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QUEEN ELIZABETH II HEALTH SCIENCES CENTRE - REVIEW OF EXTERNAL AUDITOR'S MANAGEMENT LETTER

BACKGROUND

15.1 The financial statements of the Queen Elizabeth II Health Sciences Centre are audited by a public accounting firm. The Auditor General receives audited financial statements and copies of management letters issued by the Centre's auditors which include findings and recommendations to management.

15.2 We received a copy of a management letter from the Centre's auditors to the Centre's President and Chief Executive Officer dated July 29, 1997. The letter included certain comments which we deem to be significant enough to bring to the attention of the House of Assembly. In addition, certain less significant findings related to weaknesses in internal controls are reported in paragraph 17.7 of this Report, page 190.

RESULTS IN BRIEF

15.3 The following are the principal observations resulting from our review of the management letter issued by the Centre's external auditors.

- The Centre had an operating loss of \$12.5 million and an accumulated operating deficiency of \$21.9 million at the end of 1996-97. Management also anticipates operating losses of \$11.9 million in 1997-98. The Centre is implementing a reengineering initiative which Centre management anticipates will generate total savings of \$38 million by the year 1999-2000. The auditors have indicated that *"should savings levels not be obtained and deficits continue to escalate, then the provincial government will have to underwrite those deficits in order for the hospital to continue to meet its financial obligations and continue as a going concern."*
- The Centre has recorded certain amounts as receivable from the Department of Health and Workers' Compensation Board which may not be entirely collectible. If these amounts are not collected, recognition of the uncollectibility will increase the Centre's forecasted deficit.
- The auditors found some instances where severance payments were made to employees under both the Compensation Assistance Program/Labour Adjustment Strategy and the Early Retirement Incentive Program. The Department of Health does not allow employees to benefit from both programs. To date, \$335,000 of the related receivable from the Department of Health has been written off due partially to overpayments. The Centre's auditors recommend *"that the causes of the double payments be investigated and proper controls put in place to ensure that it does not continue to happen. The possibility of recovery should also be investigated."*
- The capital costs of the renovation projects for the New Halifax Infirmary and the Victoria General Sites were 50% over budget. The Centre's auditors recommend

“that all future capital projects be carefully planned and budgeted by staff who are technically skilled and knowledgeable about the project. There should be strict budget controls throughout the entire project.”

SCOPE OF REVIEW

15.4 We reviewed the management letter of the Centre's external auditors to the President and Chief Executive Officer dated July 29, 1997. We did not perform any additional verification of the audit findings and information included in that letter.

PRINCIPAL FINDINGS

15.5 The following comments are extracted from the July 29, 1997 letter from the Centre's auditors to the President and Chief Executive Officer.

Operations

The Financial statements reflect an operating loss of \$12.5 million and an accumulated operating deficiency of \$21.9 million at the end of the current year. The hospital administration had budgeted for an operating loss of \$24 million, however, significant savings and expense reductions resulted in reducing anticipated losses for the current fiscal year.

The hospital has a bank indebtedness of \$14.5 million as of March 31, 1997. Management anticipate operating losses of \$11.9 million in the next fiscal year. In addition to operating losses, management have planned for capital projects of \$24.9 million and investment in reengineering of \$8.4 million which, when added to the operating losses, will require funding of \$45.7 million. This results in a total cash requirement of \$44.5 million in addition to the existing \$14.5 million operating line currently in use, for a potential borrowings of \$60 million next year to finance accumulated deficits.

The hospital is operating at \$316,000,000 total expenditures for 1996/97 fiscal year. Excluding inflation, management forecast expenditures can be maintained at this level. Management have been required by government to reduce the annual cost of operations by reducing the revenue from Government.

As a response, the hospital has commenced a major reorganization of the way it does business by retaining consultants to advise management on a major reengineering of operations. The project is under way with savings expected to be realized commencing in the coming year. As at March 31, 1997, the hospital has invested \$2.1 in the project and anticipate an additional investment of \$8.4 in the current year. Targeted cost reductions over the next three years are \$4.8 million in 1997/98, \$22.4 million in 1998/99 and \$10.5 million in 1999/00 for a combined savings of \$37.7 million.

The actions by management and the level of funding support provided by the Province will impact on the potential savings identified by management. If the deficit is not fully funded or should management not implement change then the planned savings will be at risk.

Labour negotiations will commence this autumn with the union. These negotiations will have a significant impact on the financial position of the institution. Management have not provided for any significant salary adjustments arising from settlement with union employees in their business

plan. Any settlement beyond the current collective agreement will result in non-budgeted losses for which the hospital has no source of revenue beyond the Province of Nova Scotia.

Should savings levels not be obtained and deficits continue to escalate, then the provincial government will have to underwrite those deficits in order for the hospital to continue to meet its financial obligations and continue as a going concern.

Capital Renovations

During the audit, we were requested to review the control processes in place as they relate to the capital renovation projects for the New Halifax Infirmary and the Victoria General Sites.

A brief summary of our conclusions arising from our audit are as follows:

The capital cost of the renovation project were overrun by 50%. This was due, in our opinion to:

1. A failure to budget the project properly including the omission of the project managers fees.
2. The project was not properly controlled by the administration of the hospital with the result that numerous charges were initiated by clinical managers during all phases of the renovations which resulted in substantial extras which were not subject to budget controls.
3. Failure by the project managers to control the projects within a predetermined budget.

We recommend that all future capital projects be carefully planned and budgeted by staff who are technically skilled and knowledgeable about the project. There should be strict budget controls throughout the entire project.

Accounts Receivable - Workers' Compensation Board

A receivable of \$3.967 million from the Workers' Compensation Board continues to be carried on the accounts of the hospital as at March 31, 1997. This is a result of air quality problems at the old Camp Hill Hospital. This receivable is largely unchanged from last year, however management contends it remains collectible by virtue of no claims having ever been rejected in the appeal process. The appeal process is very slow and cannot be accelerated as the WCB process each claim through an extended appeal process, if necessary. During the current year, \$19,000 in claims were approved and paid.

It has been, and continues to be the contention of management, should the WCB reject any individual claims, the provincial government will indemnify the hospital. There is no written commitment from the provincial government to support management's assumption.

We recommend hospital management pursue this item aggressively with both the provincial government and the WCB to come to a resolution. If the aggregate of claims cannot be resolved within a relatively short period of time, the hospital may have to recognize a loss on this account receivable and look to the Province of Nova Scotia to fund this additional loss.

Accounts Receivable - Department of Health

In last year's management letter, we identified a discrepancy between the Department of Health audit confirmation, and the hospital's financial statements. The nature of the discrepancy relates to environmental claims paid to employees during the time period of December 3, 1993 to March 31, 1994. The DOH could not acknowledge they owe this amount because they insist that no claim has been filed with them for this item.

As stated last year, if the hospital does not substantiate this claim, then the hospital will have additional deficit of up to \$1.9 million which has not been budgeted. During the course of our audit, we determined that the administration have still not provided the necessary documentation.

We recommend that the required information to facilitate payment of this claim be compiled and forwarded to the Department of Health immediately. If this issue is not resolved within a reasonable time frame, then it should be written-off.

Included in the DOH net receivable is \$2.30 million in environmental claims which date back to the 1993/94 and 1994/95 fiscal years. The DOH have confirmed these amounts in each of the last two years for audit purposes, but have not forwarded payment.

We recommend management request payment from DOH for this account receivable.

Included in the DOH net receivable is \$3.28 related to the move into the new Halifax Infirmary. The DOH agreed in principle to fund the move expenses and have confirmed, for audit purposes, an amount owing of \$1.7 million. Management have indicated that discussions have taken place with DOH on this issue and feel the receivable will be recovered in full. An agreed upon settlement amount has not been confirmed in writing.

We recommend management pursue collection of this account receivable immediately. If DOH do not make payment, then the \$1.58 difference will represent an unbudgeted loss for which the hospital has no other source of funding.

The receivable from Department of Health for severance payments to former QEII employees is \$5.401 million. This is made up of both Compensation Assistance Program/Labour Adjustment Strategy (CAP/LAS) and Early Retirement Incentive Program (ERIP) programs. The receivable is based on actual payments by the hospital to former employees, while the claims to DOH have been made by Human Resources.

Based on representations of management, severance payments were paid to some employees under both programs. DOH does not allow employees to benefit from both programs. There were also instances where payments were made above the maximum allowed. During the year, the hospital contracted a senior accountant to ensure all claims were submitted to the Department of Health. The amount of the loss to the QEII has not been determined. To date, \$335,000 of the receivable has been written off due to overpayments and unrefundable miscellaneous costs.

We recommend that the causes of the double payments be investigated and proper controls put in place to ensure that it does not continue to happen. The possibility of recovery should also be investigated. We also recommend that reconciliation between the receivable and the approvals and rejections from DOH be done regularly.

CONCLUDING REMARKS

15.6 The external auditors of the Queen Elizabeth II Health Sciences Centre have expressed concerns about the financial position of the Centre in relation to the accumulated deficit and anticipated future deficits. The Centre plans to recover these deficits through future cost savings. If the planned savings do not occur, then the Province and Centre will have to deal with the question of how to finance large accumulated deficits. The situation is serious enough to warrant careful monitoring by the Department of Health and the government.

RESPONSE OF DEPARTMENT OF HEALTH AND QEII HEALTH SCIENCES CENTRE

Operations

The Department of Health and the QEII Health Sciences Centre entered into a multi year business plan in March 1996. This plan anticipated the QEII operating at a deficit position in the early years of the plan to allow them to implement efficiencies over several years. These efficiencies would allow the QEII to repay this deficit and operate with a balanced budget.

At the end of the first year of the plan, the QEII was on target with respect to its operating results and had identified many areas where efficiencies to reduce operating costs could be implemented.

During 1997/98, the QEII and the Department of Health have continued to meet regularly to review the financial position of the QEII. Where deviations from the original business plan have occurred, the Department has provided additional funding to the QEII to compensate for this.

With any multi year plan it is expected that the actual funding levels will be reviewed and adjusted as the plan unfolds. This is the strategy being used by the QEII and the Department of Health in managing the financial position of the QEII.

Capital Renovations

The following changes have been implemented to address concerns raised through the audit:

Budget

- *Budgets are prepared by the Director, Engineering Services and the managers of Facility Planning and Renovations in consultation with program planning staff, other departmental staff and with the input of external architectural expertise. These budgets are reviewed by Financial and Corporate Services.*
- *Annual renovations' budgets must be approved by the Vice President, Diagnostic and Therapeutic Services and by the Vice President, Financial and Corporate Services.*
- *Final renovation budgets are approved by the Finance and Audit Committee of the Board of Directors.*
- *Budgetary performance rests with the Vice President, Diagnostic and Therapeutic Services through the Director, Engineering Services and the managers of Facility Planning and Renovations.*
- *Contingencies have been established to fund change orders and other project uncertainties. Project managers are expected to manage the change process to the level of established contingency.*

Tendering

- *Project work must be tendered based upon specifications developed by in-house staff with assistance of external architects.*

Infrastructure/Reporting

- *A detailed project listing, complete with actual, budget, projected and percentage complete information is sent to the Audit and Finance Committee each month. Engineering Services provides all projected and percentage completed information.*
- *Project costing records kept by Engineering Services are reconciled to Financial and Corporate Services records on a regular basis.*

Accounts Receivable - Workers Compensation Board and Department of Health

With respect to accounts receivable from Workers Compensation Board and the Department of Health, the QEII and the Department continue to work closely to resolve these issues.

The Occupational Health staff at QEII and the Director of Human Resources at Department of Health have been meeting regularly to develop a strategy for addressing the issues of WCB management and environmental health issues.

The Department of Health has funded the QEII for both the outstanding environmental illness claims and the costs of the move to the New Infirmary.

With respect to the CAP/LAS and ERIP programs, the QEII has reviewed this process and have made modifications to the process to ensure that payments under both plans no longer occur. In addition, the QEII has begun to reconcile outstanding claims monthly.
