15.

QUEEN ELIZABETH II HEALTH SCIENCES CENTRE - COMMENTS ON FINANCIAL SITUATION

BACKGROUND

15.1 In Chapter 15 of my 1997 Annual Report, I included extracts from a July 29, 1997 management letter from the Queen Elizabeth II Health Sciences Centre's (QEII) financial statement auditors to its Chief Executive Officer which raised serious concerns about operating losses and the accumulated deficit of the Centre. At that time, the Centre was undergoing a reengineering initiative and had prepared a business plan which anticipated that savings would be generated in future years to offset the accumulated deficits. The auditors stated that "*should savings levels not be obtained and deficits continue to escalate, then the provincial government will have to underwrite those deficits in order for the hospital to continue to meet its financial obligations and continue as a going concern.*" In my 1997 Report, I stated that the situation at the Centre was serious enough to warrant careful monitoring by the Department of Health and the government.

15.2 During the current year, my Office planned to undertake an audit of the Centre to follow up on these concerns. An audit plan was prepared and discussed with the Centre's Finance and Audit Committee in March 1998. The Committee, the Board Chair and the Chief Executive Officer of the Centre all indicated their support for the proposed audit. Staff from my Office visited the Centre in early April 1998 to obtain preliminary information and finalize plans for more detailed audit work to be conducted in late summer or early fall of 1998.

15.3 The audit plan discussed with the Centre's Audit and Finance Committee in March 1998 specified the following scope for the proposed audit:

- Governance and accountability including strategic and operational planning and performance reporting
- Financial management
- Capital expenditure planning and control
- Procurement
- Use and control of information technology including Year 2000 readiness of financial and non-financial systems including medical equipment
- Use and control of the work of consultants

15.4 In early June 1998, my staff were informed that the Centre's Board of Directors had engaged a firm of management consultants to consult and report on a number of issues relating to the QEII's financial situation and business plan initiatives. We learned that the scope and objectives of the proposed consulting assignment included those that we had presented to the Board in March. We discussed the apparent duplication of audit effort with members of the Centre's Board and management and the appointed firm. We agreed to discontinue our planned audit on the condition that we would receive copies of any reports produced by the firm, and be invited to attend Board and Committee meetings where findings were presented by the firm. We indicated to the Board Chair our intention to rely upon the firm's work in preparation of our Annual Report to the House of Assembly. We have received copies of reports issued to date and have attended meetings of the Finance and Audit Committee where these were presented.

15.5 Accordingly, this report is primarily based upon information included in reports prepared by a firm of management consultants and released to the Board of the Centre in the fall of 1998.

RESULTS IN BRIEF

15.6 The following are the principal observations from our review:

- The audited financial statements for the year ended March 31, 1998 reported an operating deficit of $26.2 million for the year (including depreciation and amortization of capital funding) and an accumulated deficit of $41.3 million. This deficit is consistent with the projected deficit of $48.9 million included in the Centre's March 1996 Business Plan (projected deficit for 1996-97 was $30.9 million and for 1997-98 was $18.0 million).

- The Canadian Council on Health Services Accreditation performed a review of the Centre in June 1998. The review resulted in award of a three-year accreditation and the reviewers indicated that "*excellent care processes are evident throughout the organization.*" The review report included several recommendations for improvement, and also noted that "*the organization verges on financial non-viability as a result of the significant $42,000,000 debt it carries.*"

- The Centre is projecting an operating deficit of $33 million for 1998-99 (including depreciation, but excluding $20 million estimated for Year 2000 costs for which the Centre has requested funding from the Department of Health and the write-off of deferred reengineering costs). An operating deficit of $18.6 million (including depreciation, but excluding Year 2000 costs) is projected for 1999-2000. The Centre's total debt as at March 31, 1999 is projected to be $141.511 million (if there is no funding from the Department of Health for Year 2000 costs). The Centre has a strategic plan, and a Business Plan dated November 6, 1998 which has been approved by the Board.

- The Department of Health approved the Centre's 1996 and 1997 Business Plans. Senior management of the QEII told us that the Centre had been asked by the government to delay certain initiatives in the Business Plan until the 1998-99 fiscal year and that the Centre received a payment of $12.330 million from the Department of Health which was compensation to the Hospital for the financial impact of delayed initiatives.

- Consultants reviewing aspects of the Centre's finances and financial management processes have identified significant deficiencies in financial management of both operations and capital projects. There is an urgent need for the Centre's Board and management to improve the fundamental financial management processes of the Centre and establish a plan to deal with the existing deficits so that the Centre may continue to meets its mission in the future and deliver essential health care services to the public. The Centre has prepared a response to the consultants' report which includes a plan for dealing with identified deficiencies.

- A review of the Centre's Year 2000 readiness by external consultants noted that although significant progress has been made in the last year, some deficiencies remain which must be dealt with by the Centre to ensure that potential problems are avoided. The Centre indicated that it has a plan in place to deal with any deficiencies noted.

- The Centre's Board had concerns about a large reengineering project known as Project QUEST and hired consultants to review it and report to the Board. The consultants intended to finalize their report and issue it to the Board in late October 1998. However, the Board's consultants and the private sector partner for Project QUEST (also a consulting firm) disagreed with respect to certain aspects of the draft report. The private sector partner has provided additional information and comments during a number of meetings with the Board's consultants. The information is being considered for inclusion in an adjusted draft report. At the time of writing of this Report (early December 1998), a final report had not yet been issued. We will continue to monitor the status of the consultants' report related to Project QUEST and will comment on it in our 1999 Annual Report.

- The Centre released its audited financial statements for the year ended March 31, 1998 in June which showed $8.5 million in deferred reengineering costs related to Project QUEST as an asset. In October 1998, the Canadian Institute of Chartered Accountants issued guidance which suggests that reengineering costs incurred after October 1998 be expensed. The Centre has indicated that the $8.5 million will be expensed during the 1998-99 fiscal year. This amount is not included in the Centre's projected operating deficit of $33 million for 1998-99.

SCOPE OF REVIEW

15.7 Our review included the following documents:

- audited financial statements of the Queen Elizabeth II Health Sciences Centre for the year ended March 31, 1998

- management letter from the Centre's external financial statement auditors to the Chair of the Board of Directors of the Queen Elizabeth II Health Sciences Centre dated June 26, 1998

- *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check* prepared by external consultants and issued to the Board of the Centre in September 1998

- *Preliminary Report Queen Elizabeth II Health Sciences Centre - Financial Areas* prepared by external consultants and issued to the Board of the Centre in October 1998

- *Canadian Council on Health Services Accreditation Survey Report* dated June 21-26, 1998

- QEII Health Sciences Centre Health Services Business Plan approved by the Centre's Board on November 6, 1998

- management letter from the Centre's external financial statement auditors to the Centre's Vice-President Finance and Corporate Services dated July 29, 1997 relating to capital projects for the New Halifax Infirmary and Victoria General sites (this letter was received by the Centre in 1997 but was not reviewed by our Office until after the 1997 Annual Report of the Auditor General had been released).

15.8 We discussed certain aspects of these documents with members of the Centre's Board and management, staff of the management consulting firm who prepared the reports, and management of the Department of Health.

PRINCIPAL FINDINGS

Finances

15.9 *Financial results for the year ended March 31, 1998* - The audited financial statements for the year ended March 31, 1998 reported an operating deficit of $26.2 million for the year (including depreciation and amortization of capital funding) and an accumulated deficit of $41.3 million. This deficit is consistent with the projected deficit of $48.9 million included in the Centre's March 1996 Business Plan (projected deficit for 1996-97 was $30.9 million and for 1997-98 was $18.0 million).

15.10 The deficit has been financed by borrowing. The Centre shows bank indebtedness of $26 million (1997 - $14 million) and amounts owing to the Department of Health of $35.6 million as at March 31, 1998 (1997 - $4 million owing from Department of Health).

15.11 In addition, the Centre reports an unfunded balance of $45.8 million in its capital fund. This represents capital acquisitions to date in excess of funding received, and will affect operations in future years as depreciation expense in excess of the funded amounts. This amount has been financed through borrowings of the capital fund from the operating fund.

15.12 *Consultants' preliminary report to Board of Directors on financial areas* - As part of the consulting engagement referred to in paragraph 15.4 above, external consultants issued a report to the Centre's Board of Directors dated October 9, 1998 on the Centre's finance area and financial reporting. The following are extracts from that report:

Extract from Preliminary Report Queen Elizabeth II Health Sciences Centre - Financial Areas dated October 9, 1998

- "Based upon the QEII's current financial situation, and as recognized and projected by management, it will begin to experience cash flow problems again at the latest in early January 1999. In this fiscal year...cash requirements have already exceeded the $30M Line of Credit arrangement established with the Bank...This occurred in July, and an advance of some $22M on this year's revenue was received from the Department of Health to cover the shortfall. It is estimated that the cash shortfall will increase throughout the balance of the fiscal year to a point where it reaches approximately $75-$85M as of the end of March 1999. (This excludes the August 31, 1998 amount owing to the Department of Health of $41M.) It must be noted that the March 31 shortfall is premised upon a number of significant assumptions. For example, Y2K expenditures are included as cash outflows of $20M. According to the Y2K plan, a comprehensive evaluation and costing of remediation of the Y2K issue will not be completed until late October 1998. It will not be known until that point in time, as to the amount of money required to fulfill this particular initiative. As requested by the Department of Health, no funding revenue has been included with respect to these expenditures.

  As well, budgetary overruns have already occurred in year-to-date actual to budget financial performance. Should this continue it will increase the ending indebtedness.

Further, in the latest budget there are proposed savings initiatives of approximately $5M, the achievement of which may or may not occur. Should these not be achieved, and budget overruns continue, it is entirely possible that the unfunded amount will be greater." (pages 21-22)

- "The QEII now clearly faces a very serious issue as to how the current cash flow deficit, currently estimated at some $75-$85M as at the end of this fiscal year, is going to be financed. This needs to be addressed immediately or the QEII will have inadequate cash resources to meet its current liabilities in early 1999...It is not likely that a financial institution will lend further funds if a repayment mechanism is not in place. Financial institutions are not so much interested in collateral security as they are in attachable future cash flow. It is our view that the Department of Health may be the only financing alternative available; however complete business plans including cash projections and repayment initiatives will undoubtedly be required to support any additional short term financing." (pages 8-9)

- "Our view at the present time, is that there is no formal recovery planning in place at the hospital..." (page 18)

- "On June 3, 1998 the Minister of Health requested that all health care entities in the Province prepare and submit a Business Plan in a prescribed format...To date [October 9, 1998] the Plan has not been submitted although the majority of detailed financial information requested by the Department of Health and due on August 31 was submitted...We recommend that substantially greater emphasis and commitment to producing quality, accurate and timely information begin to take place, and communication be improved between the QEII and the Department of Health so that each are working with a common agenda." (pages 19-20)

- "The draft budget for the fiscal 1998-1999 year was first submitted to the Finance and Audit Committee on March 30, 1998. It has been changing over the past several months, and as recently as October 6, 1998. This has made analysis by us and the Committee very difficult as it has been a moving target. Further, at this date, almost halfway through the fiscal year, it still remains unapproved. This is unacceptable for an organization of this size. We recommend that the budget process begin earlier and be fixed and approved at a much earlier date." (page 10)

- "It is our observation that the quality, timeliness and accuracy of cash flow monitoring and projecting is less than satisfactory. Given the serious financial situation faced by the Hospital we believe that much greater emphasis should be placed on this process to ensure that accurate and complete cash flow projections are available to senior management and the Board." (page 7)

- "We suggest that the skills and depth of resources of the finance department may be inadequate to meet current project and business needs. Additional skilled staff may be required to support the function." (page 8)

15.13 The consultants' report includes a 60 Day Action Plan with seven recommendations. It also identifies three areas of immediate action which, they believe, can positively impact the financial situation at the hospital in the near term.

15.14 *Management's response to consultants' report* - In late November 1998, the Centre's management indicated that the recommendations in the consultants' report had been accepted and were being addressed. Specifically, management indicated the following:

- The Department of Health made a commitment to provide cash financing and $10.8 million was to be received in late November.
- The timing of Year 2000 spending continues to be difficult to predict.
- Based on the October 31, 1998 financial statements, there is no significant variance between actual and budgeted results.
- The Centre feels strongly that the Department of Health must be a significant part of the recovery plan. The Centre indicated the Department of Health continues to move forward with its planning and that the Department has indicated that the Centre will receive further instructions in the new year in order to begin preparation of a multi-year plan. The Centre has hired an interim Chief Financial Officer with no responsibilities other than finance, and management believes that it has expertise to develop and implement recovery planning.
- The QEII is making efforts to improve communication with the Department of Health.
- The Centre's budget process has been changed for 1999-2000 to allow earlier tabling of the budget.
- Cash flow reporting requires constant monitoring and is an area where management believes it is improving. Improvements will continue to be made.
- Financial Services now reports to an interim Chief Financial Officer whose sole focus is financial issues.

15.15 *Comments on finances included in CCHSA Accreditation Survey Report* - The Canadian Council on Health Services Accreditation (CCHSA) is a non-profit, non-government organization that helps health service organizations across Canada examine and improve the quality of the care and services they provide to their clients. Approximately 1,500 health service organizations voluntarily participate in the CCHSA's accreditation program. According to the CCHSA, "*accreditation is one of the few and most effective measures that health service organizations can use to accurately assess their level of performance. It is a peer review and a self-assessment process that focuses on ways to continuously improve the health care system. Each health service organization's performance is assessed against national standards set by the CCHSA in collaboration with the health care community and related stakeholders. The assessment is designed to address processes, outcomes, and structures with the focus on continuous improvement within the health service delivery system.*" (taken from CCHSA website)

15.16 The CCHSA conducted an accreditation review of the Centre in June 1998. The process resulted in the award of a three-year accreditation to the Centre. The CCHSA Accreditation Survey Report includes many positive comments with respect to the Centre's operations such as "*excellent care processes are evident throughout the organization.*" (page 1). It also states that "*there is no question that the board members are committed to maintaining and improving the standards of care throughout the organization. The board has a remarkably good understanding of the requirements of the health care system in the region, and its role and relationship to it. Its members are also* *committed to creating, with government and the province as a whole, a better health care system for the people of Nova Scotia.*" (page 22)

15.17 However, the Accreditation Survey Report includes a strong recommendation with respect to the finances of the Centre. That recommendation is as follows:

Extract from CCHSA Accreditation Survey Report dated June 21-26, 1998

Recommendation

It is important that the board understand its requirements to maintain and ensure the financial viability of the organization, confirming the resources available can support the overall programs and services of health care delivery for which it is responsible. The staff perceive that they are under-staffed even though there are several reports and strong evidence to the contrary. Clearly from the staff's viewpoint, a major chasm between reality, practice and perceptions has been created partly because the government appears unable to meet the financial requirements to assure the board of its fiscal viability. The board must either receive additional funding or reduce the cost to match the available resources.

In essence, it is apparent that the organization verges on financial non-viability as a result of the significant $42,000,000 debt it carries. The estimated $26,000,000 deficit this fiscal year, and the apparent resistance and unwillingness of government to permit the appropriate actions be taken exacerbates this fundamental problem. It is therefore recommended that the board work with management and the staff to ensure that they understand the importance of achieving a balanced budget and that actions are taken to achieve this through a business, operational budgeting and planning process as soon as possible. Further, it is imperative that the board work directly with government to resolve the issues associated with such a plan and act directly on the plan in order to re-establish the financial integrity of the principal hospital in Nova Scotia. (pages 22-23)

15.18 *Conclusions* - The Centre's financial position and operating results have deteriorated in the last year. Consultants reviewing aspects of the Centre's finances and financial management processes have identified significant deficiencies in financial management of both operations and capital projects. There is an urgent need for the Centre's Board and management to improve the fundamental financial management processes of the Centre and establish a plan to deal with the existing deficits so that the Centre may continue to meet its mission in the future and deliver essential health care services to the public.

15.19 Management of the QEII has indicated that the cash management and budgeting issues have been addressed. The QEII acknowledges the seriousness of its cash flow situation, appears to be working diligently to address the issues identified by the consultants and would welcome any assistance in this area.

Business Plan

15.20 The Centre prepared a Business Plan dated March 1996 which was described by Centre management as the official business plan in April 1998. The Centre also has a strategic plan dated February 1998 which includes a goal relating to demonstration of fiscal accountability (page 9) and an initiative to "*establish a plan with government to remove accumulated debt by March 1999.*"

15.21 As noted in Chapter 12 of this Report (paragraph 12.25), the Department of Health introduced an accountability framework for the health sector in December 1996 which required the annual submission of a Health Services Business Plan to the Department of Health. It was to be the key planning document to set out and agree upon performance expectations for the year. The Centre prepared a Business Plan in January 1997 according to the Department of Health's accountability framework but the Centre did not yet have a budget for 1997-98 when that Plan was prepared so it did not include 1997-98 projections.

15.22 The Department of Health approved the Centre's 1996 and 1997 Business Plans. In October 1997, the Department of Health sent the Centre a cheque for $16.83 million representing an increase from Department of Health funding allocated to the QEII during the Estimates process. Included in that cheque was an amount of $12.330 million which was identified as "*loss of projected savings associated with delays in Business Plan initiatives...It is expected that this funding will enable the QEII to operate within their planned operating deficit of $19.25M as outlined in the business plan presented by the QEII to the Department of Health...*" (letter from Deputy Minister of Health to CEO of QEII, dated October 1, 1997). Senior management of the QEII told us that the Centre had been asked by the government to delay certain initiatives in the Business Plan until the 1998-99 fiscal year and that this payment represented compensation to the Hospital for the financial impact of delayed initiatives.

15.23 The Minister of Finance announced in his June 1998 Budget Address to the House of Assembly that business plans would be required from Regional Health Boards and Non-designated Organizations. On June 3, 1998 the government officially requested that business plans be prepared for the 1998-99 fiscal year by July 10, 1998. We have concerns about the Department's decision to not require Business Plans for 1998-99 prior to the beginning of the fiscal year (see Chapter 12, paragraph 12.26). The Department of Health indicated that it would respond to the submissions by August 31, 1998. The Office of the CEO of the QEII believed that insufficient time had been provided for preparation of the Plan and the QEII was the only organization which did not submit the business plan by August 31, 1998. The Centre did provide some of the more detailed information that had been requested by August 31, 1998. The QEII filed a Health Services Business Plan, which had been approved by its Board of Directors, with the Department of Health on November 6, 1998.

15.24 We reviewed a copy of the Health Services Business Plan dated November 6, 1998. It includes the following projections (made September 6, 1998) for the 1998-99 fiscal year:

Projected Operating Deficit	$25.847 million
Projected Capital Amortization	7.929
Net Expenditures over Revenue	33.776
Projected Year 2000 Cost	20.000
Total Deficit for 1998-99	$53.776 million

15.25 In addition to this amount, the Centre has an opening accumulated deficit of $41.3 million, and the Centre projects that its accumulated capital expenditures (difference between the unamortized balance of capital assets acquired to date and capital funding received) will be $46.433 million. If the QEII does not receive funding of anticipated Year 2000 costs, the projected total debt as at March 31, 1999 will be $141.511 million which is comprised of:

1998-99 Deficit	$ 53.776 million
Deficit at beginning of 1998-99 fiscal year	41.302
Unamortized net capital expenditure	46.433
Total Projected Debt as at March 31, 1999	$141.511 million

15.26 The Centre's Business Plan identifies several fiscal initiatives to generate savings/reduce costs but the 1998-99 impact of $5 million has been incorporated in the $25.847 operating deficit projection for the year. These initiatives are projected to generate savings/cost reductions of $12 million in 1999-2000 and another $9 million savings/cost reduction is expected from other identified initiatives. The Centre projects that expenditures (including $10 million of capital amortization) will exceed revenues in 1999-2000 by $18.6 million even when the savings/cost reductions are included. The annual target for savings/cost reductions from these fiscal initiatives when fully implemented is $49 million. The Business Plan does not include financial projections beyond the 1999-2000 fiscal year.

15.27 As noted in Chapter 12 of this Report (paragraph 12.29), the Department of Health is currently analysing Business Plans received from the Regional Health Boards and Non-designated Organizations and developing options for meeting health system objectives which are to be reviewed with the Priorities and Planning Committee and Executive Council. The QEII does not yet know whether its Business Plan has been approved.

Year 2000 Readiness

15.28 The firm of management consultants hired by the Centre's Board issued a report to the Board in September 1998 titled *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*. The objectives of the review were to:

- review and comment on the status of the key Year 2000 activities for the hospital using the Year 2000 Health Check methodology to ensure that the project is moving forward in a way that meets its objectives and deadlines; and
- provide recommendations in respect of any deficiencies which came to their attention during the review.

15.29 The following comments are extracted from *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*.

Extract from *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*

Conclusions - A summary of findings

- Business ownership of the Year 2000 problem is evident with some exceptions.
- Project plans and control mechanisms are not yet sufficient to adequately manage the initiative.
- The target date of September 1999 places the hospital at considerable risk.
- It is not clear that the organization has recognized the urgency of Year 2000 work.
- Policies exist to ensure that new purchases/development are Year 2000 compliant but they are not always followed.
- A formal communication plan exists but has not always been followed.
- The QEII does not have contingency plans dealing with the Year 2000.
- The inventory of "products" is largely complete.
- It is not clear that sufficient human resources have been secured for the successful completion of the project.
- There are a number of areas of concern with respect to remediation activities.
- Communication with "service" suppliers has not yet started.

- QEII has established clear contractual guidelines.

In conclusion while the QEII has made significant progress in the past year, there are a number of areas to address in order to ensure that the Year 2000 project is successful. To summarize:

- There is uneven participation across the portfolios that should be addressed by the Office of the CEO - the primary areas of concern are Information Technology Services and physicians.
- Priorities have to be established with respect to system implementation work - all but Year 2000 work and mission critical or life threatening system delivery activities should be put on hold until after Year 2000 compliance. Shifting of resources will follow this re-prioritization.
- Detailed remediation and testing plans that roll up to a master timeline are critical and must be monitored closely to ensure that the project is progressing on time.
- Risk assessment and contingency planning should begin in earnest for the QEII.

We would suggest that the recommendations made during the review be adopted and that the Board and Office of the CEO adopt an "emergency room" view of the Year 2000 project over the next several months to ensure that efforts are focused exclusively on Year 2000 activities and that realistic plans are in place and being followed. (pages 36-38)

15.30 Management has indicated that the QEII accepts all but one of the consultants' recommendations in this area. The consultants recommended that all communications in response to inquiries from external parties relating to the Centre's Year 2000 readiness be cleared with the QEII's legal counsel and it is this recommendation which has been rejected.

15.31 The Centre estimates costs of $30 million related to dealing with the Year 2000 problem (of which $20 million is estimated for 1998-99). At the date of writing of this report (late November 1998), there was no approved source of funding for this expenditure.

Reengineering

15.32 *Project QUEST* - On July 19, 1996 the Centre issued a call for expressions of interest related to the selection of a private sector partner to assist the Centre in meeting its operational and fiscal challenges. The following objectives for the strategic partnership were included in the *Partnership Expression of Interest Specifications* dated July 19, 1996:

"*Specifically, the partnership will work together to:*

- *provide strategic project management in organizing and preparing the institution for coming changes;*
- *provide a proven methodology/process(es) in achieving redesign success;*
- *jointly identify and prioritize potential process redesign projects that yield the greatest potential for quality, service, and cost improvement targets;*
- *provide project resources (project leaders, project staff, change management professionals, etc.) to compliment our process teams;*
- *to assist in implementing process redesign projects and to measure results against identified targets;*
- *to design and implement a "transfer of knowledge" program in which process redesign/change management skills are transferred to QEII management and staff;*
- *to jointly identify and prioritize functions within Information Technology Services which could be provided more effectively and more efficiently using alternate delivery vehicles (eg. network management, desktop support);*

- *to provide resources (people, technology, financial) to ensure the successful implementation of current enabling technology solutions;*
- *to assess the potential of expanding QEII information solutions regionally and provincially to satisfy and support health reform initiatives;*
- *to provide resources (people, technology, financial) to develop marketing strategies, proposals and services where appropriate to support the regional and provincial provision of information technology solutions and services;*
- *to maintain the QEII "technology current" in support of hospital and regional and provincial information technology requirements;*
- *to provide innovative funding/financing arrangements where risks are shared, benefits and milestones are achieved and future potentials are explored and realized.*" (pages 8 and 9)

15.33 In early 1997, a contract was signed with a management consulting firm which became the private sector partner for the Start-Up Phase of the project which became known as Project QUEST. This first contract had a maximum cost of $1.1 million. A second contract for the Diagnostic, Visioning and Redesign Phase was signed in March 1997 for a maximum cost of $2.8 million. Additional letters of agreement were signed by the Centre and the firm during the following months. As at March 31, 1998, the Centre had incurred costs of $8.5 million related to the project (excluding related hardware and software acquisitions).

15.34 There was a clause in most of the agreements between the Centre and the firm which indicated that a portion of fees (20-25%) would be held back until net savings in operations of the Centre had been realized.

15.35 In July 1997, the private sector partner wrote to the Centre regarding the "less stable" environment in which the project was then operating and the firm's concern that events outside of the control of the firm and the Centre would prevent the generation of some of the anticipated net savings. The letter proposed the following:

> "*In the event that occurrences completely outside the control of* [name of firm] *prevent the generation of "Net Cost Savings",* [name of firm] *will be reimbursed in full for all fees incurred up to that point in time. We would work with you to develop a mutually acceptable payment schedule.*"

15.36 Management of the Centre agreed to the proposal and, therefore, assumed additional risk related to the Project QUEST partnership from the private sector partner. The amount of the holdback referred to in this agreement is in the range of $1 million to $2 million. The Centre has not paid the amount to the private sector partner and is currently considering whether the amount is owed.

15.37 The Centre's Board had concerns about Project QUEST. The consultants hired by the Board in April 1998 and referred to in paragraph 15.4 were asked to review various aspects of Project QUEST and report to the Board. On October 27, 1998 the consultants made a presentation of the tentative findings in their draft report to the Finance and Audit Committee of the Board of the Centre to confirm the accuracy and seek additional information. We attended that presentation. The consultants intended to finalize their report and issue it to the Board shortly after the October 27 meeting. We intended to review that report and use it as the basis for our comments on Project QUEST in our current Report to the House of Assembly.

15.38 Following the October 27, 1998 meeting, the consultants hired by the Centre to review Project QUEST provided information from their draft report to the private sector partner for Project

QUEST (a firm of management consultants as described in paragraph 15.33 above) to confirm the accuracy and obtain any additional information. The two firms of consultants disagreed on certain aspects of the draft report. The private sector partner has provided additional information and comments during a number of meetings with the Centre's consultants. The information is being considered for inclusion in an adjusted draft report. At the time of writing of this Report (early December 1998), a final report had not yet been issued.

15.39 We will continue to monitor the status of the consultant's report related to Project QUEST and will comment on it in our 1999 Annual Report.

15.40 *Deferred reengineering costs* - The March 31, 1998 audited financial statements of the Centre report $8.479 million (1997 - $2.144 million) in deferred charges related to Project QUEST as an asset on the Statement of Financial Position. Note that this amount is reported as an asset and was not included in the calculation of the operating deficit for the year. Note 7 to the financial statements indicates "*During the year, $6,355,000 (1997 - $2,144,000) in re-engineering costs were deferred. These costs, which total $8,479,000 as at March 31, 1998, consist of external consulting fees and internal expenditures incurred on the re-engineering project. The deferred costs will be amortized in future periods as savings are realized.*"

15.41 In their management letter to the Centre's Board Chair dated June 2, 1998, the Centre's external auditors noted the following under the caption *Management Judgments and Accounting Estimates Relating to Sensitive Accounting Estimates and Disclosures*:

> "*Management believes that this deferred charge does have future economic benefit and that future cost savings will result, against which the deferred amount will be amortized. For this reason, the deferred amount has not been written-off as a charge against income.*"

15.42 The Canadian Institute of Chartered Accountants (CICA) issues guidance with respect to generally accepted accounting principles in Canada in the form of a Handbook. At the time of the March 31, 1998 financial statement audit, the CICA Handbook did not deal specifically with the issue of accounting treatment for reengineering costs but included general guidance on concepts related to the nature of an asset and recognition of expenses and losses: "*Expenses and losses are generally recognized when an expenditure or previously recognized asset does not have future economic benefit.*" (Section 1000.50) Whether a future economic benefit will result from the incurrence of the $8.5 million expended on Project QUEST is largely a matter of professional judgement with respect to the likelihood of achieving projected savings. Management and the external auditors believed that it was likely that a related future benefit would materialize.

15.43 Subsequent to the issue of the audited financial statements, the CICA Emerging Issues Committee issued an Abstract related to Accounting for the Costs of a Business Process Reengineering Project which requires that reengineering costs incurred after October 28, 1998 be expensed as incurred. This guidance does not directly apply to the QEII's situation because the reengineering costs were incurred prior to October 1998.

15.44 The Centre's management has indicated that the $8.5 million will be expensed during the 1998-99 fiscal year. This amount is not included in the Centre's projected operating deficit of $33 million for 1998-99.

Audit/Consulting Assignment in Progress

15.45 As noted in paragraph 15.4 above, the Centre's Board of Directors engaged a firm of management consultants in the spring of 1998 to consult and report on a number of issues relating to the QEII's financial situation and business plan initiatives. As noted previously, most of the work has been completed but the firm is to perform additional work in the areas of governance and the Centre's contract with Health Staff Inc. relating to casual staffing in the nursing area (contract was signed on October 31, 1996 and later discontinued).

CONCLUDING REMARKS

15.46 We reported concerns about the QEII's financial situation in our 1997 Annual Report. During the past year, the situation has deteriorated even further and others (auditors, consultants, accreditation reviewers) have also expressed concerns. In 1997 we indicated that the situation was serious enough to warrant careful monitoring by the Department of Health and the government and we repeat that recommendation. Although the Department of Health has initiated a business planning process for Regional Health Boards and Non-designated Organizations (see Chapter 12, page 137), an approved plan to deal with the financial situation of the Centre and the other Regional Health Boards and Non-designated Organizations has not yet been developed and we urge the government to give this critical matter priority.

15.47 The Centre has undergone several recent staffing changes in key positions which may have contributed to the deficiency in financial management and financial planning. At the time of writing of this Report a new CEO had recently been hired and the key position of Vice President of Finance and Corporate Services, which had been vacant, had been recently filled on an interim basis. Those in key Board and management positions have significant challenges ahead of them in dealing with the critical financial situation of the Centre while continuing to maintain or improve the level of care.