

# Cairns and Hinterland Hospital and Health Service

Budget build analysis

Reliance Restricted

30 September 2016 | DRAFT

The accompanying draft report has been prepared under the terms of our engagement contract dated 11 July 2016 and addenda dated 14 September 2016 and 29 September 2016 (the "Engagement Agreement") and is only intended for use by the parties to the Agreement.

These findings and recommendations highlight the issues that we have identified to date. We have not yet completed our work and it is possible that further work will identify other issues or further clarify the issues discussed in the attached. Accordingly, EY accepts no responsibility for loss arising from any action taken or not taken by anyone using these findings and recommendations. Copies should not be made, nor should this document be distributed to others, without our express written permission. If you require any further information or explanations, please do not hesitate to contact us.



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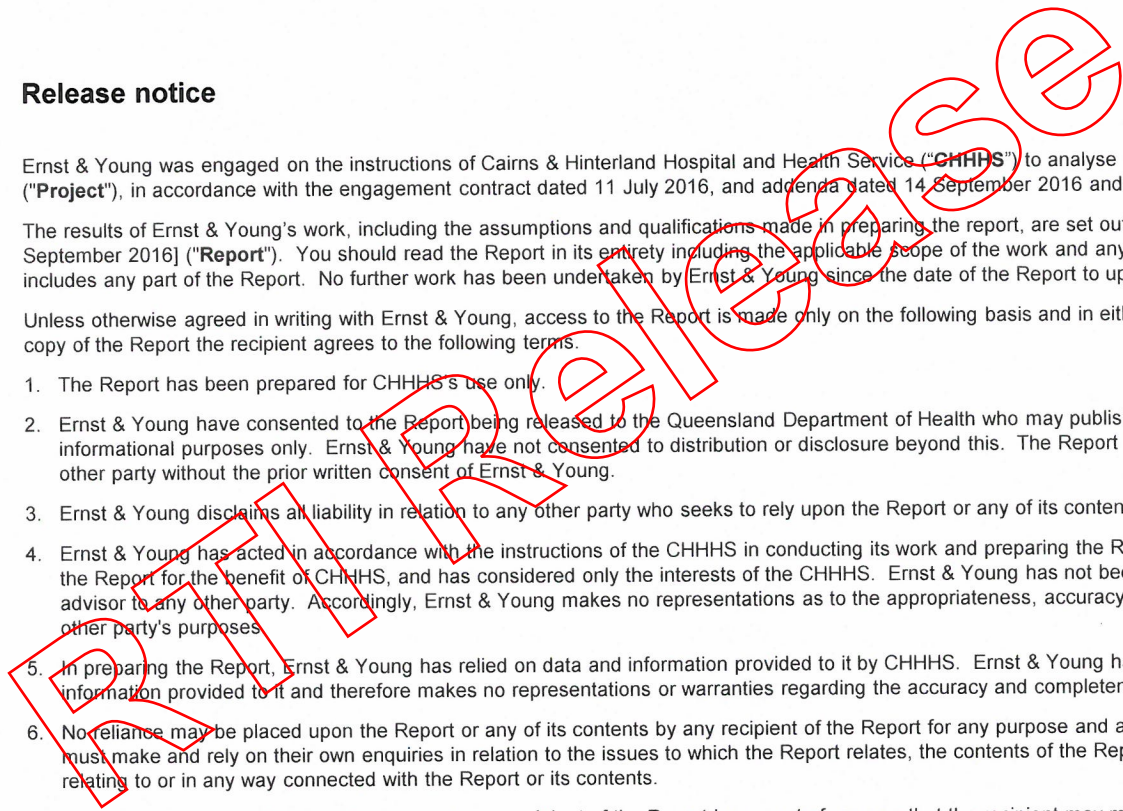
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Ernst & Young was engaged on the instructions of Cairns & Hinterland Hospital and Health Service ("CHHHS") to analyse CHHHS's FY17 budget build ("Project"), in accordance with the engagement contract dated 11 July 2016, and addenda dated 14 September 2016 and 29 September 2016.

The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the report, are set out in Ernst & Young's report dated [30 September 2016] ("Report"). You should read the Report in its entirety including the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

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**Any person intending to read this Report should first read this letter**

**Reliance Restricted**

**Mr Michael Walsh  
Administrator  
Cairns and Hinterland Hospital and Health Service  
85 Spence Street  
Cairns QLD 4870**

**Cairns and Hinterland Hospital and Health Service**

**30 September 2016**

Dear Sir

**Cairns and Hinterland Hospital and Health Service**

In accordance with your instructions, we have performed the work set out in our engagement contract dated 11 July 2016 and addenda dated 14 September 2016 and 29 September 2016 (the "Engagement Agreement") in connection with an independent assessment of the 2016/17 budget build process adopted by management of Cairns and Hinterland Hospital and Health Service ("CHHHS") (the "Independent Assessment").

**Purpose of our report and restrictions on its use**

This Report was prepared on the specific instructions of CHHHS solely for the purpose of the Independent Assessment and should not be used or relied upon for any other purpose.

This Report and its contents may not be quoted, referred to or shown to any other parties except as provided in the Engagement Agreement.

We accept no responsibility or liability to any person other than to CHHHS, or to such party to whom we have agreed in writing to accept a duty of care in respect of this Report, and accordingly if such other persons choose to rely upon any of the contents of this Report they do so at their own risk.

**Nature and scope of the services**

The nature and scope of the services, including the basis and limitations, are detailed in the Engagement Agreement.

Our work in connection with this engagement is of a different nature to that of an audit or a review of information, as those terms are understood in applicable Australian auditing standards. All the information we have received is the responsibility of CHHHS management ("Management"). We have not sought to establish the reliability of the information given to us except as specifically stated in the Report. Consequently, we give no assurance on such information.

[The contents of our Report have been reviewed by CHHHS's management to confirm to us the factual accuracy of the Report.]

Whilst each part of our Report addresses different aspects of our work, the entire Report should be read for a full understanding of our findings and advice.

Our work commenced on 11 July 2016 and was completed on 30 September 2016. Therefore, our Report does not take account of events or circumstances arising after 30 September 2016 and we have no responsibility to update the Report for such events or circumstances.

We appreciate the opportunity to provide our services to CHHHS. Please do not hesitate to contact us if you have any questions about this engagement or if we may be of any further assistance.

Yours faithfully,

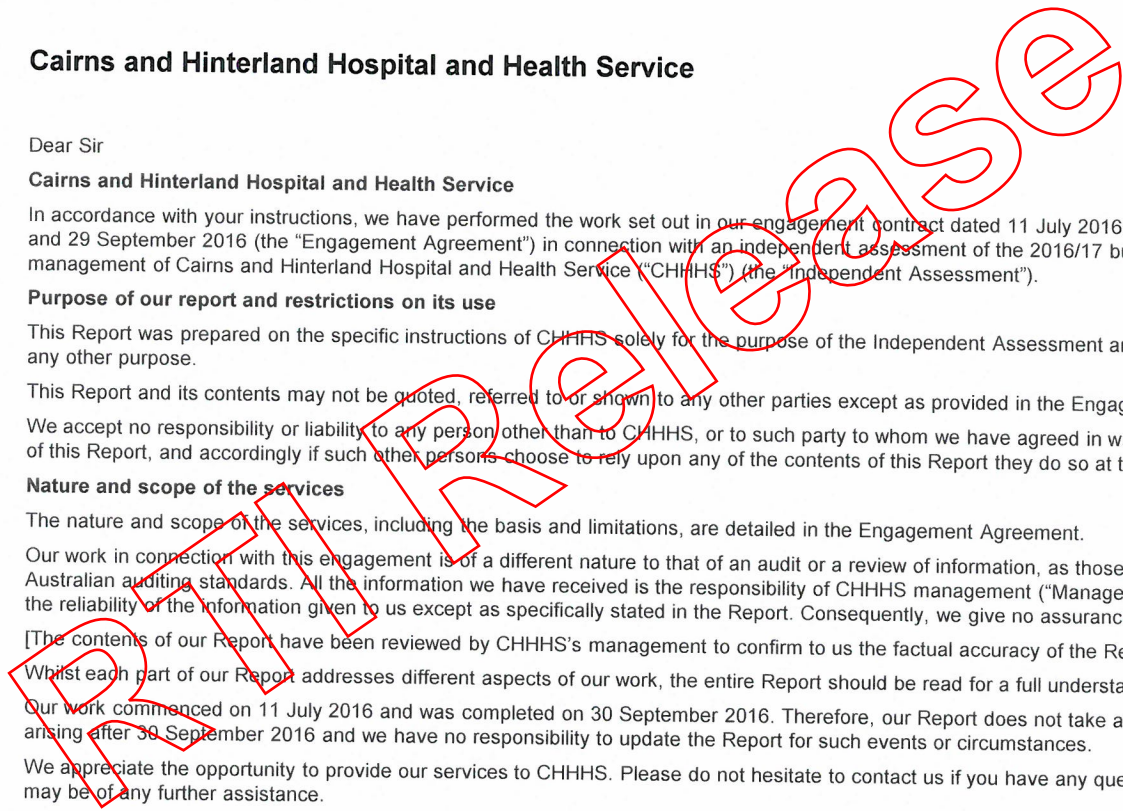
**DRAFT**

Chris Parkes  
Ernst & Young

Yours faithfully,

**DRAFT**

Jonathan Lunn  
Ernst & Young



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## Dashboard

### Dashboard

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**Current 2016/17  
budgeted deficit**

**(\$80.5m)**

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This is the current 2016/17 budgeted deficit based on the latest available information received from CHHHS management. Deficit is based on budgeted revenue of \$820.0m and costs of \$900.5m and assumes no action taken by Management.

**Estimated 2016/17  
Organisational  
Sustainability Plan  
savings (risk adjusted)**

**\$17.7m**

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An organisational sustainability plan commenced in June 2016 to identify cost savings across a number of initiatives, to be realised in 2016/17. These savings initiatives have been estimated at \$22.7m and risk adjusted to \$17.7m.

**Additional 2016/17  
savings schemes**

**\$13.4m-  
\$15.6m**

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To further reduce the deficit, Management has identified a number of additional options to change services, reduce overheads and increase revenue, with estimated cost savings of \$13.4m - \$15.6m in 2016/17.

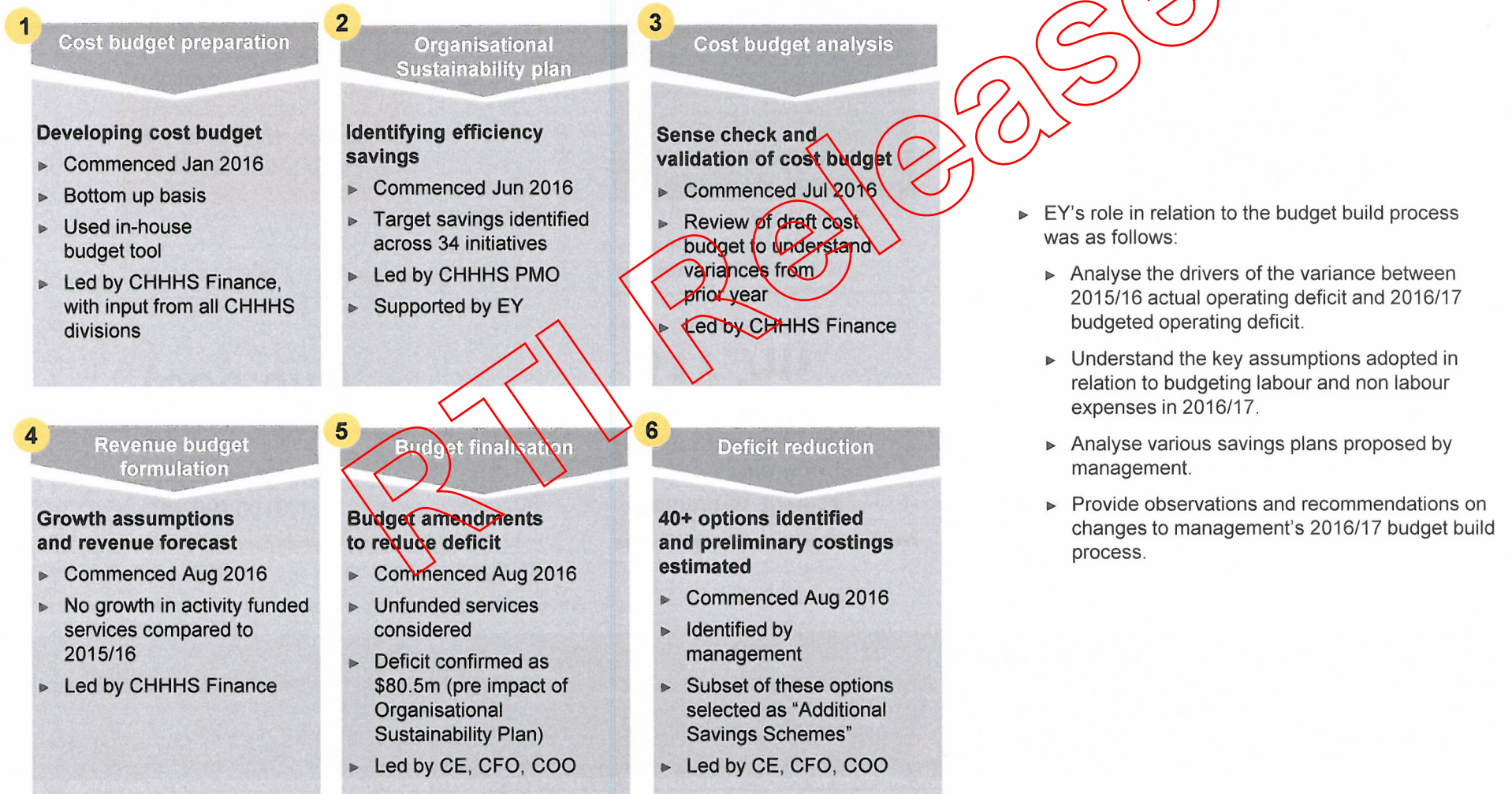
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## Budget build process overview

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Set out below is a summary of the key phases adopted by Management as part of the 2016/17 budget build process.



## Executive summary

### Dashboard

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### Item

### Findings

#### 2016/17 budgeted deficit of \$80.5m

- ▶ Budgeted deficit has been based on a bottom up cost build budgeting process.
- ▶ Cost increases are the primary driver of the \$80.5m budget deficit in 2016/17, which is \$60.5m higher than the 2015/16 reported deficit.
- ▶ The 2015/16 reported deficit included \$13.3m of non-recurrent funding provided by the Department of Health. Removing this non-recurrent funding results in an adjusted operating deficit in 2015/16 of \$33.3m.

### Supplementary financial analysis

| Currency: A\$m                              | 2015/16        | 2016/17        | Variance      |
|---|----------------|----------------|---------------|
| <b>Revenue</b>                              | <b>835.3</b>   | <b>820.0</b>   | <b>(15.3)</b> |
| Labour expenses                             | (588.6)        | (621.4)        | (32.8)        |
| Operating expenses                          | (229.4)        | (240.4)        | (11.0)        |
| Depreciation and amortisation               | (37.3)         | (38.7)         | (1.4)         |
| <b>Total costs</b>                          | <b>(855.3)</b> | <b>(900.5)</b> | <b>(45.2)</b> |
| <b>Operating surplus (deficit)</b>          | <b>(20.0)</b>  | <b>(80.5)</b>  | <b>(60.5)</b> |
| Less non-recurrent funding                  | (13.3)         | -              | 13.3          |
| <b>Adjusted operating surplus (deficit)</b> | <b>(33.3)</b>  | <b>(80.5)</b>  | <b>(47.2)</b> |

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#### Budgeted revenue of \$820m

- ▶ Base funding received from the Department of Health of \$772.9m as per the Service Agreement dated July 2016.
- ▶ Own source revenue ("OSR") in addition to the Service Agreement has been budgeted by each division within CHHHS. The total OSR budgeted in 2016/17 of \$108.3m is 8.7% higher than the total OSR received in 2015/16.
- ▶ Included in the OSR amount is an additional \$17.5m relating to an expected increase in funding for the full year cost of the new Hepatitis C drugs program introduced in 2015/16.
- ▶ ABF relates to budgeted activity growth of 4.1% over threshold targets that have been set for CHHHS. Activity targets for 2016/17 are 125,266 Queensland Weighted Activity Units ("QWAU").

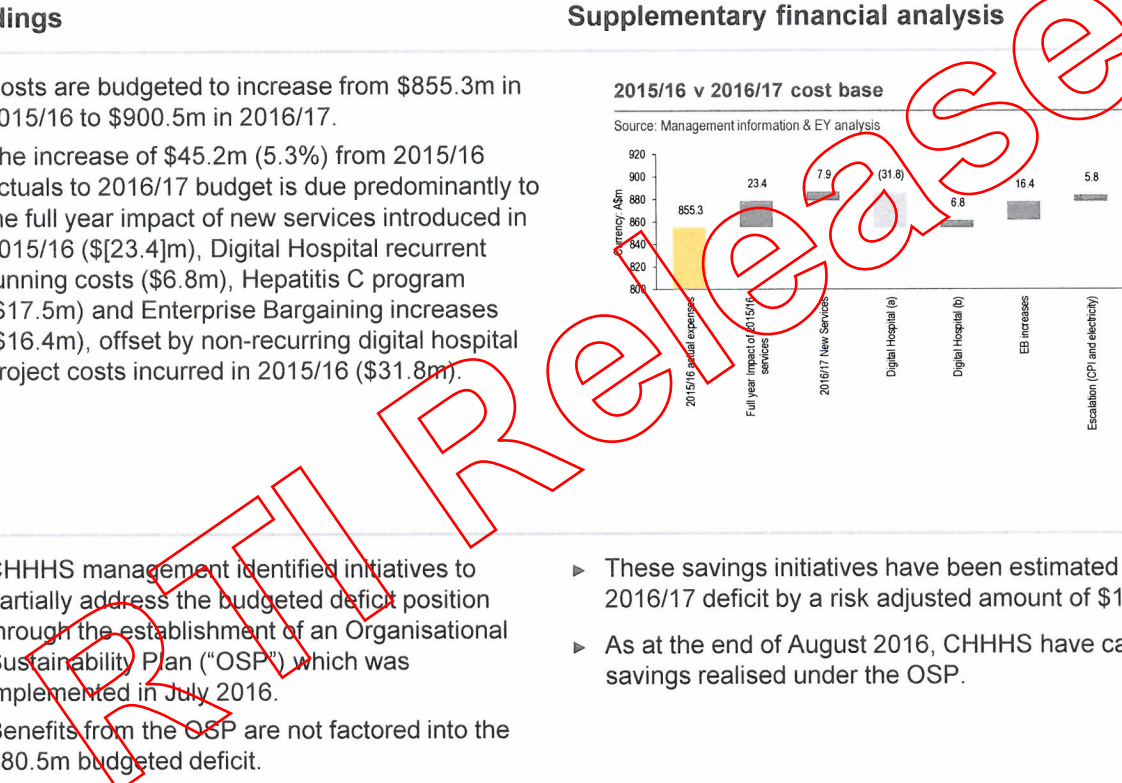
| Currency: A\$m               | Per Service  |                                 | Total        |
|------------------------------|--------------|---------------------------------|--------------|
|                              | Agreement    | Additional to Service Agreement |              |
| ABF funding                  | 494.8        | 10.2                            | 505.0        |
| Own source revenue           | 79.6         | 28.7                            | 108.3        |
| Block funding                | 84.8         | -                               | 84.8         |
| Department of Health funding | 113.7        | 8.2                             | 121.9        |
| <b>Total revenue</b>         | <b>772.9</b> | <b>47.1</b>                     | <b>820.0</b> |

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## Executive summary

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| Item   | Findings   | Supplementary financial analysis   | Page         |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
|--|--|--|--------------|-------------|-------------------------|-------|--------------------------------------|------|----------------------|-----|----------------------|--------|----------------------|-----|--------------|------|----------------------------------|-----|-------|------|-------|-------|------------------------|-------|--------------|
| <p><b>Budgeted costs of \$900.5m</b></p>         | <ul style="list-style-type: none"> <li>▶ Costs are budgeted to increase from \$855.3m in 2015/16 to \$900.5m in 2016/17.</li> <li>▶ The increase of \$45.2m (5.3%) from 2015/16 actuals to 2016/17 budget is due predominantly to the full year impact of new services introduced in 2015/16 (\$23.4m), Digital Hospital recurrent running costs (\$6.8m), Hepatitis C program (\$17.5m) and Enterprise Bargaining increases (\$16.4m), offset by non-recurring digital hospital project costs incurred in 2015/16 (\$31.8m).</li> </ul> |  <p><b>2015/16 v 2016/17 cost base</b><br/>Source: Management information &amp; EY analysis</p> <table border="1"> <caption>Waterfall Chart Data: 2015/16 v 2016/17 cost base</caption> <thead> <tr> <th>Category</th> <th>Value (\$m)</th> </tr> </thead> <tbody> <tr> <td>2015/16 actual expenses</td> <td>855.3</td> </tr> <tr> <td>Full year impact of 2015/16 services</td> <td>23.4</td> </tr> <tr> <td>2016/17 New Services</td> <td>7.9</td> </tr> <tr> <td>Digital Hospital (a)</td> <td>(31.8)</td> </tr> <tr> <td>Digital Hospital (b)</td> <td>6.8</td> </tr> <tr> <td>EB increases</td> <td>16.4</td> </tr> <tr> <td>Escalation (CPI and electricity)</td> <td>5.8</td> </tr> <tr> <td>Hep C</td> <td>17.5</td> </tr> <tr> <td>Other</td> <td>(0.8)</td> </tr> <tr> <td>2016/17 budgeted costs</td> <td>900.5</td> </tr> </tbody> </table> | Category     | Value (\$m) | 2015/16 actual expenses | 855.3 | Full year impact of 2015/16 services | 23.4 | 2016/17 New Services | 7.9 | Digital Hospital (a) | (31.8) | Digital Hospital (b) | 6.8 | EB increases | 16.4 | Escalation (CPI and electricity) | 5.8 | Hep C | 17.5 | Other | (0.8) | 2016/17 budgeted costs | 900.5 | <p>p. 16</p> |
| Category   | Value (\$m)  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| 2015/16 actual expenses                          | 855.3  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Full year impact of 2015/16 services             | 23.4   |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| 2016/17 New Services                             | 7.9  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Digital Hospital (a)                             | (31.8)   |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Digital Hospital (b)                             | 6.8  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| EB increases                                     | 16.4   |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Escalation (CPI and electricity)                 | 5.8  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Hep C  | 17.5   |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| Other  | (0.8)  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| 2016/17 budgeted costs                           | 900.5  |  |              |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |
| <p><b>Organisational sustainability plan</b></p> | <ul style="list-style-type: none"> <li>▶ CHHHS management identified initiatives to partially address the budgeted deficit position through the establishment of an Organisational Sustainability Plan ("OSP") which was implemented in July 2016.</li> <li>▶ Benefits from the OSP are not factored into the \$80.5m budgeted deficit.</li> </ul>   | <ul style="list-style-type: none"> <li>▶ These savings initiatives have been estimated to reduce the 2016/17 deficit by a risk adjusted amount of \$17.7m.</li> <li>▶ As at the end of August 2016, CHHHS have calculated \$2.6m of savings realised under the OSP.</li> </ul>   | <p>p. 25</p> |             |                         |       |                                      |      |                      |     |                      |        |                      |     |              |      |                                  |     |       |      |       |       |                        |       |              |



## 2016/17 Key budget assumptions and comparison to 2015/16 actuals

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### 2015/16 Actual deficit v 2016/17 budget deficit

| Currency: A\$m                              | Notes | 2015/16        | 2016/17        | Variance      |
|---|-------|----------------|----------------|---------------|
| <b>Revenue</b>                              | 1     | <b>835.3</b>   | <b>820.0</b>   | <b>(15.3)</b> |
| Labour expenses                             | 2     | (588.6)        | (621.4)        | (32.8)        |
| Operating expenses                          | 3     | (229.4)        | (240.4)        | (11.0)        |
| Depreciation and amortisation               | 4     | (37.3)         | (38.7)         | (1.4)         |
| <b>Total costs</b>                          |       | <b>(855.3)</b> | <b>(900.5)</b> | <b>(45.2)</b> |
| <b>Operating surplus (deficit)</b>          |       | <b>(20.0)</b>  | <b>(80.5)</b>  | <b>(60.5)</b> |
| Less non-recurrent funding                  |       | (13.3)         | -              | 13.3          |
| <b>Adjusted operating surplus (deficit)</b> |       | <b>(33.3)</b>  | <b>(80.5)</b>  | <b>(47.2)</b> |

Source: Management information

### Revenue

- 1 ▶ 2016/17 revenue is based on the following key assumptions:
- ▶ Base funding received from the Department of Health ("DoH") of \$772.9m as per the Service Agreement dated July 2016.
  - ▶ Additional \$47.1m revenue budgeted over Service Agreement funding, which predominantly relates to own source revenue and growth funding.
  - ▶ 241 fewer units of activity, as measured by National Weighted Activity Units ("NWAU"), are budgeted to be delivered in 2016/17 compared to 2015/16. [OPEN: insert comment to explain rebasing and variance]
  - ▶ \$31.8m received in 2015/16 will not be recurring in 2016/17 since this was project funding to start up the Digital Hospital initiative.

### 2 Labour expenses

- ▶ 2016/17 labour expenses are based on the following key assumptions:
  - ▶ An increase in average employees across all divisions of 321 FTE from 2015/16 to 2016/17.
  - ▶ Most clinical positions are 100% backfilled and locum costs are built on a case by case basis.
  - ▶ \$16.4m increase relating to enterprise bargaining escalation funded through the 2016/17 Service Agreement.
  - ▶ 143 budgeted positions are unoccupied for Jul – Aug 2016, and are occupied thereafter.

### 3 Operating expenses

- ▶ 2016/17 operating expenses (non-labour) are based on the following key assumptions:
  - ▶ 2016/17 operating expenses were obtained by extrapolating the first 8 months of 2015/16 actuals adjusted for material one off occurrences, part year services and escalation factors.
  - ▶ Electricity costs will increase by 12% from 2015/16 to 2016/17.
  - ▶ A general inflation factor of 2.5%.

### 4 Depreciation and amortisation

- ▶ 2016/17 depreciation and amortisation are based on the following key assumptions:
  - ▶ Depreciation expense is calculated both on the current asset base and to reflect new assets commissioned.
  - ▶ Amortisation is charged in respect of software.
  - ▶ Depreciation and amortisation is fully funded through Department of Health funding.

# 2

## Budgeted revenue

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**Revenue is predominantly determined by purchased activity levels, with funding allocations outlined in the Service Agreement**

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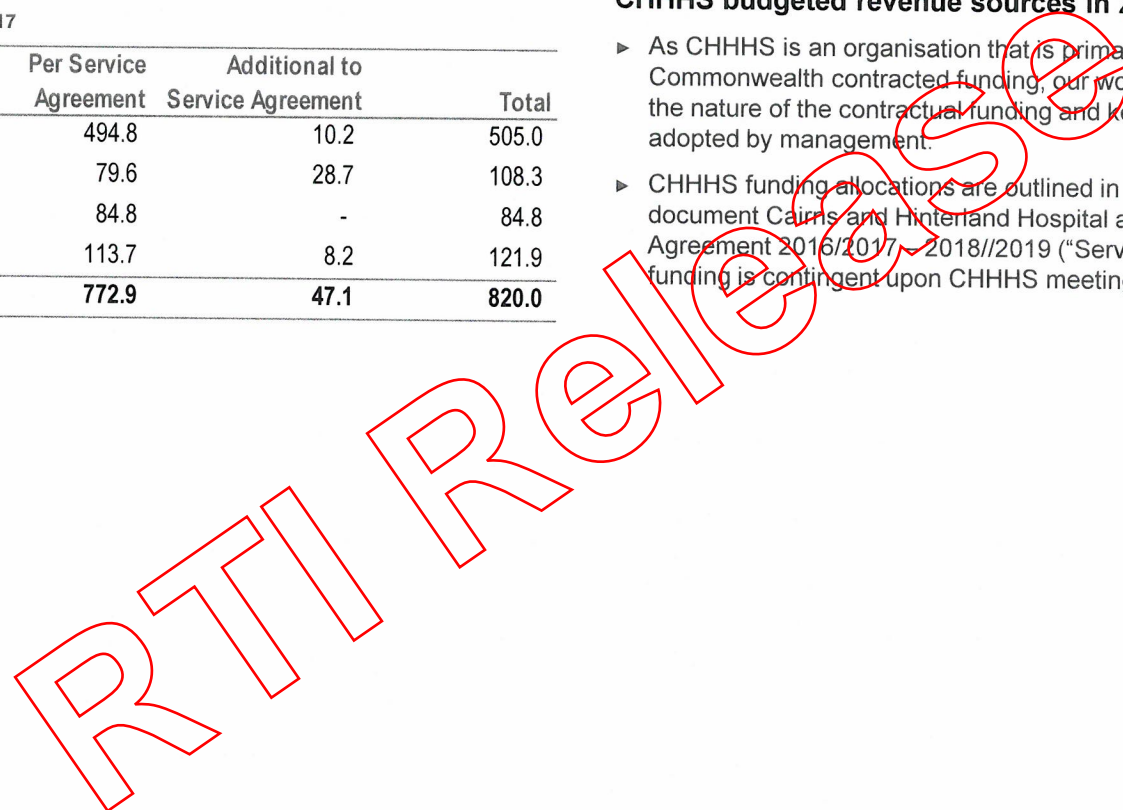
Funding sources, CHHHS budget 2016/17

| <i>Currency: A\$m</i>        | Per Service Agreement | Additional to Service Agreement | Total        |
|------------------------------|-----------------------|---------------------------------|--------------|
| ABF funding                  | 494.8                 | 10.2                            | 505.0        |
| Own source revenue           | 79.6                  | 28.7                            | 108.3        |
| Block funding                | 84.8                  | -                               | 84.8         |
| Department of Health funding | 113.7                 | 8.2                             | 121.9        |
| <b>Total revenue</b>         | <b>772.9</b>          | <b>47.1</b>                     | <b>820.0</b> |

Source: Management information

**CHHHS budgeted revenue sources in 2016/17**

- ▶ As CHHHS is an organisation that is primarily funded through State and Commonwealth contracted funding, our work focused on understanding the nature of the contractual funding and key revenue assumptions adopted by management.
- ▶ CHHHS funding allocations are outlined in the Queensland Government document Cairns and Hinterland Hospital and Health Services Service Agreement 2016/2017 – 2018//2019 (“Service Agreement”) and some funding is contingent upon CHHHS meeting various performance criteria.



## Revenue is predominantly determined by purchased activity levels, with funding allocations outlined in the Service Agreement

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### Funding sources, CHHHS budget 2016/17

| <i>Currency: A\$m</i>        | Per Service Agreement | Additional to Service Agreement | Total        |
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| <b>Total revenue</b>         | <b>772.9</b>          | <b>47.1</b>                     | <b>820.0</b> |

Source: Management information

### Activity budget, 2016/17

|                   | Notes | Per Service Agreement (Units: QWAU) | Per Service Agreement (adjusted for overstatement) (Units: NWAU) | Additional to Service Agreement (Units: NWAU) |
|-------------------|-------|-------------------------------------|--|---|
| ABF               | 1     | 113,848                             | 96,130   | 3,972   |
| Block funding     |       | 11,418                              | -  | -   |
| <b>WAW budget</b> |       | <b>125,266</b>                      | <b>96,130</b>  | <b>3,972</b>                                  |

Source: Management information and Service Agreement

#### Notes to table

1. NWAU target is shown net of a pending adjustment of 1,892 NWAU agreed with the Department of Health

### Activity levels, 2015/16 and 2016/17

| <i>Number of activity units</i>          | 2015/16        | 2016/17        | Variance      |
|--|----------------|----------------|---------------|
| <b>QWAU target per Service Agreement</b> | <b>98,728</b>  | <b>125,266</b> | <b>26,538</b> |
| NWAU target per Service Agreement        | 94,248         | 96,130         | 1,882         |
| NWAU growth over target                  | 6,094          | 3,972          | (2,122)       |
| <b>NWAU delivered</b>                    | <b>100,342</b> | <b>100,102</b> | <b>(240)</b>  |
| <b>% NWAU growth over target</b>         | <b>6.5%</b>    | <b>4.1%</b>    | <b>2.3%</b>   |

Source: Management information and Service Agreement

#### Notes to table

1. A rebasing of QWAU took place in 2016/17 into 'Q19' QWAU. QWAU in this table are stated on a like for like basis in 'Q19' units

### Key sources of funding for CHHHS comprise:

#### 1. Activity based funding ("ABF")

##### Per Service Agreement

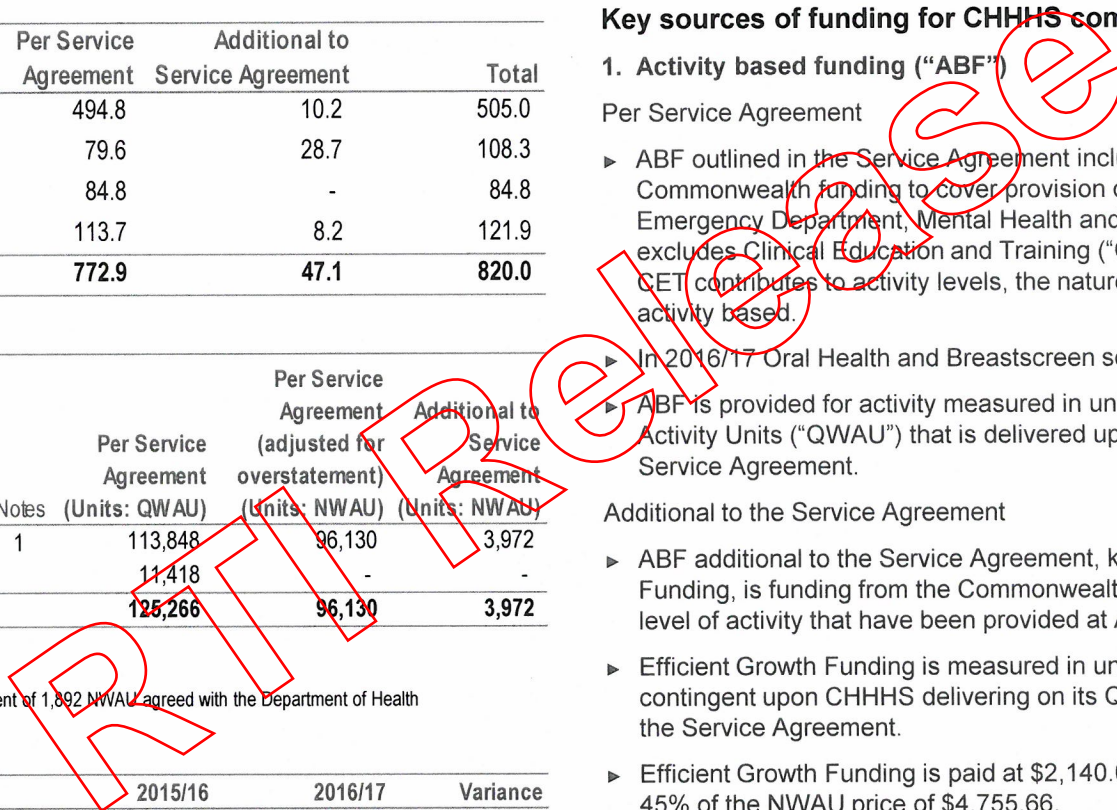
- ▶ ABF outlined in the Service Agreement includes both State and Commonwealth funding to cover provision of Inpatient, Critical Care, Emergency Department, Mental Health and Outpatient services. It excludes Clinical Education and Training ("CET"), as notwithstanding that CET contributes to activity levels, the nature of the payment for CET is not activity based.

- ▶ In 2016/17 Oral Health and BreastScreen services also transferred to ABF.

- ▶ ABF is provided for activity measured in units of Queensland Weighted Activity Units ("QWAU") that is delivered up to the level specified in the Service Agreement.

##### Additional to the Service Agreement

- ▶ ABF additional to the Service Agreement, known as Efficient Growth Funding, is funding from the Commonwealth for services over a threshold level of activity that have been provided at ABF facilities.
- ▶ Efficient Growth Funding is measured in units of NWAU and eligibility is contingent upon CHHHS delivering on its QWAU activity purchased under the Service Agreement.
- ▶ Efficient Growth Funding is paid at \$2,140.05 per NWAU, calculated as 45% of the NWAU price of \$4,755.66.
- ▶ The 2016/17 budget includes Efficient Growth Funding of \$10.2m in respect of:
  - ▶ Services delivered representing 3,972 NWAU in 2016/17, valued at \$8.5m (based on 45% of the NWAU price).
  - ▶ \$1.7m in relation to services delivered in 2015/16 that exceeded the 2015/16 year end accrual for Efficient Growth Funding.



**Revenue is predominantly determined by purchased activity levels, with funding allocations outlined in the Service Agreement**

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- 4. Organisational sustainability plan
- 5. Additional deficit reduction initiatives
- 6. Budget build process and recommendations

Funding sources, CHHHS budget 2016/17

| Currency: A\$m               | Per Service Agreement | Additional to Service Agreement | Total        |
|------------------------------|-----------------------|---------------------------------|--------------|
| ABF funding                  | 494.8                 | 10.2                            | 505.0        |
| Own source revenue           | 79.6                  | 28.7                            | 108.3        |
| Block funding                | 84.8                  | -                               | 84.8         |
| Department of Health funding | 113.7                 | 8.2                             | 121.9        |
| <b>Total revenue</b>         | <b>772.9</b>          | <b>47.1</b>                     | <b>820.0</b> |

Source: Management information

[OPEN] insert reconciliation of 2015/16 OSR to 2016/17 OSR and include explanation of reduction in OSR in 2016/17 after effect of Hepatitis C drugs is adjusted. Also include risk weighted \$3.64m OSR from Organisational Sustainability Plan.

[Also include a separate page detailing build up of total budgeted activity levels]

**Key sources of funding for CHHHS comprise:**

**2. Own source revenue ("OSR")**

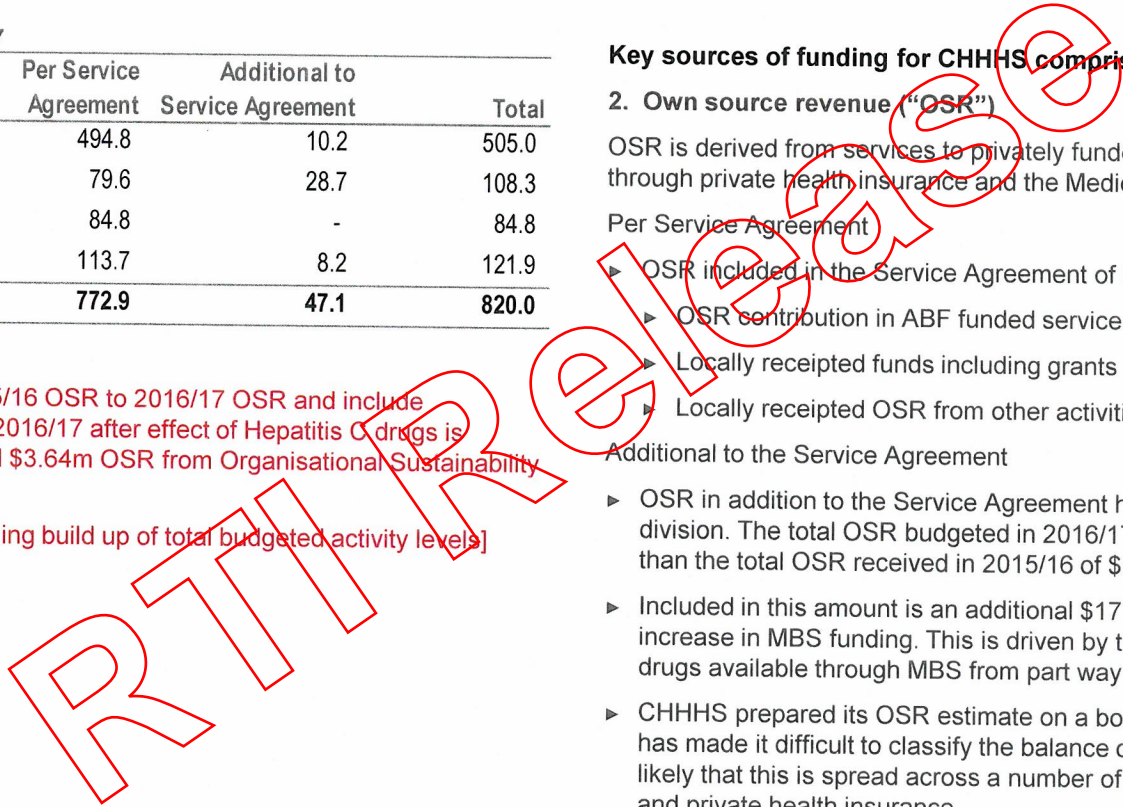
OSR is derived from services to privately funded patients including funding through private health insurance and the Medicare Benefits Scheme ("MBS").

Per Service Agreement

- ▶ OSR included in the Service Agreement of \$79.6m comprises:
  - ▶ OSR contribution in ABF funded services (\$31.0m)
  - ▶ Locally received funds including grants (\$13.6m)
  - ▶ Locally received OSR from other activities (\$35.0m).

Additional to the Service Agreement

- ▶ OSR in addition to the Service Agreement has been budgeted by each division. The total OSR budgeted in 2016/17 of \$108.3m is 8.7% more than the total OSR received in 2015/16 of \$99.6m.
- ▶ Included in this amount is an additional \$17.5m relating to an expected increase in MBS funding. This is driven by the full year effect of Hepatitis C drugs available through MBS from part way through 2015/16.
- ▶ CHHHS prepared its OSR estimate on a bottom up basis by division which has made it difficult to classify the balance of the additional OSR, but it is likely that this is spread across a number of categories including grants and private health insurance.



## Revenue is predominantly determined by purchased activity levels, with funding allocations outlined in the Service Agreement

|                           |  |
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### Funding sources, CHHHS budget 2016/17

| Currency: A\$m               | Per Service Agreement | Additional to Service Agreement | Total        |
|------------------------------|-----------------------|---------------------------------|--------------|
| ABF funding                  | 494.8                 | 10.2                            | 505.0        |
| Own source revenue           | 79.6                  | 28.7                            | 108.3        |
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| Department of Health funding | 113.7                 | 8.2                             | 121.9        |
| <b>Total revenue</b>         | <b>772.9</b>          | <b>47.1</b>                     | <b>820.0</b> |

Source: Management information

### Department of Health funding additional to Service Agreement

| Department of Health Funding additional to Service Agreement   | 2016/17    |
|--|------------|
| State / Hepatitis B program  | 0.3        |
| State / ATSIB Cultural Capability Framework  | 0.2        |
| State / Regional Public Health oversight of the North Queensland Aboriginal and Torres Strait Islander Sexually Transmissible Infections Action Plan 2016-2021 | 0.9        |
| State / Rapid Response Targeted Community Screening  | 0.5        |
| State / PREp program   | 1.0        |
| State / Clinical Prioritisation Criteria (CPC)   | 0.5        |
| State / Mental Health Indigenous Liaison Officer   | 0.1        |
| State / Backlog incentive funds  | 1.0        |
| Commonwealth / Rheumatic Heart Funding   | 0.9        |
| Commonwealth / Mosquito control  | 1.0        |
| Other  | 1.9        |
| <b>Total</b>   | <b>8.2</b> |

Source: Management information

#### Notes to table

- 'Other' relates to revenue that was originally double counted in formulating revenue estimates. This is now unallocated and if not received is a risk to delivering budgeted revenue.

### 3. Block funding

Block funding (both State and Commonwealth) covers teaching training and research, community mental health services and hospitals which would not be viable under the ABF funding model.

#### Per Service Agreement

- ▶ Block funding included in the Service Agreement comprises:
  - ▶ Block funded hospitals (\$40.3m)
  - ▶ Community mental health services (\$24.7m)
  - ▶ Teaching, training and research (\$19.8m).

### 4. Department of Health funding

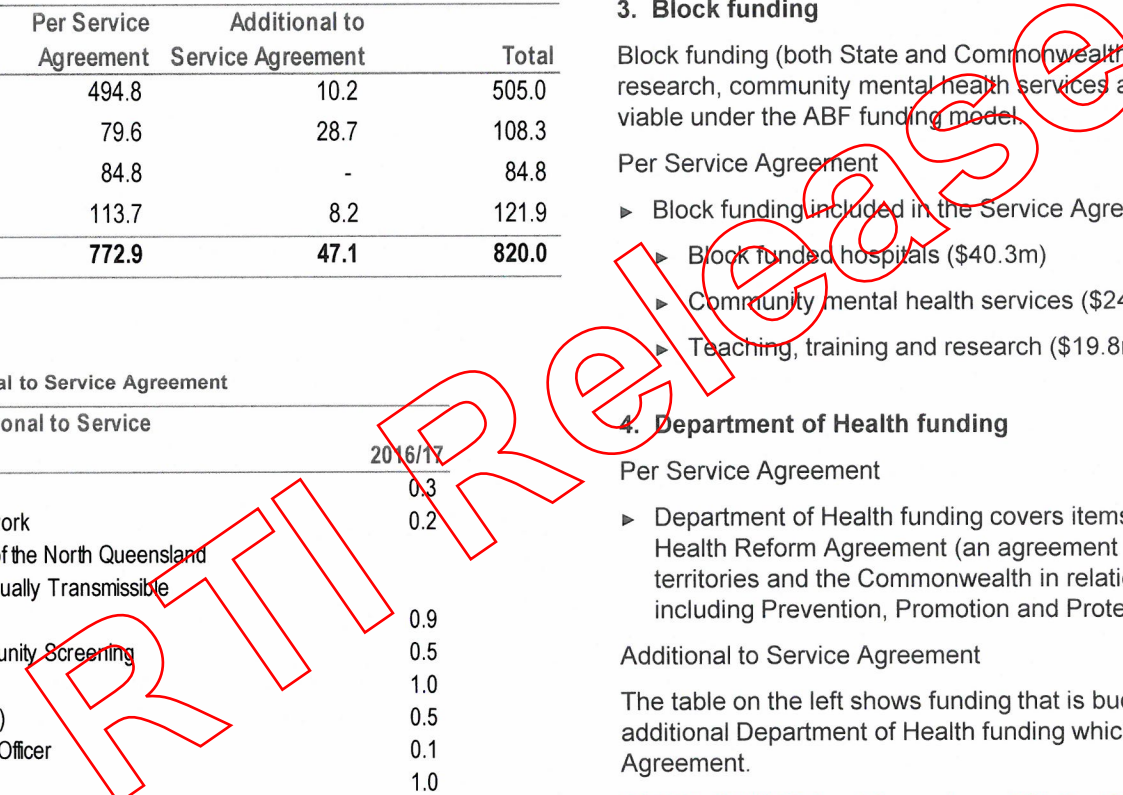
#### Per Service Agreement

- ▶ Department of Health funding covers items not covered by the National Health Reform Agreement (an agreement entered into by all states, territories and the Commonwealth in relation to Australia's health system) including Prevention, Promotion and Protection, and depreciation.

#### Additional to Service Agreement

The table on the left shows funding that is budgeted to be received as additional Department of Health funding which is not included in the Service Agreement.

[OPEN: CHHHS to advise nature of \$1.9m 'Other' funding, may need to be removed]



## Revenue assumptions and basis for assumptions

|                           |  |
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### Revenue assumptions

Management has made the following assumptions in developing the 2016/17 revenue budget:

- ▶ Performance criteria as outlined in the Service Agreement are satisfied. We understand that CHHHS did not forgo any revenue through falling short of performance criteria in 2015/16.
- ▶ \$8.5m Efficient Growth Funding is received in relation to deliver of 3,972 NWAU over target.
- ▶ Revenue relating to long stay patients at period end is not accrued.
- ▶ Own source revenue continues to be earned at a comparable rate to 2015/16 and any elections made by doctors under Rights of Private Practice principles do not affect this<sup>1</sup>.
- ▶ Enterprise Bargaining increases are fully funded, i.e. CHHHS is fully covered for EB increases for established positions regardless of whether the positions are occupied at the date of determining the quantum of funding.

### Supporting information

- ▶ Management has provided the following information in support of the principal revenue assumption regarding NWAU delivered over Service Agreement purchased activity levels:
  - ▶ Actual growth funding earned in 2015/16 was \$14.0m of which \$1.7m was under-accrued in 2015/16 so will be recognised in 2016/17.

### Other considerations

- ▶ Factors which rendered a 2015/16 vs 2016/17 comparison of funding by division or cost centre impractical included:
  - ▶ The allocation of revenue being performed on different bases in 2015/16 and 2016/17, with 2016/17 being the first year in which CHHHS undertook to allocate revenue according to purchased (as opposed to delivered) activity.
  - ▶ Rebasing of QWAU between Q18 QWAU in 2015/16 and Q19 QWAU in 2016/17, with different health care activities earning different levels of QWAU relative to each other, between the two years.
- ▶ Activity is measured in Weighted Activity Units ("WAU") which relate to services provided. CHHHS' cost structure and chart of accounts is not structured on the same basis and any one Service Related Group ("SRG") activity may be delivered across multiple different cost centres and divisions, as the patient progresses through treatment. This makes it impractical to evaluate metrics related to WAU generated (such as cost per WAU) across different services.

1. Rights of private practice govern the mechanism by which a medical specialist may be remunerated for providing treatment

# 3

## Budgeted costs

| In this section                | Page |
|--------------------------------|------|
| 2016/17 budgeted costs         | 17   |
| Labour analysis                | 18   |
| Operating expenses analysis    | 21   |
| 2015/16 to 2016/17 cost bridge | 22   |

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**Costs are budgeted to increase by \$45.2m in 2016/17 from actual costs in 2015/16**

Dashboard

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**2015/16 Actual deficit v 2016/17 budget deficit**

| Currency: A\$m                              | 2015/16        | 2016/17        | Variance      |
|---|----------------|----------------|---------------|
| <b>Revenue</b>                              | <b>835.3</b>   | <b>820.0</b>   | <b>(15.3)</b> |
| Labour expenses                             | (588.6)        | (621.4)        | (32.8)        |
| Operating expenses                          | (229.4)        | (240.4)        | (11.0)        |
| Depreciation and amortisation               | (37.3)         | (38.7)         | (1.4)         |
| <b>Total costs</b>                          | <b>(855.3)</b> | <b>(900.5)</b> | <b>(45.2)</b> |
| <b>Operating surplus (deficit)</b>          | <b>(20.0)</b>  | <b>(80.5)</b>  | <b>(60.5)</b> |
| Less temporary funding                      | (13.3)         | -              | 13.3          |
| <b>Adjusted operating surplus (deficit)</b> | <b>(33.3)</b>  | <b>(80.5)</b>  | <b>(47.2)</b> |

Source: Management information & EY analysis

**CHHHS budgeted cost sources in 2016/17**

- ▶ This section considers CHHHS’s budgeted cost base in 2016/17. Budgeted costs were built using a “bottom-up” approach by each of the seven divisions of CHHHS.
- ▶ Labour costs include all internal and external labour costs inclusive of oncosts, allowances, leave entitlements, contractors and other miscellaneous employee related expenses.
- ▶ Operating expenses represent all non-labour related expense categories.
- ▶ Pursuant to the Service Agreement CHHHS depreciation and amortisation expense is calculated both on the current asset base and to reflect new assets commissioned, and is funded by an equivalent revenue receipt (included within Department of Health funding).

RTI REVIEWED

## The movement in labour costs from 2015/16 to 2016/17 is driven by an increase in headcount and an increase pursuant to the Enterprise Bargaining Agreements

|                         |  |
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| 2 Budgeted revenue      | 6 Budget build process and recommendations |
| <b>3 Budgeted costs</b> |  |

### Labour by category 2015/16 v 2016/17

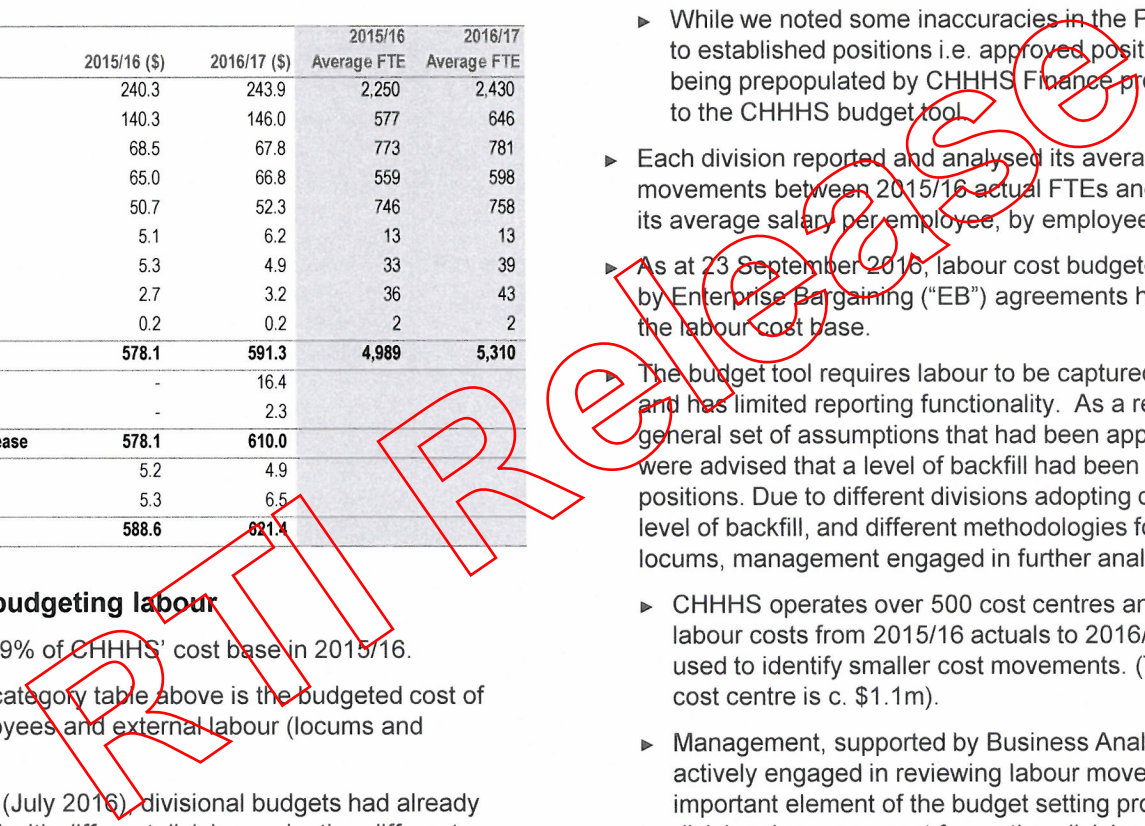
| Currency: A\$m  | 2015/16 (\$) | 2016/17 (\$) | 2015/16 Average FTE | 2016/17 Average FTE |
|---|--------------|--------------|---------------------|---------------------|
| Nursing   | 240.3        | 243.9        | 2,250               | 2,430               |
| Medical   | 140.3        | 146.0        | 577                 | 646                 |
| Admin   | 68.5         | 67.8         | 773                 | 781                 |
| Health Practitioners  | 65.0         | 66.8         | 559                 | 598                 |
| Operational   | 50.7         | 52.3         | 746                 | 758                 |
| VMO   | 5.1          | 6.2          | 13                  | 13                  |
| Professional  | 5.3          | 4.9          | 33                  | 39                  |
| Trades  | 2.7          | 3.2          | 36                  | 43                  |
| Technical   | 0.2          | 0.2          | 2                   | 2                   |
| <b>Total by category</b>                                    | <b>578.1</b> | <b>591.3</b> | <b>4,989</b>        | <b>5,310</b>        |
| Unallocated EB increase                                     | -            | 16.4         |                     |                     |
| Unallocated maternity leave expense                         | -            | 2.3          |                     |                     |
| <b>Total labour costs including unallocated EB increase</b> | <b>578.1</b> | <b>610.0</b> |                     |                     |
| Other Employee Related Expenses                             | 5.2          | 4.9          |                     |                     |
| Workcover Premiums  | 5.3          | 6.5          |                     |                     |
| <b>Total labour costs</b>                                   | <b>588.6</b> | <b>621.4</b> |                     |                     |

Source: Management information & EY analysis

### Management's approach to budgeting labour

- ▶ Labour comprised more than 69% of CHHHS' cost base in 2015/16.
- ▶ Included in the labour cost by category table above is the budgeted cost of both Queensland Health employees and external labour (locums and temporary contractors etc.)
- ▶ At the time of our engagement (July 2016), divisional budgets had already been created in the budget tool with different divisions adopting different approaches; thus our approach centred on understanding the key assumptions and referencing the CHHHS primary control documents:
  - ▶ CHHHS Finance pre-populated the budget tool with occupied positions as recorded in the CHHHS Positions Occupied ("PosOcc") report. This report identifies c 5,200 approved positions (as at Aug 2016) and the budget tool records each individual position, including details such as salary, commencement and termination date of position (where applicable) and backfill assumptions.

- ▶ While we noted some inaccuracies in the PosOcc report (primarily related to established positions i.e. approved positions), the benefit of labour costs being prepopulated by CHHHS Finance provided consistency in the upload to the CHHHS budget tool.
- ▶ Each division reported and analysed its average full time equivalent ("FTE") movements between 2015/16 actual FTEs and 2016/17 budgeted FTEs, and its average salary per employee, by employee category.
- ▶ As at 23 September 2016, labour cost budgeted increases of \$16.4m driven by Enterprise Bargaining ("EB") agreements have not been allocated across the labour cost base.
- ▶ The budget tool requires labour to be captured on a position by position basis and has limited reporting functionality. As a result it was difficult to establish a general set of assumptions that had been applied to labour costs, although we were advised that a level of backfill had been applied to the majority of clinical positions. Due to different divisions adopting different assumptions around the level of backfill, and different methodologies for tasks such as recording locums, management engaged in further analysis of the labour cost base:
  - ▶ CHHHS operates over 500 cost centres and a review of movements in labour costs from 2015/16 actuals to 2016/17 budget by cost centre was used to identify smaller cost movements. (The average labour cost per cost centre is c. \$1.1m).
  - ▶ Management, supported by Business Analysts who had built the budget, actively engaged in reviewing labour movements by cost centre. An important element of the budget setting process was the involvement of divisional management from other divisions in all reviews, to draw on inter-divisional knowledge, and provide peer review.



## The movement in labour costs from 2015/16 to 2016/17 is driven by an increase in headcount and an increase pursuant to the Enterprise Bargaining Agreements

|                         |  |
|-------------------------|--|
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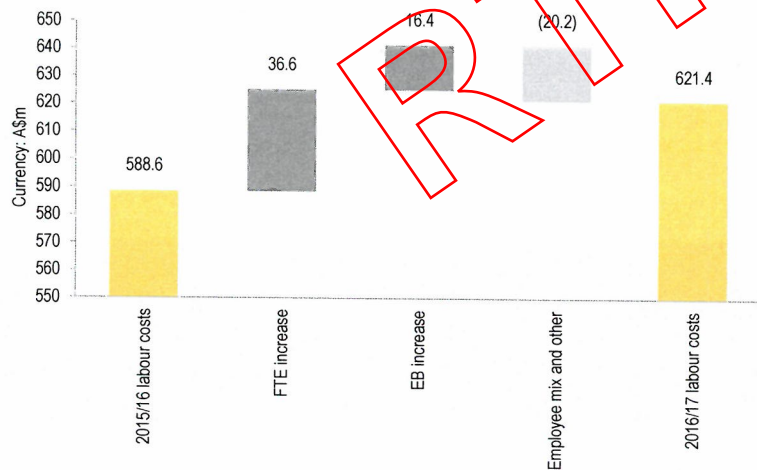
### Labour by category 2015/16 v 2016/17

| Currency: A\$m  |              |              | 2015/16      | 2016/17      |
|---|--------------|--------------|--------------|--------------|
|   | 2015/16 (\$) | 2016/17 (\$) | Average FTE  | Average FTE  |
| Nursing   | 240.3        | 243.9        | 2,250        | 2,430        |
| Medical   | 140.3        | 146.0        | 577          | 646          |
| Admin   | 68.5         | 67.8         | 773          | 781          |
| Health Practitioners  | 65.0         | 66.8         | 559          | 598          |
| Operational   | 50.7         | 52.3         | 746          | 758          |
| VMO   | 5.1          | 6.2          | 13           | 13           |
| Professional  | 5.3          | 4.9          | 33           | 39           |
| Trades  | 2.7          | 3.2          | 36           | 43           |
| Technical   | 0.2          | 0.2          | 2            | 2            |
| <b>Total by category</b>                                    | <b>578.1</b> | <b>591.3</b> | <b>4,989</b> | <b>5,310</b> |
| Unallocated EB increase                                     | -            | 16.4         |              |              |
| Unallocated maternity leave expense                         | -            | 2.3          |              |              |
| <b>Total labour costs including unallocated EB increase</b> | <b>578.1</b> | <b>610.0</b> |              |              |
| Other Employee Related Expenses                             | 5.2          | 4.9          |              |              |
| Workcover Premiums  | 5.3          | 6.5          |              |              |
| <b>Total labour costs</b>                                   | <b>588.6</b> | <b>621.4</b> |              |              |

Source: Management information & EY analysis

### Labour movement 2015/16 v 2016/17

Source: Management information & EY analysis



Key drivers of the budgeted increase in labour costs are summarised in the adjacent table and bridge:

- ▶ FTE increases are budgeted across all labour categories in 2016/17, with the exception of VMOs and Technical categories, which are budgeted to remain constant. Notable increase in FTEs by category are:
  - ▶ Nursing FTEs are forecast to increase by 8.0% and incorporate the minimum nurse-to-patient ratios that were introduced in Queensland in July 2016.
  - ▶ Medical and Health Practitioner FTEs are forecast to increase by 12.1% and 7.0% respectively reflecting the full year impacts of new services introduced in 2015/16 and a low vacancy rate budgeted in 2016/17.
- ▶ The unallocated maternity leave expense represents an estimated budget for maternity leave that was allocated to labour categories as incurred in 2015/16.
- ▶ The adjacent bridge shows the movement in total labour expenses from 2015/16 to 2016/17 attributable to FTE increases, EB increases and a change in the employee mix incorporating all internal labour, overtime, contractors, other employee related expenses and leave entitlements:
  - ▶ \$36.6m increase relates to budgeted FTE growth of 6.4% (321 FTEs) driven predominantly by the Nursing, Medical and Health Practitioner categories discussed above.
  - ▶ \$16.4m increase reflecting budgeted escalation in labour costs driven by Enterprise Bargaining agreements. EB escalation is yet to be allocated to the labour cost categories by CHHS management.
  - ▶ \$20.2m decrease due to a change in the employee mix from 2015/16, including a reduction in locum costs and overtime.
- ▶ Limitations existed in the analysis of FTEs and external labour movements. Through discussions with divisions it was identified that there were inconsistencies in the budgeting of locums distorting the labour mix analysis.
- ▶ We note the increase in labour costs by category (pre EB increase) of 2.3% is higher than the 1.6% increase in activity budgeted to be delivered in NWAU. We note that the Organisational Sustainability Plan seeks to address this variance by plans designed to achieve reductions in overtime and locum costs (excluded from the \$80.5m budget deficit).

**Average monthly FTEs is budgeted to increase from [x] at June 2016 to [x] at June 2017**

Dashboard

- 1 Executive summary
- 2 Budgeted revenue
- 3 Budgeted costs
- 4 Organisational sustainability plan
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[OPEN: Awaiting monthly FTE data for analysis on closing June 16 actual FTE to closing Jun17 budgeted FTE movement]

[Also need to link SDS and MOHRI FTE numbers]

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## Operating expenses are budgeted to increase 4.8% on 2015/16 actuals

### Dashboard

- 1 Executive summary
- 2 Budgeted revenue
- 3 Budgeted costs

- 4 Organisational sustainability plan
- 5 Additional deficit reduction initiatives
- 6 Budget build process and recommendations

### 2015/16 v 2016/17 operating expenses

| Currency: A\$m                         | 2015/16      | 2016/17      | \$ Variance | % Variance  |
|--|--------------|--------------|-------------|-------------|
| Blood And Clotting                     | 2.4          | 2.4          | (0.0)       | (0.3%)      |
| Building Services                      | 1.5          | 1.6          | 0.0         | 3.1%        |
| Catering And Domestic Expenses         | 12.1         | 12.6         | 0.5         | 4.1%        |
| Clinical Supplies                      | 29.5         | 30.7         | 1.2         | 4.1%        |
| Communications Expense                 | 9.1          | 9.1          | 0.1         | 0.9%        |
| Computers Expense                      | 8.0          | 5.2          | (2.9)       | (35.7%)     |
| Consultancies Expense                  | 9.5          | 0.0          | (9.5)       | (99.8%)     |
| Drugs                                  | 43.4         | 60.9         | 17.5        | 40.4%       |
| Electricity And Other Energy Expense   | 8.8          | 9.8          | 1.1         | 12.1%       |
| Employment Agency Fees                 | 2.3          | 2.1          | (0.2)       | (7.2%)      |
| Non Capitalised Asset Related Expenses | 1.7          | 1.2          | (0.5)       | (28.8%)     |
| Operating Leases                       | 5.2          | 5.4          | 0.2         | 3.8%        |
| Other Expenses                         | 5.1          | 7.3          | 2.2         | 42.5%       |
| Other Motor Vehicle Expenses           | 0.6          | 0.6          | 0.0         | 4.8%        |
| Other Supplies And Services            | 20.9         | 19.8         | (1.1)       | (5.1%)      |
| Outsourced Service Delivery            | 18.3         | 18.6         | 0.3         | 1.6%        |
| Pathology Charges                      | 14.7         | 15.4         | 0.7         | 4.7%        |
| Prosthetics                            | 6.7          | 6.9          | 0.2         | 2.8%        |
| Repairs And Maintenance                | 15.2         | 17.0         | 1.8         | 11.9%       |
| Travel Expenses                        | 14.1         | 13.4         | (0.7)       | (5.1%)      |
| Water Supply Expenses                  | 0.3          | 0.4          | 0.0         | 11.2%       |
| <b>Total operating expenses</b>        | <b>229.4</b> | <b>240.4</b> | <b>11.0</b> | <b>4.8%</b> |

Source: Management information & EY analysis

### Operating expenses

- ▶ Operating expenses were budgeted based on the first 8 months of actual costs from 2015/16 extrapolated to reflect a full year. To accurately budget for the 2016/17 operating expenses, divisions made adjustments for estimates of one off expenses incurred in 2015/16, impacts of new and full year services and adjustments for escalation increases.
- ▶ Operating expenses had a net increase of \$11.0m in 2016/17 driven predominantly by the following material movements:
  - ▶ \$2.9m reduction in computer expenses relating to non-recurring digital hospital expenditure.
  - ▶ \$9.5m reduction in consultancies expense relating to consultants used in the implementation phase of the Digital Hospital initiative.
  - ▶ \$17.5m increase in drugs driven by the increase in Hepatitis C costs budgeted in 2016/17. The budgeted revenue assumes this cost will be reimbursed in full.
- ▶ \$1.1m increase in electricity expenses due to a 12% increase in budgeted electricity costs which is materially consistent with terms agreed with the provider for 2016/17.
- ▶ \$2.2m increase in other expenses relating to a number of account codes across the CHHHS.
- ▶ \$1.8m increase in repairs and maintenance expense partly driven by maintenance contracts required in 2016/17 for new equipment that was still under warranty in 2015/16.
- ▶ A 2.5% CPI escalation factor applied to all operating cost categories (other than electricity).