Introduction

3.001   Earlier this year we wrote about maintaining financial and service performance during organisational change.[1] Among the risks we identified was the increased potential for:

- inability to report accurately on financial and non-financial performance; and

- breakdown in financial control systems.

3.002   During the 1998-99 financial year, two large and important public sector organisations underwent major organisational changes:

- With effect from 1 October 1998, the income support function of the Department of Social Welfare and the employment functions of the Department of Labour were put together to become the Department of Work and Income. The latter department then had to integrate the functions into a co-ordinated service.

- With effect from 1 July 1998, the Health Funding Authority began operations under that name as successor to the Transitional Health Authority (which had been set up to combine the functions of the previous four Regional Health Authorities). During 1998-99 the Health Funding Authority undertook an extensive restructuring exercise.

3.003   The Department of Work and Income and the Health Funding Authority are among the largest spenders of taxpayers' money. In 1998-99, the total of appropriations for Vote Work and Income was $9,059 million[2], and the total of appropriations in Vote Health for the purposes of the Health Funding Authority was $6,217.3 million.

3.004   Given those very large sums of money, it was important

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1   *First Report for 1999*, parliamentary paper B.29[99a], pages 51-62.

2   This was not a full-year's appropriations. The appropriations were for the nine-month period from 1 October 1998 to 30 June 1999.

that the organisations took every feasible step to maintain the quality of financial management at a high level during the time of change.

3.005   This article reports on the findings of our 1998-99 annual audits of the Department of Work and Income and the Health Funding Authority, with a particular focus on the findings relevant to financial management and control.

3.006   While acknowledging that organisational restructuring imposes considerable burdens on management and staff, in our view neither organisation was as successful in maintaining its standard of financial management as it could have been.

Department of Work and Income

3.007   The Department of Work and Income (the Department) has undergone a significant amount of change over a short period. The change process is ongoing and will not end until integration of the constituent functions is finished.

3.008   When the Department was established, the policies and procedures used by the antecedent organisations were adopted as an interim measure. This allowed the Department to continue to provide its essential services to the community.

3.009   The Department has been replacing the adopted policies and procedures with those of its own devising, which are intended to be more appropriate for its new operations. Again, that process is ongoing.

Overall Control Environment

3.010   During the period 1 October 1998 to 30 June 1999, the considerable changes occurring within the Department predictably risked weakening – and did in fact weaken – the overall control environment from that which existed in its antecedent organisations. However, we believe that the Department has recognised the impact of change on its control environment and is taking steps to ensure that improvements are achieved.

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Areas Requiring Improvement

3.011 The areas of financial management where we considered that improvement was necessary as at 30 June 1999 included:

- controls over expenditure;

- the quality of variance reporting;

- the quality of reconciliation controls over Crown and departmental accounts;

- strengthening of the delegations in place;

- strengthening systems of self-review;

- the accuracy of and internal control over benefit payments, including discretionary benefits;

- the monitoring of legislative compliance;

- the appropriateness of outputs and their related performance measures; and

- systems for capturing and reporting non-financial performance information.

3.012 Since 30 June 1999, the Department has initiated a number of actions that should improve its overall management control environment in 1999-2000 and future years. Specifically, it has:

- begun a probity project on prudent expenditure;

- reviewed delegation levels and revised the delegations documentation;

- updated and implemented changes to the *Financial Policies and Procedures Manual*;

- restructured the Finance Unit;

- prepared and issued *Strategic Plan 1999-2004*;

- progressed the risk management project which includes legislative compliance;

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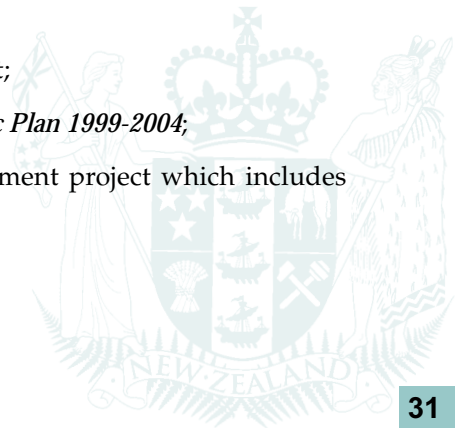
- implemented changes to key performance indicator systems;

- made significant improvement in human resource matters;

- carried out extensive coaching and training courses;

- begun a review on output classes; and

- begun work on developing an activity-based costing system.

3.013 Given the large sums of money administered by the Department, we will be maintaining a close watch on these initiatives to ensure that they are successfully implemented.

Health Funding Authority

3.014 Although there had already been a full year of transition after the Transitional Health Authority was established on 1 July 1997, the Health Funding Authority (HFA) undertook an extensive restructuring exercise (known as "Transformation 98") during 1998-99.

3.015 Our concern is that the changes under Transformation 98 have had an adverse impact on the HFA's financial control environment. This is reflected in deterioration in our assessments of the three aspects of financial management, as follows:

Management Aspect	Assessment 1999	Assessment 1998
Financial control systems	Just Adequate	Satisfactory
Financial management information systems	Just Adequate	Satisfactory
Financial management control environment	Just Adequate	Satisfactory

Note: For an explanation of the ratings used in the assessments, see page 22.
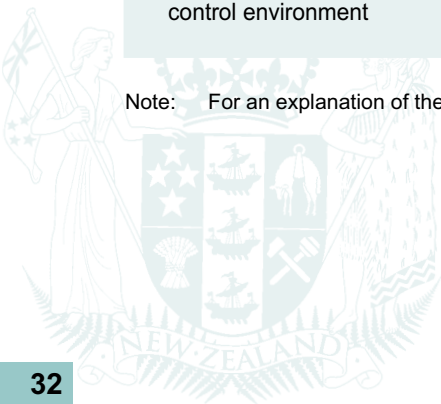
3.016 During 1998-99 the HFA's internal auditors reviewed:

- payment procedures;
- general ledger and reporting systems;
- contracting; and
- information systems management.

3.017 The internal auditors found significant weaknesses in the HFA's systems of internal control and information systems management. These and our own audit findings raised serious concerns about the HFA's financial control environment and the quality and reliability of its management reporting.

3.018 Therefore, we extended the scope of our audit. As a result, we found a large number of significant errors in accruals (accounting for services delivered but not yet paid for). In addition, the quality of financial reporting to senior management during the year was poor, particularly in explaining variations between budgets and actual results.

3.019 We believe that situation raises serious doubts about the reliability of the monthly financial information used for management decision making, Board reporting, and external agency reporting.

3.020 The HFA has taken steps to address these matters. Successful resolution will be dependent on senior management support and better communication between corporate finance, the operating groups, the Shared Support Services Group, and the Information Management Group.

General Ledger System

3.021 The HFA operated six different general ledger systems during the year. The four systems inherited from the former Regional Health Authorities (RHAs) continued to operate for the first four months. One of those systems (from the former Southern RHA) was then utilised for a two-month period. Finally, the HFA replaced this with a new proprietary system from 1 February 1999.

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3.022 Significant problems were experienced with the Southern RHA system, which resulted in difficulties in accessing transaction-level detail during the two months the system operated. Following the decision to use the Southern RHA system, it quickly became evident that it was unlikely to meet the HFA's business needs. The HFA then decided to install its own general ledger system.

3.023 While the HFA faced time pressures brought about by the rapid organisational change, we believe that this situation could have been avoided if the HFA had applied a more robust approach to the system evaluation and selection process. As the general ledger is a core business system, we would have expected the decision to change it to have been supported by a documented business case. No such business case was prepared.

Contract Management System

3.024 The HFA implemented a national contract management system during the year as part of the consolidation of its core business systems for information and invoice processing. The contract management system is a key management tool supporting the following business processes:

- management and monitoring of provider contracts;

- payments to providers;

- accruals for services delivered by providers but not yet paid for; and

- budgeting and forecasting for provider expenditure and commitments.

3.025 A number of significant problems have arisen with this system, particularly in relation to the integrity of the data it contains about the contracts with providers. In our view, these problems have significantly affected the HFA's ability to manage its business efficiently and effectively.

3.026 Our assessment is that the problems associated with the contract management system can be attributed to two main causes:

- **Selection and implementation of the system**. The system purchased was chosen before Transition 98 had been completed and the consequent new business processes had been developed. In addition, poor quality data was transferred into the new system.

- **Effectiveness of consultation with the users**. Key users were not involved in specifying the user requirements, and the operating groups were not adequately involved in developing the new contracting business policy or "business rules" for putting data into the new system.

3.027　The lack of consultation and training, and the problems with the general ledger and contract management systems, meant that many staff set up their own stand-alone systems. Continued reliance on these stand-alone systems has introduced inconsistencies and inefficiencies to the contract management business processes. It has also meant that the operating groups have accepted only very limited accountability for the accuracy and reliability of the contract management system.

3.028　This situation should be a fundamental concern for the HFA. Failure to rectify the problems identified will mean that the benefits envisaged from the contract management system will not be realised. In our view, the current systems are very cumbersome, resource-intensive, and prone to error.

3.029　We understand that the HFA has implemented an "Integrity of Financial Systems Project". Project timelines need to be adhered to and resources, including a project manager at a senior level, need to be directed to making the project a success.

Information Systems Management

3.030　The internal auditors' draft report on the review of information systems management raises some serious concerns regarding the HFA's information systems environment. We are particularly concerned about the risk that information produced from key systems may not be able to be relied upon for reporting and management purposes.

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3.031　The Information Management Group needs to establish a sound information management environment that can support the processing of information. The draft report identifies a number of areas where basic information systems controls need to be defined and implemented.

3.032　A major issue for the HFA is how it moves forward in a structured and controlled manner. The specification, development and implementation of systems that meet the needs of the business are high priorities.

3.033　The internal auditors have made the following recommendations to ensure systematic decision making that should minimise the risk of systems needing to be redesigned when requirements have been more clearly defined:

- the Executive Management Team needs to formally endorse the authority of the Information Management Council (an internal group of senior managers) to identify and prioritise projects that will meet the needs of the business;

- "owners" of core applications need to be identified and ownership responsibilities defined and agreed;

- a formal project management methodology needs to be developed and implemented;

- change management procedures need to be developed, documented and implemented; and

- disaster recovery plans and business continuity plans need to be fully developed and tested for all key systems.

3.034　We endorse these recommendations. We consider that they are fundamental to the integrity of the HFA's financial management and control systems and require urgent attention.

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