

Report to the Commissioner on the audit of
Southern District Health Board
for the year ended 30 June 2016

Key messages

Our proposed opinion

Without modifying our opinion, we have included an emphasis of matter paragraph in our proposed audit opinion on the DHB's financial statements. The paragraph refers to the application of the going concern assumption in the preparation of the financial statements, on the basis of the letter of comfort from the Ministers of Health and Finance.

We also propose a modified opinion on its service performance information as in previous years.

Financial sustainability

The 2015/16 year is the first time in a number of years that the DHB has met its agreed budgeted deficit. The favourable budget variance is still an increase on the deficit achieved last year, and is also after the receipt of additional funding.

Nevertheless, the DHB has achieved the budget that it signed up to with the Minister, an achievement which also reflects absorption of some unexpected costs relating to asbestos contamination.

We also noted commendable improvements in the DHBs budget preparation, monitoring and forecasting processes this year, and early review and preparation of the 2016/17 draft plan. We understand that the plan is yet to be signed off by Ministers.

The key challenge for the DHB continues to be its ability to maintain sustainable services and at the same time achieve long term financial viability and break-even. Given the significant reduction in budgeted deficits expected in the future, the DHB and Commissioners are fully aware that sustained attention will be needed in these areas, and that the pursuit of sustained budget savings will be needed.

Management control environment, financial and non-financial information systems and controls

Our assessment of the control environment, financial and non-financial information system is as follows:

| | |
|--|--|
| Management control environment | |
| 2016: Needs improvement (2015: Needs improvement) | We have recommended that the Commissioners to continue addressing the major improvements recommended at the earliest reasonable opportunity. |
| Financial information systems and controls | |
| 2016: Good (2015: Needs improvement) | We have recommended some improvement to be made for further enhancement. |
| Service performance information and associated systems and controls | |
| 2016: Good (2015: Good) | We have recommended some improvement to be made for further enhancement. |

The rationale for these assessments is set out the narrative below. Our key recommendations are summarised in Appendix 2.

Thank you

We would like to thank the Commissioners and management for their constructive relationship and assistance provided during the audit.



Andy Burns
Audit Director
21 October 2016

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1 Our audit opinion

1.1 We intend issuing an unmodified audit opinion on the financial statements

Without qualifying our opinion, we intend to include an emphasis of matter paragraph in the audit opinion relating to the DHB's financial statements.

This is the same approach as that taken in our opinion on the 2013/14 and 2014/15 financial statements.

The opinion will refer to the DHB's difficult financial position, and its reliance on the ongoing financial support of the Ministers of Health and Finance to prepare its accounts on a going concern basis.

We comment further on the basis of our opinion in sections 2.1 and 2.2 below.

1.2 We intend issuing a modified opinion on the performance information

As in the previous years, we intend issuing a qualified opinion on the DHB's service performance information. This is due to significant measures of the DHB relying on information from third-party health providers. The DHB's control over much of this information is limited, and there are no practical audit procedures to determine the impact of this limited control. This remains a sector issue, and the qualification is expected to apply to a number of DHBs for the 2015/16 financial year.

1.3 Application of the going concern assumption underlying the financial statements

The DHB has prepared its financial statements on a going concern basis despite the accumulated deficits to date. We have accepted the validity of the going concern assumption in the preparation of the financial statements on the basis of a letter of comfort from the Ministers of Health and Finance to the Commissioners of the DHB.

The DHB has included paragraphs within its annual report describing its reliance on the letter of support from the Ministers, and outlining the Commissioners commitment to making progress towards the ongoing financial viability of the DHB.

1.4 Uncorrected misstatements

The financial statements are free from material misstatements, including omissions.

2 Key financial reporting matters and areas of focus

2.1 Financial sustainability – a year in review

For the year ended 30 June 2016 the DHB has recorded a deficit of \$33.54 million against a budgeted deficit of \$35.96 million. This is the first time in a number of years that the DHB has recorded a deficit below the agreed budget.

This favourable result is largely driven by additional Ministry of Health (MOH) funding for children under 13 year olds and extra elective procedures, as well as a

relatively smaller net increase in overall expenses, which was supported by savings predominately from the provider arm.

The deficit position means the DHB will continue to require deficit support to enable the DHB to be financially viable.

2.2 Financial sustainability – looking ahead to 2016/17

2.2.1 Budget 2016/17

In the last financial year, we observed that the protracted period of discussion with the Ministry of Health (the Ministry), caused delay in the approval and adoption of the 2016 annual plan.

We note for the 2017 annual plan process that:

- a timeline was developed and adopted to improve the 2017 annual plan process and accountability of relevant staff; and
- the Commissioners' structured meeting and reporting work plan ensured timely review and approval of the first draft annual plan before its first submission to the Ministry, which occurred in March 2016.

We understand that the submitted budget is targeting a \$22 million deficit, which is \$11.5 million less than that reported deficit for 2015/16 year.

We also understand that this budget has yet to be signed off by Ministers.

Recommendations

Given the significant reduction in budgeted deficit, it is a timely reminder to the DHB and Commissioners to ensure they sign up to a budget that they have confidence the DHB can deliver against, within a timescale that enables them to put those budget plans into practice.

For budgets to be realistic and effective, they need to be reviewed and challenged in a timely and robust manner by management.

Management comment

We continue to improve our budgeting rigour and get buy-in for budgets by staff responsible for their completion. There will be further developments on the ability of the organisation to forecast in 2016/17. The deficit target for 2016/17 is \$22 million, and this is the first stage in getting the DHB out of deficit. A high level reconciliation has been performed to explain the core movements, which leave a small task element of additional savings to be made in order to meet the target. Management recognise that to reduce the deficit by this amount is a challenge and are putting in extra controls around discretionary spend areas in order to manage the year end position.

2.3 Budget preparation, monitoring and forecasting

Well designed and comprehensive reporting systems enable management to appropriately allocate resources and make strategic decisions with the best available information. For budgets to be realistic and effective, they need to be reviewed and challenged in a timely and robust manner by management.

Improvements noted in the quality assurance processes applied to setting the budget

We have commented in successive audits on the progress made by the DHB to improve its budget preparation, monitoring and forecasting processes.

We have noted the following changes made to the DHB's budgeting and forecasting processes for 2015/16:

- monthly financial reports are starting to be provided to the CEO on the sixth day after month end, with a summary report presented to the Commissioners on the seventh day;
- there has been an increased level of monitoring and reviewing of budgeting, forecasting, and savings tracking at the Finance, Audit and Risk Committee level; and
- there is also improvement in the DHB's forecasting. This is highlighted through examples such as factoring potential asbestos removal costs in the forecasts for the remaining months of the 2016 financial year, when the asbestos issue was discovered.

Sustained focus will be needed in these areas as tighter budget restrictions start to impact the DHB.

Management comment

Noted. We aim to continue to improve in this area going forward.

2.4 Impairment of assets and review of asset lives

2.4.1 Land and buildings

The DHB has been facing significant investment challenges to maintain its facilities and infrastructure to appropriate standards. The DHB has historically deferred building maintenance where possible, and prioritised maintenance work to ensure essential clinical services are not disrupted.

The DHB's land and building assets were revalued in 2014. This year, we reviewed the basis and assumptions used in the DHB's annual land and building fair value assessment for reasonableness and compliance with the relevant accounting standards.

We gained an understanding of the DHB's progress made against the deferred building maintenance plan embedded in the 2014 valuation. We accepted the DHB's

conclusion that there was no material difference between the land and buildings carrying value and fair value as at 30 June 2016.

2.5 Accounting for provisions and accruals

Due to the nature of the DHB's operations, there is a significant level of accrued expenditure and provisions, which are estimated based on management assumptions and judgements at the end of each financial year.

While this is regarded as a normal accounting practice for the preparation of the financial statements, the uncertainties underlying those applied assumptions need to be continuously monitored to ensure reasonableness and appropriateness.

During the audit, we reviewed the management's assessments and assumptions underlying the major accrued expenditure and provisions. Our findings are as follows:

2.5.1 Provision for Holiday Act 2003 non-compliance

In light of the recent Holiday Act 2003 (the Act) compliance issue across both public and private entities in New Zealand, the DHB engaged a consultant to complete a review of its payroll systems compliance with the Act.

The review identified areas of potential exposure or non-compliance, which formed the basis for the DHB to estimate and recognise a provision based on an analysis of payroll data.

We reviewed the DHB's methodology, significant assumptions, and accounting treatment adopted in calculating its provision estimate. We are satisfied that the assumptions underlying the provision are reasonable, and the estimated balance meets the appropriate accounting criteria for recognition in the financial statements.

Recommendations

We recommend the DHB:

- seeks legal advice to assess the scale of potential legal obligation as a result of any non-compliance with the Act;
- based on advice received, perform a more thorough and detailed review of this matter including any further exposure and estimate of potential liability; and
- investigate what payroll system improvements are needed to ensure compliance with the Act going forward.

Management comment

We agree that the identified issue has highlighted an area where improvements can be made and will be:

- 1) *Working through the current area of non-compliance either as a DHB or nationally with all DHBs to seek a resolution which will include legal advice.*
- 2) *Continue to review the payroll process/system.*

2.5.2 Provision for asbestos contamination

In 2015, the DHB identified an asbestos contamination issue in some of its buildings. In the 2016 year, the DHB has incurred asbestos surveying and removal costs of \$1.75 million. In addition to this, the DHB has recognised a \$1.2 million provision for potential remedial costs.

The provision estimate was based on asbestos survey results to date and the DHB's own priority assessment.

To support the inclusion of a provision, the DHB considers a constructive obligation exists as an expectation has been developed with staff and other parties that it will responsibly manage and where possible remove asbestos.

We have accepted the inclusion of a provision based on information provided. We also acknowledge this is a developing issue and the wider exposure is still uncertain. For this reason, we will continue to monitor the accounting treatment as new information becomes available.

2.6 Capital investment planning

In our interim management report (dated 15 July 2016) we provided an update on the DHB's current asset management practices and developments regarding the Dunedin Hospital redevelopment and urgent capital work programme.

We note the business case and funding of \$11 million was approved by MOH in July 2016. At the time of preparing this report design work had begun and the project is expected to be completed in February 2018.

The DHB's Intensive Care Unit (ICU) upgrade project formed part of the urgent capital work programme. We understand that the ICU upgrade involves the construction of a modern and fit-for-purpose unit, which is aimed to improve significantly the level of service to the community.

Please keep us informed of any developments and progress in relation to the DHB's wider capital programme.

2.7 Severance payments

Severance payments contain an element of discretion and for this reason can come under public scrutiny. During the year a number of the DHB's senior management team including the Chief Executive departed.

As part of our audit, we obtained a complete listing of senior management individual severance payments paid or payable by the DHB as at 30 June 2016.

We reviewed the balances against relevant supporting documentation and good practice accepted across the public sector. We note in particular that:

- Each severance was subject to independent mediation.
- Verbal independent legal advice was also obtained.

We have no issue to bring to your attention.

2.8 Declaration of related parties interests

We reviewed the related parties' transactions and balances, and gained assurance that the disclosure in the financial statements is appropriate, and in line with the applicable accounting standards.

However, we found that not all related parties' interests, including some directorships in companies, are captured in the interest register.

Whilst our audit work confirmed the non-declarations had no impact to the related parties transaction disclosure in the financial statements, we would like to remind the DHB that related parties is an area of interest from a probity perspective. By not declaring all interests, particularly the pecuniary interests, exposes the DHB to an increase in conflict of interest risk and potential for reputational damage.

Recommendations

We recommend the DHB:

- implement independent reviews and checks, such as performing searches into the Companies Office Register, to ensure all related parties interests are captured in the interest register; and
- reiterate the importance of timely declarations and the updating the interest register amongst those charged with governance and key management personnel.

Management comment

We agree that the declaration of related party interests is very important to reduce risk and protect members interests within the governance function.

We will reiterate the importance of disclosure to ensure the interest register is updated and will adopt random checks against the Companies Office Register.

2.9 Accountability document compliance

From our review of the draft 2016/17 Annual Plan we note it currently does not include a prospective Statement of Cash Flows, which is a requirement of the accounting standard *PBE FRS 42 Prospective Financial Statements*.

Recommendations

We recommend the DHB in preparing its forecast financial statements for the Annual Plan ensure they comply with applicable accounting standards.

Management comment

This will be adopted in the 2017/18 annual plan.

3 Environment, systems, and controls (ESCO)

The ESCO assessment is a mandatory reporting requirement under the Auditor-General's reporting framework. It covers three aspects:

- management control environment;
- financial information systems and controls; and
- service performance information and associated systems and controls.

The ESCO assessment involves assigning a grade. The grade assigned directly reflects the recommendations for improvement as at 30 June 2016.

The grades are not an assessment of management's overall performance or an assessment of how effective the board is in achieving its financial and service performance objectives. Appendix 4 explains the grading scale and underlying assumptions for these grades. We reached our conclusions in the context of our work in forming an opinion on the financial and service performance statements.

3.1 Management control environment

| Management control environment | |
|--|--|
| 2016: Needs improvement (2015: Needs improvement) | We have recommended that the Commissioners to continue addressing the major improvements recommended at the earliest reasonable opportunity. |

We performed a high-level assessment of the management control environment. We considered the overall attitude, awareness, and actions of the Commissioners and management in establishing and maintaining effective management procedures and internal controls. Our assessment of these areas was based on regular discussions with key members of senior management, the Commissioners, and our accumulated knowledge of the DHB's business.

In performing this assessment we consider both the "design effectiveness"¹ and "operational effectiveness"² of internal control. The explanation of these terms is outlined below. However, it is not the purpose of our assessment to provide you with assurance on internal control in its own right. As such we provide no assurance that our

¹ Control is effective to either prevent or detect a material error in either the financial statements and/or performance information. The control is "fit for purpose".

² Control has operated effectively throughout the period tested.

assessment will necessarily identify and detect all matters in relation to internal control.

We have assessed the management control environment as “needs improvement” after taking into account the size of the organisation and complexity of the DHB’s operations.

In making our assessment we commend that:

- The DHB has appropriate structures in place to support the Commissioners in planning, overseeing, and monitoring its operations; as well as in achieving the Commissioners’ strategic focus and priorities for their term of office. A key development is the re-introduction of the Finance, Audit and Risk Committee, with an external chair appointed.
- The DHB shares the expected levels of integrity, ethical values and behaviour throughout the organisation via formal policies and procedures published on the staff intranet. This is supported by the renewed focus in the current year, with the DHB refreshing and reviewing a number of key policies and implementing a policy review timetable with regular reporting to the Finance, Audit and Risk Committee.
- The Commissioners and management foster an environment of continual improvement that is highlighted through the well-structured annual internal audit programme, the implementation of both external and internal audit recommendations. Also, the launch of the stakeholder engagement work plan – “Owning Our Future”. The goal of this work plan is to re-shape the DHB as “an organisation united around its aims and the way it operates”.

In 2015, we assessed the management control environment as “needs improvement” on the basis of a several key areas requiring improvement. 2015/16 was the first full year under the Commissioners, and in this short period of time we note a number of positive developments in these highlighted areas in our interim management report. Whilst this positive progress is commended, we have maintained our assessment as “needs improvement” for the following reasons:

- Budgeting process – whilst we saw for the first time in a number of years the DHB come within its budgeted deficit. The overarching message from the Minister of Health is for the DHB to achieve a sustainable financial position, which includes a credible path to break-even. Whether the improvements we have noted in the budgeting and monitoring process is sufficient to allow the DHB to meet the Ministers expectations is to some extent unproven. However, we understand the draft 2016/17 budgeted deficit submitted for approval is lower than the current year’s final deficit result, and as such will test the sufficiency of identified improvements.
- The DHB’s senior management has undergone significant change in the past year with the departure of a number of experienced staff including the Chief Executive. The DHB has addressed the issue in the short term with the use of external consultants (for example in HR) and the secondment of an acting CEO. The challenge for the DHB will be to attract and recruit

appropriately skilled and experienced staff to fill these key roles, with minimal disruption to the DHB's current improvement path.

- The DHB's risk management framework can be widened to incorporate strategic, operational, financial reporting, and compliance risks. Additionally, the DHB needs a risk matrix system that is able to identify and rank its top risks.
- There continues to be room for improvement in the IT control environment, and in the design and operational effectiveness of activity level controls. We are again highlighting the risk around lack of an up to date disaster recovery plans (DRP) and DR testing regime. Given the high reliance of the DHB on information technology to support the attainment of strategic objectives and the delivery of health services, continuity of operations is a significant business risk. We also wish to highlight that there has not been significant progress on most of the issues we have raised in the past years.
- As reported in prior years, contract management practice is covered by a number of different policies and procedures across the DHB. As a result, the DHB is exposed to risk of inconsistency and confusion around which policy is acceptable. An overarching organisation-wide contract management policy, supported by comprehensive procedures, guidelines and templates that are in line with the good practice in the public sector, would further enhance the DHB's contract management processes. We note that the DHB's internal audit functions has also recommended improvements to contract management practices which are in the process of being implemented by the DHB.

3.2 Financial information systems and controls

| Financial information systems and controls | |
|--|--|
| 2016: Good (2015: Needs improvement) | We have recommended some improvement to be made for further enhancement. |

We reviewed the internal controls in place for your key financial information systems. Internal controls are the policies and processes that are designed to provide reasonable assurance as to reliability and accuracy of financial reporting, as well as compliance with significant legislative requirements. These internal controls are designed, implemented, and maintained by the Commissioners and management. Both "design effective" and "operationally effective" internal control is important to minimising the risk of either fraud or misstatement occurring. The responsibility for the effective design, implementation and maintenance of internal control rests with the governing body.

In making our assessment, we took into account the following matters:

3.2.1 Internal controls

We reported our assessment of the DHB's control environment in our interim report to the Commissioners dated 15 July 2016. Our testing confirmed that we could place reliance on the internal controls for the purposes of our audit.

3.2.2 Payroll system compliance to Holiday Act 2003

Our comments and recommendations made in section 2.5.1 in regards to the DHB's payroll system non-compliance issue, contribute to this overall assessment.

3.2.3 Related parties interest declaration

Our comments and recommendations made in section 2.8 also contributes to this overall assessments.

3.3 Service performance information and associate systems and controls

| Service performance information and associated systems and controls | |
|---|---|
| 2016: Good (2015: Good) | Improvements noted during the year, and there are room for further enhancement. |

We reviewed the environment, processes, and controls for developing service performance objectives and targets, as well as monitoring and reporting on service performance. This included reviewing the DHB's statement of intent that was included in the Annual Plan. We focused on obtaining an understanding of how the DHB:

- identifies its outcomes and objectives;
- develops its plans; and
- measures and monitors its performance.

In making our assessment we took into account the following matters:

3.3.1 Qualified opinion on the performance information

Service performance reporting is an integral part of our parliamentary accountability system and helps demonstrate efficiency, effectiveness, and value for money in the public sector. It also enables the DHB to manage its performance more effectively and supports good decision making.

Current year

Since 2014, we have issued a qualified audit opinion on service performance information for all DHBs. This was because we found that DHBs generally did not have controls over much of the performance information from third-party health providers, which is used in reporting against health targets. DHBs did monitor how performance was tracking against targets, but could not provide us with evidence that they were checking that the information reported to them by third parties was reliable. As a result, we were not able to obtain the evidence needed to be able to express an audit opinion on all the performance information reported by each DHB.

We recognised that this was a sector wide question, and encouraged DHBs and the MOH to work together to consider cost effective options for addressing this issue.

We plan on issuing a qualified audit opinion because we did not obtain all the information and explanations we required about third-party performance information reported by the DHB. We noted that some significant performance measures of the Health Board, (including some of the national health targets, rely on information from third-party health providers, such as primary health organisations. The Health Board's control over much of this information is limited, and there are no practical audit procedures to determine the effect of this limited control.

We reiterate that this does not mean that the health target performance reporting by the DHB was wrong, or that there was a failure of the DHBs' service delivery, or any wrongdoing or false reporting by the DHB, or that the information reported from GPs was wrong. It simply means that we were unable to verify some significant performance information.

Moving forward

In response to the qualified opinion the Ministry of Health (MoH) has carried out pilot work in co-operation with pilot DHBs. This pilot was designed to gain an understanding of the total system of collating and reporting performance information by PHOs and DHBs.

The MoH confirmed the process used to report performance information and the controls within that process. This pilot has allowed for the development of a proposed audit approach, which may allow for the lifting of the current qualified opinion in the future.

A level of work by the DHB, PHO and their internal auditors is required including:

- The DHB or PHO internal auditor will need to be able to provide assurance to us that General Practitioners within the District are using standard Patient Management System (PMS) reporting.
- PHO must be in a position to be able to explain and evidence the controls and oversight it has over the General Practitioners performance results.

A level of work by the DHB, PHO and their internal auditors is required including. In discussion with DHB management it was confirmed that the DHB does not wish to carry out this work this year, but will consider its implementation as part of the 2016/17 audit.

Recommendation

We recommend the DHB work with other DHBs, the MoH and WellSouth Primary Health Network (PHO) to allow it to obtain assurance over the reliability of the performance information that third parties report.

Management comment

Southern DHB will continue to participate as part of 20 DHBs in this national work.

3.3.2 Improvements noted in faster cancer treatment health target

The DHB implemented our monitoring recommendation. This included the DHB appointment of a FCT project manager during the year. One of the project manager's responsibilities is to perform an accuracy review of the Urology departments data input to help improve patient pathways. This allows the DHB to proactively monitor patients approaching the 62 day target.

There has also been noted improvement in the consistency of data recording during our testing. However, some service lines continue to record this information in a different and variable manner.

Recommendation

We recommend the DHB make the recording of this information as consistent as possible. Where this information is unclear, when staff input patient details into the FCT system, they should document what information they drew from to identify the key information.

Management comment

This recommendation is scheduled in the work plan for this year, thus ensuring that peer review is efficient and decisions are transparent.

Appendix 1: Explanation of priority rating system

Our recommendations for improvement and their priority are based on our assessment of how far short the Health Board is from a standard that is appropriate for the size, nature, and complexity of its business. We have developed the following priority ratings for our recommended improvements:

| | |
|--|---|
| Urgent Major improvements required | Needs to be addressed <i>urgently</i> These recommendations relate to a significant deficiency that exposes the District Health Board to significant risk. Risks could include a material error in the financial statements and the performance information; a breach of significant legislation; or the risk of reputational harm. |
| Necessary Improvements are necessary | Address at the earliest reasonable opportunity, generally <i>within 6 months</i> These recommendations relate to deficiencies that need to be addressed to meet expected standards of good practice. These include any control weakness that could undermine the system of internal control or create operational inefficiency. |
| Beneficial Some improvement required | Address, generally <i>within 6 to 12 months</i> These recommendations relate to deficiencies that result in the District Health Board falling short of best practice. These include weaknesses that do not result in internal controls being undermined or create a risk to operational effectiveness. However, in our view it is beneficial for management to address these. |

Appendix 2: Issues identified during the audit

The following table summarises our recommendations and their priority

| Recommendation | Section | Urgent | Necessary | Beneficial |
|---|---------------|--------|-----------|------------|
| Holiday Act 2003 Compliance and provision | | | | |
| <p>We recommend the DHB:</p> <ul style="list-style-type: none"> seek legal advice regarding the scale of its legal obligation a result of any non-compliance with the Act; perform a more thorough and detailed review of this matter including any further exposure and estimate of potential liability; and investigate what payroll system improvements are needed to ensure compliance with the Act going forward. | Section 2.5.1 | | ✓ | |
| Accountability document compliance | | | | |
| We recommend the DHB in preparing its forecast financial statements for the Annual Plan ensure they comply with applicable accounting standards. | Section 2.9 | | ✓ | |
| Related parties interests declaration | | | | |
| <p>We recommend the DHB:</p> <ul style="list-style-type: none"> implement independent reviews and checks, such as performing searches into the Companies Office Register, to ensure all related parties interests are captured in the interest register; and reiterate the importance of timely declarations and the updating the interest register amongst those charged with governance and key management personnel. | Section 2.8 | | ✓ | |
| Faster cancer treatment health target | | | | |
| We recommend the DHB make the recording of this information as consistent as possible. Where this information is unclear, when staff input patient details into the FCT system, they should document what information they drew from to identify this key information. | Section 3.3.2 | | ✓ | |

Appendix 3: Further information about our ESCO assessments

We applied a standard framework, used across central government and crown entities, to assess your environment, systems, and controls. The elements included in each aspect of this framework are outlined below.

Management control environment

Indicative areas included in management control environment

This is the foundation of the internal control environment and may include consideration of the:

- clarity of strategic planning;
- communication and enforcement of integrity and ethical values;
- commitment to competence;
- participation by those charged with governance, for example, the involvement and influence of the Audit Committee and the Commissioner;
- management philosophy and operating style;
- organisational structure;
- assignment of authority and responsibility;
- human resources policies and practices;
- risk assessment and risk management;
- main entity-level control policies and procedures;
- information systems and communication (including planning and decision-making for information technology);
- monitoring; and
- arrangements for legislative compliance.

Financial information systems and controls

Indicative areas included in financial information systems and controls

These are the systems and controls (including application-level computer controls) over financial performance and financial reporting, and include the:

- appropriateness of information provided;
- presentation of financial information;

- reliability of systems;
- control activity (including process-level policies and procedures); and
- monitoring.

Service performance information and associated systems and controls

Indicative areas included in service performance information and associated systems and controls

This concerns the quality of the service performance measures selected for reporting against, as well as the systems and controls (including application-level computer controls) over service performance reporting, and includes the:

- appropriateness of information provided and reported;
- presentation of statement of service performance information;
- reliability of systems;
- control activity (including process-level policies and procedures); and
- monitoring.

Comments are based on conclusions drawn from the 2016 statement of service performance systems and reporting against performance measures.

Explanation of grades

| Grade | Explanation of grade |
|-------------------|---|
| Very good | We have made no recommendations for improvement. |
| Good | We have recommended that some improvements be made. |
| Needs improvement | We have recommended that major improvements be made at the earliest reasonable opportunity. |
| Poor | We have recommended that fundamental improvements be made urgently. |

Notes on environment, systems, and controls for measuring financial and service performance

- 1 The reporting under Part 4 of this report, *Environment, systems, and controls for measuring financial and service performance*, is a by-product of the underlying audit work we carried out to form an opinion on the financial and service performance statements. Its scope is limited to those areas of the management control environment, information systems, and controls that we have given attention to in the course of the audit.
- 2 Our recommendations for improvement generally refer to the more notable weaknesses in the design or operation of the management control environment, information systems, or controls. The recommended improvements determine the grade assigned. A single, serious deficiency drawing a recommendation for improvement may, of itself, determine the grade. Similarly, the most serious deficiency among several will draw a stronger recommendation and affect the grade accordingly.
- 3 Deficiencies in the management control environment, information systems, or controls are the gaps between what we observe and what we determine, in our professional judgement, constitutes best practice (see below). Auditors' professional judgement is informed by many factors, including national and international standards, knowledge of best practice, and standards and expectations for the public sector in New Zealand.
- 4 To help ensure the relevance to all entities of our recommendations and grading, our recommendations are made with reference to what is considered best practice given the size, nature, and complexity of the Health Board. Notions of best practice will vary among entities because what is considered necessary, sufficient, or beneficial for some entities may not be so for others. Therefore, there is no "one size fits all" standard across the public sector. Rather, recommendations for improvement are based on our assessment of how far short the Health Board is from a standard that is appropriate for the size, nature, and complexity of its business.
- 5 Further, notions of best practice may vary over time in response to change; for example, changes in the operating environment, changes to standards, and changes in general expectations. Therefore, grades assigned to entities may fluctuate from year to year according to how entities respond to changes in the environment and in best practice expectations. Grades may also be affected from year to year because of changes in emphasis, in keeping with our risk-based approach to testing systems and controls.
- 6 We recommend improvements only when we consider that the benefits of the improvements would justify the costs.
- 7 We base our recommendations for improvement on our conclusions about the state of the Health Board's management control environment, information systems, and controls as at the financial year end.

Appendix 4: Mandatory disclosures

| Area | Key messages |
|--|--|
| Our responsibilities in conducting the audit | <p>We carried out this audit on behalf of the Controller and Auditor-General. We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.</p> <p>The audit of the financial statements does not relieve management or the Commissioners of their responsibilities.</p> <p>Our audit engagement letter contains a detailed explanation of the respective responsibilities of the auditor and the Commissioners.</p> |
| Auditing standards | <p>We carry out our audit in accordance with generally accepted audit standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency that are immaterial to your financial statements. The Commissioners and management are responsible for implementing and maintaining your systems of controls for detecting these matters.</p> |
| Auditor independence | <p>We confirm that, for the audit of the Southern District Health Board's financial statements for the year ended 30 June 2016, we have maintained our independence in accordance with the requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.</p> <p>Other than the audit, we have not provided any engagements for the Southern District Health Board during the year ended 30 June 2016. In addition, we have no relationships with, or interests in, the Southern District Health Board.</p> |
| Other relationships | <p>We are not aware of any situations where a spouse or close relative of a staff member involved in the audit occupies a position with the Southern District Health Board that is significant to the audit.</p> <p>We are not aware of any situations where a staff member of Audit New Zealand has accepted a position of employment with the Southern District Health Board during or since the end of the financial year.</p> |
| Unresolved disagreements | <p>We have no unresolved disagreements with management about matters that individually or in aggregate could be significant to the financial statements. Management has not sought to influence our views on matters relevant to our audit opinion.</p> |