

Public Hospitals: 2014–15 Audit Snapshot

Tabled 12 November 2015

The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector. The Auditor-General conducts financial audits and performance audits, and reports on the results of these audits to Parliament.

On 12 November 2015, the Auditor-General tabled his audit report, *Public Hospitals: 2014–15 Audit Snapshot*.

Overview

Report presents outcomes and observations from the 2014–15 financial audits of 87 Victorian public hospitals and 19 controlled entities.

Key messages:

- Hospitals face short- and long-term financial sustainability risks.
- Net deficits from operations of more than \$700 million annually in the past five years.
- Hospitals face short-term cash flow issues.
- Hospitals unable to generate sufficient operating surplus for asset renewal and replacement.
- Sustainable funding model for public hospitals needed.

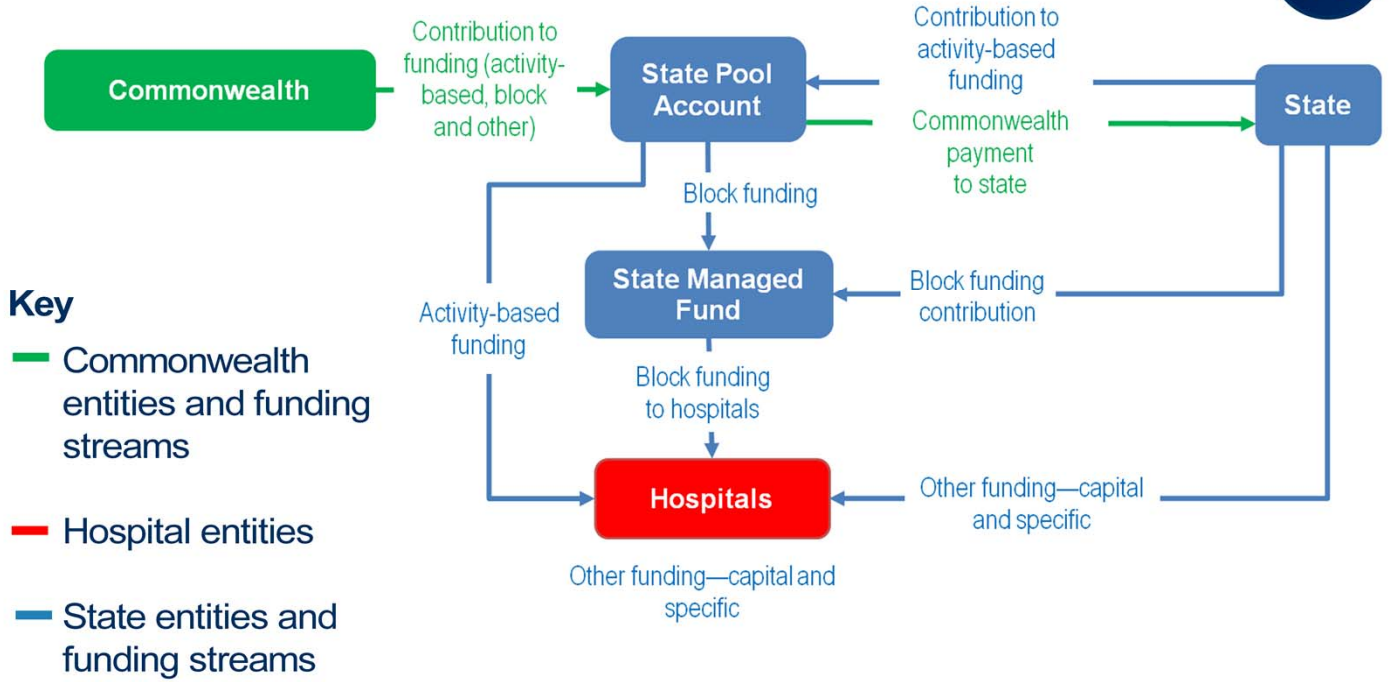
This report covers the results of the 2014–15 financial audits for the public hospital sector—consisting of 87 public hospitals and 19 controlled entities.

All audited entities have received clear audit opinions.

Key messages of the report:

- Hospitals face short- and long-term financial sustainability risks.
- The sector, after adjusting for capital funding, had shown deficits from operations of more than \$700 million annually in the past five years. This has contributed to short-term cash flow issues, where we found hospitals had to stretch paying creditors beyond 30 days and also used money, such as those held for specific purposes and foundation donations, for operational purposes. Targets for creditors and debtors have also been set at 60 days.
- As hospitals are not funded for depreciation and have been unable to build up surpluses, consequently they face long-term financial sustainability risks to enable them to fund new or replacement assets as required.

Funding flow to Victorian hospitals



The government funding model for public hospitals is complex.

We have provided a high-level overview of the flow of funds between the commonwealth, state government and the hospitals. This is only in the Victorian context.

Hospitals basically receive three types of funding:

- activity-based funding
- block funding, and
- other—one off—specific purpose grants, such as capital.

All of this is in line with the National Health Reform Agreement 2011. The funding is managed through the State Pool Account.

Background

Key balances at 30 June 2015

Cohort	Revenue (\$ million)	Expenditure (\$ million)	Net result (\$ million)	Net assets (\$ million)
Metro	9 340.65	9 429.47	-88.82	6 448.51
Regional	2 844.05	2 895.69	-51.64	2 116.34
Rural	404.21	421.14	-16.93	429.56
Small rural	563.05	571.57	-8.53	909.20
Total	13 151.95	13 317.88	-165.92	9 903.61

- Sector had a turnover of \$13.2 billion (\$12.9 billion in 2013–14).
- Comprehensive deficit of \$165.9 million (\$235.7 million in 2013–14).

Key balances for the sector are based on the consolidated financial statements of the 87 hospitals which are split into four cohorts based on their location, catchment population and size.

The sector had a turnover of \$13.2 billion with public hospitals receiving \$10.7 billion in government funding, or 83 per cent of their revenue. Last year it was also 83 per cent.

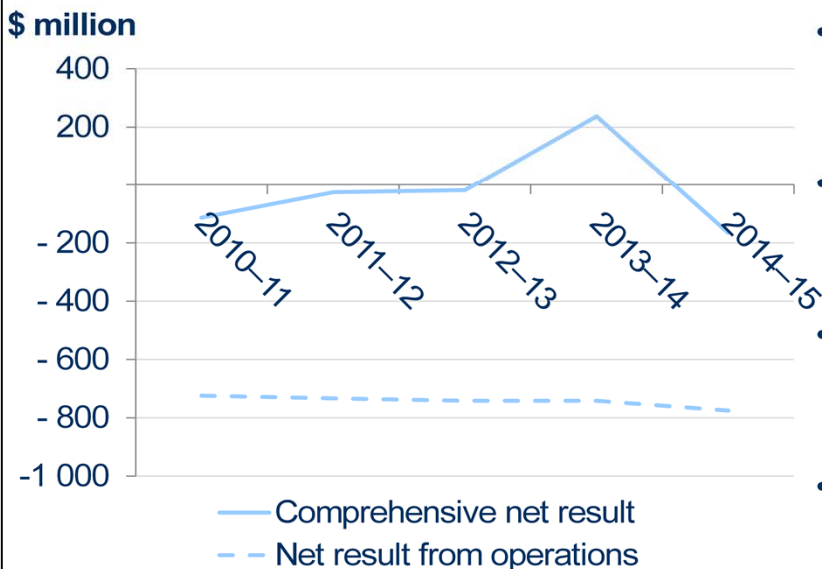
Government funding includes capital funding of \$700 million. The composition of revenue is consistent with last year.

Total expenditure was \$13.3 billion, of which the major expense is employees, which makes up 66.4%.

The final net result for the sector was a comprehensive net deficit of \$165.9 million.

Net deficit from operations

Comprehensive and operational net results of public hospital sector



- The sector had a net deficit from operations of \$775 million in 2014–15 (\$742 million in 2013–14)
- The net deficit from operations is > \$700 million annually in the past five years.
- Public hospitals are unable to generate sufficient surplus for asset renewal and replacement.
- Increased longer-term financial sustainability risks.

We have compared the comprehensive result, as discussed in the previous slide, with the operational result.

As shown in the graph this has resulted in the sector showing an operating deficit of \$775 million in the current year and a consistent deficit of more than \$700 million for previous years.

Although hospitals are not funded for depreciation they still need to fund this. However they have not generated sufficient surpluses for this purpose.

This generates long-term sustainability risks for hospitals.

Financial sustainability risk indicators

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Indicator	Industry average		Metro average 2014–15	Regional average 2014–15	Rural average 2014–15	Small rural average 2014–15
	2010–11 to 2014–15	2014–15				
Net result ratio	-1.5%	-2.6%	-0.6%	-2.0%	-4.0%	-3.8%
Liquidity ratio	1.1	1.1	1.1	0.8	1.0	1.3
Average number of cash days available	39.47	35.5	20.5	29.7	36.2	55.8
Capital replacement ratio	1.1	1.2	1.3	1.4	0.8	1.3
Internal financing ratio	-75.5%	-96.5%	-174.8%	-86.8%	-52.6%	-71.6%

Five financial sustainability risk indicators are assessed across each of the 87 hospitals.

Indicators have been enhanced slightly since prior years to make sure that they are consistent across other sector reports—but only minor changes were made:

- the net result and liquidity ratios do not make any adjustments for one-off or unusual items, and
- the previous self-financing ratio has been replaced by the internal financing ratio.

This assessment is based on audited financial statements—not just operational items—also includes capital funding.

Of the five indicators, three are short term—net result, liquidity and available cash days—and two are long term—capital replacement and internal financing.

Financial sustainability risk indicators

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- 31 received a letter of comfort from the Minister for Health.
- Short-term indicators—net result, liquidity and available cash days:
 - 69 had a comprehensive net deficit
 - 48 had liquidity ratio of less than one.

This year 31 letters of comfort were issued by the Minister for Health (32 in 2014). A letter of comfort is only requested by the hospitals when they need cash-flow support to enable them to meet current and future operational obligations for a minimum of 12 months from the date of certification of the financial statements.

In terms of short-term indicators we found 69 hospitals had a net comprehensive deficit and 48 had liquidity ratio of less than one, where one represents breaking even.

Financial sustainability risk indicators

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Long-term indicators—capital replacement and internal financing:

- 50% rated high risk for capital replacement.
- 80% rated high risk for internal financing in each of past five years.

Implication:

- Hospitals face short- and long-term financial sustainability issues.
- Hospitals face short-term cash flow issues.
- Hospitals unable to generate sufficient surplus for asset renewal and replacement.

Hospitals hold \$12.3 billion of assets and had depreciation expense of \$770 million.

In terms of long-term indicators:

- over 50% of hospitals were rated high risk for capital replacement, and
- more than 80% were rated high risk for internal financing in each of the past five years.

The implications are that:

- hospitals face short- and long-term financial sustainability risks
- hospitals face short-term cash-flow issues, and
- hospitals have been unable to generate surpluses to fund asset renewal and replacement.

Recommendations

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		Accepted
That public hospitals' governing boards and their management:		
1.	implement appropriate governance and monitoring mechanisms to ensure all audit findings are addressed on a timely basis.	✓
That public hospitals:		
2.	comply with requirements of Standing Direction 4.5.6 <i>Treasury Risk Management of the Financial Management Act 1994</i>	✓
5.	review their debtor collection policy and processes, and follow up on debtors that are overdue	✓
6.	use restricted funds only for their intended purpose.	✓

In summary, we made six recommendations in the report.

Of the six recommendations the department has accepted the four that were directed at hospitals.

Recommendations

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		Accepted
That the Department of Health & Human Services:		
3.	reviews the public hospital funding model to provide sustainable operational funding to enable public hospitals replace or acquire new assets as required	x
4.	reviews and sets a commercially accepted target for the terms of trade with creditors and debtors, in line with state government policy.	Partially

It was disappointing the department did not accept, or only partially accepted, the two recommendations directed to them, and the Acting Auditor-General has responded to the department in Appendix E of our report.

The recommendation not accepted by the department was to review public hospital funding and provide sustainable operational funding to enable hospitals to replace or acquire new assets as required.

We have found that capital revenue is not awarded evenly across the hospitals and they have not been able to generate sufficient surpluses to fund asset replacement and renewal. This has resulted in the sector showing indicators of high risks in capital replacement and internal financing, as previously discussed.

The department's emphasis on the results excluding capital revenue or depreciation does not address the longer-term risks and could ultimately impact the quality and variety of services provided by the public hospitals.

The other recommendation, which the department has only partially accepted, was to review and set commercially accepted targets for terms of trade with creditors and debtors in line with state government policy. Here the Acting Secretary only supports in principle, and this is subject to consideration of funding. This is not in line with state government policy of 30 days, as the current target for the hospitals is 60 days.

Key messages

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The sector has generated a net deficit from operations of more than \$700 million in each of the past five years.

Hospitals face short- and long-term financial sustainability risks.

Hospitals face short-term cash flow issues and long term they are unable to generate sufficient surplus for asset renewal and replacement.

The take away from the report is:

- The sector has generated a net deficit from operations of more than \$700 million in each of the past five years.
- Hospitals face short- and long-term financial sustainability risks, and
- Hospitals face short-term cash flow issues and in the long term they are unable to generate sufficient surplus for asset renewal and replacement.

Overall message

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The funding model for the hospital sector needs to be reviewed and be financially sustainable for all hospitals.

In conclusion, the funding model for the hospital sector needs to be reviewed and be financially sustainable for all hospitals.

Our report also highlights public hospital boards' inability to adequately align their responsibilities to report a financially sustainable entity when they are unable to cover their operating expenses with their operational revenue.

Contact details

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For further information on this presentation please contact:

Victorian Auditor-General's Office

[p] 8601 7000

[w] www.audit.vic.gov.au/contact_us.aspx

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