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Audit Report No.26 2003–04
Performance Audit

Supporting Managers—Financial Management in the Health Insurance Commission

Health Insurance Commission

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of Australia 2004

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Canberra ACT
6 February 2004

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Health Insurance Commission in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Supporting Managers—Financial Management in the Health Insurance Commission*.

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely



P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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Abbreviations/Glossary

AIMS	Accrual Information Management System
ARAS	Audit and Risk Assurance Services Branch
AUS	Australian Auditing Standard
BIP	Business Improvement Program
EFT	Electronic Funds Transfer
FINNET	The Health Insurance Commission's Financial Management Information System
FKMP	Financial Knowledge Management Plan
FMIS	Financial Management Information System
FPD	Finance and Planning Division
FSTD	Financial Systems Training and Development Section
FTE	Full Time Equivalent
FTP	Financial Training Plan
GL	General Ledger
HIC	Health Insurance Commission
MDI	Managing Director's Instruction
OPA	Output Pricing Agreement
OSS	On-line Statistical System
PBS	Pharmaceutical Benefits Scheme
PSA	Performance Support Agreement
YTD	Year-To-Date

Summary and Recommendations

Summary

Background

1. This audit examines aspects of financial management in the Health Insurance Commission (HIC). It has a particular emphasis on the financial framework and systems and their ability to assist managers to make informed decisions on the efficient and effective use of resources. The ANAO has made six recommendations to assist the HIC to meet its financial management objectives.
2. In recent years, the Commonwealth Government has reformed financial management in the Commonwealth public sector in order to improve stewardship and accountability. Legislation places responsibility for the efficient, effective and ethical use of resources on the directors of Commonwealth authorities and companies and on the Chief Executive Officers (CEOs) of departments and agencies. In order to discharge their responsibilities, they need to ensure that their organisations have a level of financial management that assists their managers to use resources efficiently and effectively. This audit examines the response of the HIC to these reforms.
3. The HIC¹ is a statutory authority, created under the *Health Insurance Commission Act 1973*, within the Health and Ageing Portfolio. It was established to administer what has become Australia's universal health insurance scheme, Medicare. The HIC also administers many other health-related programs on behalf of the Commonwealth Government.²
4. The HIC processed 221.4 million services in 2002–03, involving \$8.1 billion in Medicare benefits. In the same year, it also processed 174 million services, involving \$5.2 billion in benefits paid under the Pharmaceutical Benefits Scheme (PBS) and Repatriation Pharmaceutical Benefits Scheme (RPBS). These two programs and the 30 Per Cent Private Health Insurance Rebate program are the major programs administered by the HIC. They accounted for more than \$15.5 billion of the \$16.6 billion in payments made by the HIC in 2002–03.
5. Commonwealth health initiatives involve financial and operating approaches which acknowledge that agencies, such as the HIC, are accountable for the delivery of selected government programs supported by an appropriate administration infrastructure—both in terms of capital and operating funds. Of significance is whether the financial management approaches adopted are based on sound financial structures. An important consideration is how those structures align to, and are considered in, the entities' resource allocation processes, both

¹ A more detailed description of the HIC can be found in Chapter 1.

² Appendix 1 contains a list of the health related programs administered by the HIC.

in administering and delivering government programs. This, however, was not the focus of the audit. Rather, the focus was whether the financial framework and processes of the HIC provided an adequate basis for coming to an informed conclusion on the major overriding issue.

6. The audit objective was, therefore, to examine the effectiveness of the HIC's internal control structures, as well as its financial management framework and processes, in order to form an opinion on their ability to support HIC Commissioners and managers in making informed decisions on the proper use of Commonwealth resources. To form the opinion, the ANAO examined whether the HIC's:

- internal control structure and environment are sufficiently adequate to provide Commissioners with assurance that the resources allocated to the HIC are managed efficiently and effectively; and whether the
- financial management framework, systems and reports are adequate to assist Commissioners and managers to efficiently and effectively manage the resources for which they are responsible.

7. The audit comments on the ability of financial management in the HIC to support managers in their work. The audit does not comment on the finances of the HIC and is not designed to provide an opinion on the HIC's financial position. This is done in the context of the HIC's annual financial statements.

Key findings

Does the HIC have a Robust Internal Control Structure and Control Environment? (*Chapter 2*)

Further enhancement is required before the ANAO could consider the HIC's internal control structure and control environment to be fully reliable and sufficiently comprehensive for management and audit purposes.

8. The ANAO found that, while the HIC's internal control structure and control environment have improved in recent years, they cannot yet be considered robust and fully reliable. In the ANAO's opinion, too many financial management issues are being raised by the ANAO, as external auditors, rather than being internally identified and attended to by management. As part of the audit of the HIC's 2002–03 financial statements the ANAO raised a new high risk 'A' issue and nine new control 'B' issues (see Chapter 2 for details).³

³ Financial statement audit issues are categorised as level A, B or C:

- A—those matters that pose significant business or financial risk to the agency and must be addressed as a matter of urgency;
- B—control weaknesses that pose moderate business or financial risk to the agency or matters referred to management in the past, which have not been addressed satisfactorily; and
- C—matters, which are procedural in nature or minor administrative failings.

9. Further, while advice to the Commissioners on risks has improved since 2000, the HIC needs to ensure that advice on the risks associated with new or existing programs addresses all aspects of risk, including operational and financial risks. Until this occurs, the HIC's control environment is not providing Commissioners with an adequate level of assurance that financial risks, particularly for new programs, are being properly identified and adequately addressed. This involves both insurable and non-insurable risk.

While Commissioners are presented with a useful range of data, the ANAO has identified opportunities to improve the utility of reports to Commissioners.

10. The ANAO noted that there is a useful range of data provided to Commissioners to allow them to monitor the HIC's financial position. However, both this report and the ANAO's audit of the HIC's 2002–03 financial statements identified opportunities, and made recommendations, for further improvement in financial management reporting to Commissioners.

The HIC has made good progress in developing a culture of stewardship and accountability.

11. The ANAO has concluded that the HIC has made good progress in developing a culture of stewardship and accountability amongst its managers. However, ANAO observations indicate that further work is required to ensure that stewardship and accountability is integrated into everyday management for managers at all levels.

Does the HIC have an appropriate financial management framework in place? (Chapter 3)

Although the HIC has put in place a sound financial management framework, documentation and communication of financial management responsibilities needs further attention to be fully effective.

12. The HIC's financial management framework is consistent with good practice⁴ and provides a sound structure for the attainment of its objectives. However, the ANAO found during the course of the performance audit that, while various documents exist in the HIC which identify different components of the HIC's financial management framework and relevant responsibilities, no single overriding strategic document, which clearly sets out the context, nature and requirements of financial responsibilities of the HIC's Commission, managers and staff⁵, was readily available for that purpose. Absence of such a documented

⁴ See Table 3 at the beginning of Chapter 3 for a description of the elements of an effective financial management framework.

⁵ The financial roles and responsibilities of staff in Finance and Planning Division are set out in job descriptions (see Chapter 5).

reference poses a risk to the HIC, as those with financial responsibilities, including those new to such roles, may have a differing understanding of responsibilities and associated requirements and may not perform all activities required of such roles. This is important both for awareness and for accountability for performance.

Overall, the HIC has identified its financial management risks and taken adequate steps to manage them.

13. The HIC implemented a revised approach to risk management during 2002. Financial risks to the HIC are outlined in the Corporate Risk Management Plan and in the Finance and Planning Division (FPD) Risk Management Plan. Risk management plans, which include financial risks where appropriate, have been developed at Division, State and lower levels within the HIC. However, there needs to be closer integration between operational risk assessments and financial risk assessments, particularly for new programs.

Are HIC managers provided with financial data that is relevant, accurate and timely? (Chapter 4)

Overall, the financial data provided to HIC managers is relevant and accurate and is used by them to support their decision-making.

14. HIC reports contain both financial and non-financial performance data. The financial data in reports is sourced from FINNET⁶ and is the primary source of data used by HIC managers to meet their financial management responsibilities. It is widely used by these managers and is considered by them to be directly relevant to their needs. The HIC produces Whole of Government reports and the Executive Business Report to the Commission within a tight timeframe that is consistently met. However, the timeframe for delivery of Divisional and State monthly financial reports to HIC managers, at 15 days after the end of the month, is slow compared to that of other public sector organisations.

Financial data is appropriately presented and delivered to HIC managers.

15. The HIC makes use of both financial and non-financial data in preparing budgets, reporting and monitoring performance. Financial data is presented to HIC managers in a form that is clear, understandable and in accordance with their financial management needs. However, there is scope to streamline the Monthly Financial Report and better explain actions taken to manage budget variances.

⁶ FINNET is the HIC's financial management information system.

While the HIC has identified its managers' financial data requirements, consultation with managers has been limited.

16. The HIC has identified the requirements of managers and other users of financial data and taken steps to meet their needs. However, consultation with users about their data needs has been limited. FPD has developed initiatives to improve consultation with users on their needs. Financial data is generally considered by HIC managers to be readily accessible and able to be delivered in accordance with their financial management requirements.

The data produced by the HIC's FMIS is accurate and reliable.

17. The financial data provided by FINNET is sufficiently accurate and reliable to meet the financial management responsibilities and needs of line managers. However, there is only limited documentation on the interfaces (links) between the HIC's Financial Management Information System (FMIS) and associated business systems. This presents a risk that critical processes required to ensure that FMIS data are complete may not be correctly followed, resulting in the loss, or corruption, of data.

Do the HIC managers and staff have the required skills, training and support to use financial data? (Chapter 5)

Generally, financial staff have appropriate skills and experience. Senior operational managers have a good understanding of their financial responsibilities, but the understanding of less senior staff could be enhanced.

18. Generally, the HIC's financial staff, including financial staff in divisions and in State offices, have appropriate skills and experience. Amongst non-financial staff, senior managers have a good understanding of their financial responsibilities. At less senior levels, a significant proportion of staff indicated that their understanding could be better. The HIC provides financial management training and other support to its staff.

FPD is not involved in the recruitment of Divisional Finance Coordinators and State Finance Managers.

19. A risk to the HIC identified by the ANAO was the lack of FPD advice on, or involvement in, the recruitment of Divisional Finance Coordinators and State Finance Managers. Unless FPD is involved in recruitment for these positions, there is a risk that staff without appropriate skills, understanding and experience could be recruited.

Financial training needs are assessed and financial management training is provided within the HIC.

20. The HIC provides financial training to staff at all levels. The HIC has developed systems and tools to assist in assessing financial training needs and in providing financial training. Many of the supporting tools were introduced during 2003. The HIC should ensure that they are fully implemented.

Managers and staff are well supported in using, analysing and interpreting financial data.

21. The HIC's FPD provides managers and staff with a comprehensive range of financial support services, including an FPD intranet site, Help Desk and annual workbook. FPD also provides information sharing forums (monthly and annual or bi-annual), one-to-one assistance to staff members who require specific help, and technical accounting and policy advice to HIC managers and staff as requested.

Overall audit opinion

22. In the ANAO's opinion, the HIC's internal control structures and environment, as well as its financial management framework and processes have improved in recent years. However, they need further enhancement before they could be assessed as fully supporting the HIC's Commissioners and managers in making informed decisions on the proper use of Commonwealth resources.

23. The ANAO found that, while the HIC's control environment has improved, it is not yet providing Commissioners with a sufficient level of assurance that financial risks are being properly addressed and adequately managed, particularly for new programs. The number of issues found in the 2002–03 audit of the HIC's financial statements (one 'A' and nine 'B' findings) was a factor in the ANAO concluding that the HIC's information systems and control procedures required further improvement. The ANAO has made recommendations to address these issues as part of the financial statement audit.⁷ A summary of these recommendations is included as Appendix 3 to this report.

24. The HIC has developed a financial management framework that is consistent with good practice and provides a sound structure for the attainment of its objectives. However, it needs to ensure that all of its managers, at all levels, have a good understanding of their role within the framework.

⁷ For more information see: ANAO Audit Report No.61 2002–03 *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending June 2003*, Canberra and ANAO Audit Report No.22 2003–04, *Audits of Financial Statements of Australian Government Entities for the Period Ended 30 June 2003*, Canberra.

25. The HIC's produces Whole of Government reports and the Executive Business Report to the Commission within a tight timeframe that is consistently met. The HIC's managers are generally provided with relevant and accurate financial data, which they use in decision-making. However, timeliness of the reports provided to managers should be improved. There is also an opportunity to streamline the presentation of data in reports to make them more effective. Limited documentation of the interfaces (links) between the HIC's FMIS and associated business systems presents a risk to the completeness of FMIS data.

26. The HIC has a finance division with qualified and experienced staff. Given this, the division preferably should be involved in the appointment of financial support staff in other divisions and in state offices, at least in an advisory capacity. Financial management training is provided to both financial and operational staff. The ANAO assessed operational staff as generally having the skills required to use financial data, with more senior staff having higher skill levels. The package of systems and tools currently used to assist in assessing financial training needs and providing training is new. The HIC needs to ensure they are fully implemented. The HIC's managers and staff are provided with comprehensive support services to assist in using financial data effectively.

Recommendations

27. The ANAO made six recommendations assist the HIC in meeting the objectives set for its financial management systems. The HIC agreed to all recommendations.

HIC's response

28. HIC commenced a financial management improvement program over two years ago, and further enhancements are planned for 2004.

29. HIC welcomes the Performance Audit by ANAO of its Financial Management and notes that the audit opinion concludes that HIC has developed a sound financial management framework, and that the framework is consistent with good practice. The framework covers financial processes, procedures and controls, risk management processes, and management reporting. It is integrated with the HIC's governance structure, corporate planning, and performance management.

30. In order to further strengthen financial management in HIC, ANAO have included six recommendations in their report. HIC agrees with all these recommendations and is committed to implementing them during the course of 2004.

Recommendations

**Recommendation
No.1
Para 2.67**

The ANAO recommends that, when providing advice to the Commission on service delivery initiatives, HIC's operational managers should consult with Finance and Planning Division to help ensure that the advice covers both operational and financial issues (including risks).

HIC's response: Agreed.

**Recommendation
No.2
Para 3.47**

The ANAO recommends that, to improve understanding by the Commission, managers and staff of their financial management responsibilities, the HIC implement a strategy for developing a single document that describes the financial management responsibilities of the Commission, managers and staff, and increase training of lower level managers in these responsibilities. The HIC should ensure that all managers and staff with financial management responsibilities are aware of, and are familiar with, the documentation.

HIC's response: Agreed.

**Recommendation
No.3
Para 4.77**

The ANAO recommends that, in order to improve the utility of financial data provided to HIC managers for regular financial monitoring and decision-making, monthly financial reports be delivered to managers closer to the end of the relevant month.

HIC's response: Agreed.

**Recommendation
No.4
Para 4.80**

The ANAO recommends that, to help ensure all financial system interfaces are correctly maintained and processed, adequate documentation and procedures be developed to assist HIC staff to maintain the interfaces and manage month-end and year-end business processes, including system reconciliations.

HIC's response: Agreed.

**Recommendation
No.5
Para 5.52**

The ANAO recommends that Finance and Planning Division should advise on the development of the selection criteria and/or the selection of Finance Coordinator and State Finance Manager positions to help ensure that suitably skilled staff are employed.

HIC's response: Agreed.

**Recommendation
No.6
Para 5.55**

The ANAO recommends that, to ensure that financial training assessment and provision of financial training leads to appropriately skilled staff and managers, the HIC develop a more coordinated approach to financial management training. The approach could include, for all roles or functions with financial management responsibilities, the following elements which are currently not implemented in the HIC:

- competencies by role or function;
- the identification of training (internal and external) that would be useful for the roles or functions;
- an assessment and record of staff members' current financial skills/competencies, including formal qualifications;
- the identification of staff members' financial training needs as identified in the Performance Support Agreement process and by Finance and Planning Division;
- a process for recording training attended by such staff; and
- an awareness program of the role Performance Support Agreements, the Financial Knowledge Management Plan and the Financial Training Plan play in assessing financial training needs and providing financial training in the HIC.

HIC's response: Agreed.

Audit Findings and Conclusions

1. Introduction

This Chapter has three parts. The first briefly describes the role of the Health Insurance Commission and the environment in which it operates. The second discusses the importance of financial management as a key governance and management discipline. The third sets out the audit's objective, approach and methodology.

Part I—The Health Insurance Commission

1.1 The Health Insurance Commission (HIC) is a statutory authority, created under the *Health Insurance Commission Act 1973*, within the Health and Ageing Portfolio.⁸ The HIC was established to administer what has become Australia's universal health insurance scheme, Medicare. The HIC's stated purpose is 'to improve Australia's health through payments and information'⁹. In order to fulfil this purpose, the HIC has around 4 700 staff spread across National Office, six State offices¹⁰ and 226 Medicare offices. The HIC made benefit payments and other payments of \$16.6 billion in 2002–03. The HIC's administrative expenses in 2002–03 were \$476 million, with expenses of \$533 million budgeted for 2003–04.

1.2 The HIC administers many health-related programs on behalf of the Australian Government.¹¹ The three major programs are Medicare, the Pharmaceutical Benefits Scheme and the 30 Per Cent Private Health Insurance Rebate. These accounted for more than \$15.5 billion of the \$16.6 billion payments made by the HIC in 2002–03.

1.3 The HIC processed 221.4 million services, representing \$8.1 billion in Medicare benefits in 2002–03. In that year it also processed 174 million services, representing \$5.2 billion in benefits for the Pharmaceutical Benefits Scheme (PBS) and Repatriation Pharmaceutical Benefits Scheme (RPBS).

HIC structure

1.4 The HIC is a Commonwealth authority and operates within the provisions of the *Commonwealth Authorities and Companies Act 1997*. This Act regulates certain aspects of the financial affairs of Commonwealth authorities. In particular, it has rules about reporting and accountability. The Act also addresses other matters relating to Commonwealth authorities, such as banking, investment and the conduct of officers.

⁸ The HIC's website is <www.hic.gov.au>.

⁹ Health Insurance Commission, *Annual Report 2002–03*, Canberra, 2002, p.8.

¹⁰ The Australian Capital Territory (ACT) is serviced through the Commission's New South Wales (NSW office), while the Northern Territory (NT) is serviced by the Commission's South Australian (SA) office.

¹¹ Appendix 1 contains a list of the health related programs administered by the HIC.

1.5 Section 10 of the *Health Insurance Commission Act 1973* provides that the Health Insurance Commission shall comprise a chairperson, the managing director of the Commission, and seven other members. Section 28 empowers the Commission to ‘engage such persons as it thinks necessary for the purposes of this Act’ which provides the authority to employ HIC staff. The Commission acts as a board of directors.

1.6 In this audit we use ‘Commission’ for the Commissioners acting as a board of directors and ‘HIC’ for the organisation as a whole.

Separation of Medibank Private

1.7 Prior to 1998 the HIC included Medibank Private, a government-owned private health insurer. Medibank Private was (and still is) Australia’s largest private health insurer. The business of Medibank Private was a major focus for the Commissioners and senior management of the Commission until 1998. Since then, the Commissioners and senior management of the HIC have been refocussing the HIC on its role without Medibank Private; adapting to public sector reforms; ensuring that it is making best use of new service delivery technologies; and implementing new functions assigned to it by the Government.

1.8 A major outcome of the new focus is the HIC’s Business Improvement Program¹² (BIP). The 2001–02 Commonwealth budget allocated \$125 million over four years, beginning in 2002–03, for this program. Its purpose is to improve service delivery and reduce costs by transforming a range of HIC products and services. It uses new and improved service delivery channels that are emerging from advances in the Internet and related technologies.

Policy framework

1.9 HIC activities are conducted within the Australian Government policy framework set by the Department of Health and Ageing (Health), the Department of Veterans’ Affairs, the Department of Family and Community Services and relevant legislation (particularly the *Health Insurance Act 1973*). The HIC seeks to contribute to policy development by providing regular information and advice from its day-to-day operations.

Part II—Financial management

1.10 There have been a number of reforms in the public sector designed to improve stewardship and accountability. These include reforms to legislation and reforms to public sector accounting and budgeting practices.

¹² Further information can found on the HIC’s web site <www.hic.gov.au> in its 2002–03 annual report on pp. 9–11.

1.11 The *Audit Act 1901* was replaced in 1997 with three Acts;

- *Financial Management and Accountability Act 1997*;
- *Commonwealth and Companies Act 1997*; and
- *Auditor-General Act 1997*.

1.12 The new legislation places responsibility for the efficient and effective use of resources on the directors of Commonwealth authorities and companies, and on the Chief Executive Officers (CEOs) of Commonwealth departments and other entities operating under the *Financial Management and Accountability Act*.

1.13 A further legislative reform was the introduction of the *Public Service Act 1999*, which replaced the *Public Service Act 1922*. The new Act includes guidance on the behaviour of public servants. HIC officers are not employed under the *Public Service Act*, but the ethical guidelines provided to them are consistent with those in the Act.

1.14 The introduction of accrual reporting to the public sector in 1994–95 was designed to focus public sector managers' attention on effectively managing all the resources for which they have responsibility, not just cash flows. Output and outcome based budgeting and reporting, another recent reform, was also designed to have managers focus more on managing for results than just simply managing inputs.

1.15 These legislative and associated changes were intended to provide managers with increased flexibility in an evolving environment and thereby improve the performance of their organisations. However, with greater management flexibility comes an increase in personal accountability,¹³ and with it a need to recognise and manage risk for better performance.

1.16 The reforms have established clear expectations for more effective public sector governance. This demands sound corporate governance,¹⁴ including effective planning and risk management. Consequently, public sector organisations, particularly the larger ones, need a high level of management skills supported by sophisticated systems to ensure effective control over business decisions and operations. These factors play a key role in enabling managers to discharge their performance and accountability obligations and meet the challenges of an often-complex environment.

¹³ **Accountability** is the process whereby public sector agencies and the individuals within them are responsible for their decisions and actions and submit themselves to appropriate external scrutiny. Accountability can only be achieved when all parties have a clear understanding of their responsibilities, and roles are clearly defined through a robust organisational structure. Barrett P.J, *Corporate Governance—More Than a Passing Fad*, Address to Attorney-General's Department, Alfred Deakin Club Luncheon, 2002.

¹⁴ See Appendix 2 for more information on corporate governance.

1.17 In the Commonwealth public sector, financial management covers a broad range of activities, including program delivery policies, mechanisms, systems and controls. The function also includes management, planning, processing, reporting and evaluation.¹⁵

1.18 Financial management has dual purposes:

- as an internal management tool; and
- to meet external accountability and performance obligations.

1.19 The financial management framework within an organisation is integral to the structures, processes, controls and behaviours that constitute effective corporate governance. Managerial responsibility and accountability for performance outputs and outcomes include sound financial performance and control.

1.20 The primary responsibility of line managers (program managers) in the public service is quality program delivery and/or policy development. Competent program managers use a number of tools, including financial management, to achieve their primary responsibility. By treating these tools as a discipline, competent managers minimise the need to constantly deal with administrative processes and maximise the time available for their broader responsibilities.

1.21 In focussing on financial performance as a key measure of organisational accountability, an important distinction needs to be made between the measures of financial performance in the public and private sectors. For instance, the difference between the measures of capital efficiency relevant in the private sector and financing requirements in the public sector needs to be appreciated. Some private sector financial ratios may have only limited relevance in the Australian public sector context in measuring financial performance. There is, nevertheless, a disciplined resource allocation process that should be common to both sectors.

1.22 In the HIC's context, the real measure of financial performance involves objective and measurable resource allocations being aligned to priority operating areas which match the Government's service delivery requirements. The financial position of the HIC (as shown in the balance sheet) should reflect prudent financial management standards, demonstrating that resources being allocated by HIC executive management are consistent with the strategic directions of the Commission. Financial information, including outcome indicators, should therefore be available to the Commission to enable it to manage proactively the HIC's financial position as well as its service delivery.

¹⁵ ANAO, Audit Report No.7 1995–96, *Financial Management, Department of Veterans' Affairs*, Canberra.

The HIC's responsibility for Commonwealth funds

1.23 Resource management in Commonwealth Government departments and agencies distinguishes between the funds required to operate the department or agency (departmental funds) and the funds used to deliver services to the Australian people (administered funds).¹⁶ The HIC has full authority and stewardship over its departmental funds. That is, the Commissioners and managers, at all levels, are responsible for decisions on the best use of departmental funds and are accountable for these decisions.

1.24 The HIC is not responsible for determining the purposes that constitute the best use of administered funds. For example, the HIC does not decide whether funds should be used for hospital services, or whether these funds may be better used in providing primary health care services and keeping people out of hospital. These decisions are made by the Government and the Parliament. The HIC's stewardship of administered funds is limited to ensuring that these funds are used for the purposes for which they have been appropriated and are accurately accounted for.

1.25 For example, the HIC, in administering Medicare, needs to be able to demonstrate that Medicare benefits are paid only to eligible people; that the service for which the benefit is claimed has been performed; and correctly described; and that the amount claimed is correct. Claims should also be paid promptly. The controls to achieve these goals should be built into the systems used to administer the scheme.

1.26 There is also a requirement to ensure that the financial data from program administration systems is accurately passed to the HIC's Financial Management Information System (FMIS). A key requirement is a robust control environment both in program administration and in financial management. The program control environment is beyond the scope of this performance audit. The financial management control environment, both for administered funds and departmental funds, is discussed in Chapter 2.

1.27 A further stewardship requirement for administered funds is the ability to provide comprehensive, accurate and timely data to inform decisions on the best use of these funds. This data is used by managers both in the HIC and in Health to prepare policy advice for government. It is also used by the Government to inform policy decisions. In recognition of this, the ANAO will, in future, conduct a performance audit on the integrity of data held in HIC databases.

¹⁶ *Administered items are those assets, liabilities, revenues and expenses controlled by the Government and managed or overseen by agencies or authorities on behalf of Government. Departmental items are those assets, liabilities, revenues and expenses controlled by agencies or authorities and used in producing their outputs.* Department of Finance and Administration web site, viewed 22 December 2003 <www.finance.gov.au>, search 'Definition: Administered Items'.

1.28 Good stewardship also requires the HIC to report to government (or to the responsible department) any matter that may affect the Government's (or department's) accounting of the funds which the HIC is administering on its behalf. An example is the accounting treatment of an administered funds item, which does not affect the HIC's financial statements, but which will affect the department's financial statements, or the Government's ability to accurately account for its use of taxpayers' funds.

Part III—The audit

1.29 This performance audit complements the work of the ANAO in financial statement audits. It has been designed to provide additional assurance to Parliament, the HIC's Commissioners and its Executive that the HIC's financial management framework and systems are effectively supporting managers in their work, and to identify areas where improvement is needed.

Audit objective and scope

1.30 The audit objective was to examine the effectiveness of the HIC's internal control structure, as well as its financial management framework and processes, in order to form an opinion on their ability to support HIC managers in making informed decisions on the proper use of Commonwealth resources. To form the opinion, the ANAO examined whether the HIC's:

- internal control structure and control environment are adequate to provide Commissioners with assurance that the resources allocated to the HIC are managed efficiently and effectively; and whether the
- financial management framework, systems and reports are adequate to assist managers to efficiently and effectively manage the resources for which they are responsible.

1.31 The audit comments on the ability of the HIC's financial systems and processes to support Commissioners and managers in their work. The audit does not comment on the finances of the HIC. As well, it is not designed to, nor does it present a view of the HIC's financial position. Neither does the audit comment on the accuracy of individual payments made by the HIC on behalf of other agencies.

Audit criteria

1.32 The ANAO used four criteria in this audit. These were:

- whether the HIC has a robust internal control structure and control environment (Chapter 2);

- whether the HIC has an appropriate financial management framework in place (Chapter 3);
- whether the HIC's managers are provided with financial data that is relevant, accurate and timely (Chapter 4); and
- whether the HIC takes sufficient action for managers and staff to acquire the required skills, training and support to use financial data (Chapter 5).

Audit methodology

1.33 The ANAO engaged the firm of IBM Business Consulting Services to help review the above audit criteria using their knowledge of industry better practice; develop a test program; conduct fieldwork; and assist with the preparation of a draft report.

1.34 Fieldwork was conducted between October 2002 and August 2003 in the Commission's National Office in Canberra and in State offices in Sydney, Melbourne and Adelaide. Fieldwork comprised of:

- interviews with HIC Commissioners;
- interviews with HIC officers;
- a survey of other HIC officers; and
- examination of HIC documents and data.

1.35 Evidence collected as part of the ANAO's audit of the HIC's financial statements for 2002–03 was also used to assist in reaching an opinion on certain aspects of the HIC's financial management.

1.36 The audit complies with ANAO Auditing Standards. It cost \$375 000.

Other relevant documents

1.37 ANAO documents used in preparing the criteria and test program for this audit include:

- Better Practice Guide, November 1999, *Building a Better Financial Management Framework*;
- Better Practice Guide, November 1999, *Building Better Financial Management Support*;
- Audit Report No.61, 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003* (and earlier years); and

- Audit Report No.7, 1995–96, *Financial Management—Department of Veterans Affairs*.

2. Does the HIC have a Robust Internal Control Structure and Control Environment?

This Chapter presents the ANAO's findings on the HIC's internal control structure and control environment, and also covers recommendations made by the ANAO as part of the audit of the HIC's financial statements for 2002–03.

Assessing an organisation's internal control structure and control environment

2.1 Australian Auditing Standards¹⁷ define the areas an auditor is required to examine in order to assess the accuracy of an organisation's financial statements. Australian Auditing Standard (AUS) 402, *Risk Assessments and Internal Control*,¹⁸ requires auditors to assess the internal control structure and control environment as part of the audit of an organisation's financial statements. These standards form the basis of the Auditor-General's auditing standards set under Section 24 of the *Auditor-General Act 1997*.

2.2 This audit uses the work completed by the ANAO in forming an opinion on the HIC's 2002–03 financial statements to assist in forming an opinion on the contribution of the HIC's internal control structure and control environment in assisting Commissioners, the HIC's executive and its managers to make informed decisions on the proper use of Commonwealth resources.

2.3 ANAO findings on the internal control structure and control environment are published in an annual report,¹⁹ *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities*. Further information is published in the report *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June*. The ANAO's opinion on the financial statements of each Commonwealth entity is published as part of the annual report of each entity.

¹⁷ Australian Auditing Standards are issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia.

¹⁸ Australian Auditing Standard AUS 402, *Risk Assessments and Internal Controls*, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, October 1995, paragraph 10.

¹⁹ The relevant report is ANAO Audit Report No.61 2002–03 *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003*, Canberra and ANAO Audit Report No.22 2003–04, *Audits of Financial Statements of Australian Government Entities for the Period Ended 30 June 2003*, Canberra.

Does the HIC have an unqualified audit opinion for its 2002–03 financial statements?

Audit finding

2.4 The ANAO gave an unqualified audit opinion on the HIC's 2002–03 financial statements.

2.5 Section 8 of the Commonwealth Authorities and Companies Act states that the Auditor-General is the auditor of each Commonwealth authority. Each year the ANAO conducts an audit of the HIC's financial statements. A copy of the independent audit report can be found as Appendix 4. The audit opinion in that report reads as follows:

- (i) the financial statements have been prepared in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*; and
- (ii) the financial statements give a true and fair view, in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia and the Finance Minister's Orders, of the financial position of the Health Insurance Commission and economic entity as 30 June 2003 and their performance for the year then ended.

Inherent Uncertainty regarding the liabilities for the IBNR²⁰ Scheme

Without qualification to the opinion expressed above, attention is drawn to the following matter. As indicated in Note 1.16 to the financial statements,²¹ the Health Insurance Commission has recorded an estimate of \$498.5 million in relation to the Commonwealth's liabilities for the Medical Indemnity IBNR Scheme for Medical Defence Organisations. This estimate is based on independent actuarial assessment. As explained in the note, there is inherent uncertainty regarding this estimate of the Commonwealth's liability and the Commonwealth will continue to conduct an assessment of this amount in future years.²²

2.6 Readers should note that this opinion is about the accuracy of the HIC's published financial statements. It does not comment on the quality of any aspect of the HIC's financial management. Thus an unqualified audit opinion is consistent with both good financial management and that which needs to improve.

²⁰ Incurred But Not Recorded (INBR).

²¹ The HIC's financial statements for 2002–03 can be found as part of its annual report.

²² The HIC's management of the Medical Indemnity Scheme is discussed later in this Chapter.

Internal control structures and control environment

Internal control structures

2.7 An entity's internal control structure²³ is defined in Australian Auditing Standard (AUS) 402, *Risk Assessments and Internal Control*, as:

management's philosophy and operating style, and all the policies and procedures adopted by management to assist in achieving the entity's objectives.²⁴

2.8 The internal control structure reflects an entity's leadership style, commitment to risk management, the quality of its business processes, and its capacity to achieve its outputs and outcomes. An effective internal control structure is crucial to safeguarding an entity's assets and resources, preventing or detecting and correcting irregularities should they occur, and maintaining complete and accurate financial records, which allow the timely preparation of financial information for decision-making and statutory reporting purposes. AUS 402 also states that the internal control structure extends beyond those matters that relate directly to financial reporting and consists of three elements: the control environment, information systems and control procedures.

2.9 This audit examines aspects of the HIC's control environment, with some comment on the HIC's information systems and control procedures. Information systems and control procedures are addressed in detail in the ANAO's audit of the HIC's financial statements for 2002–03.

2.10 Ultimate responsibility for the internal control structure and control environment of an organisation rests with the directors (Commonwealth authorities and companies) or the CEO (Commonwealth entities, including departments). For the HIC, responsibility lies with the Commissioners. Directors and CEOs are accountable to Parliament, through the relevant Minister, for the manner in which they discharge their responsibilities.

The control environment

2.11 Australian Auditing Standard 402 defines 'control environment' as

the overall attitude, awareness and actions of management regarding internal control and its importance in the entity.²⁵

²³ For further information see: ANAO Audit Report No.61 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003*, Canberra, p.35.

²⁴ Australian Auditing Standard AUS 402, *Risk Assessments and Internal Controls*, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, October 1995, paragraph 10.

²⁵ Extract from CPA Australia *Members' Handbook* December 2002 issue, AUS 402, *Risk Assessments and Internal Controls*.

2.12 The Standard describes the control environment as consisting of the following factors:

- management’s philosophy and operating style;
- the organisational structure;
- the assignment of authority and responsibilities;
- internal audit;
- the use of information technology;
- human resources; and
- the audit committee.

2.13 The external auditor, in coming to a conclusion on an organisation’s control environment, assesses the operational impact of these factors.

2.14 There are three tools that can be used to notify the directors or CEO of risks (including financial risks) to the organisation. These are:

- risk assessments by managers;
- internal audit activities; and
- external audit activities.

2.15 A feature of better practice organisations is the generation of a culture of active risk management. In these organisations managers will continually assess and manage the risks associated with the programs they administer. Where material risks (both operational²⁶ and financial) arise through control weaknesses, managers will notify the executive and, if necessary, the directors, of the risks and the actions planned to treat, or mitigate, these risks. This should be the primary means through which board members are notified of material risks.

2.16 Internal audit provides a secondary means through which board members can be notified of risks (or provided with assurance that no new risks have been identified in the area audited). In the HIC, Internal Audit assists managers responsible for new projects to develop risk management plans for projects. The unit also conducts audits of existing programs. Where required, these audits are tailored to provide the Commission with an assurance on the robustness of the program’s internal control structure. HIC Internal Audit reports are tabled at meetings of the Commission’s Audit Committee and provided to all Commissioners.

²⁶ Examples of operational risks are: inability to achieve required timetables; inability to achieve required outputs; inability to meet required customer service standards; breaches of legislation; and impact on reputation.

2.17 The tertiary means of notification is the external auditor, who will advise the directors of any matter that, in the auditor's opinion, presents a significant financial, or business, risk to the organisation. External auditors will communicate with the board (Commission) both informally and through formal reports. Note that better practice indicates that management (the primary level) should identify most issues, with few (if any) issues identified by external auditors (the tertiary level).

Does the HIC have a robust control environment?

Audit finding

2.18 The answer is not yet, since in the ANAO's opinion too many financial management issues are being raised by the ANAO, as external auditors, rather than being internally identified and attended to by management. While advice to the Commissioners on risks has improved since 2000, the HIC needs to ensure that advice to Commissioners, on the risks associated with new or existing programs, addresses all aspects of risk, including operational and financial risks. Until this occurs, the HIC's control environment does not yet provide Commissioners with an adequate level of assurance that financial risks, particularly for new programs, are being properly identified and adequately addressed.

2.19 In an organisation with a robust control environment, the ANAO expects that financial management issues, including risks, will be identified within the agency and corrective action taken. On the other hand, if the external auditor is drawing attention to accounting, control or financial management issues which have the potential to lead to a qualified or modified audit opinion, the auditor is likely to have concerns about the robustness of the organisation's control environment.

2.20 The ANAO considers that it is detecting too many issues that the HIC itself should have identified and addressed. The next part of the report provides relevant examples from this audit and from the audit of the HIC's 2002–03 financial statements.

Examples—Performance Audit

2.21 As part of this audit, the ANAO examined data provided to the Commission on a number of projects. The HIC has two types of projects²⁷—those that involve the funds it uses to manage itself (departmental funds), where the HIC is responsible for determining the best use of these funds—and those involving

²⁷ See paras 1.23 to 1.28.

funds managed on behalf of others (administered funds), where the Government has decided on the use of the funds and requested the HIC to develop appropriate administrative systems and properly administer the program.

2.22 An example of a project involving departmental funds is the HIC's Business Improvement Program. It is a primary responsibility of the Commission to ensure that returns used to justify the investment in this program are realised. The risk to the Commission is that the expected returns do not eventuate, with a consequent adverse impact on the HIC's financial position. The Commission has identified this risk and is receiving regular reports to provide assurance that the risk is being properly managed.

2.23 Examples of administered fund projects are the implementation of the 30 Per Cent Private Health Insurance Rebate and the Medical Indemnity Program. The Government required the HIC to introduce both programs at short notice. The HIC, when implementing these programs, had to adopt interim solutions in order to meet the Government's deadlines. Interim measures can be a practical solution to a difficult administrative problem. However, they can also carry risks.

2.24 The 30 Per Cent Private Health Insurance Rebate²⁸ was introduced in January 1999. The ANAO found that the first briefing to Commissioners informing them of the financial risks that arose from the interim solution adopted was in February 2001.²⁹ The controls environment for the scheme was classified as a major finding in the audit of the HIC's 2000-01 financial statements. A subsequent ANAO report on the implementation of the 30 Per Cent Private Health Insurance Rebate highlighted a number of financial issues that impacted on the HIC's management of this scheme.

2.25 A new program being implemented in 2003 is the Medical Indemnity Insurance Scheme. Under this scheme the Government is assuming responsibility for a class of liabilities³⁰ incurred by United Medical Protection.³¹ The nature of these liabilities means that their value (estimated at \$498.5 million) cannot be accurately assessed, as stated in the 'emphasis of matter' note to the audit opinion for the HIC's 2002-03 financial statements.

2.26 In response to its request, the Commission received a thorough briefing in March 2003 from management on the operational risks faced by the HIC

²⁸ The 30 Per Cent Private Health Insurance Rebate is a financial incentive for individuals to purchase private health insurance. For more details on the scheme and ANAO findings see: ANAO Audit Report No.47 2001-02, *Administration of the 30 Per Cent Private Health Insurance Rebate*, Canberra.

²⁹ Commonwealth expenditure on the 30 Per Cent Private Health Insurance Rebate for 2000-2001 was \$1.93 billion.

³⁰ Incurred but not reported liabilities.

³¹ United Medical Protection, which is Australia's largest medical indemnity insurer, was placed in liquidation in 2002.

in implementing the scheme. In addition, FPD prepared a position paper on the financial aspects of the Medical Indemnity program and submitted it to the ANAO in June 2003. However, the ANAO could find no briefing to the Commission containing information on the uncertainty associated with the estimate of the value of the liabilities being assumed by the Government. The matter was eventually brought to the Commission's attention by the ANAO at an Audit Committee meeting in July 2003. The Commission received a full briefing from HIC staff at its August 2003 meeting.

2.27 The liabilities are Commonwealth Government liabilities that are difficult to estimate with certainty. They are not 'departmental funds' and do not present a risk to the HIC's balance sheet nor to the HIC's administration of the Medical Indemnity Insurance Scheme. However, as part of its stewardship role, the HIC needed to be able to advise the Government on the uncertainty inherent in the estimate of these liabilities. Without sufficient knowledge of the uncertainty, the Commissioners would have had difficulty in meeting this responsibility.

2.28 These examples point to inconsistencies in the integration of program, or operational, and accounting advice to the Commission on important matters. As a result, the HIC's control environment is not providing Commissioners with a sufficient level of assurance that financial issues or risks are being properly identified and adequately addressed. This involves both insurable and non-insurable risk.

2.29 The ANAO noted from its examination of Commission papers that briefings to Commissioners on operational issues and risks have improved considerably over the past three years. This needs to be matched by improved briefings on financial issues and risks. One way of achieving this would be for operational managers to consult with Finance and Planning Division (FPD) when preparing briefs for the Commission, to ensure that financial issues and risks are covered. Where FPD advises that there are no financial issues or risks that should be brought to the Commission's attention, this should be stated explicitly in the brief. Consultation with FPD should be matter of course, particularly on new issues.

Examples—Controls Report

2.30 As mentioned earlier, the ANAO tables in Parliament each year a report; *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities*³² (Controls Report). Each report contains:

³² ANAO Audit Report No.61 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending 30 June 2003*, Canberra and earlier reports.

the ANAO's assessment of audit findings relating to major entity internal control structures, including governance arrangements, information systems and control procedures through to March.³³

2.31 The ANAO's findings for the HIC in the 2002–03 report covered:³⁴

- corporate governance;
- reconciliations;
- asset management and recording;
- IT control environment;
- business continuity management; and
- financial reporting.

2.32 In the 2002–03 Controls Report the ANAO concluded:

The current internal control environment supporting the Commission's activities has many positive elements. However, immediate improvement in mainframe security access and control is required. Continued improvement is also required within the internal control structure to address remaining issues raised by the ANAO. In a number of cases, the Commission has already taken action to address aspects of the deficiencies identified by the ANAO. The Commission has advised that a continuing high priority has been placed on resolution of all matters brought to its attention.

2.33 The ANAO acknowledges the work done by the HIC to improve its control environment. However, the issues identified by the ANAO during this audit, and the issues reported by the ANAO in the Controls Report for 2003, have led the ANAO to conclude that the HIC has not yet developed a sufficiently robust control environment to provide adequate assurance to all stakeholders.

Does the HIC have robust information systems and control procedures?

Audit finding

2.34 Not yet. As part of the audit of the HIC's 2002–03 financial statements the ANAO raised one new 'A' issue and nine new 'B' issues. The range and number of issues raised has been a major factor in the ANAO concluding that the HIC's information systems and control procedures require further improvement before they can be considered to be robust and fully reliable.

³³ *ibid*, p.13.

³⁴ *ibid*, p.164.

2.35 Table 2.1, drawn from the Controls Reports for the last four years, shows the number of 'A' and 'B' issues³⁵ outstanding as at March of each year.

Table 2.1

HIC Audit Issues outstanding at March–2000 to 2003

Year	A	B	Total
2000	4	32	36
2001	1	20	21
2002	1	12	13
2003	0	7	7

Source: ANAO 2003, Audit Report No.61, 2002–03, *Control Structures as part of the Audit of Financial Statements of Major Commonwealth Entities for the Year Ending June 2003*, Canberra, p.165, and earlier reports.

2.36 The Controls Report is complemented by another report: *Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June*. This report summarises the final results of the audits of the financial statements of Commonwealth entities and represents the second report of the year on financial statement audits for the last financial year. The report provides information on the number of matters resolved since the Controls Report was issued and any new matters raised.

2.37 Table 2.2 appears in the report for the period ended June 2003.

Table 2.2

Audit Issues, HIC, to August 2003

Category	Issues outstanding at March 2003	Issues resolved prior to August 2003	New issues to August 2003	Issues outstanding at August 2003
A	0	0	1	1
B	7	1	9	15
Total	7	1	10	16

Source: ANAO

³⁵ Financial statement audit issues reported in management letters are categorised as level A, B or C:

- A—those matters that pose significant business or financial risk to the agency and must be addressed as a matter of urgency. This assessment takes account of both the likelihood and consequences of the risk eventuating;
- B—control weaknesses that pose moderate business or financial risk to the agency or matters referred to management in the past, which have not been addressed satisfactorily. These would include matters where the consequences of the control weakness might be significant, although there is little likelihood of the consequences eventuating; and
- C—matters, which are procedural in nature or minor administrative failings. These could include relatively isolated control breakdowns, which need to be brought to the attention of management.

2.38 The new 'A' issue is summarised below. The 'A' issue and the 15 outstanding 'B' issues at August 2003, the ANAO recommendation for each issue (from the management letter) and the HIC's response for each issue can be found in Appendix 3.

Project Management System—program cost attributions

2.39 In the final management letter, the ANAO noted that the HIC had implemented the project management module of their financial information system³⁶ during the current year. Audit testing sought to compare revenues from billings of Health with associated costs for a number of specific projects and programs to evaluate revenue recognition and the completeness of revenue accruals. For a number of projects and programs there were significant positive and negative discrepancies between recorded billings and associated costs. These discrepancies still remained even after the attribution of further indirect costs via manual adjustments. In the ANAO's opinion, this matter presented a significant business/financial risk to the HIC.

2.40 The issues identified in the financial statements audit identify potential risks that, if left unaddressed, could affect the overall accuracy and reliability of financial data and the HIC's financial statements. The financial statement auditor's work for the 2002–03 financial statement audit led them to conclude that the HIC's information systems and control procedures require further improvement before they can be considered robust and fully reliable.

Does the HIC have a robust internal control structure?

Audit finding

2.41 Not yet. Before the ANAO could so consider the HIC's internal control structure, it needs to be satisfied that the components (information systems, control procedures and control environment) are also robust and are working together to provide an internal control structure that can be fully relied on. The ANAO is not satisfied that these components are sufficiently robust at this time.

2.42 In this report we have so far examined the components of the HIC's internal control structure. This section examines how the components are working as a whole.

³⁶ The HIC's FMIS uses the SAP financial management and accounting software package. SAP consists of a series of modules covering various aspects of the accounting system of a large organisation. An organisation can implement all modules or just those modules it requires.

2.43 Australian Auditing Standards³⁷ require an auditor to conduct testing of transactions (substantive testing) as part of the work required to assess the accuracy of items in an organisation's financial statement. The auditor determines the extent of the testing required after an examination of the organisation's internal control structure. A robust internal control structure provides a financial statement auditor with an assurance that data from the organisation's FMIS can be relied on. In this case the auditor may only conduct minimum substantive testing. However, if the auditor cannot gain adequate assurance on the accuracy of a financial statement item from examination of the control structure, he or she must conduct more extensive substantive testing.

2.44 The ANAO, while conducting the audit of the HIC's 2002–03 financial statements, considered that it could not fully rely on the HIC's internal control structure and conducted compensatory substantive testing. Earlier in this report, the ANAO has found that the HIC's control environment, controls procedures and information systems need further work before they could be considered robust. As a result the ANAO has concluded that the HIC does not yet have a sufficiently robust internal control structure.

Is the financial data provided to the HIC's Commissioners sufficient and relevant and is it appropriately presented and delivered?

Audit finding

2.45 The financial data provided to Commissioners is relevant and is integrated with other performance data. The range of data presented to Commissioners is sufficient to allow them to monitor the HIC's financial position and take action if risks or other issues arise. However, both this report and the ANAO's audit of the HIC's 2002–03 financial statement have identified opportunities and made recommendations to further improve financial management reporting to Commissioners.

2.46 If the financial data presented to an organisation's board is not sufficient and relevant, or is not appropriately presented and delivered, the board may have difficulty in interpreting the data and therefore in discharging its responsibilities. The HIC's monthly reports are discussed in detail in Chapter 4. The reports provided to Commissioners were examined to allow the ANAO to assess whether the Commissioners are being provided with the information that they require to gain an assurance that management has identified risks to HIC outcomes and taken appropriate action.

³⁷ Australian Auditing Standard AUS 402, *Risk Assessments and Internal Controls*, issued by the Australian Accounting Research Foundation on behalf of the Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, October 1995.

2.47 The ANAO noted that the range and quality of data provided to Commissioners has improved in recent years. This has provided an opportunity for more sophisticated analysis, which if implemented, will strengthen governance in the HIC. The HIC has informed the ANAO that extra resources have been allocated in 2003–04 for a project to continue to improve financial reporting.

2.48 During the audit of the HIC's financial statements for 2002–03, the ANAO identified a Management Opportunity³⁸ to assist in improving the HIC's current financial reporting framework. This opportunity was communicated to the HIC in a letter dated 17 December 2003.

2.49 The letter states:

From our review we believe an opportunity exists for the HIC to further enhance the internal financial reporting forums within the organisation and the following comments are designed to assist HIC management in its own review of this area. In many aspects the HIC has much of the form of management reporting that is expected in 'better practice' organisation, but the ANAO believes significant opportunities exist to improve current reporting with respect to:

- the type of information reported;
- the level of detail contained within reports;
- depth and breadth of analysis; and
- how variances are analysed and depicted.

2.50 The letter includes a detailed recommendation designed to assist the HIC to improve the quality of financial management reporting. Recommendation No.3 of this Report complements the recommendation in the letter. Enhancement of internal financial reporting would assist Commissioners to manage proactively the HIC's financial priorities, as mentioned in para 1.22.

2.51 The HIC is not required to make a surplus. It operates on the principle that the payments it receives for providing services should cover its costs. When the HIC embarks on a major development, such as the Business Improvement Program, Commissioners need to be confident that expected savings, plus any payments from Government to assist with the project, will cover the cost of the project. In other words, Commissioners require assurance that the HIC's financial position will be maintained.

2.52 The monthly Executive Business Report provides Commissioners with details by program on financial and operational outcomes against budget. These reports include results for the current month, year to date, and the same month

³⁸ A 'Management Opportunity' is defined as: *an issue that does not have a negative impact on the control environment but has been included for management consideration.*

last year. The reports also include the financial position for the HIC as a whole showing, for the year to date, revenues, expenditures and balance sheet position, but not projected year end financial results.

2.53 The monthly Executive Business Report is supplemented with budget reviews at mid-year and at the end of the third (March) quarter. If first quarter results are materially less than budget, a first quarter review may be completed also. These reviews provide information on progress and comparisons with results for the previous five years. The reviews include projections to the end of the current year but not beyond. At the beginning of each year the Commission is provided with a review of the budget for the coming year. The 2003–04 review, which included results for 2001–02 and 2002–03 and projections to 2006–07, was provided to the Commission in June 2003.

2.54 The HIC's BIP is a very large project. Were it to fail, there would be a serious impact on the HIC's financial position. The HIC prepared a major review of the BIP four-year plan, which was presented to the Commission in February 2003. The review included a financial summary that showed the project's financing and the expected returns. An examination of Commission papers showed that the review was followed by further reports as significant changes have occurred. Of relevance in future reports would be whether operational decisions and executive management actions are consistent with the Commission's financial parameters as projected in the forecast financial performance and financial position.

2.55 The Executive Business Report contains, in addition to financial and performance data, explanations of variances from budget. The ANAO expected that each material variance would be explained in terms of factors beyond the HIC's control and factors within the HIC's control. Where a variance was due to factors beyond the HIC's control, we expected to find a recommendation for any required adjustment to approved budgets, both for the current year and, if applicable, for future years. Where the factor was within the HIC's control, we expected a statement from the responsible manager of the action taken or to be taken to achieve the approved budget. These details are not currently provided in the Executive Business Report. As stated earlier, the final management letter for the audit of the HIC's 2002–03 financial statements contains a recommendation that addresses the reporting of variances in some detail.

2.56 The ANAO notes that there is a useful range of data provided to Commissioners to allow them to monitor the HIC's financial position. However, the only projection of the HIC's financial position for future years to be provided to the Commission was as part of the annual budget review. The ANAO suggests that more frequent projections of the HIC's financial position in future years may provide Commissioners with greater ability to manage the financial position proactively.

Does the HIC have a culture of stewardship and accountability?

Audit finding

2.57 The ANAO concluded that the HIC has made good progress in developing a culture of stewardship and accountability amongst its managers. However, ANAO observations indicate that further work is required to ensure that stewardship and accountability is an integral part of everyday management for managers at all levels.

2.58 An essential element of a robust control environment is a strong culture of stewardship and accountability. A number of information gathering tools were used during the audit, including interviews, a questionnaire and a review of relevant HIC documentation. The combination of several tools provided an effective opportunity to gather information from a wide range of sources. This information was used to form an opinion on the extent to which financial management stewardship and accountability are integral parts of the culture of the HIC's managers.

2.59 This audit gathered information that assisted in answering the above question, without the latter being a central focus of data collection. Therefore, the views expressed here are indicative rather than conclusive.

2.60 The answers to interview questions, coupled with other discussions, evidence of achievements in recent years and plans for the future, present a consistent picture of an organisation making good progress in developing a culture of stewardship and accountability amongst its managers. Of particular interest was the answer to a question as to whether managers needed financial information in order to meet their financial management responsibilities. All managers answering the questionnaire replied that they had a need. However, only 73 per cent (but 100 per cent of General and State Managers) replied that they had a definite need. Twenty-four (24) per cent replied that they had some need. This is an indication that a minority of managers have not yet fully included stewardship and accountability as an integral part of their culture, so that it becomes part of their everyday management.

2.61 This report has identified areas where action by the HIC would assist in strengthening stewardship and accountability in the HIC's managerial culture. Recommendations No.2, 5 and 6 to this report are particularly relevant.

Conclusion—Chapter 2

Does the HIC have a Robust Internal Control Structure and Control Environment?

2.62 The ANAO found, that while the HIC's internal control structure and control environment have improved in recent years, they cannot yet be considered robust and fully reliable.

2.63 In assessing the HIC's control environment, the ANAO found that too many issues were being raised by the ANAO, as external auditors, rather than being identified and attended to by HIC management. Further, the ANAO identified examples where, although operational risks associated with a program had been notified to the Commissioners, financial risks were not identified until much later. As result, Commissioners are not receiving a sufficient level of assurance that financial risks are being properly identified and adequately addressed.

2.64 As part of the audit of the HIC's financial statements for 2002–03 the ANAO examined the HIC's information systems and control procedures. The financial statement audit identified one new category 'A' issues and nine new category 'B' issues. The range and type of issues identified resulted in some doubts that the HIC's information systems and control procedures are fully reliable or robust.

2.65 The ANAO noted that the range and quality of data provided to Commissioners has improved in recent years. However, both this audit and the audit of the HIC's financial statements for 2002–03 have identified opportunities and made recommendations to improve the quality of financial reporting to the Commission and within the HIC.

2.66 The ANAO has concluded that the HIC has made good progress in developing a culture of financial management stewardship and accountability amongst its managers. However, ANAO observations indicate that further work may be required to ensure that stewardship and accountability is an integral part of everyday management for all managers.

Recommendation No.1

2.67 The ANAO recommends that, when providing advice to the Commission on service delivery initiatives, the HIC's operational managers should consult with Finance and Planning Division to help ensure that the advice covers both operational and financial issues (including risks).

HIC's response

2.68 Agreed.

2.69 Finance and Planning Division will formalise the process in consultation with operational managers.

3. Does the HIC have an Appropriate Financial Management Framework in Place?

This Chapter describes an effective financial management framework and compares the HIC's performance with this framework.

A better practice financial management framework

3.1 The financial management framework within an entity establishes and communicates:

- financial management responsibilities and practices, both internal and external;
- financial risk management practices; and
- financial data needs of managers.

3.2 Table 3.1 outlines an effective financial management framework:

Table 3.1

Elements of an effective financial management framework

<p>Financial management responsibilities and practices</p>	<ul style="list-style-type: none"> • legislative and policy responsibilities that are of a financial nature being clearly set out and assigned • lines of accountability clearly defined • executive instructions, delegations and guidance being in place and accessible • regular training being conducted to ensure that managers and staff are aware of their obligations and the activities that need to be performed in order to discharge these obligations • regular monitoring and reporting processes to measure compliance with responsibilities being in place
<p>Financial risk management</p>	<ul style="list-style-type: none"> • a whole of organisation risk assessment is undertaken and flows down throughout the organisation to appropriate levels of detail • strategies for dealing with and/or mitigating risks • policies and procedures for managing risk • responsibilities assigned for monitoring and reporting on risk

Financial data needs	<ul style="list-style-type: none"> • key users of financial data being identified • consultations being held with key users about their data needs and a mechanism for feedback being in place • financial data needed by key users being defined, documented and communicated
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Source: IBM Business Consulting Services.

3.3 To assess the HIC’s financial management framework the audit team examined whether:

- the HIC has identified and clearly communicated its financial management responsibilities;
- the HIC has identified its financial risks and the strategies and processes in place for managing financial risks; and
- the HIC has identified and communicated the financial data needs of its managers.

3.4 The HIC describes its strategic management framework as consisting of:

- a governance structure;
- corporate planning;
- performance management; and
- financial management.

How does the HIC’s financial management framework compare with good practice?

Audit finding

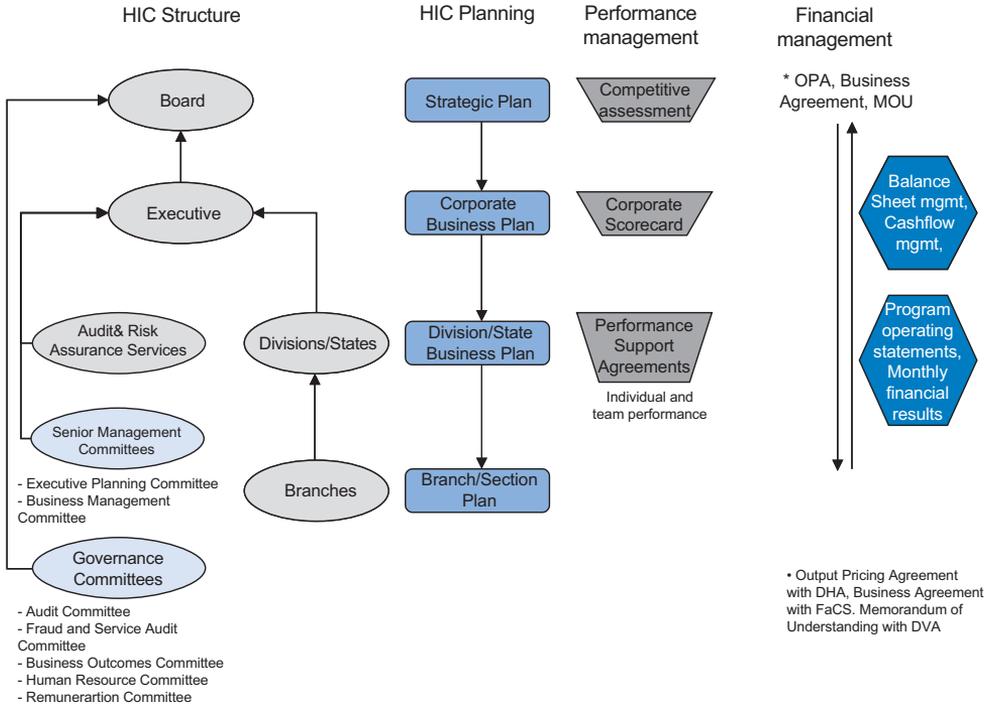
3.5 The HIC’s management framework is consistent with good practice.³⁹ The framework covers financial processes, procedures and controls, risk management processes, and management reporting. It is reasonably integrated with the HIC’s governance structure, corporate planning, and performance management.

3.6 Figure 3.1 sets out the HIC’s strategic management framework.

³⁹ As described in Table 3.

Figure 3.1

HIC’s strategic management framework



Source: prepared by the ANAO from the HIC’s Managing Directors Instructions (MDI): *Strategic Management Framework* and Annual Report 2001–02.

3.7 Although not explicit in HIC documentation, each element of the strategic management framework includes aspects of financial management responsibility as outlined in Table 3.2.

Table 3.2

Aspects of financial management responsibility

Element	Related aspects of financial management
Governance structure	Establishes external ⁴⁰ and some internal ⁴¹ financial responsibilities and accountabilities
Corporate planning	Establishes some internal financial responsibilities and accountabilities
Performance management	Provides financial accountability mechanisms
Financial management	Provides financial processes, procedures and controls

Source: derived from the HIC’s MDI: *Strategic Management Framework*.

⁴⁰ External financial responsibilities include those established in relevant legislation, such as the *Commonwealth Authorities and Companies Act 1997*, and agreements with other agencies and organisations, such as the Output Pricing Agreement the HIC has with the Department of Health and Ageing.

⁴¹ Internal financial responsibilities are those determined by the HIC for the HIC and its staff.

Governance structure

3.8 The components of HIC's corporate governance structure are described in Table 3.3.

Table 3.3

Governance structure and responsibilities

Structure	Responsibilities
Commissioners	<ul style="list-style-type: none"> • accountable to the Minister • ensure good corporate governance, determine and approve corporate strategy, and provide guidance and oversight to senior management • convene, as necessary, not less than 11 times per year • operate 5 standing governance committees: Audit Committee, Fraud and Service Audit Committee, Business Outcomes Committee, Human Resource Committee and Remuneration Committee
The Executive	<ul style="list-style-type: none"> • accountable to the Commission • consists of the Managing Director, Deputy Managing Director and National Manager Operations • reviews outcomes and issues raised in the senior management committees • meets weekly
Business Management Committees	<ul style="list-style-type: none"> • accountable to the Managing Director • has two major roles: <ul style="list-style-type: none"> o shares data, develops and reviews the strategic plan; and o monitors business performance, initiates business enhancements and decides revenue and expenditure issues: also responsible for management of the progress and the delivery of outputs and outcomes of projects

Source: the HIC's MDI: *Strategic Management Framework*, confirmed by ANAO fieldwork.

3.9 As a Commonwealth authority, HIC is subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act) and associated regulations and orders. The CAC Act provides the general governance, reporting, and accountability framework for the HIC and imposes a detailed regime for the conduct of officers.⁴²

3.10 In addition to the external financial accountabilities set out in legislation, the HIC has a Strategic Partnership Agreement (SPA) with Health.⁴³ Included

⁴² Health Insurance Commission *Annual Report 2001–02*, Canberra, 2002, Appendix A, Statutory Reports, p.145.

⁴³ See ANAO 2002, Audit Report No. 5, 2002–03, *The Strategic Partnership Agreement between the Department of Health and Ageing and the Health Insurance Commission*, Canberra.

in the stated purpose of the SPA is the definition of the financial arrangements between Health and the HIC. Specifically, the SPA includes an Output Pricing Agreement (OPA) that defines the basis on which Health funds the HIC to provide services such as Medicare and PBS payments. Similarly, the HIC also has business agreements with the Department of Family and Community Services (FaCS) and the Health Department of Western Australia, and a Memorandum Of Understanding with the Department of Veterans' Affairs (DVA) for the provision of HIC services and associated financial arrangements.

3.11 The HIC has also set out internal financial management responsibilities, including for risk management, in:

- Managing Director's Instructions (MDIs) and associated financial policies and procedures; and
- Financial Delegations (also an MDI).

Corporate Plans

3.12 The ANAO found that corporate planning in the HIC involves three key types of plans, summarised in Table 3.4.

Table 3.4
HIC corporate planning types

Plan type	Description
Strategic plan	Sets broad strategic directions for HIC. It is aimed at both internal and external stakeholders and includes the HIC's purpose, values, strategic themes and key results areas and operates on a 3 year cycle
Corporate business plan	Identifies corporate business goals, objectives, initiatives, measures and targets to implement the strategic plan through the HIC on an annual cycle
Division and State plans	Align with the Corporate business plan and contribute to the achievement of corporate goals through assigning responsibility for relevant corporate objectives. The plans contain objectives, initiatives, measures and targets and assigned responsibilities for actioning (including financial and non-financial measures and targets) on an annual cycle

Source: derived from the HIC's intranet: *Strategic and Business Planning, confirmed by ANAO fieldwork.*

3.13 In many cases, below the Division and State plans, the ANAO found that branch or section plans are also developed to meet the objectives of the Division or State Plan of which they are a part.

3.14 The FPD's financial management responsibilities are set out in the FPD divisional plan and associated branch plans. These responsibilities relate to

both internal and external requirements. Where appropriate, other internal financial management responsibilities are assigned to HIC senior managers in the Division and State plans. These may then be assigned further in branch or section plans.

3.15 Separate risk management plans are developed at the whole of the HIC level, at Division and State level, and in some branches. These identify responsibilities for particular risks, including financial risks. The risk management plans are linked to the objectives of each area and their business plans.

3.16 Interviews confirmed that managers at all levels were fully aware of the planning process and their role in it. It was clear that development of the plan for their area and managing to that plan were important parts of their management processes. The ANAO noted that the Strategic and Business Planning Branch of FPD supports managers in this process.

3.17 These findings led the ANAO to conclude that the HIC corporate planning process is reasonably sound.

Performance management

3.18 Performance management can be used to ensure that an organisation aligns its performance with its strategy and plans and also with appropriate industry practice and benchmarks.⁴⁴

3.19 The HIC's managers are held accountable for their financial management responsibilities through a performance management process which includes:

- Performance Support Agreements (PSA)—all HIC staff have an individual PSA which details performance goals, measures, expected behaviours, and learning and development needs;
- Business Plans (Division/State/Branches)—these are aligned with the Corporate Business Plan and contain measures and targets; and
- the Corporate Scorecard—which considers the HIC's performance across four perspectives: financial, customer, internal business process, and development and growth.

3.20 The ANAO found that the elements of a sound performance management process are in place. However, a key component of the process is relatively new. The PSA process, discussed further in Chapter 5, was introduced in the 2001–02 financial year. As such, it is not possible to assess the effectiveness of the process until one or more full cycles have been completed.

⁴⁴ ANAO Better Practice Guide 2003, *Public Sector Governance*, Canberra, p.24.

Financial management

3.21 Key processes, procedures and controls in place at the HIC, to ensure that financial management responsibilities are met are described in Table 3.5.

Table 3.5

HIC processes, procedures and controls

Processes, procedures, controls	Description
Planning and budgeting	Establishment of HIC's strategies, and development of financial budget targets for Divisions, States, Branches, programs and projects that align with strategies and external reporting requirements. These also incorporate relevant non-financial data such as planned transaction volumes for Medicare Offices.
Monthly reporting	<ul style="list-style-type: none"> Variance analysis by divisions, states, projects and programs of actual expenditure against budget targets Performance measures included in Corporate Scorecard Program results, HIC Operating Statement, HIC Balance Sheet, HIC Cashflow
Financial policies and procedures	The HIC has financial policies and procedures that relate to specific financial functions. See Appendix 5 for a list of these policies and procedures.

Source: Derived from the HIC's MDI: *Strategic Management Framework*, confirmed by ANAO.

3.22 The design of the HIC's financial management processes, procedures and controls as described in Table 3.5 is typical of good practice. Documentation of planning, budgeting and monthly reporting, however, must be developed or improved to provide managers and staff with a clearer understanding of how these processes, procedures and controls relate to their financial management responsibilities. The effectiveness of these is discussed in Chapter 2.

Has the HIC identified and clearly communicated its financial management responsibilities?

Audit finding

3.23 Partially. The ANAO found during the course of the performance audit that, while various documents exist in the HIC which identify different components of the HIC's financial management framework and relevant responsibilities, no single overriding strategic document, which clearly sets out the context, nature and requirements of financial responsibilities of the HIC's Commission, managers and staff, was readily available for that purpose. Absence of such a documented reference poses a risk to the HIC, as those with financial responsibilities, including those new to such roles, may have a

differing understanding of responsibilities and associated requirements and may not perform all activities required of such roles. This is important both for awareness and accountability for performance.

Understanding and communication of financial management responsibilities

3.24 Better practice⁴⁵ indicates that where a position or role has financial management responsibilities, these should be documented and made available to the holder of that position or role. The ANAO found that documentation of financial management responsibilities is incomplete. At the time of this audit responsibilities of FPD staff were set out in job descriptions. However, the ANAO found that the financial management responsibilities for other HIC staff were often not documented.

3.25 This poses a risk to the HIC, as those with financial responsibilities, including those new to such roles, do not have a documented reference establishing their financial responsibilities and the associated requirements of such responsibilities. FPD identified the financial skills required for some functional roles in its January 2003 Financial Knowledge Management Plan (FKMP). The FKMP is discussed further in Chapter 5.

3.26 Interviews and questionnaires⁴⁶ revealed a range of levels of understanding of financial management responsibilities. In some cases, across all roles, such responsibilities were narrowly defined in terms of budget management and reporting while others recognised the broader context including relevant legislation, the HIC's governance structure and MDIs, and financial delegations.

3.27 In the questionnaire, 45 per cent of respondents stated that they had a good understanding of their legislative and policy responsibilities with regard to financial management, while 52 per cent said that their understanding could be better.

3.28 Thirty eight (38) per cent of questionnaire respondents (including 80 per cent of General/State Managers) stated that financial management, legislative, and policy responsibilities had been clearly defined and communicated, while 50 per cent answered that the quality of definition and communication could be better.

⁴⁵ ANAO Better Practice Guide 2003, *Public Sector Governance, Public Sector Governance and the Individual Officer, Guidance Paper No.1*, Canberra, p.3.

⁴⁶ During the audit, interviews and questionnaires were conducted with and issued to, a selection of FPD staff and HIC managers, including: General Managers of divisions, State Managers, Branch Managers (national office and states), Finance Coordinators of divisions, State Finance Managers and Medicare Office Managers.

3.29 Questionnaire responses showed that 76 per cent of staff questioned had received training to enable them to understand their financial management responsibilities. Of those, 84 per cent had received training less than 3 years ago. Training was considered by 42 per cent to be totally satisfactory while 54 per cent thought that the training could have been better. There was no evidence to suggest that the training received more recently was considered any more adequate than training received in the past.

3.30 The FPD has identified the training in its Financial Training Plan (FTP) that it plans to arrange over the next 18 months to address areas of financial management responsibility. The FTP is discussed further in Chapter 5.

3.31 These factors led the ANAO to conclude that insufficient documentation of financial management responsibilities and incomplete communication of these responsibilities poses a risk to the effectiveness of the HIC's financial management framework. The ANAO suggests that the HIC's documentation should detail:

- all financial responsibilities (legislative, policy, strategic, operational, and risk, by role);
- how the Commission, managers and staff are held accountable (including timeframes);
- the processes, procedures and controls in place to meet responsibilities; and
- the information provided to assist them in meeting their responsibilities.

Has the HIC identified its financial risks and taken steps to manage them?

Audit finding

3.32 Overall, the HIC has identified its financial management risks and taken adequate steps to manage them. A revised approach to risk management was implemented during 2002. Financial risks to the HIC are outlined in the Corporate Risk Management Plan and in the FPD Risk Management Plan. Risk management plans, which include financial risks where appropriate, have been developed at Division, State and lower levels within the HIC. However, there needs to be closer integration between operational risk assessments and financial risk assessments, particularly for new programs. An appraisal of the process of review of and reporting against risk management plans has yet to take place.

3.33 Risk management in the HIC is defined by the HIC's MDI: *Managing risk and internal accountability* and the Audit and Risk Assurance Services Branch's (ARAS) policy and process on risk management. The HIC's risk management framework and policy refers to the Aust/NZ Standard 4360 *Risk Management*. The principal theme of the policy is that managers at all levels are responsible for managing risk.

3.34 A risk management approach has been in place in the HIC for several years. The HIC completed a major revision of risk management in 2002. As part of the revision, the Corporate Risk Management Plan has also been revised. Further, risk management policy was also revised to ensure that all Divisions and States have risk management plans that align with the Corporate Risk Management Plan.

3.35 Interviews conducted during the performance audit revealed that, while Divisions and States, and some branches, have developed risk management plans, managers considered that the revised risk management process is still maturing. Seventy six (76) per cent of questionnaire responses stated that they were fully aware of a risk management plan for their area.

Building blocks of risk management

3.36 'Building blocks' of risk management in the HIC include:

- *individual risk management plans*: for each Division and State, and each project (within the definition issued);
- *risk action plans*: actions needed to bring risk down to an acceptable level. All such actions must be assigned to and accepted by a specific management position or permanent management committee;
- *monitoring and review*: of the effectiveness of risk actions, and assessment of emerging risks. The policy also requires that specific managers perform particular tasks, including revising each risk management plan;
- *audits*: audits performed by the ARAS will recommend specific variations to risk management plans based on independent audit evidence and analysis. The ARAS work program is based on aggregate risk assessment under the Corporate Risk Management Plan; and
- *reporting of risk*: implications of all risk management plans, including the implications of failure to prepare risk management plans, are to be reported in aggregate to the Executive, Audit Committee, and Commission.

3.37 Risk Management Plans are registered with the ARAS Branch, which maintains a database of HIC risks. The database is used to facilitate monitoring of risk management (for both operational and financial risks) and to assist in

providing an assurance to Commissioners on the management of risk in the HIC. A Risk Management Toolkit has been developed by the ARAS Branch to assist HIC managers to develop their risk management plans. It resides on the HIC intranet. The toolkit was reviewed and authorised in May 2002 by the ARAS Branch.

3.38 The Risk Management Toolkit recommends that risk management plans should be routinely reviewed and brought up-to-date. A HIC general guide advises that all risks should be reviewed at least annually as a normal aspect of the business planning cycle. Some risks, such as those relating to projects, may require more frequent reviews. ARAS Branch may also request specific risk management plans, or risks, to be reviewed at any time.

3.39 Interviews provided a range of responses on whether risk management plan reviews and reporting processes had occurred and the frequency of these practices. One hundred per cent of questionnaire responses stated that plans for their areas were last reviewed less than a year ago. Given that the revised approach to risk management in the HIC has only recently been implemented, the questionnaire response is likely to relate to the development of risk management plans at various levels in the HIC. Until the revised process has been in operation for at least two years, it is not possible to assess whether the review of, and reporting against, risk management plans are operating effectively.

Financial risk management

3.40 Financial risks are outlined in the Corporate Risk Management Plan and particularly, in the FPD Risk Management Plan. The FPD Risk Management Plan includes:

- general context information and a stakeholder list;
- identified financial risks;
- a risk owner for each risk identified;
- risk ratings for each risk;
- factors influencing the risk and current controls in place;
- activities required to address each risk and who is to take the action;
- timing of action; and
- review timeframe and sign off.

Examples of financial risk management in the HIC

Managers at all levels in the HIC are responsible for identifying and managing the risks, both financial and otherwise, that could adversely impact on their ability to effectively and efficiently achieve their outcomes. The examples below illustrate some financial risks in the HIC:

At the organisation level

Part of the rationale for the HIC's Business Improvement Program is lower administration costs in future years. Funding for the BIP includes borrowings to be repaid from future savings. If the BIP is not successful these savings may not be realised. The HIC has adopted strategies to manage this risk.

At the division level

The Government requested the HIC in 1999 to introduce a system to administer the 30 Per Cent Private Health Insurance Rebate on a tight timeframe. A risk was that the HIC could not meet that timeframe. To address this risk the initial system was introduced with limited financial controls. More robust controls are being introduced (2002–03) now that the system is operational.

Risk management in the HIC has been designed to ensure that risks at all levels are managed in a coordinated and coherent manner.

3.41 The ANAO's review of the HIC's risk management plans and processes, coupled with the high awareness amongst managers of risk management processes, led it to conclude that, overall, the HIC has identified its financial risks and taken steps to manage them. In Chapter 2, the ANAO discusses the need for closer integration of the assessment of operational risk and financial risk when preparing the risk management plan for a program, particularly new programs.

HIC's achievements in the identification of financial risks and steps taken to manage them

3.42 Examples of good practice⁴⁷ achieved by the HIC in terms of financial risk management include:

- a corporate risk management plan exists and flows down to division and state risk management plans and in some cases branch risk management plans;
- risks, including financial risks, have been identified, rated and assigned to responsible managers for action; and
- tools and expert assistance in developing an appropriate plan are available to managers and staff.

⁴⁷ See Table 3.1 at the beginning of this Chapter.

Conclusion—Chapter 3

Does the HIC have an appropriate financial management framework in place?

3.43 The HIC's financial management framework provides a sound structure for the attainment of its objectives. However, improved documentation and communication to managers of financial management roles and responsibilities are required to ensure that the framework is operating effectively.

3.44 The HIC has, consistent with good practice, built a financial management framework that is integrated with its governance structure, corporate planning, and performance management. The framework covers financial processes, procedures and controls, risk management processes, and management reporting.

3.45 However, the HIC's documentation setting out the context, nature and requirements of financial management, legislative, and policy responsibilities of the HIC's Commission, managers and staff is incomplete. Senior managers stated that they had a good understanding of their financial management, legislative, and policy responsibilities. However, more than half of lower level managers questioned indicated that the definition and communication of their financial responsibilities could be better.

3.46 Components of the financial management framework, such as performance management via the PSA process and risk management processes, have only recently been implemented or revised. These processes need to operate for one (or more) years before their effectiveness can be fully assessed.

Recommendation No.2

3.47 The ANAO recommends that, to improve understanding by the Commission, managers and staff of their financial management responsibilities, the HIC implement a strategy for developing a single document that describes the financial management responsibilities of the Commission, managers and staff, and increase training of lower level managers in these responsibilities. The HIC should ensure that all managers and staff with financial management responsibilities are aware of, and are familiar with, the documentation.

HIC's response

3.48 Agreed.

3.49 Planning is underway to develop a single document that explains HIC's overall financial management framework. This document will detail:

- all financial responsibilities (legislative, policy, strategic, operational, and risk, by functional position);
- how managers and staff are held accountable including timeframes;
- the processes, procedures, and controls in place to meet responsibilities; and
- financial information requirements.

3.50 This document will be developed in Quarter 4 of financial year 2003–04.

3.51 HIC will develop a communication strategy for ensuring that managers and staff are aware of and understand the financial management framework. The overall financial management framework will link to the following existing documents:

- HIC Strategic Plan;
- Finance and Planning Division Business Plan;
- Branch Plans and individual Performance Support Agreements;
- Knowledge Management Plan and Training Plan;
- Managing Director’s Instructions and Financial Management Policies and Procedures;
- reporting timetables; and
- other reports.

4. Are HIC Managers Provided with Financial Management Data that is Relevant, Accurate and Timely?

This Chapter describes better practice in the preparation and use of internal financial reports and compares the HIC against this standard.

Financial reports better practice

4.1 The ability to produce reports that assist managers with the planning, execution and monitoring of an organisation's performance is critical to the effectiveness of financial management. In considering the effective delivery and use of financial information to HIC managers, it is necessary to consider the presentation and delivery of financial management reports as well as the content of those reports. The essential characteristics of financial reports,⁴⁸ and the data contained in them, are listed in Table 4.1.

Table 4.1

Essential characteristics of financial reports

Presentation	<ul style="list-style-type: none"> • reports are presented in a style which is easy to understand and use • reports make sufficient use of graphs and tables to convey key financial results and trends • reports are appropriately succinct, summarised and exception-based to convey the key messages and areas of concern to management • reports provide relevant non-financial information such as commentaries and financial/non-financial ratios • reports compare financial data over time (eg. year on year, month on month) and between different areas of the organisation • a standard, agreed format for monthly financial reporting is in place • the needs of managers have been evaluated and taken into account in the design of financial reports • reports are sufficiently flexible to allow different views and aggregations of data to be easily provided to satisfy managers' individual needs
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⁴⁸ ANAO Better Practice Guide 1999, *Building a Better Practice Financial Management Framework: Defining, Presenting and Using Financial Information*, Canberra, pp.33-46.

Delivery	<ul style="list-style-type: none"> • reports are easily obtained from financial systems, without the need for specialist intervention • managers have a choice in the way they receive reports. For example electronically via the intranet or email system, but if more appropriate, in hard-copy • reports are delivered within a reasonable timeframe and with regularity that allows financial data to be effectively used
Content	<ul style="list-style-type: none"> • content is relevant to the defined needs of managers • financial data is based on accurate and reliable records from the FMIS • financial data is based on consistently interpreted and classified financial transactions from a common chart of accounts • financial data in the FMIS is consistent and reconciled with data from source systems • financial data is accrual-based and also cash-based where required • financial data is forward-looking • financial data provided in reports is used in decision-making and organisation performance management, including: <ul style="list-style-type: none"> – Commission and Executive meetings – corporate and business planning – budget preparation – project business case and cost-benefit analysis – activity based management and costing – output pricing – process improvement – performance monitoring and review

Source: Derived from the ANAO Better Practice Guide—*Building a Better Financial Management Framework* (1999) Part 2.

4.2 The HIC’s financial reports were assessed against these characteristics.

Has the HIC identified its managers’ financial data requirements and taken adequate steps to meet them?

Audit finding

4.3 Yes. The HIC has identified the requirements of managers and other users of financial data and taken steps to meet their needs. However, consultation with users about their data needs has been limited. FPD has developed initiatives to improve consultation with users on their needs.

Users of financial data

4.4 FPD has identified internal users of financial data, who consist mainly of those with specific financial management responsibilities. These include: the Commission, the Executive, Division Managers (known as General Managers), Finance Coordinators (of Divisions), Branch Managers, Cost Centre Managers,⁴⁹ Program Managers, Project Managers, State Managers, State Finance Managers, Regional and Branch Managers, Medicare Office Managers, and FPD staff.

4.5 Finance Coordinators and State Finance Managers support Division and State management through the provision of financial analysis services. They work with Division and State Managers to address their specific financial management needs.

4.6 The Parliament and the Australian people are important external users of the HIC's financial data. Other external users include agencies the HIC has funding arrangements with and agencies to which the HIC is required to provide financial reports (such as the Department of Finance and Administration, Australian Taxation Office, and the ANAO)

Financial data required by users

4.7 Financial data needs of HIC management have been identified by the FPD and addressed through a process of gradual refinement. Analysis of data and documentation, provided during the course of the audit, showed that the FPD has considered the nature of financial management activities and associated data requirements of various roles within the HIC from the Commissioners to Cost Centre Managers. Data provided to managers in such roles is discussed in later in this Chapter. Appendix 6 sets out by management group the nature of the financial activities undertaken, associated data requirements and information provided in reports.

4.8 When asked whether they had a need to receive financial data, 73 per cent of those responding to the audit questionnaire⁵⁰ stated that they had a definite need to receive financial data in order to meet their management responsibilities (this included 100 per cent of General and State Managers), while 24 per cent stated that they had some need.

4.9 Responses to questionnaires showed that the range of financial data respondents required to perform their roles included:

⁴⁹ Branches may be made up of one or more cost centres.

⁵⁰ During the audit, interviews and questionnaires were conducted with and issued to, a selection of FPD staff and HIC management roles including: General Managers of Divisions, State Managers, Branch Managers (national office and states), Finance Coordinators of Divisions, State Finance Managers, Medicare Office Managers.

- actual expenditure against budget;
- revenue data;
- project revenue and expenditure against budget;
- scorecard data, such as transaction volumes and other productivity measures;
- forecast data;
- cashflows; and
- cash process data.

4.10 The FPD has developed monthly financial reports to address management's needs. Changes to these reports are made when management, including the Commission, makes such request.

4.11 Once the financial General Ledger (GL) is closed for month-end processing,⁵¹ Cost Centre Managers, Branch Managers (Division and State), Medicare Office Managers, Finance Coordinators and State Finance Managers access standard financial reports in the HIC's FMIS, called FINNET, to examine variances between actual and budget expenditure. Results of these examinations are used by the FPD when its staff collate key monthly financial reports.

4.12 External user requirements are generally specified in the reporting requirements of the various agencies and the specific arrangements the HIC has with them, such as the Output Pricing Agreement between Health and the HIC.

Consultation and communication with users regarding their needs

4.13 When asked whether they had been consulted about the content, accuracy, timeliness, frequency and format of financial data, 25 per cent of questionnaire respondents stated that they had been fully consulted on all of these aspects, while 50 per cent of responses stated that they had been consulted on their needs for some of these aspects.

4.14 The FPD has identified, in its FKMP, a number of initiatives to improve consultation with users of financial data. Examples of such initiatives include:

- discussion with managers to determine the extent to which FPD services, including financial and performance data, satisfy managers' needs; and
- review of data needs of internal stakeholders.

⁵¹ When an account is 'closed' for processing at the end of a period, no further entries can be made for the closed time period.

4.15 No documentation or communication strategies regarding financial data requirements of users were available for review during the performance audit.

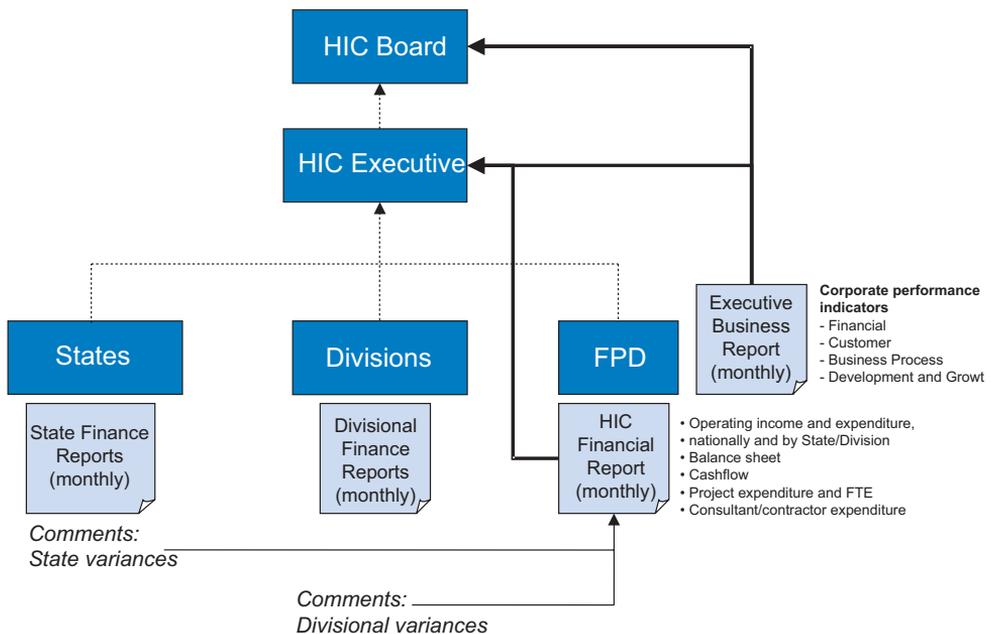
HIC’s achievements and actions to improve processes in the identification of managers’ financial data requirements and steps taken to meet them

4.16 The HIC has identified users of financial data and provided monthly financial reports to them. The FPD has included initiatives in its FKMP to address the need for improvement in the identification of the financial data requirements of users.

What financial reports are currently produced?

4.17 The HIC produces a number of regular financial reports at different levels of the organisation. The overall reporting structure and flows of financial data are summarised in Figure 4.1:

Figure 4.1
HIC reports and reporting flows



Source: derived from interviews and surveys conducted within HIC during the performance audit.

Executive Business Report

4.18 Produced monthly by FPD, the purpose of the Executive Business Report⁵² is to provide an assessment of HIC's overall business performance, according to defined corporate performance indicators. This report is used by the HIC's Commissioners to discharge their responsibilities.⁵³ In addition to financial indicators, this report also measures key aspects of customer service performance (e.g. response times, complaints and compliments, timeliness, customer satisfaction) as well as internal business processes (e.g. claim processing accuracy, percentage of transactions processed on-line) and staff satisfaction. It is produced from a number of sources, including FINNET.

4.19 The key financial measures used in corporate performance indicators are:

- revenue;
- operating expense;
- net profit;
- capital expenditure; and
- working capital.

Other reports to Commissioners

4.20 The following additional reports are provided to Commissioners:

- Mid Year Financial Review; and
- Third Quarter Financial Review.

4.21 These reports include a summary of year to date financial performance, and the projected outcome for the financial year. They provide financial information on major projects, benefit payments, and cash flows, as well as the current and projected statement of financial position.

Monthly Financial Report

4.22 Produced by FPD, the purpose of the Monthly Financial Report is to provide the HIC Executive with a comprehensive assessment of the financial health of the HIC. It presents actual performance against budget for each State and Division and comments on significant variances against budget. The financial

⁵² Appendix 7 provides further information on the contents of the HIC's financial reports.

⁵³ The service provided to Commissioners by the Executive Business Report is discussed in Chapter 2.

data in this report is extracted from FINNET. The comments on variances are prepared by the responsible managers.

Monthly State Financial Reports

4.23 Produced by State Finance Sections, the purpose of the monthly State Financial Reports is to provide each State Manager and their respective management teams with a comprehensive assessment of their financial performance. This report includes performance against budget, with a greater focus on throughput/volume related measures than in National Office. Again, the financial data in these reports is extracted from FINNET. It is supplemented by data from program administration systems.

Divisional Monthly Financial Reports

4.24 Produced by Divisional Finance Coordinators, Divisional Monthly Financial Reports are used to provide divisional management with a comprehensive assessment of the financial performance of their Division. These reports are largely based on standard FINNET financial reports and are used in contributing to the FPD Monthly Financial Report variance analysis. The reports typically provide expenditure data at a lower level of account detail for deeper analysis of variances by cost centre managers.

Other Reports

4.25 A number of FINNET reports are used for financial reporting, including budget variance reports for cost centre managers (i.e. cost centre by cost element/account). At a State level, reports from FINNET incorporate statistical data for analysing transaction volumes and throughput in the State.

4.26 In summary, the HIC produces a variety of reports containing financial data. These reports have been designed to meet the needs of managers at various levels within the HIC.

Is the financial data provided to HIC managers relevant?

Audit finding

4.27 Yes. The financial data provided through standard FINNET reports is the primary source of data used by HIC managers to meet their financial management responsibilities. It is widely used by these managers. As such, the financial data provided in reports is considered by managers to be directly relevant to their needs.

4.28 Financial data produced for monthly reporting is widely used by all levels of management from cost centre manager up to the Commission. Identified uses of financial data received by managers include:

- resource allocation;
- planning;
- budget preparation;
- project tracking;
- financial trend analysis;
- cash management and forecasting; and
- costing of new projects and policy proposals.

4.29 For the majority of HIC managers, standard monthly reports from FINNET providing actual, budget and variance data are generally sufficient in monitoring and controlling financial performance. Other managers draw upon more comprehensive financial management data provided elsewhere such as in balance sheet, cashflow and program reports to meet more specific financial management needs and accountabilities.

4.30 The financial data provided in monthly financial reports is generally considered by HIC managers to be directly relevant to their financial management needs and accountabilities. Questionnaire responses confirmed that 56 per cent of managers indicated their financial data needs were being fully met by current reports, while 44 per cent said their needs were only partly met.

4.31 Appendix 6 was prepared from information collected by the ANAO and from documentation provided during the course of the audit. It sets out for each management group (from the Commissioners to Cost Centre Managers) the nature of the financial activities undertaken, and the ANAO's analysis of data requirements. It compares requirements with the data provided in reports to these managers.

4.32 The content of the financial reports provided to the groups outlined above indicates the types of financial management accountability placed on managers, with a clear focus on reporting:

- accrual based data, rather than cash and accrual;
- departmental operations, rather than departmental and administered;
- historical data, rather than forecasts;
- operating revenues and expenses, rather than capital expenditure, other assets, liabilities and equity; and

- directly controllable expenses, such as staff costs and suppliers, rather than indirect costs and allocated corporate overheads; (while this data is provided in cost centre reports, it is not used by the majority of HIC managers).

4.33 If data from a FMIS is not relevant (i.e. it does not meet managers' needs) the latter will maintain their own spreadsheets and databases to ensure they have the data they need. These are known as shadow systems. The ANAO looked for evidence of shadow systems in the HIC and found none.

4.34 The results of a comparison of data provided against data needed, together with a majority of managers' assessing that data provided to them was directly relevant, and the lack of shadow systems, led the ANAO to the opinion that the financial data provided to the HIC's managers is relevant.

HIC's achievements regarding the relevance of financial data

4.35 The contents of HIC reports include the following achievements:

- a single chart of accounts⁵⁴ is defined and consistently applied across the HIC; and
- the monthly allocation of corporate overheads to cost centres provides data concerning the full cost of operations and is used in determining program/output costs.

4.36 Further discussion regarding the accuracy and reliability of the underlying financial data that is provided through the FMIS in management reports is discussed later in this Chapter.

Is financial data appropriately presented to HIC managers?

Audit finding

4.37 Financial data is presented to HIC managers in a form that is clear, understandable, and in accordance with their financial management needs. While there are areas in which the presentation of financial reports generally is in line with better practice,⁵⁵ there is scope to streamline the Monthly Financial Report and better explain action taken to manage budget variances.

⁵⁴ A chart of accounts is a list of the account numbers and titles included in the General Ledger.

⁵⁵ See Table 4.1 at the beginning of this Chapter.

Presentation of reports

4.38 The format used for presenting financial data, through the Executive Business Report and the Monthly Financial Report, is generally considered clear and easy to understand by senior management. The focus of these reports is on the presentation of the operating result and variances between actual and budgeted revenues and expenditures. There is general consistency in financial reporting across these different reports and with individual reports produced by the States and Divisions.

4.39 The ability of the Executive Business Report to provide an assurance to Commissioners that managers are properly addressing variances from budget is discussed in Chapter 2.

4.40 The Monthly Financial Report includes a substantial amount of commentary on major variances against budget. It is quite long (typically in excess of 40 pages) and provides detail and commentary across all Divisions and States as well as on the consolidated HIC results. Given that most of this information is further analysis of the consolidated results along organisational lines or alternative views of the same information, there is scope for reduction in the size of this report, through the use of drill-down and exception-based reporting techniques. Most financial data is presented in text or tabular format, with only limited use being made of graphs to present summarised financial data. Of the reports examined during the audit, only two graphs were provided (total income and expenditure comparison).

4.41 These findings led the ANAO to the opinion that the Monthly Financial Report does not meet all of the essential characteristics for the presentation of financial reports outlined in Table 4.1. A more focused presentation incorporating more of the essential characteristics in Table 4.1 would facilitate the use of the Monthly Financial Report by managers.

4.42 There is scope for greater consistency in the presentation of the Monthly Financial Report. In particular, the depth of explanation of variances in the Monthly Financial Report varies from State to State and Division to Division. In some sections detailed explanations are provided for relatively minor variances, while in other sections larger variances have very limited explanations. In addition, there is some inconsistency in the reporting of variances in dollars, in thousands of dollars and in millions of dollars across the different States and Divisions.

4.43 The ANAO does not consider the Monthly Financial Report presentation issues to be of high risk to the HIC, as the required financial data can still be communicated to HIC managers. However, improvements in the presentation of reports would make it easier for this financial data to be received and understood.

HIC's achievements in the presentation of financial data

4.44 While the ANAO has identified a numbers of aspects of presentation in HIC reports where improvement would be beneficial, elements of presentation good practice⁵⁶ already incorporated into existing reports include:

- in the Executive Business Report, the use of key financial performance measures amongst other measures in the balanced scorecard;
- in the Monthly Financial Report, presentation of both Full Time Equivalent (FTE) analysis and staff-related costs in a consistent format (Expenditure by Resource report);
- assignment of responsibility for comments in the Monthly Financial Report to a particular manager in the HIC;
- in the Monthly Financial Report, inclusion of the year-end outlook (in addition to full year budget) from October onwards, to enable an assessment of the likely year-end financial result;
- State by State comparative data in State financial reports, including throughput/volume analysis;
- provision of comparative year to date data with the previous financial year; and
- comparable expenditure classifications used between the Monthly Financial Report and other internal reports, such as the State Financial Reports.

Is financial data appropriately delivered to HIC managers?

Audit finding

4.45 Financial data is generally considered by HIC managers to be readily accessible and able to be delivered in accordance with their financial management needs. However, the timeframe for delivery of monthly financial reports to HIC managers is slow compared to that for other public sector organisations.

4.46 Most financial data is accessed directly from FINNET by Finance Coordinators, FPD staff and State finance staff using standard reports and enquiries. Managers can elect to receive financial data either in hard-copy or electronic format, rather than by directly accessing FINNET themselves. Where required, managers are able to tailor the format of monthly financial reports

⁵⁶ See Table 4.1 at the beginning of this Chapter.

that they receive (through FINNET standard reports and various forms of data extraction into spreadsheets).

4.47 Although few managers were concerned about this issue, the timeliness with which financial data is delivered, in its final form to HIC managers, is slow compared to that of other public sector organisations⁵⁷. The HIC's finalised financial reports, including relevant commentaries, are not available until up to the fifteenth working day after the end of the month. This is largely due to a number of mandatory month-end process factors as follows:

- the month-end process begins with the close of the GL, which does not occur until the fifth working day of the following month.⁵⁸ This is partly due to the timing of the operation of a large number of interfaces⁵⁹ with feeder systems,⁶⁰ collation of statistical data for revenue collection purposes and legislative requirements affecting the timing of data provided from health funds to the HIC;
- once the GL is closed for the month, Finance Coordinators and State Finance Managers review financial data in FINNET to examine variances between actual and budget expenditure; and
- results of these reviews are provided to the FPD, which is responsible for collating the monthly Executive Business Report and the monthly Financial Report.

4.48 While the current time frame for delivery of financial data is sufficient for reporting to the monthly Commission meetings, and for meeting monthly and annual Whole of Government reporting deadlines, quicker delivery would assist managers within the HIC in the day-to-day financial monitoring and control of resources. FPD has recognised the need to enhance the timeliness and quality of financial management reporting and has approved a project for the 2003–04 financial year. The HIC should also investigate the feasibility of amending systems, processes and legislation to enable financial data to be delivered on a timelier basis, taking into account the costs and benefits of such improvements.

⁵⁷ A suggested benchmark for most public sector organisations is the delivery of financial reports within 2-3 working days after the end of the month (*Source: IBM Business Consulting Service—Financial Management Benchmarking Program benchmarking data*).

⁵⁸ Better practice organisations close their General Ledger on the first working day of the following month.

⁵⁹ The point at which two computer systems meet to pass data between each other is known as an interface. An interface can be physical (a link between systems on different computers) or logical (a link between two systems on the same computer), or both physical and logical.

⁶⁰ The HIC has a number of computer systems constructed to assist with the administration of programs or other aspects of the HIC's business. These systems, known as feeder systems, capture or create financial information that needs to be passed (fed) to the HIC's core accounting system.

4.49 An external pressure on the HIC to improve the timeliness of monthly reporting is future changes in the monthly reporting timetable announced by the Department of Finance and Administration.⁶¹

HIC's achievements in the delivery of financial data

4.50 The delivery of financial data at the HIC includes the following achievements:

- most managers have a choice of either electronic or hard-copy reports. In most cases are able to quickly obtain reports via their respective Divisional Finance Coordinator or State Finance Section;
- FINNET is widely accepted as the definitive source of financial data from which financial reports and financial data sets are extracted; and
- the use of multi-dimensional reporting tools⁶² to view financial and non-financial data from FINNET on a monthly basis.

Is financial data integrated with performance data?

Audit finding

4.51 Yes. The HIC makes use of both financial and non-financial data in preparing budgets, reporting and monitoring performance. The integration of financial and non-financial data is well established in the reports of the States and other areas of the HIC that manage administered transactions.

4.52 The integration of financial and non-financial data is relevant to a number of performance management activities in the HIC and in the provision of financial reports.⁶³ The use of non-financial data that supports and explains changes in financial results enables a more robust approach to budget variance and trend analysis in financial reports. For example, an epidemic may lead to an unexpectedly high number of Medicare claims. This will show in financial statements as a higher than expected level of Medicare payments and a higher than expected level of processing costs. If reports to managers combine financial data with other performance data, such as planned and actual transaction volumes, the utility of these reports is greatly increased.

⁶¹ Department of Finance and Administration: *Estimates Memorandum 2002/13–15/11/2002*, Recommendations 2 (p.3) and 8 (pp.4-5).

⁶² The HIC uses Cognos software, which is a multi-dimensional reporting tool. It presents a strategic view of financial data: i.e. by business unit, by program, by geographic unit and by accounting element such as contracting expenses.

⁶³ This Chapter discusses the integration of financial information and operational information in planning, budgeting and monitoring. The integration of financial and operational information in risk assessment and risk management is discussed in Chapter 2.

4.53 The preparation of budgets in the HIC to a large extent makes use of relevant non-financial data about factors that most influence cost and revenue behaviour. This data includes:

- budgeting for salary related costs on the basis of FTE levels and expected increases in rates of salary (such as performance based pay);
- budgeting for property on the basis of expected changes in the National Property Portfolio;
- budgeting for Information Technology (IT) services costs on the basis of expected IT volumes and consumption levels;
- budgeting for depreciation on the basis of current asset levels and expected asset acquisitions, disposals and revaluations over the period;
- expected usage of IT and property resources which are built into a corporate overhead allocation model and allocated down to cost centre level; and
- the use of planned levels of throughput (e.g. expected number of Medicare claims processed) to determine funding for operational areas of the HIC, such as the Medicare offices. The unit costs are those established in transaction production plans for that financial year. As a result, reporting at State level is focused on variances in planned throughput levels from period to period and comparisons of throughput performance between Regions and Branch offices.

4.54 Generally, the HIC aligns its budgeting process with its strategic, corporate and business unit planning processes. For example, business initiatives for the forthcoming financial year are separately identified and costed during the budgeting process. FPD also recently introduced budgeting over a three-year period to align with the corporate planning horizon.

4.55 The production of financial reports incorporates both financial and non-financial data, although the extent of integration varies. While general cost centre reports to managers via FINNET are focused on financial data only, many operational areas, particularly the States, obtain reports from FINNET and operational systems to incorporate both financial and non-financial data into their monthly reports.

4.56 Reports in which non-financial data could be more integrated with financial data include:

- the program operating statement provides program costs and revenues but not the associated financial performance indicators; and

- reporting of allocated corporate overheads to cost centres: which does not provide details of the units of consumption giving rise to such costs.

Examples of the integration of financial and performance data in the HIC

4.57 Reports in which non-financial data is well integrated with financial data include:

- a balanced scorecard approach used in the Executive Business Report and State Financial Reports;
- reporting of transaction and other volumes at State, Regional and Branch level;
- reporting of expenditure by resource in the Monthly Financial Report, which allows both FTE and staff cost data, including budget variances, to be easily compared;
- recording of non-financial transaction/throughput volumes in FINNET from the Online Statistical System (OSS); and
- use of performance data from the e-procurement⁶⁴ system.

Is the data produced by the HIC's FMIS accurate and reliable?

Audit finding

4.58 The financial data provided by FINNET is sufficiently accurate and reliable to meet the financial management responsibilities and needs of line managers. However, there is only limited documentation on the interfaces (links) between the HIC's FMIS and associated business systems. This presents a risk that critical processes required to ensure that FMIS data are complete may not be correctly followed, resulting in the loss, or corruption, of data.

Need for accurate and reliable reports

4.59 When managers cannot rely on the data presented to them in reports from an organisation's central accounting or other information systems they develop their own records. This creates a situation where decisions by lower and middle level managers are based on data that is not available to, and often not aligned with, the data available to senior management or the organisation's

⁶⁴ An e-procurement system is an on-line system that is integrated with suppliers' systems and which enables electronic ordering, receipt and invoicing of goods and services.

executive board. Thus it is extremely important that the data in an organisation's FMIS and supporting systems is accurate and reliable and is so regarded by the organisation's managers.

HIC's FMIS

4.60 The design of the financial system, including the chart of accounts and the controls over the provision of financial data from feeder systems into the FMIS, can markedly affect the accuracy and reliability of financial data in the FMIS and supporting systems.

4.61 The HIC's primary financial management information system—FINNET—is deployed nationally and used by all levels of management throughout the HIC. FINNET uses the SAP financial management and accounting software package.⁶⁵ All departmental financial transactions are accounted for in FINNET. Administered transactions are processed via feeder systems linked with FINNET.

4.62 The building blocks supporting the delivery of financial data are documented in the HIC's chart of accounts. The HIC Chart of Accounts Business Rules provide guidance in the definition of appropriate General Ledger accounts, cost elements, cost centres and procedures for the maintenance of accounts. The chart of accounts itself is well documented and maintained. However, development of an annotated chart of accounts⁶⁶ would provide more consistent and clearer account definitions for users.

4.63 Interviews found management and staff to be generally confident that the data in FINNET is accurate and reliable. Although staff raised some concerns, such as mispostings and the correct allocation of staff (and resulting salary amounts) to cost centres, most believed the monthly financial management reporting process ensured such concerns were addressed. The FPD also indicated that the SAP project accounting module is currently being implemented to strengthen project reporting and controls (e.g. improved whole of life project costing and splitting of operating and capital project expenditures).

4.64 ANAO financial statement auditors have reported that, in the audit of the HIC's 2002–03 financial statements, no material adjustments were required to FINNET data. These factors have led the ANAO to an opinion that the financial data provided by FINNET is sufficiently accurate and reliable to meet the needs of line managers.

⁶⁵ SAP consists of a series of modules covering various aspects of the accounting system of a large organisation. An organisation can implement all modules or just those modules it requires.

⁶⁶ An annotated chart of accounts provides users with descriptions and guidance about the accounts.

Supporting systems

4.65 A number of interfaces are used to transfer financial data into the FMIS from feeder systems, including the following:

- OSS—transaction and service volume statistics (monthly); and
- Aurion—payroll/human resource system (fortnightly).

4.66 A number of interfaces also exist between the Reserve Bank and FINNET to facilitate the processing of cheque and Electronic Funds Transfer (EFT) payments from the HIC.

4.67 FPD staff advised that there are processes in place that ensure the reliability and accuracy of data in FINNET. These include:

- daily bank reconciliations;
- reconciliations between administered funds and transaction volumes by program; and
- monthly reconciliations of balance sheet items and control accounts associated with feeder systems, such as Aurion.

4.68 The interim audit of the HIC's financial statements for 2002–03 found that many reconciliations were completed satisfactorily. However, the audit identified five reconciliations that were not being completed satisfactorily. These have been addressed by the HIC.

4.69 There is a lack of adequate, up-to-date and clear documentation on the FMIS interfaces and associated business processes. There is no clear diagram that defines the FMIS and associated flows of data. Such documentation would be beneficial given the complex nature and number of interfaces involved and the volume of transactions processed. It would support the needs of both technical and non-technical HIC staff in managing critical month-end and year-end business processes, including system reconciliations. The absence of adequate system and interface documentation presents a risk that critical processes required to ensure the FMIS is complete may not be correctly followed, resulting in the loss, or corruption, of data.

Is data from the FMIS and supporting financial systems compatible with the HIC's financial statements?

Audit finding:

4.70 The data is compatible, but only with manipulation. The use of a single company code, which does not distinguish between departmental and administered funds, reduces the ability to directly trace externally reported financial data back to FINNET. The HIC has identified the risks that arise from the use of a single company code and has taken action to manage them.

4.71 In organisations that have achieved better practice in financial management, the published financial statements can be produced directly from the organisation's FMIS. Reasons why this is desirable include:

- data available to managers and the executive board from the FMIS matches data that will be provided to external stakeholders; and
- manipulation of data increases the likelihood of error in the published financial statements. The more complex the manipulations the greater the chance of error.

4.72 The financial data used in preparing the HIC's 2002–03 Financial Statements was sourced primarily from FINNET. The primary financial statements (i.e. Statements of Financial Performance and Financial Position) are produced directly from FINNET. The Statement of Cashflows and the notes to the accounts are prepared outside the financial system (in a spreadsheet).

4.73 The primary reason for this treatment was that no separate company codes were used for administered and departmental items. Different account codes were used to differentiate these items. The use of a single company code presents potential risks to the accuracy of data in FINNET. The HIC has identified these risks and taken action to manage them. The HIC has commented that moving to separate company codes for departmental (HIC) funds and administered funds is a major exercise, best tackled when implementing a major redevelopment of its accounting systems.

Conclusion—Chapter 4

Are HIC managers provided with financial data that is relevant, accurate and timely?

4.74 Overall, the financial data provided to HIC managers is relevant and accurate and is used by them to support their decision-making. Reports contain both financial and non-financial performance data.

4.75 However, based on observations in other Commonwealth agencies, the timeframe for delivery of monthly financial reports, at 15 days after the end of the month, is slow. Further, the ANAO considers that there is scope to increase the utility of the Monthly Financial Report by streamlining its format and moving it closer to good practice.

4.76 There is only limited documentation on the interfaces (links) between the HIC's FMIS and associated business systems. This presents a risk that critical processes required to ensure FMIS data are complete and may not be correctly followed, resulting in the loss, or corruption, of data.

Recommendation No.3

4.77 The ANAO recommends that, in order to improve the utility of financial data provided to HIC managers for regular financial monitoring and decision-making, monthly financial reports be delivered to managers closer to the end of the relevant month.

HIC's response

4.78 Agreed.

4.79 HIC is currently reviewing the processes for preparation of financial reports to ensure prompt delivery of information to managers. The Executive Business Report, and State and Divisional Reports will be included in the review.

Recommendation No.4

4.80 The ANAO recommends that, to ensure all financial system interfaces are correctly maintained and processed, adequate documentation and procedures be developed to assist HIC staff to maintain the interfaces and manage month-end and year-end business processes, including system reconciliations.

HIC's response

4.81 Agreed.

4.82 It is noted that HIC is developing new business systems and that the documentation of interfaces will need to include these new systems.

4.83 HIC is currently undertaking a major redevelopment of IT systems and documentation of all interfaces amongst the different systems into and out of FINNET will be developed as part of the project.

5. Do the HIC’s Managers and Staff have the Required Skills, Training and Support to use Financial Data?

This Chapter describes principles for sound financial management skills, training and support and compares the HIC against these principles.

Financial management skills, training and support principles

5.1 Managers and staff with financial management responsibilities must have the necessary skills, receive appropriate training and be provided with adequate support to enable them to use the available financial data. Principles for these requirements are summarised in Table 5.1.

Table 5.1

Principles for sound financial management skills, training and support

Skills	<ul style="list-style-type: none"> • Role definition/job descriptions for all finance staff positions being developed, documented and communicated • Competency standards being established and implemented for each role • Qualifications/experience of all staff with financial management responsibilities being of an appropriate level
Training	<ul style="list-style-type: none"> • Regular assessment of skills/competencies against standards • Responsibility for training clearly assigned • Adequate training capacity and resources in place • Structured training program in place and available to all staff that need access to it
Support	<ul style="list-style-type: none"> • Policies and procedures being readily available to all staff • All staff having access to Help desk services • All staff having access to technical experts when required • Communication forums being held on a regular basis to disseminate and discuss information and issues relating to financial management

Source: IBM Business Consulting Services

5.2 A number of FPD and Commission-wide initiatives have recently been introduced in the HIC. These will affect the way in which the HIC ensures that managers and staff have the required skills, training and support to use financial data. These initiatives include:

- Performance Support Agreements (PSA);

- the FPD Financial Knowledge Management Plan (FKMP); and
- the FPD Financial Training Plan (FTP).

5.3 These initiatives are discussed in more detail in the following sections.

Do the HIC’s financial staff have the skills and experience necessary to provide financial data of the required standard?

Audit finding

5.4 Yes. The HIC has a finance division with qualified and experienced financial staff. Overall, most other financial staff have appropriate skills and experience. A risk to the HIC identified by the ANAO was the lack of FPD advice or involvement in the recruitment of Divisional Finance Coordinators and State Finance Managers. Unless FPD is involved in recruitment for these positions, there is a risk that staff without appropriate skills, understanding and experience could be recruited.

Qualifications and experience—Chief Financial Officer

5.5 As part of the Commonwealth Government’s financial management reforms,⁶⁷ each major Commonwealth organisation is encouraged to appoint a Chief Financial Officer (CFO), with appropriate financial management skills and experience, who reports directly to the CEO. The HIC has met these requirements.

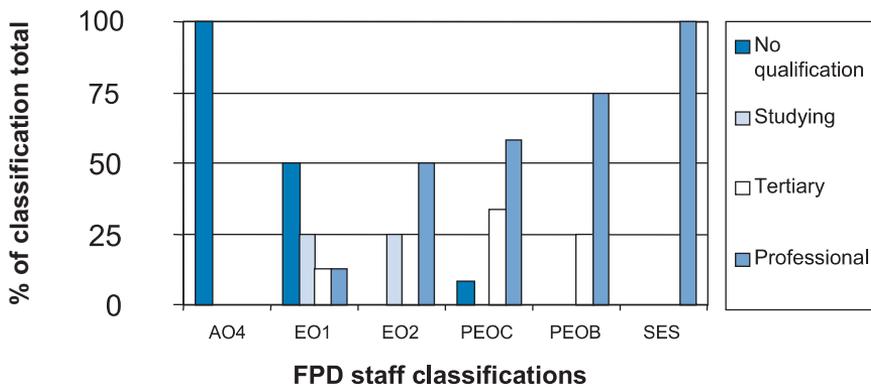
Qualifications and experience—other staff

5.6 In January 2003, the FPD had a team of 36 staff members involved in financial work,⁶⁸ including the CFO. The average time that these staff had been employed in a financial role, either within or outside the HIC, was 9.7 years. Figure 5.1 depicts the qualifications of FPD staff by HIC classification.

⁶⁷ See Chapter 1.

⁶⁸ This number excludes Strategic and Business Planning Branch and support staff.

Figure 5.1
FPD staff financial qualifications by classification⁶⁹



Source: Interviews and questionnaires during fieldwork for the performance audit.

5.7 Of the 36 FPD staff:

- 16 are members of a professional accounting or financial body; that is, the Institute of Chartered Accountants, Institute of Certified Practising Accountants, Institute of Chartered Certified Accountants, or Australian Insurance Institute;
- seven of the staff, who do not have membership of the professional bodies have relevant tertiary qualifications (Bachelor of Commerce, Associate Business Diploma (Accounting), Bachelor of Business); and
- a further three staff are currently studying accounting and commerce.

5.8 Those without formal financial qualifications are mainly at less senior levels. Although these staff do not hold formal qualifications, some have considerable experience in financial roles, ranging from three months to 25 years.

5.9 The roles of these staff include activities such as: Help Desk, manual and electronic payment processes, journal entries, travel allowance processes, assistance with financial system maintenance and new module implementations, and FPD intranet site maintenance.

5.10 The FPD intends to use the new PSA process to identify any gaps in the skills of the FPD staff and to identify their training needs.

⁶⁹ PEOB (Principal Executive Officer) Class B = APS Executive Level (EL) 2, PEOC = EL1, EO2 (Executive Officer) Level 2 = APS Level 6, EO1 = APS Level 5, AO4 (Administrative Officer) Level 4 = APS Level 4.

Role definitions and skills criteria

5.11 When the FPD recruits staff into the Division, the position and job descriptions are defined and financial qualifications are stressed. Broad role definitions and a selection of job descriptions were reviewed during the performance audit. The ANAO found that the job descriptions reviewed assist FPD staff to understand their role and the activities that they are to perform. A general description of the nature of financial skills required by all finance staff (not by role) is included within the FKMP.

5.12 The role of FPD includes:

- coordinating the strategic and business planning processes;
- managing the budget process;
- performance analysis and management reporting;
- developing the Output Pricing Arrangements;⁷⁰
- producing the year-end financial statements;
- developing financial systems; and
- developing policies and procedures in the above areas.

5.13 Each Division has a Finance Coordinator; each State has a State Finance Manager. These staff provide assistance to their respective Divisions and States and are responsible for:

- financial planning;
- resource planning;
- budgetary planning and preparation;
- reviewing performance against budget; and
- other financial analysis services.

5.14 Finance Coordinators and State Finance Managers are not part of FPD. They report to and are managed by the individual Divisions and States that they support. They are, however, supported by FPD in a number of ways (discussed in more detail in the following sections). Performance audit interviews revealed that, although the majority of Finance Coordinators and State Finance Managers have a financial qualification and/or financial experience, some do not.

5.15 A current risk to the HIC is the possibility of appointment of persons without appropriate skills and experience to Finance Coordinator and State

⁷⁰ Defines the basis on which Health funds the HIC to provide services such as Medicare and PBS payments.

Finance Manager positions. At the time of the audit FPD, was not involved in recruitment to these positions. Even though training and ongoing support are provided by the FPD to Finance Coordinators and State Finance Managers, it is essential that staff recruited into these positions have the appropriate financial skills and experience. Advice from the FPD during the development of the selection criteria and during the selection process for these positions should assist in helping to ensure that appropriately qualified staff are appointed.

HIC's achievements in the provision of financial staff with appropriate skills and experience

5.16 Public sector reforms have highlighted the need for improved financial management skills, including strengthening senior financial positions.⁷¹ The HIC has built a finance division that has qualified and experienced finance staff.

5.17 Planned improvements in the areas of training assessment and provision of training for finance staff, as well as managers and staff (including Finance Coordinators and State Finance Managers), via the PSA process and the FKMP and FTP should also improve the financial management skills of the HIC's financial staff.

Are financial training needs assessed and is financial training provided within the HIC?

Audit finding

5.18 The HIC provides financial training to staff at all levels. The HIC has developed systems and tools to assist in assessing financial training needs and in providing financial training. However, the PSA process is in its infancy and the FKMP and FTP will be implemented during 2003. Unless these initiatives are fully implemented, the HIC runs the risk of not providing an adequate service to its staff in terms of financial training needs assessment and provision of financial training.

Identification of training needs

5.19 Financial training provided within the HIC has been limited to the FPD's perception of the HIC's needs from its dealings with managers, staff, Divisional Finance Coordinators and State Finance Managers. Divisional Finance Coordinators and State Finance Managers have also played an important part in

⁷¹ See Commonwealth Management Advisory Board *Beyond Bean Counting—Effective Financial Management in the APS, 1998 and Beyond*, Canberra, 1997, and CPA Australia, *Beyond Bean Counting 2000—A Benchmark of Effective Financial Management in the Australian Public Sector*, Melbourne, 2000.

identifying training needs, including externally provided training, which may benefit managers and staff. From 2003 the identification of financial training needs will be assisted by the FMKP process (discussed later).

Provision of training

5.20 The FPD has a team of four staff (the Financial Systems Training and Development section (FSTD)) who are responsible for internal financial training. The team develops course material, delivers financial training and provides follow-up support such as:

- one-on-one sessions with staff requiring further assistance; and
- maintenance of course material on the FPD intranet site.

The team delivers its training courses throughout the year but also has responsibilities in addition to training.

5.21 Over the last 24 months the financial training delivered by FSTD to HIC managers and staff⁷² has included:

- budget construction training;
- training on the financial management responsibilities of cost centre and project managers;
- financial systems-related training: navigation, reporting, up-grade, system module specific training; and
- specific accounting policy and procedures training.

5.22 HIC staff have also attended externally provided financial management training in topics including:

- amendments to relevant legislation;
- Accrual Information Management System (AIMS) training;
- financial systems-related training; and
- balanced scorecard.

5.23 Attendance at internally provided training is not mandatory for staff who have financial management responsibilities. However, it is generally accepted by them that attendance is worthwhile if they are to fulfill their responsibilities. Responses to the audit questionnaire showed that 85 per cent of staff questioned had received internal training in aspects of financial management.

⁷² FSTD also provides 'train the trainer' type training to Divisional Finance Coordinators and State Finance Managers. The Divisional Finance Coordinators and State Finance Managers then train managers and staff with financial responsibilities in their respective Divisions or States.

The new Performance Support Program

5.24 During the 2001–02 financial year, the HIC introduced a new performance management system called the Performance Support Program (PSP).⁷³ As part of the PSP all HIC staff now have an individual PSA that details performance goals, measures, expected behaviours, and identifies learning and development needs. Training needs of HIC staff members are identified in the learning and development section of the PSA by the individual staff member in conjunction with their manager. These needs are reassessed and revised in a formal annual PSA review. As at 30 June 2002, 92 per cent of the HIC's staff had a PSA in place.⁷⁴ However, at the time of this performance audit, the process had not been in place long enough for formal reviews to have occurred.

The Financial Knowledge Management Plan

5.25 In January 2003, based on the financial training needs identified in the initial PSA process, the FPD finalised a Financial Knowledge Management Plan and an associated Financial Training Plan. The FKMP 'aims to bring together a range of initiatives and activities that foster and promote financial resource management in the HIC through leveraging knowledge' while the FTP 'addresses the formal training elements of the Financial Knowledge Management Plan'.

5.26 As well as identifying a range of future FPD initiatives, the FKMP also identifies:

- the financial skills (not qualifications) required by some operational positions (General Managers, project managers, purchasing staff, cost centre financial managers, finance staff (general) and Finance Coordinators and human resource staff, but not program managers); and
- the financial training needs required in the HIC as established from the PSAs, discussions with managers, the financial skills assessment by functional position, and FPD's Business and Risk Management Plans.

The Financial Training Plan

5.27 Based on the financial skills required by functional positions and the financial training needs identified in the FKMP, the FTP includes:

- a more detailed discussion of the financial training needs analysis undertaken by the HIC;
- a list of training that has been delivered over the last two years by the FPD; and

⁷³ Further information can be found in HIC 2002, *HIC Annual Report 2001–02*, Canberra, p.37.

⁷⁴ *ibid.*

- a plan for the type of financial training to be undertaken over the period January 2003 to June 2004 (including whether the training is likely to be provided internally or externally, and a target date for delivery of each type of training need).

Monitoring

5.28 The FKMP and the FTP do not indicate how an individual's financial skills development and training attendance will be monitored. The HIC assumes that individual staff members and their supervisor will ensure that this happens via the PSA process. When the HIC evaluates the effectiveness of the PSA process, the evaluation should include an assessment of whether such monitoring occurs.

HIC's achievements in financial training needs assessment and financial training provision

5.29 A number of sound practices are used by the HIC in terms of providing financial training. A financial training team exists and is responsible for the delivery of a training program to financial and non-financial managers and staff. Internal training courses are provided at least annually and course materials are maintained on the FPD intranet site providing access to all HIC staff. External financial training is also available.

5.30 The HIC's recognition of the need for improvement is reflected in the recent finalisation of the FKMP and FTP. The FKMP and FTP enhance the existing training program by identifying the particular skills that are needed by some functional positions and determining the training that is appropriate for those positions. Financial training needs are now assessed using a formalised process, the PSA. General managers have a percentage target included in their individual PSA, requiring them to meet the training needs identified in the PSAs of their staff.

Do the HIC's operational managers and staff have the skills required to use financial data?

Audit finding

5.31 Generally, yes. Up until now, the HIC has not kept data on the financial management skills and experience of its operational managers. It has put initiatives in place to improve its knowledge of these matters. The data collected by the ANAO indicated a good level of understanding of financial responsibilities, particularly amongst more senior staff. Most managers have received financial training. Further, the ANAO did not identify any serious

deficiencies in the ability of HIC operational managers and staff, as a whole, to use financial data in their work.

5.32 In the past the HIC has not evaluated the financial skill requirements of operational managers' positions nor assessed the training needs of managers against these requirements. As stated above, the new FKMP identifies the skills needed by some operational positions. Further, PSAs should identify skill deficits and training needs, including financial management skills and training.

5.33 In coming to an opinion about this question, the ANAO noted that 85 per cent of the managers and staff interviewed in the course of this performance audit had attended internally provided financial training. Questionnaire responses showed that:

- 27 per cent had received training in analysing, interpreting and using financial data and training on the HIC's financial structure and systems;
- 58 per cent had received training in some of these areas; and
- 15 per cent had received no training in these areas.

5.34 Of the 85 per cent of respondents trained, 39 per cent considered the training to be fully adequate while 61 per cent considered the training to be only partially adequate. There was no evidence to suggest that the training provided more recently was considered any more adequate than training received in the past. Interestingly, 88 per cent of all respondents stated that additional training to assist them to analyse, interpret and use financial data and understand the HIC's financial structure and systems would be useful to at least some extent.

5.35 In the questionnaire, 45 per cent of respondents stated that they had a good understanding of their legislative and policy responsibilities with regard to financial management, while 52 per cent said that their understanding could be better. Further, 38 per cent of questionnaire respondents (but 80 per cent of General/State Managers) stated that they understood their financial management responsibilities, while 50 per cent answered that their understanding could be better.

5.36 The answers given in interviews, coupled with the responses to the questionnaire, indicated that the HIC's operational managers and staff, as a whole, have a good understanding of the financial processes that their roles require them to contribute to. Further, they have received training to assist them to fulfil their financial management responsibilities.

5.37 While the ANAO did not test the financial skills of operational managers and staff, our work did not reveal any serious deficiencies in the ability of HIC operational managers and staff, generally, to use financial data in their work. The information available led the ANAO to conclude that, on the balance of

probabilities, the HIC's operational managers and staff have the skills required to use financial data.

Are managers and staff well supported in using, analysing and interpreting financial data?

Audit finding

5.38 Yes. The HIC's managers and staff are provided with comprehensive financial support services.

HIC's financial support services

5.39 The HIC's managers and staff have access to, and use, a number of financial support services. The FPD intranet site is available to all HIC staff. It includes information such as financial management forms, FINNET on-line documentation, financial management policies and procedures, other reference material, and information about FPD and FPD contacts.⁷⁵ It is the FPD's preference that all HIC staff should use the FPD intranet site as their 'first point of call' for financial queries.

5.40 The FPD Help Desk provides assistance in relation to FINNET support, such as login problems, passwords, navigation around FINNET, and running reports in the system. Queries about the reconciliation of benefits (manual cheque process) from the Medicare Offices also come to the Help Desk.

5.41 The FPD annual workbook is distributed to attendees of the Budget Construction training course and is also located on the FPD intranet site. Its purpose is to provide cost centre managers with concepts and procedures for budget construction in FINNET. It includes budget preparation information regarding salary planning and non-salary planning, revenue planning (for revenue other than that established in the Output Pricing Agreement), and worksheet attachments that may assist in the preparation process. Relevant corporate policy references and useful cost information are also included.⁷⁶

5.42 Information sharing forums are also coordinated and run by the FPD. A monthly meeting with Finance Coordinators is held to keep them informed on financial management issues and reporting requirements. A similar monthly meeting, via teleconference, is held between the FPD and State Finance Managers. Annual or bi-annual conferences are run by the FPD for Finance Coordinators and State Finance Managers to enhance communication and share information.

⁷⁵ See Appendix 8 for a more comprehensive list of contents of FPD's intranet site at the time of audit fieldwork.

⁷⁶ Policy references such as the HIC's asset definition and asset recognition threshold and cost information such as travel allowance rates.

5.43 FPD staff also provide:

- one to one assistance to staff members who require specific help or who have been unable to attend training sessions; and
- technical accounting and policy advice to HIC managers and staff as requested.

Users' opinions on the access and adequacy of the service

5.44 Interviews conducted throughout the performance audit and responses to questionnaires found that the HIC's managers and staff generally considered that they had access to financial expertise and support.⁷⁷ Many of the interviewees relied on their Finance Coordinator, or State Finance Manager, as their first point of call for any financial matters, highlighting the need to ensure that such positions are filled with appropriately skilled people.

5.45 Seventy four per cent (74 per cent) of questionnaire respondents stated that they have access to expertise to support them in using, analysing and interpreting financial data, while 24 per cent stated they have only limited access. Of those who had access to support, 56 per cent considered that the support was fully adequate to meet their needs, while 44 per cent thought that the level of support was adequate only to a limited extent and could be improved.

5.46 Recognising the need to obtain comments from service users, the FPD has included in the FKMP an initiative to discuss with managers the extent to which FPD services, including financial and performance data, satisfies their needs.

HIC's achievements in support of managers and staff in the analysis and interpretation of financial data

5.47 Many of the types of support services offered, as discussed above, are consistent with the principles for sound financial management support outlined in Table 5.1 at the beginning of this Chapter.

Conclusion—Chapter 5

Do the managers and staff have the required skills, training and support to use financial data?

5.48 Generally, the HIC's financial staff, including financial staff in divisions and in State offices, have appropriate skills and experience. Amongst non-financial staff, senior managers have a good understanding of their financial

⁷⁷ Responses to interviews and questionnaires are detailed in Appendix 9.

responsibilities. At less senior levels, a significant proportion of staff indicated that their understanding could be better.

5.49 The ANAO found that FPD has a training cell that provides financial training to HIC managers and staff. The HIC has developed initiatives to better assess training needs. Further, the HIC's managers and staff are provided with comprehensive financial management support services.

5.50 The ANAO has made recommendations for

- FPD involvement in the recruitment of Finance Coordinators and State Finance Managers; and
- the development of a coordinated approach to financial management training.

5.51 The HIC has recognised the need for these improvements. Recently introduced initiatives (PSAs, the FKMP, and the FTP) should address deficiencies in some of these areas. However, these initiatives are yet to be fully implemented and there is a risk that, unless they are fully implemented, the HIC will not provide an adequate service to its managers and staff and ultimately to its external stakeholders.

Recommendation No.5

5.52 The ANAO recommends that Finance and Planning Division should advise on the development of the selection criteria and/or the selection of Finance Coordinator and State Finance Manager positions to ensure that suitably skilled staff are employed.

HIC's response

5.53 Agreed.

5.54 Finance and Planning will consult with States and Divisions in order to implement this recommendation.

Recommendation No.6

5.55 The ANAO recommends that, to ensure that financial training assessment and provision of financial training leads to appropriately skilled staff and managers, the HIC develop a more coordinated approach to financial management training. The approach could include, for all roles or functions with financial management responsibilities, the following elements which are currently not implemented in the HIC:

- competencies by role or function;
- the identification of training (internal and external) that would be useful for the roles or functions;
- an assessment and record of staff members' current financial skills/competencies, including formal qualifications;
- the identification of staff members' financial training needs as identified in the PSA process and by FPD;
- a process for recording training attended by such staff; and
- an awareness program of the role the PSA, FKMP and FTP play in assessing financial training needs and providing financial training in the HIC.

HIC's response

5.56 Agreed.

5.57 HIC has developed a Training Plan that incorporates the training needs identified in the Performance Support Agreements, the Financial Knowledge Management Plan, and the Risk Management Plan. HIC is in the process of developing a strategy to implement the plan. This will ensure that the necessary financial management skills are developed in the organisation.

Canberra ACT
6 February 2004



P. J. Barrett
Auditor-General

Appendices

Appendix 1: Health-Related Programs Administered by the HIC on behalf of the Australian Government

1. This Appendix lists health related programs administered by the HIC on behalf of the Australian Government.

Table A1.1

Expenses administered on behalf of Government (2002–03)

Program	Expenditure \$000
Medicare	8,174,548
Pharmaceutical Benefits Scheme	4,783,927
Federal Government 30 per cent rebate on health insurance	2,166,284
Repatriation Pharmaceutical Benefits Scheme	427,700
Practice Incentives Program	244,056
Hearing Services Program	153,632
General Practice Immunisation Incentives scheme	36,975
Health Program Grants	12,985
Rural Retention Program	17,973
Australian Childhood Immunisation Register	8,059
Medical Indemnity	501,444
Other	69,630
Total	16,597,213

Table A1.2

Other Health Related Programs (2002–03)

- Compensation Recovery Program for Medicare and nursing home benefits;
- Australian Organ Donor Register;
- General Practice Registrars' Rural Incentive Payments Scheme;
- Family Assistance Office in partnership with Centrelink, the Australian Taxation Office and the Department of Family and Community Services; and
- Claims processing and payments for:
 - Department of Veterans' Affairs (the Veterans' Treatments Accounts);
 - Office of Hearing Services; and
 - Health Department of Western Australia

Source: HIC

2. Payments of medical treatment for veterans are undertaken pursuant to a Memorandum of Understanding with the Department of Veterans' Affairs (DVA). As a result the HIC issued cheques to the value of \$1.6 billion on behalf of DVA.

Appendix 2: Corporate Governance

1. Corporate governance in public sector agencies is the framework established by a governing body to ensure that stakeholders, primarily the Parliament, the Government and the Australian community, have assurance that the agency is fulfilling its responsibilities with due diligence and accountability.⁷⁸
2. Good public-sector corporate governance exists when a public sector entity, in achieving its legislative and policy objectives, attains a culture or environment of disciplined, ethical and accountable stewardship of the resources entrusted to it.⁷⁹
3. Corporate governance is a cohesive framework of related elements. Basic key themes and activities include:⁸⁰
 - leadership;
 - management environment;
 - risk management;
 - monitoring; and
 - accountability.
4. Sound corporate governance depends on the integration of these inter-related elements within an appropriate structure and environment. The proper practice of key management disciplines, such as risk management, performance monitoring, human resource management and financial management, contribute towards effective corporate governance.
5. The Commonwealth Auditor General has stated that:⁸¹

the challenge is not to simply ensure that all the elements of corporate governance are effectively in place, but that its purposes are fully understood and integrated as a coherent and comprehensive organisational strategy focussed on being accountable for agency and entity conduct and results.
6. The aim is not simply *conformance* with legal and procedural requirements, but, importantly, to achieve improvement in agency *performance (or results)*.

⁷⁸ ANAO *Controlling Performance and Outcomes, Better Practice Guide to Effective Control*, Canberra, 1997.

⁷⁹ This definition has been developed primarily from ANAO *Applying Principles and Practice of Corporate Governance in Budget Funded Agencies*, Canberra, 1997.

⁸⁰ *ibid.*

⁸¹ Barrett P.J., *Corporate Governance in the Public Sector Context*, presentation as part of the MinterEllison Seminar Series, 18 April 2001.

Appendix 3: Findings and Recommendations outstanding at August 2003 from the 2002–03 Financial Statement Audit

Table A3.1 shows the ANAO's Category A finding from the audit of the HIC's 2002–03 financial statements outstanding at August 2003 and the recommendation against each finding, while Table A3.2 shows the Category B findings.

Table A3.1
2002–03 Category A findings—outstanding at August 2003

Finding	Recommendation	HIC Management Response
<p>Program Management System—program cost attributions</p> <p>The ANAO notes that the HIC implemented the (SAP) project management system during the current year. Audit testing of the project cost attribution framework revealed that in general it is operating properly, notwithstanding that a number of instances of incorrect cost allocation were noted by the ANAO.</p> <p>However, our review of various new software/system programs, initiatives and projects being developed in the current year has also highlighted an apparent discrepancy in the nexus between attributed costs and associated billings.</p> <p>We understand that the funding for new program systems involves a negotiation process between Health and the relevant HIC Business Unit to arrive at a cost which properly reflects HIC's full cost of development for the support system.</p>	<p>The ANAO recommends that the importance of managing proper financial outcomes on new projects and programs should be emphasised to relevant personnel such that the effective management of desired financial outcomes and governance become part of the normal operating activities of HIC staff.</p> <p>More specifically ANAO recommends that HIC:</p> <ul style="list-style-type: none"> • agrees with Health a methodology and basis for calculating and including overhead costs attributable to projects it undertakes; and • implements a more accurate cost attribution process within its financial system for new projects and programs so as to ensure the allocation of costs reflects accurately the timing of those costs and the full costs of development that can be related back to the original budget. 	<p>HIC provides prices for work it carries out for the Department of Health and Ageing (DoHA) on a 'fixed price' basis. HIC and DoHA already have an agreed pricing methodology, and it is well understood between both parties that prices, once quoted, are fixed, and that HIC bears any risk associated with cost variations. HIC uses a business approach, whereby deficits on some projects are offset by surpluses on other projects.</p> <p>If the amount of work required to complete the project is different to that expected, costs will vary. In some cases HIC makes surpluses, while on others there may be a deficit. Whilst a large deficit is shown in the table for PBS Initiatives, the majority of this is offset by a significant surplus on Lipids. These two initiatives are interrelated and are both focussed on increased PBS compliance activities. Overall, HIC aims to break even on project work. In relation to the projects listed above, (all the projects are undertaken</p>

<p>Our audit testing sought to compare revenues from billings of Health with associated costs for a number of specific projects and programs to evaluate revenue recognition and the completeness of revenue accruals. For a number of projects and programs there were significant positive and negative discrepancies between recorded billings and associated costs. These discrepancies still remained even after the attribution of further indirect costs via manual adjustments.</p>	<p>ANAO further recommends that the expanded costing system solution be complimented by a more rigorous regular review of the financial performance of all new projects and programs by the Finance and Planning Division and Program representatives to ensure relevant funding and project/program scope issues are identified and addressed with Health in a timely manner, if necessary.</p> <p>The review of the results of each project/program development should also be used to enhance and finesse the initial cost estimation process for future projects.</p>	<p>on behalf of DoHA), the total revenue is \$36.8 million, and the total costs including overheads is \$37.1 million resulting in HIC incurring a net deficit of \$0.3million. This represents only 0.8% of project revenues and is consistent with HIC's overall objective of achieving a close to breakeven result on the total project portfolio.</p> <p>In the last financial year HIC implemented a project accounting system that has allowed for more accurate tracking of project costs. HIC is further enhancing the system and, as project managers have become more familiar with its use, improved project reporting is becoming available.</p> <p>HIC will also ensure regular reviews of the financial performance of all new projects and programs</p> <p>Given that all the above projects are undertaken on behalf of DoHA, the overall net deficit to HIC is only \$0.3million on a total revenue of \$36.8 million, and the HIC has already implemented a substantial component of the project accounting system. HIC believes that this finding is overstated as a category A.</p>
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Table A3.2
2002–03 Category B findings—outstanding at August 2003

Finding	Recommendation	HIC Management Response
<p>Medical Indemnity financial reporting risk management</p> <p>Whilst Medical Indemnity had a major impact on the 2002–03 HIC financial statements, the ANAO considers that the ongoing financial reporting risks attaching to Medical Indemnity will be just as challenging in 2003–04. This is primarily because 2003–04 will involve:</p> <ul style="list-style-type: none"> • the commencement of claims processing under various schemes; • a further 12 months operation of each scheme; • assessment of the impact of new claims; • commencement and possible further changes to the contribution levy and the recognition of the related receivables; and • potential for further reforms to the Government's Medical Indemnity package. <p>Each of these items will need to be carefully assessed and managed by HIC to ensure key financial reporting risks are satisfactorily mitigated and the internal control environment residing over the Medical Indemnity Schemes is adequate and commensurate with key stakeholder expectations.</p>	<p>The ANAO recommends that the Finance and Planning Division supplement its existing systems development representatives, currently involved with the Medical Indemnity project, with appropriate resources who are familiar with the key statutory financial reporting risks attaching to Medical Indemnity. These resources should have responsibility for the mitigation of assessed financial reporting risks attaching to Medical Indemnity. They should also ensure they work closely with Program Personnel to ensure all financial reporting and audit issues are proactively managed and controlled in readiness for the 2003–04 year end. This will include seeking dialogue with the ANAO regarding identified risks and associated audit considerations and also with the Department of Health and Ageing (Health) regarding consistency of reporting and reconciliations of inter-entity disclosures. We recommend the Finance and Planning Division commence this process with a detailed risk assessment of all aspects of the current Medical Indemnity Scheme administered by HIC.</p>	<p>(a) Agreed.</p> <p>HIC recognises the complex nature of the financial reporting requirements for Medical Indemnity, and continues to commit substantial resources to financial reporting and systems development to ensure financial reporting risks are mitigated. HIC manages a number of complex benefit programs, and is using this experience in the development of appropriate controls and risk mitigation strategies in relation to Medical Indemnity.</p> <p>Regular updates will be included in the CFO reports to management and the Commission.</p> <p>(b) Partially Agreed.</p> <p>Finance and Planning Division already has two separate teams working on Medical Indemnity. The Systems Development Section was responsible for building a component of the Medical Indemnity application in conjunction with the Information Technology Services Division. Both teams liaised with the Program area as necessary.</p> <p>HIC is currently reviewing the level of resources provided to the Finance function.</p>

Finding	Recommendation	HIC Management Response
<p>Mainframe security access management:</p> <ul style="list-style-type: none"> User access is granted based on existing user's profile rather than based on access rules formally defined commensurate with their responsibilities. During our audit fieldwork we noted that there was no formal process in place to ensure that users changing job function have their access permissions updated on a timely basis, such as removal of access from applications no longer used for their specific job function. Regular reviews of user access by the application owner to ensure that user access permissions are current, appropriate and in accordance with defined user access profiles on at least a six monthly basis. Minimum password length required for the mainframe is four characters. Best practice indicates that a minimum password length of at least six characters is required. Passwords are required to be changed every forty-five days. Best practice indicates that passwords should be changed every thirty days. 	<p>The ANAO recommends that:</p> <ul style="list-style-type: none"> HIC formally define standard user profiles and RACF functional group structures for each job function based on the premise that access should only be granted commensurate with the employee's responsibilities. Access should then only be granted based on formally defined profiles or otherwise individually approved by the application owner; formal procedures should be implemented to ensure that user's access profiles are updated in accordance with the defined standard user profiles when they change job function within HIC; user access permissions should be reviewed by application owners or their delegate, on at least a six monthly basis, to ensure that user access permissions are up-to date and appropriate; Minimum password length requirements on the mainframe should be increased to a minimum of six characters; and Maximum password age should be set to a maximum of thirty days. 	<p>In progress</p> <p>There were five recommendations raised by ANAO relating to this finding. Of these, three have been completed, and the remaining two will be completed by 15 January 2004.</p>

Finding	Recommendation	HIC Management Response
<p>Business continuity management:</p> <p>The HIC is currently developing and implementing business continuity plans and disaster recovery plans in accordance with the ANAO's best practice guide for Business Continuity Management. Whilst management have made progress towards implementing a comprehensive business continuity plan and supporting disaster recovery plans they have not yet been formally implemented and tested.</p>	<p>The ANAO recommends that HIC complete the development and implementation of business continuity plans and disaster recovery plans in accordance with best practice and should also be regularly tested.</p> <p>A similar issue has been raised since 1998-1999.</p>	<p>In progress</p> <p>Substantial progress with this has been achieved, and significant amount of work has been undertaken by HIC, with first stage work nearly complete. HIC is currently finalising the plans and is also currently evaluating tender responses that will assist in the testing of business unit plans. Enhanced Data Centre and Communications Changes are being implemented to improve the recoverability and Disaster recovery testing is currently scheduled as part of the acceptance of these changes</p>
<p>Security incident reporting:</p> <p>Since the commencement of IBM GSA as the IT outsourcer, the activity of reviewing IT security reports has not been completed by HIC although this remains the responsibility of the HIC. Whilst HIC have assigned the responsibility for security monitoring, no clear policies or procedures have been developed and implemented and reviews of security reports have not yet commenced.</p>	<p>The ANAO recommends that HIC develop and implement policies and procedures to ensure that meaningful IT security reports are generated and reviewed to identify instances of:</p> <ul style="list-style-type: none"> • unauthorised access to systems; • attempts to gain inappropriate access to systems; and • misuse of privileged system administration functions. 	<p>In progress</p> <p>HIC has instigated a project to address this finding. The Project commenced at the end of October 2003 and will be completed by Quarter 2 of 2004. The major phases are:</p> <ul style="list-style-type: none"> • Review • Gap Analysis • Development Plan • Development • Acceptance and Implementation • Awareness Campaign

Finding	Recommendation	HIC Management Response
<p>Expired agreements with external entities: The HIC does not have current agreements with some of the external entities it deals with.</p>	<p>The ANAO recommends that the Commission finalise the current draft agreements immediately and develop a process by which to ensure agreements are negotiated and finalised prior to the agreements' respective expiration dates.</p>	<p>In progress HIC is moving to finalise the schedules referred to in this finding as quickly as possible. Moreover, HIC has developed draft procedures and processes with respect to developing and reviewing schedules under the Strategic Partnership agreement. These procedures are to be ratified at the next HIC/Health Management Committee meeting between the two agencies. These procedures provide for a standard template for the development of schedules and agreed processes for the reviewing and renewal of existing schedules. These processes are supported by an internal HIC working group that includes representation from all relevant Divisions within the HIC. Consultation with DoHA is then undertaken with respect to output from this group. These procedures will be followed with respect to MOU's in place or being developed with other purchasers of HIC services including Western Australian Department of Health. The outcome of these arrangements will ensure schedules are negotiated and finalised prior to expiration.</p>

Finding	Recommendation	HIC Management Response
<p>Leased assets stock-take: No stock-take of leased assets is being performed.</p>	<p>The ANAO recommends that HIC obtain a list of all leased assets from IBM GSA to allow substantiation of the costs being incurred by HIC, thus ensuring that HIC is only paying for the assets that they are utilising, and no incremental liability accrues to HIC for missing assets.</p>	<p>In progress As part of recent refresh of desktops, HIC undertook a complete audit of refreshed desktops and associated equipment. The hardware refresh commenced in November 2002 and finished in early April 2003. In addition, HIC is currently in the process of introducing charge-back for its services. As part of the IT charge-back HIC is reconciling all desktop assets. The billing process also enables HIC to reconcile chargeable assets on a regular basis, where all the additions and removals (off and ons) are reported regularly by IBM/GSA.</p>
<p>Portable and attractive asset register: Currently only some branches within HIC are maintaining a register for their portable and attractive items, which have been borrowed or are in use by HIC staff. Also, items which are not initially capitalised but which could affect future decisions are not detailed for management. This would include bulk purchased items that fall under the capitalisation threshold, which could be included within the HIC's assets if recorded as a material class of assets.</p>	<p>The ANAO recommends that HIC establish a central portable and attractive register and ensure that the policy and procedures relating to portable and attractive assets are adhered to.</p>	<p>Resolved Consistent with Managing Director's Instruction (MDI) 15 – <i>Public Property</i> – a portable and attractive register for assets owned by the HIC has been established by FPD utilising a Microsoft Access database for the purpose.</p>

Finding	Recommendation	HIC Management Response
<p><i>Incorporating change management into financial risk assessment</i></p> <p>The current organisational structure and communication processes within HIC results in Finance and Planning Division having primary responsibility for initiating the identification, investigation and analysis of key financial reporting risks.</p> <p>As a consequence, the ability of HIC to effectively incorporate the impact of operational change within its risk management framework, and in particular the financial accounting and reporting risks associated with such change did not appear to operate satisfactorily in a number of instances during 2002-2003. HIC is continually adding new programs and schemes to its suite of administrative responsibilities, however we consider that the identification, assessment and management of accounting and financial reporting risks attaching to such change requires improvement. Examples of operational change which appear not to have been managed as effectively, from a financial perspective, as they could have been during the current reporting period include:</p> <ul style="list-style-type: none"> • Medical Indemnity; • reverse EFT payments; • reporting and monitoring of financial outcomes associated with new projects and programs; and 	<p>ANAO recommends that HIC implement more formal processes to ensure the timely identification of financial risks arising out of its operational activities. A suggested step that could be considered to achieve this includes formalising the reporting channels between Business Units and Finance and Planning Division in relation to financial issues. This could be achieved by, for example, implementation of an "Accounting Matters for Consideration Process". The objective of this process would be to have each Business Unit complete a standard proforma document which contains a number of open-ended questions on various financial reporting topics. The questions would be designed to bring to the attention of the Chief Financial Officer those issues within the Business Units that require Finance and Planning Division consideration and analysis. A consolidated summary of the responses from individual Business Units could then be reported on formally to the Audit Committee and include Finance and Planning Division conclusions/ observations.</p>	<p>Agreed</p> <p>HIC prepares a Financial Risk Management Plan which aims to identify and reduce the overall financial risk to the organisation. The plan includes risks associated with taking on new programs as a result of legislative changes. HIC will build upon this by formalising reporting channels between business units and finance areas to help identify these risks in a timely manner.</p> <p>Regular updates will be included in the CFO Reports to the Audit Committee.</p>

Finding	Recommendation	HIC Management Response
<ul style="list-style-type: none"> particular benefit types not being incorporated into the Outstanding Claims model. <p>As the nature of the HIC business changes and key business processes are reengineered, there is a real need for establishing effective communication channels between Business Units and the Finance and Planning Division. In part this will be a cultural change, but it will also require a formal communication process to be established which addresses financial reporting risks. Essentially Business Units need to engage the Finance and Planning Division on a more regular and formal basis.</p>		

Finding	Recommendation	HIC Management Response
<p>Finance and Planning Division structure and resources</p> <p>ANAO considers that the existing level of HIC Finance and Planning Division resources is adequate to accommodate a stable accounting environment with regular repetitive transaction processes, but that the current organisational and resource structures of the Division are limited in their ability to adequately address:</p> <ul style="list-style-type: none"> • changes in the operational business model; • changes in the financial reporting framework; • the timely preparation and proper review of key year-end financial information; and • maintaining an adequate internal control framework with sufficient levels of supervisory review and embedded quality assurance processes. 	<p>ANAO recommends that HIC evaluate the ability of the existing Finance and Planning Division resources to meet the needs of key internal and external stakeholders with respect to the financial reporting function. Specifically this review should incorporate a risk assessment and development of appropriate mitigation strategies to ensure the HIC Finance and Planning Division has sufficient resources to:</p> <ul style="list-style-type: none"> • meet key stakeholder expectations; • meet the much shorter reporting deadlines without compromising data integrity; • embed adequate quality assurance processes and controls within the Branch; • accommodate changes in the HIC operational business model; • mitigate financial reporting risks throughout the organisation to an acceptable level; and • ensure financial reporting outcomes are timely outcomes and are controlled outcomes. 	<p>Agreed.</p> <p>HIC will undertake a review of the finance function including an assessment of the resourcing level required.</p>

Finding	Recommendation	HIC Management Response
<p>Administered general ledger reconciliations</p> <p>General ledger reconciliations are an important control mechanism over the integrity of information reported within the financial statements.</p> <p><i>Medicare and PBS schemes</i></p> <p>As part of the ANAO's routine audit procedures we sought to audit the Medicare and PBS expenses and payables reconciliations between the general ledger (SAP) and the underlying benefit recording system. These reconciliations were not possible in the current year. Investigations by representatives from the Finance and Planning Division indicated that the legacy systems do not have sufficient functionality to report total benefit expenses and year-end payables. ANAO was required to adopt point in time audit procedures which compensated for this problem by testing individual settlements between the legacy systems and the general ledger in order to conclude on the accuracy of the Administered financial statements.</p> <p><i>Grant Expenses and Accruals</i></p> <p>The various grant schemes administered by HIC reside on a number of legacy systems, which provide the originating transactions for capture within the general ledger (SAP) system. Similar to our observations noted above for the Medicare and PBS schemes, we have been unable to reconcile the reported annual expense and year-end payable accruals between the</p>	<p>ANAO recommends that management investigate the possibility of sourcing information from HIC's underlying Administered legacy systems to enable the quantum of annual Administered expense amounts and period end accruals to be properly reconciled to the general ledger.</p> <p>ANAO also recommends HIC reviews how Grant accrual amounts were determined in 2002-03 and considers making changes to the process to ensure a level of accuracy and sophistication commensurate with appropriate Government reporting standards.</p>	<p>Partially Agreed.</p> <p>HIC has investigated sourcing the total quantum of Administered expenses from the legacy systems, and has concluded that due to system limitations it is not possible to obtain this information. However, daily Administered expenses are sourced from the legacy systems and reconciled to the general ledger on a daily basis.</p> <p>HIC in conjunction with the Department of Health and Ageing will review how grant accruals are determined and make changes to improve their accuracy of grant accruals.</p>

Finding	Recommendation	HIC Management Response
<p>legacy systems and the general ledger due to apparent limitations in the functionality of the underlying legacy systems.</p> <p>Legislative breach</p> <p>Throughout the current financial year HIC operated a bank account with a bank for the payment of Medicare and other benefits. On a number of occasions over a period of several months the bank account was in debit due to reverse EFT payments not being reimbursed into the account on a timely basis.</p> <p>Since 4 September 2002, section 36(1) of the Health Insurance Commission Act 1973 (the Act) has authorised HIC to borrow money in certain circumstances. However, since that date, section 36(2) of the Act has prohibited HIC from borrowing money for the purpose of making payments in the course of carrying out Medicare or other functions. Prior to 4 September 2002, section 36(1) of the Act prohibited any borrowing by HIC.</p> <p>Accordingly, prior to 4 September 2002, on those occasions that the bank account had a debit balance, HIC contravened section 36(1) of the Act. After 4 September 2002 HIC contravened section 36(2) of the Act when the account was in debit. ANAO notes that this matter has been adequately disclosed in note 1.16 to the financial statements, and understands that changes to existing administrative processes have subsequently been implemented to ensure there are no similar breaches in the future.</p>	<p>ANAO recommends that HIC reviews its implementation of preventative measures to ensure the reverse EFT bank account is not overdrawn in the future.</p> <p>ANAO also recommends that the Finance and Planning Division ensure appropriate and formal control structures are established upfront for all changes to aspects of the HIC operational business model (eg opening of Bank accounts) under their responsibility.</p>	<p>Agreed.</p> <p>Administrative processes have been implemented to ensure that a credit balance is maintained in the bank account at all times. This new process will ensure that the account will not fall into debit in the future. Procedures have been developed to ensure that legislative breaches do not occur in relation to any new bank accounts that may be opened in the future.</p>

Finding	Recommendation	HIC Management Response
<p>Review of the provision for outstanding claims model (MBS, PBS)</p> <p>The provision for outstanding claims amount recorded in the financial statements at year-end is derived from a statistical model prepared and maintained by the ITSD Group. As the provision for outstanding claims model is not under the direct control of the Finance and Planning Division it is consequently not as well understood as other year-end accruals. In response to deficiencies identified in the model in previous years, various aspects of the model were reconfigured during 2002–03 to reduce the variances between estimates and actuals. Significant progress appeared to have been made during the year in reducing the variances to acceptable tolerances, however a further reconfiguration of the model in July 2003 resulted in:</p> <ul style="list-style-type: none"> • an unexpected adjustment of approximately \$70 million to the year end provision relating to for benefit types not previously incorporated into the estimate; • significant delays to the timetable whilst Finance and Planning Division awaited the updated model from ITSD; and • no history being available to validate the accuracy of the updated model to estimate additional benefit types. 	<p>ANAO recommends that the Finance and Planning Division undertake a review of the ITSD Provision for Outstanding Claim Model and validate the data, assumptions and financial information included within the Model.</p>	<p>Agreed.</p> <p>Finance and planning Division will undertake a review of the Provision for Outstanding Claim Model that is developed and maintained by the Information Services Branch and validate the data, assumptions and financial information included within the model.</p>

Finding	Recommendation	HIC Management Response
<p>The ITSD Group are not privy to the accounting adjustments and treatments recorded in the general ledger and therefore they are not in a position to evaluate whether or not the Model is producing appropriate accounting outcomes.</p> <p>NSW Shared Business Services</p> <p>ANAO noted in relation to the NSW Shared Business Centre (SBS) that the centralised processing functions appeared to lack the requisite amount of direction and input from National Office, Finance and Planning Division, which resulted in ANAO experiencing:</p> <ul style="list-style-type: none"> • difficulties in locating source documentation; • errors in general ledger reconciliations; • untimely response to audit queries; and • difficulties in clarifying specific responsibilities of SBS in the general ledger reconciliation process. 	<p>ANAO recommends that HIC investigate the most appropriate way in which SBS receives input from the Finance and Planning Division to ensure an appropriate balance is achieved between the objectives of efficient transaction processing and management of statutory reporting risks.</p>	<p>Agreed.</p> <p>An investigation will be undertaken.</p>

Finding	Recommendation	HIC Management Response
<p>Economic dependency</p> <p>The Departmental Statement of Financial Position at 30 June 2003 depicts a significant working capital deficiency. This is primarily attributable to the employee entitlement obligations outstanding at year-end. Disclosure within the accounts states that “the Government is committed to funding pre-1 July 1998 employee entitlements on an emerging cost basis”. We note that this statement is not supported by a written document evidencing the nature and quantum of the Government’s support.</p>	<p>ANAO recommends that HIC seeks clarification, and if possible, written confirmation from Finance with respect to the nature and quantum of this commitment.</p>	<p>Agreed.</p> <p>The disclosure in Note 2 (Economic Dependency) will be aligned with the documentary undertaking provided by the Department of Finance and Administration.</p>

Finding	Recommendation	HIC Management Response
<p>Business Improvement Program - financial reporting risks</p> <p>The Business Improvement Program (BIP) represents HIC's major current operational change initiative, and this change creates the potential for significant financial reporting risks to emerge. Specifically, the success of various BIP initiatives could have a major impact on areas such as:</p> <ul style="list-style-type: none"> • The recoverability of capitalised intangibles associated with BIP initiatives; • Asset depreciation and amortisation rates; • Medicare office leases and the associated amortisation of leasehold improvements and lease space agreements; • Cost savings and the ability of HIC to meet future dividend commitments; • Headcount and restructuring provisions; and • Departmental results and cash flows. <p>The 2003-2004 year represents the commencement of expected cost savings arising out of BIP.</p>	<p>ANAO recommends that HIC implement appropriate financial monitoring and measurement mechanisms to ensure the financial management and reporting risks attaching to BIP initiatives can be efficiently and effectively assessed, measured and controlled. Specifically, ANAO believes the Finance and Planning Division should maintain a close "watching brief" over BIP activities and planned achievements in 2003-04. ANAO also recommends that measurement of BIP cost savings be incorporated into the monthly management reporting cycle as soon as possible.</p>	<p>Agreed.</p> <p>HIC has developed a 'Benefits Realisation Plan' that will set out the processes to be used to ensure planned cost savings are realised.</p>

Appendix 4: Independent Audit Report



INDEPENDENT AUDIT REPORT

To the Minister for Health and Ageing

Scope

I have audited the financial statements of the Health Insurance Commission for the year ended 30 June 2003. The financial statements include the consolidated financial statements of the economic entity comprising the Health Insurance Commission and the entity it controlled at the year's end or from time to time during the financial year. The financial statements comprise:

- Statement by the Directors;
- Statements of Financial Performance, Financial Position and Cash Flows;
- Schedules of Commitments and Contingencies;
- Schedule of Administered Items; and
- Notes to and forming part of the Financial Statements.

The members of the Board of Commissioners are responsible for the preparation and presentation of the financial statements and the information they contain. I have conducted an independent audit of the financial statements in order to express an opinion on them to you.

The audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement. Audit procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly in accordance with Australian Accounting Standards, other mandatory professional reporting requirements in Australia and statutory requirements so as to present a view of the Health Insurance Commission and the economic entity which is consistent with my understanding of the Health Insurance Commission's and the economic entity's financial position, and performance as represented by the results of their operations and their cashflows.

The audit opinion expressed in this report has been formed on the above basis.

GPO Box 707 CANBERRA ACT 2601
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Audit Opinion

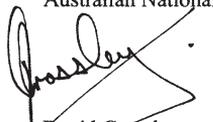
In my opinion,

- (i) the financial statements have been prepared in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*; and
- (ii) the financial statements give a true and fair view, in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia and the Finance Minister's Orders, of the financial position of the Health Insurance Commission and the economic entity as at 30 June 2003 and their performance for the year then ended.

Inherent Uncertainty regarding the liabilities for the IBNR Scheme

Without qualification to the opinion expressed above, attention is drawn to the following matter. As indicated in Note 1.16 to the financial statements, the Health Insurance Commission has recorded an estimate of \$498.5 million in relation to the Commonwealth's liabilities for the Medical Indemnity IBNR Scheme for Medical Defence Organisations. This estimate is based on independent actuarial assessment. As explained in the note, there is inherent uncertainty regarding this estimate of the Commonwealth's liability and the Commonwealth will continue to conduct an assessment of this amount in future years.

Australian National Audit Office



David Crossley
Executive Director

Delegate of the Auditor-General

Canberra
12 September 2003

Appendix 5: The HIC’s Managing Director’s Instructions (MDIs) and Financial Policies and Procedures

1. Appendix 5 lists the MDIs and detailed financial policies and procedures in place at the HIC.

Table A5

MDIs and financial policies and procedures

MDIs	<ul style="list-style-type: none"> • Strategic management framework • Delegations and authorisations • Control over Commonwealth funds • Care and custody of administered money and cash handling • Charging and costing of government activities • Managing risk and internal accountability • Procurement of goods and services • Work related expenses • Public property • Debt management • Annual Report • Other reporting requirements
Financial policies and procedures	<ul style="list-style-type: none"> • Financial delegations • Bank accounts • Bank account guidelines • Cash discrepancies • Debt management • Software accounting • Open tenders • Contract execution • Procurement • Purchasing cards • Fixed assets • Travel • Hospitality • Goods and Services Tax • Tax arrangement for GST • Estimates

Appendix 6: HIC's Financial Activities, Financial Data Requirements and Financial Reports by Management Level or Group

1. Table A6.1 shows the HIC's financial activities and data requirements of each management level or group. Table A6.2, which has the same format, shows the data and reports prepared for each management level or group.

Table A6.1
HIC's Financial Activities and Data Requirements of each Management Level or Group

Management Level/Group	Planning	Budgeting	Costing and Pricing	Cash Management	Capital/Asset Management	Program/Project Management
Commission (including committees)	evaluate financial strategies and financial business and risk management plan	monitor HIC performance to budget	<ul style="list-style-type: none"> • monitor external funding arrangements • review business proposal costings 	monitor HIC cashflow	monitor HIC capital expenditure and HIC asset position	monitor program/project performance
Executive (including committees)	evaluate financial strategies and financial business and risk management plan	establish HIC budget and monitor performance to budget	<ul style="list-style-type: none"> • establish HIC costs of services (outputs) and monitor service delivery • review business proposal costings 	monitor HIC cashflow	monitor HIC capital expenditure and HIC asset position	monitor program/project performance

Management Level/Group	Planning	Budgeting	Costing and Pricing	Cash Management	Capital/Asset Management	Program/Project Management
General Managers/Finance Coordinators	monitor and review financial strategies specific to Division	<ul style="list-style-type: none"> establish, monitor and report on Division budget (variance analysis) develop Division forecasts 	develop costing proposals			
Branch Managers/ Cost Centre Managers		monitor and report on Branch/Cost Centre budget (variance analysis)	develop costing proposals			
Program/Project Managers		monitor and report on Program/ Project budget (variance analysis)	develop costing proposals		<ul style="list-style-type: none"> manage capital expenditure capitalise project costs as appropriate 	report on program/ project operations
State Managers/ State Finance Managers	monitor and review financial strategies specific to State	<ul style="list-style-type: none"> establish, monitor and report on State budget (variance analysis) develop State forecasts 	develop costing proposals			

Management Level/Group	Planning	Budgeting	Costing and Pricing	Cash Management	Capital/Asset Management	Program/Project Management
Regional/State Branch and Medicare Office Managers		monitor and report on Region/State/Medicare Office budget (variance analysis)	develop costing proposals	manage and control cash holdings at Medicare Offices		
FPD	develop and monitor financial strategies and financial business and risk management plan	<ul style="list-style-type: none"> establish HIC budget and monitor performance to budget report on HIC budget and forecasts establish, monitor and report on FPD budget- coordinate internal budget process develop policies and procedures 	<ul style="list-style-type: none"> establish HIC costs of services (outputs) and monitor service delivery review costing proposals develop policies and procedures 	<ul style="list-style-type: none"> monitor and report on HIC cashflow-prepare cash forecasts manage funding flows develop policies and procedures 	<ul style="list-style-type: none"> monitor HIC capital expenditure and HIC asset position manage assets develop policies and procedures 	<ul style="list-style-type: none"> report on program/project operations develop policies and procedures

Source: derived from interviews, questionnaires and documentation reviews during the performance audit.

Table A6.2
HIC Financial Data and Reports Prepared for each Management Level or Group

Management Level/Group	Planning	Budgeting	Costing and Pricing	Cash Management	Capital/Asset Management	Program/Project Management
Commission (including committees)		Total HIC revenues and expenses—YTD and current month	Operating expenses by output—YTD and current month	Cashflow Statement	Capital expenditure by project; Balance sheet	Program revenues and expenses; project expenditure current month and YTD
Executive (including committees)	Corporate plan—financial targets	Total HIC revenues and expenses—YTD and current month, variance; full year outlook	Operating expenses by output—YTD and current month, Allocated indirect costs	Cashflow Statement, Cashflow forecasts	Capital expenditure by project; Balance sheet	Program revenues and expenses; project expenditure current month and YTD
General Managers/Finance Coordinators	Divisional business plans—financial targets	Divisional revenues and expenses—YTD and current month, variance, full year outlook	Allocated indirect costs			
Branch Managers/ Cost Centre Managers		Branch /cost centre expenses, current month and YTD, variances	Allocated indirect costs			

Management Level/Group	Planning	Budgeting	Costing and Pricing	Cash Management	Capital/Asset Management	Program/Project Management
Program/Project Managers						Program and project expenditure, current month and YTD
State Managers/ State Finance Managers	State business plans—financial targets	State revenues and expenses, by major line items—current month, YTD and variance	Allocated indirect costs			
Regional/State and Medicare Office Managers		Region /Branch revenues and expenses, by major line items—current month, YTD and variance	Allocated indirect costs			
FPD	Corporate plan—financial targets	HIC revenues and expenses—budget variances (FPD Monthly Report)	Operating expenses by output—YTD and current month. Allocated indirect costs	Cashflow Statement, Cashflow forecasts	Capital expenditure by project; Balance sheet	Program revenues and expenses; project expenditure current month and YTD

Source: derived from interviews, questionnaires and documentation reviews during the performance audit.

Appendix 7: HIC's Internal Financial Reports

1. Financial performance data in the Executive Business Report includes:
 - an overview of financial performance – revenues and expenses;
 - a program operating statement (which reports on the funds administered by the HIC by program);
 - a capital investment and cashflow summary (the projects with the ten largest positive or negative variances from planned expenditure are reported individually); and
 - a balance sheet.
2. The Executive Business Report also includes details of the volume and value of transactions, by month and year to date. It includes comparisons against budgeted volumes and values, against the previous month and against same month the previous year. The accompanying commentary provides details of movements within programs.
3. Major sections of the Monthly Financial Report include:
 - financial summary—explanation of major variances and other highlights;
 - total income and expenditure comparison between current year and previous year – year to date and current month;
 - operating statement – current month, year to date budget variances and full year budget;
 - balance sheet;
 - cashflow statement;
 - expenditure by resource - operating and capital;
 - expenditure by resource by state - National Office, Projects, State Office;
 - expenditure by Resource by Division;
 - project expenditure by project;
 - project Full Time Equivalents (FTEs) by project and employment type;
 - program operating statement—current month, year to date, full year plan;
 - consultants and contractors expenditure by Division;
 - consultant expenditure by project, and
 - contractor expenditure by project.

4. The major elements of State Financial Reports include:
 - a financial summary and commentary on major variances and highlights;
 - a summary of throughput performance against plan – based on both raw and weighted transactions;
 - expenditure analyses by cost category—month to date and year to date;
 - expenditure analyses by branch/cost centre;
 - total operating results (margin) and unit costs;
 - FTE and average salaries; and
 - revenue analysis by transaction type (eg. Medicare, PBS, Childcare, 30 Per Cent Rebate and categories within these elements).

Appendix 8: Finance and Planning Division Intranet Site

Table A8

FPD Intranet site

Information	Description
Financial management forms	Various forms. For example: Instrument of delegation, FINNET user access request forms, Standard cost centre request form
Reference material	Presentations, process and research documents, links to useful websites. For example: ANAO website and Federal Government information website
FINNET on-line documentation	Training documentation for functions undertaken in the financial management system, FINNET
Financial management policies and procedures	For example: financial delegations policy and guidelines, accounting policies and guidelines, information management guidelines
About FPD	Divisional information about FPD including: the role of FPD and FPD's Business Plan
Contact details	How to contact FPD staff

Source: HIC Intranet: FPD site, at time of audit fieldwork.

Appendix 9: Audit Questionnaires and Interviews

1. Due to the size and complexity of the HIC, only a selection of Divisions and State/Territory offices were visited for interview purposes. A total of 43 interviews were undertaken with representatives from the following groups:

- HIC Commissioners;
- HIC Executive (all);
- Division General Managers and State Managers;
- Finance Coordinators and State Finance Managers;
- two Branch Managers from each Division;
- two Managers (Regional/Branch/or Medicare) from New South Wales, Victoria and South Australia;
- FPD Branch Managers; and
- Some FPD Section Managers and other FPD staff.

2. The Chief Information Officer and ANAO's Financial Statement Auditors were also interviewed.

3. To ensure coverage across the whole Commission, 34 questionnaires were issued to those Divisions and State/Territory offices not visited. Questionnaire recipients included:

- Division General Managers and State Managers;
- Finance Coordinators and State Finance Managers;
- two Branch Managers from each Division; and
- Managers (Branch and two Medicare) from other States.

4. All questionnaire recipients responded to the questionnaire.

5. The interview and questionnaire questions were based around the audit criteria and associated sub-criteria. The questions provided an insight into the HIC's culture of financial management accountability and stewardship.

Interview and questionnaire responses

6. Table A9 summarises the general nature of responses, by group of staff:

Table A9**Response by staff group to audit questions**

Group	Response
HIC Commissioners	<ul style="list-style-type: none"> • satisfied with the governance structure • recognised their financial management responsibilities as members of the Commission • have confidence in the abilities of the Executive and FPD Management • confirmed risk management policies and practices are in place • satisfied with Commission reporting • recognised that the HIC is strengthening skills of Finance staff
HIC Executive	<ul style="list-style-type: none"> • are working as a team to improve financial management in the HIC • recognised their financial management responsibilities as members of the HIC Executive • recognised that the financial management skills and understanding of financial management responsibilities in the HIC are improving • confirmed risk management processes are improving • satisfied with Executive reporting, although some future refinements are planned • acknowledged financial management training is provided in some topics. However, there is room for improvement
General Managers and State Managers	<ul style="list-style-type: none"> • generally have a good understanding of financial management responsibilities and no concerns that financial management responsibilities are not being met • prepare risk management plans • annual planning and monthly reporting is undertaken • strong working relationship between the States and National Office • individual performance measures exist but are in early stages of development • generally satisfied with access to expertise in terms of financial support

Group	Response
Division and State Branch Managers (including Medicare offices)	<ul style="list-style-type: none"> • a varied level of understanding of financial management responsibilities • monthly reporting is undertaken • strong working relationship between the States and National Office • individual performance measures exist but are in early stages of development • aware that policies and procedures exist and are available • acknowledged access to expertise in terms of financial support is available; however, suggest there is room for improvement • recognised that training in financial management topics is provided. However, there is room for improvement
Finance Coordinators and State Finance Managers	<ul style="list-style-type: none"> • a varied level of understanding of financial management responsibilities, though generally good • generally a strong sense of providing internal client service • strong working relationship between the States and National Office • monthly reporting is undertaken • aware that policies and procedures exist and are available • acknowledged access to expertise in terms of financial support is available; however, suggest there is room for improvement • recognised that training in financial management topics is provided. However, there is room for improvement

Source: ANAO

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