account at all times. This includes the daily cash reconciliations and reporting of actual cash held to both me and Treasury, as well as devoting a significant section to cash management in the Portfolio Monthly Management Report (which is also made available to Treasury and to both Ministers).

As a direct consequence of representations made by the Department during the recent development of the 2002-03 Budget, a number of initiatives have been implemented which alleviate some of the pressures that have been experienced by the Department in respect of its overall cash position. These include:

- an undertaking by the Treasurer to provide advanced appropriations to the Department at any time if the Department's cash position is likely to overdraw at the Reserve Bank;
- removal of "claw back" savings of \$7.5m factored in the Forward Estimates in respect of 2002-03 and 2003-04;
- in May the Department was requested to submit a Cabinet Submission which sought amongst other things, a request for additional funding of \$12.3m equivalent to the then projected increase in Health Unit deficits for 2001-02 financial year, this funding was approved in June and



distributed to Health Units which had the effect of eliminating incremental carry-over debt from 2001-02 which otherwise would have reduced allocation to Health Units in 2002-03;

- in recognition of the historic under-funding of public hospitals in the recent past, Cabinet increased appropriation by \$10.5m in 2002-03 and \$8.5m through the balance of the forward estimates under an initiative titled "Hospital System Funding". These amounts were directed specifically to address operational budget deficit of public hospitals and does not carry with it, additional spending requirements which prescribe how the funds are to be applied.

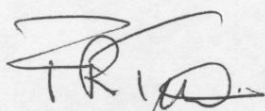
The additional Hospital System funding provided to the Department was split into two amounts, the first amount of \$4.750m has been distributed to the Department through its appropriation and has in turn been allocated to the Hospital Casemix pool for distribution to health units through the Casemix price. The second amount was initially held by Treasury and was to be distributed to the Department contingent upon the findings of the Treasury Expenditure Review currently underway within the Department. As a consequence of discussions held with the Under-Treasurer and Treasurer the Department has been encouraged to apply for these funds to be distributed ahead of the findings of the Expenditure Review team. It is intended that these amounts will be held as a strategic reserve and used to address Health Unit deficits should they materialise or otherwise, to be applied to other hospital priorities as approved by the Minister and Treasurer.

As a consequence of the above actions Health Unit deficits have been reduced to \$57.3 million as at 30 June 2002.

The Department continues to provision for bad and doubtful debts of \$54.2 million and the eventual cashing-out of these deficits through additional appropriations will continue to be a feature of future budget negotiations with Treasury.

I am confident that the arrangements that are currently in place both in respect of cash monitoring and reporting, as well as the strategies concerning the application of the additional funding will be sufficient to ensure that the Department is able to manage its cash position within the foreseeable future.

Once again I apologise for the lateness of my reply and would be happy to discuss further details of the Department's budget with you should you wish.

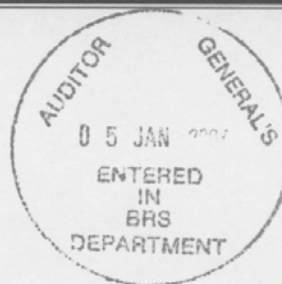


F R TURNER
Director, Financial Services



SENATOR THE HON KAY PATTERSON
 Minister for Family and Community Services
 Minister Assisting the Prime Minister for the Status of Women

Mr K.I. MacPherson
 Auditor General
 9th Floor, State Administration Centre
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Dear Auditor General,

I am writing in response to the South Australian Treasurer's media release, dated 19 December 2003, stating that more than \$33 million of Commonwealth housing funds have been inappropriately spent on health.

Subclauses 4(14) to 4(22) of the 1999 Commonwealth State Housing Agreement outline the allowable uses of assets and available funds. Should any funds have been spent for purposes other than the allowed housing related expenditure I would be greatly concerned.

My Department has advised me that the Commonwealth holds compliance certificates from the Chief Executive Officer of the South Australian Department of Human Services from 1996/97 onwards. These certificates are based on financial statements, which were audited by the South Australian Auditor General's Department, and they certify that that all funds and assets available under the *Housing Assistance Act 1996* have been used only for allowable purposes.

I would be grateful for any advice you can provide on the facts of this matter and in particular any evidence you may have on errors in the audited financial statements from 1996/97 onwards, as provided to the South Australian Department of Human Services for the purposes of the Commonwealth State Housing Agreement. Your advice by 9 January 2004 would be appreciated.

Yours sincerely

Senator Kay Patterson



**Auditor-General's
Department**

9th Floor State Administration Centre,
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Reference A04/078

9 January 2004

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Dear Minister

Statements by the Treasurer of South Australia

I refer to your letter received by my office on 23 December 2003. You have sought my advice with respect to a media release by the Treasurer of South Australia on 19 December 2003 which stated more than \$33 million of Commonwealth housing funds have been inappropriately spent on health. You have specifically asked for advice whether there were any errors in audited financial statements for the South Australian State Housing Authority as prepared by the Department of Human Services and any other facts relevant to the Treasurer's media release.

The following response is provided to your letter.

Linkage between audited financial report and Chief Executive's compliance certificate

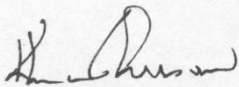
Before responding to your request I note I do not agree with the assertion in your letter that certificates provided by the Chief Executive of the Department of Human Services are based on the financial statements prepared by the Department of Human Services, for the purposes of the Commonwealth State Housing Agreement, and audited by my officers. Subclause 4(28) which requires provision of independently audited financial reports is separate from subclause 4(29) which requires the Chief Executive's certificate and there is no explicit or implied link between the two subclauses.

Subclause 4(28) requires the financial report to be prepared in accordance with national financial reporting frameworks and accounting practices. These frameworks and accounting practices do not, in my view, have a primary, or subsidiary purpose, of providing information or assurance required to provide the certificate required by subclause 4(29). Indeed the current financial reporting framework and accounting practices replaced a form of financial report whose primary purpose was to account for all sources and applications of funds.

Integrity of audited financial statements

Responding to your specific request regarding any errors in the audited financial statements I advise that I am not aware of any evidence of errors in the audited financial statements prepared by the Department of Human Services and audited by my officers for the purposes of the Commonwealth State Housing Agreement. To understand the context in which this statement is made it is appropriate to refer to the Independent Audit Reports for each year which document the scope and objectives of the audit. This will ensure your expectations of assurance provided by the audit process are consistent with the audit performed and the opinion provided.

Yours sincerely

A handwritten signature in black ink, appearing to read 'KI MacPherson', written in a cursive style.

KI MacPherson
Auditor-General