



Internal Audit and Compliance Services Report on

Townsville Aboriginal & Islander Health Services

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Findings

There are seven service agreements currently active between the Department of Communities and TAIHS. Four of the service agreements are subject to the provisions of Part A of the current standard service agreement template; two other service agreements use the same older template while the third is a different version again.

1. TAIHS is currently breaching six of the service agreements specifically Clause 15.1 (e) for four of the service agreements and clause 30.2 (c) for two of the service agreements. These provisions are the same in each of the service agreements and state that you are in breach of the service agreement if “you become subject to any form of external administration”. The Commonwealth has appointed an external Funds Administrator.
2. The seventh agreement does not contain such a provision, however Audit suspects that TAIHS is in breach of Clause 28(1)(a) of that service agreement, which provides that you must not “incur a level of financial difficulty such that in the opinion of the department, You will not be able to comply with Your obligations under this agreement”. Given TAIHS serious liquidity problems Audit suspects it will be difficult for TAIHS to comply with the requirements of this clause.
3. As a result of the testing completed Audit found that no reliance can be placed on the integrity of the electronic accounting system and its associated reports, including acquittals. Audit considers TAIHS is in breach of its service agreements, specifically clauses 5.3, 7.0, 8.1(a) (i) and (iii), 12.2(i), 12.3 and 21.1(a) of Part A of four service agreement and similar provisions in the three other service agreements.
4. Audit found that key internal controls were not being adhered to, particularly appropriate segregation of duties and system access controls. Also internal controls generally were poorly performed.
5. Audit reviewed the financial statements and found that the total audited accumulated losses for the three years ending 30 June 2010, is \$1,896,412. Audit has estimated the accumulated operating losses for the four years to 30 June 2011 at \$3,073,223. (This estimate is subject to the limitation that the integrity of the ledger is compromised and some bank reconciliations have not been completed in 2010-11 and the quantum of outstanding payment is unknown). TAIHS does have substantial fixed assets, so while TAIHS is technically not insolvent at this moment, TAIHS does face serious liquidity problems, either at present or in the near future and unless drastic changes are made to address the continued operating losses, TAIHS capacity to remain a going concern is unlikely.
6. The governance review was limited to a review of the policy, procedures, declarations and registers with respect to conflicts of interest for staff and the board. Audit found that efforts are being made to update the staff conflict of interest register and declarations; however the staff and Board conflict of interest declarations and registers are currently out of date.
7. With respect to the quality of service delivery by TAIHS, no significant issues were identified through the ACAP and ASAA review of services or through discussion with regional staff. This indicates that the quality of service delivery is at an acceptable standard to the Department.

Scope of Audit

The scope of the audit is as follows

1. Governance – to the extent allowed by the service agreements
2. Financial viability and compliance with the financial provisions of the funding/service agreement
3. Service delivery – limited to input from regional staff advising on the quality of the service provided, plus any performance reports such as the Assessment Compliance and Performance (ACAP) report and the Annual Service Agreement Assessment (ASAA).

The audit will review financial data for the last three years, which covers the period of the various service agreements currently in place.

The audit is limited to conditions set out in the various service agreements as this defines the extent of the departments funding arrangements with TAIHS. With respect to financial viability, the audit will review the overall financial position of TAIHS.

Chronology of Events

Referral of Complaint

03/06/11

The Director-General formally requested Audit undertake a financial audit of Townsville Aboriginal & Islander Health Services (TAIHS).

Approval to Conduct Audit

07/06/11

The scope of the audit was confirmed with the Director-General and a letter to TAIHS prepared and signed by the Director General advising TAIHS of the audit and appointing the Internal Audit & Compliance Services Branch to conduct the audit.

Collection of Records and Evidence

The review commenced on site on Wednesday 15 June 2011 and TAIHS made all records available to the auditor.

Examination of Records

The examination of the records was conducted using the following methodologies

1. A review of the funding schedules and the financial ledger to determine if there has been compliance with the Service Agreements.
2. A review of the audited financial statements.
3. Applying data analytic tools to the electronic ledger transactions to isolate and target sampling and to test system controls.
4. A review of the financial processes, controls and reporting environment.
5. A review of the conflict of interest policies, declarations and registers.
6. A review of the current Assessment Compliance and Performance (ACAP) reports and the Annual Service Agreement Assessment (ASAA) reports for the various funded services

Conduct of Interviews

The results of information obtained, from the interviews conducted, are represented in the detailed findings.

Detailed Findings

Governance

The service agreement requirements with respect to governance are largely limited to requirements around the management of Conflicts of Interest.

In reviewing the seven current service agreements, four service agreements are now on the new standard service agreement template, however three active service agreements were using the older templates.

Audit reviewed the different service agreement requirements and concluded that the requirements set out in the new standard template, incorporated the requirements of the various older service agreement templates.

With respect to governance the following information has been provided by the Board at the meeting on 15 June 2011:

- All Board members advised that they felt the induction program that was run was sufficient for their purposes and provided a good understanding of their roles and responsibilities with respect to conflicts of interest.
- The Board was able to articulate what a conflict of interest is, although when Audit reviewed their conflict of Interest declaration forms, Audit noted they did not declare any conflicts of interest with staff or other Board members, although these exist and the forms had not been updated since when they became Board members. The exception was Sandra Santo, Vice- President, who had recently updated her form, and it included staff and Board members who are relatives. However the new Board declaration form is more informative about what information should be listed with respect to relatives and splits it between Board and staff.
- Audit sighted a copy of the September 2010 Minutes, which recorded that a Board member had declared a conflict of interest where a particular matter arose.
- The Board provided the following explanation as to why they only had five Board members, yet the constitution requires ten Board members with a quorum of five
 - Sandra Santo, Vice President advised that the Board had sought general expressions of interest from members in February 2011, but this had received no response. Three weeks ago letters had been written to seven members seeking nominations and they had received two expressions of interest. Note - At the Board meeting on 15 June they appointed the two members to the Board who had responded to the expression of interest. The two members are Janice Burns and James Akee.
 - Board members advised that it was difficult operating with only five Board members as it meant they all had to be present or available by telelink to form a quorum, so they were keen to obtain additional members.
- Audit asked the Board about how they viewed the current financial position given that during the last four years TAIHS has recorded significant operating losses including \$393,422 in 07/08, \$613,536 in 08/09, \$889,454 in 09/10 and in 10/11 \$500,000 at 30 April, with two months to go and before depreciation is added.

- Their response was to claim the cost of Locum doctors was the cause of the deficit. However the following should be noted:
 - The cost of Locum doctors is charged to the Primary Health Care cost centre.
 - Audit reviewed program cost centres at 30 April 2011, which showed that the operating **loss** for Primary Health care was \$132,918. The operating loss for the administrative services cost centre was \$399,226 and the support services cost centre was \$209,399 giving a total operating loss from these two overhead cost centres of \$608,625. So while the cost of Locums contributes to the deficit, it is not the most significant contributor.
 - TAIHS has not developed a business strategy to rein in these operating losses with the trend showing an increase in operating losses for each of the three years to 30 June 2010 and the estimated operating for 30 June 2011 continuing this trend.
- Audit reviewed the appropriate governance clause within the service agreement (clause 23) and noted the following with respect to complying with the provisions of this clause
 - All service agreements are signed by a Director.
 - TAIHS advised that no staff conflicts of interest have arisen that required notification to the Department.
 - Conflict of Interest policies are in place for the Board and staff. No Volunteers are currently being used, so no policy regarding volunteers is in place.
 - Advised and sighted an example that declarations for any Conflict of Interests are sought at Board level and noted in the minutes.
 - Staff conflicts of interest are normally declared on the conflict of interest declaration form. These forms are currently in the process of being updated by staff.
 - Audit has concerns about the lack of HR delegations within the organisation and therefore the possibility of nepotism occurring with appointments. Note a review of recruitment and selection processes is outside the scope of this review.
 - TAIHS has recently reviewed and updated their HR policies, procedures and templates. The staff conflict of interest declaration form was updated as part of the review.
 - All TAIHS staff have been requested to complete the new conflict of interest declaration form. Audit was advised by HR that these forms have been returned but not reviewed and that an audit needed to be completed to ensure that all staff had returned updated forms.

In summary the governance review was limited to a review of the policy, procedures, declarations and registers with respect conflicts of interest for staff and the Board. Audit found that while efforts are being made to update the staff conflict of interest register and declarations, both the staff and Board conflict of interest declarations are currently out of date.

Financial viability and compliance with the service agreement and Internal Control environment

Financial Viability

In reviewing financial viability Audit reviewed the audited financial statements for the previous two years, which revealed the following information;

- the 07/08 audited financial statements (taken from the comparative figures in the 08/09 audit financial statements) show an operating loss of \$393,422;
- the 08/09 audited financial statements show an operating loss of \$613,536;
- the 09/10 audited financial statements show an operating loss of \$889,454;

The result is that the total **audited** accumulated losses for the three years ending 30 June 2010, is **\$1,896,412**. (Note the review was limited to these three years as they fall within the period of the current service agreements.)

Audit then reviewed the unaudited position at 31 May 2011 and estimated the likely financial position at 30 June 2011. It was not possible to review the financial position at 30 June 2011 as the June reconciliation of the bank account and ledger had not been finalised at the time of the audit.

This review is outlined as follows

- The unaudited YTD operating loss, per the Profit & Loss report at 31 May 2011 is \$433,350 before provisions. This represents a reduction in the YTD operating loss from the April balance with the reduction amounting to \$66,240. The result reflects grant income received during May of \$923,274.
- The expected grant income for June is estimated at around \$270,000, while expenditure for June is expected to be below average.
- Audit then completed an estimate to try to determine a likely financial position at 30 June. Set out below is the calculation

• Estimated June Grant revenue	\$270,000
• Other Revenue June(per monthly average)	<u>\$166,539</u>
• Estimated Total Revenue June	\$436,539
• Estimated Expenditure June	\$780,000 (this is a conservative estimate, as salaries alone in May were \$740,000 and the average monthly YTD expenditure is \$859,805.)
• Estimated Provisions	<u>\$400,000</u> (Depreciation & LSL, based on previous years)
• Estimated Total Expenditure & Provisions	\$1,180,000
• Estimated Net Loss in June (Rev - Exp) provisions)	\$743,461 (includes
• plus operating loss at 30 April	<u>\$433,350</u>
• Estimated operating loss at 30 June	\$1,176,811

Should this estimated operating loss at 30 June eventuate then the accumulated losses for the four years to 30 June 2011 would be **\$3,073,223**.

On the basis of the above estimate, Audit believes TAIHS is currently experiencing or will experience significant liquidity problems in the 11/12 financial year and going

concern issues within a few years. (Note it is not possible to get a clear picture of TAIHS current financial position due to the lack of confidence in the ledger and the poor internal processes, particularly with respect to managing outstanding payments.)

TAIHS could, as a short term measure raise a loan secured against existing assets, to ease their liquidity problems, but unless drastic action is taken to reign in expenditure, TAIHS financial capacity to survive beyond the next few years is unlikely.

From the best estimate of TAIHS financial position, which is subject to the limitation that the integrity of ledger is compromised and the extent of outstanding payments is unknown, (the financial position may be worse than estimated) then it appears that while TAIHS is technically not insolvent at this moment, TAIHS does face serious liquidity problems either at present or in the near future and unless drastic changes are made to address the continued operating losses, TAIHS capacity to remain a going concern is unlikely.

Financial Compliance with Service Agreement & Internal Control Environment

The Commonwealth appointed an external Funds Administrator on 21 July 2011. With the appointment of the external Funds Administrator, TAIHS became immediately in breach of six service agreements, specifically Clause 15.1 (e) of Part A of the standard service agreement for four agreements, which provides that you are in breach of the service agreement if “you become subject to any form of external administration”. Clause 30.2 (c) of two other service agreements also has the same requirement.

The seventh service agreement does not contain such a provision however Audit suspects that TAIHS is in breach of Clause 28(1)(a) of that service agreement, which provides that you must not “incur a level of financial difficulty such that in the opinion of the department, You will not be able to comply with Your obligations under this agreement”. Based on the information above and TAIHS serious liquidity problems, Audit suspects it would be difficult for TAIHS to comply with the requirements of this clause.

Audit completed system process reviews of the main financial systems including payroll, accounts payable, banking and receipting, petty cash, assets, credit cards, bank reconciliations and ledger.

The purpose of these system process reviews was to validate any underlying assumptions when performing the data analytics testing and to obtain an initial assessment of the internal control environment. Audit found that internal controls were very poor, particularly with respect to proper segregation of duties and access controls.

As part of the system review process, Audit selected a small sample of payments and traced these back to the source documentation. Audit found that the quality of the source documentation to support the payments was generally poor with supporting documentation incomplete or not present.

Credit Cards

Audit reviewed the processes and internal control environment with respect to credit cards. Credit cards are held by the Director Corporate Services, Director Operations and the Chief Executive Director.

The internal accountant advised that each credit card has a basic overall expenditure limit of \$20,000, but does not have a transaction limit or a monthly limit.

The Accounts clerk reconciles the credit cards and this was last completed in October 2010. Audit found that Credit Card expenditure is not being appropriately controlled and accounted for.

MYOB Card Changes

Audit reviewed MYOB card changes, that is, changes to the vendor, customer or employee details that were used in the transaction completed. MYOB legitimately uses this functionality to undertake some transactions i.e. voiding cheques.

Audit found there were 98 transactions where card details were changed. There are a large number of card changes in the MYOB transactions that do not coincide with the expected functionality of MYOB. There are a number of transactions where voided transactions were changed to a new vendor. There were a large number of cash transactions that were voided and this is particularly disturbing as you do not normally void cash transactions.

Audit found there are a number of transactions where the intent of the change is not clear or expected. These transactions have been referred to the Commonwealth Fund Administrator for further investigation as they are indicators of fraud.

Cash Transactions

Audit extracted all transactions where the description contained cash. Audit found that there were a number of cash transactions that were related to departmental jobs that did not have sufficient information to ascertain the recipient and purpose.

ABN Details

Audit confirmed vendors to ABN details. Audit extracted the cards relating to vendor records to identify invalid ABN vendors. Audit found that the large majority of vendors had a valid ABN. Of the invalid ABN vendors there were no purchase related transactions. This test is limited as it does not indicate that the vendors are correct as a vendor can be provided with a valid ABN that is not their registered ABN.

Assets

Audit then reviewed assets and extracted all transactions that were greater than \$5000 to identify possible asset purchases. Audit identified a number of transactions that related to departmental funds i.e. computers and office equipment. Further discussion indicated that these assets were not individually registered in the asset register and were likely to be in the lump sum figure in the register. Based on this discussion no further testing was able to be undertaken.

Audit believes the asset register for TAIHS does not comply with the requirements of the service agreement, as it is not complete and not all assets are recorded in the Asset Register in the format required by the service agreement.

Payroll General

Audit reviewed payroll and summarised the payroll history for all employees for each year for three years by employee and payment type. This was designed to ascertain the extent of change between years.

Audit found that there were some cases where there was significant change in the figures between years, but this could be partially explained by the back payments made under the equity provisions in the awards. However, Audit was able to identify transactions where employees were paid more times than expected, that is, more than the fifty two weeks. These items have been referred to the Commonwealth Fund Administrator for review.

Audit extracted all employee changes and looked for where the user undertaking the change was either the employee being changed or a family member.

Audit found there are a number of employees who are changing their own payroll master data. Audit found there is a clear conflict of interest with staff changing their own employee master data on the MYOB payroll system.

Audit then utilised a data pattern mining tool to identify possible exceptions to established payroll rules in the data. The analysis found some unusual deviations to the rules. These items have been referred to the Commonwealth Funds Administrator for further investigation.

Superannuation

Audit also tested changes made to the superannuation categories for employees.

Audit found that while the changes to the superannuation categories generally appear to be reasonable, there are some transactions that Audit has referred to the Commonwealth Funds Administrator for further investigation. Audit also found that there is a clear segregation of duties deficiency with both administrative staff and the Administrator account changing these items.

Wages

Audit also reviewed the process for changes to wages. Audit found there is a clear segregation of duties deficiency with both the administrative staff and the Administrator account changing these items. The result of this deficiency is that the integrity of the payroll could be compromised.

Transaction of Interest

Of interest was a transaction that related to Townsville City Council that was coded to Motor Vehicles expenses. This transaction was a parking infringement that was charged to departmental funds. Whilst action was taken to recover these through payroll deductions, the funds were later returned to the employee. The employee was not aware of these changes in their an indicator of fraud and the item has been referred to the Commonwealth Fund Administrator for further action.

Payroll Conclusion

As a result Audit believes the integrity of the ledger with respect to payroll has been compromised and in the example provided above there is indicators of fraud.

MYOB Master Data

Audit also tested changes to account details as MYOB allows changes to the underlying account master data. Testing found that account master data was being changed by both the system administrator and the administrative staff.

Given that these staff are also performing transactions on these accounts there is a clear segregation of duties deficiency. There were a number of cases where the account was both added and deleted by the same person. In one case, the account was created, a transaction undertaken and then the account was deleted. This matter has been referred to the Commonwealth Fund Administrator for further investigation

Acquittals

Audit also reviewed the various departmental funded programs to consider the accuracy of the acquittals provided to the Department. MYOB tracks expenditure relating to different funding programs through the job costing module.

Audit found 650 changes to transactions where the job was changed. The large number of job changes resulted in the items reported in the acquittals to the department, being either counted twice, in the subsequent period or unable to be reconciled to the acquittal previously sent to the department.

There were a number of transactions where the amount changed on a transaction directly impacted the acquittal reporting to the department, in that the change occurred outside the reporting period. The implication is that the department is not able to now fully confirm the transactions at the time the acquittal was completed.

This is especially the case given that transactions have been deleted leaving no record, therefore it is likely that some expenditure reported at the time will not be reflected in the ledgers at the current time.

Audit then reviewed the removal of transactions lines. There were 113 transactions where lines were removed from the transaction. Whilst this is normal for business the key control consideration is whether these changes impacted the acquittals supplied to the department.

Audit reviewed where the change had occurred after the transaction had been reported in an acquittal to the department. Of these transactions, the actual line items that related to departmental jobs had 150 potential impacts on the acquittals.

Audit then recalculated the acquittal amounts based on the dataset provided to determine if the transactions still matched the amount provided in the acquittal document. Audit found the ledgers provided to Audit at the time of the audit did not reconcile to the acquittals provided to the department. Most likely this is due to the poor controls over changes to the underlying transactions of those acquittals.

As a result Audit believes the integrity of the acquittal reporting for departmental funds has been compromised.

MYOB Transaction Date Changes

Audit then reviewed transaction date changes. The system logs date changes and this is a key control as the reports and reconciliations are dependent on the dates the transaction occurred. Changes in these dates would affect job reports used to create acquittal information

Audit found that there were 974 transaction items where the transaction date was changed. The analysis indicated that there was wide spread changing of transaction dates in the system by both the administrative staff and the administrator. There were 89 transactions relating to departmental jobs. 12 of these had a post acquittal reporting effect.

Audit believes given the extent of changes to transaction dates in the system, by a number of parties, the integrity of the financial accounts, associated internal controls and reports have been compromised.

Bank Reconciliations

Audit then reviewed the bank reconciliations to assess how regular bank reconciliations were performed and whether they are performed appropriately. The regular and correct performance of bank reconciliations is a key internal control in ensuring that the integrity of the ledger is maintained and financial reports, generated for internal management, the Board or funding body acquittals are accurate and timely.

Audit found that bank reconciliations were not current, were performed on an irregular basis and have not been reconciled to the bank statements on some occasions. The last balanced bank reconciliation on file was for October 2010, that is, balanced to both the bank statements and the ledger. As the last balanced bank reconciliation was completed for October 2010, this indicates that TAIHS is not in a position to know their true financial position.

Audit found that over a three year period there were 28 changes to bank reconciliations of which 9 related to the main trading cash account. A large number of reconciliations were undone by both the finance clerk and the administrator account. Of special interest is the period of time which had elapsed between when the bank reconciliation was completed and when it was undone. There was also evidence that transactions underlying the bank reconciliations were later deleted or changed on the same day that bank reconciliations in MYOB were undone.

Audit found that the internal controls over bank reconciliations were ineffective. The nature and time of the transaction changes associated with reopening past bank reconciliations would suggest that the organisation would be at great risk of fraud occurring. The reopening of the bank reconciliations would also indicate that the accounts and associated reporting from those accounts could not be relied upon.

MYOB Transactions Deleted

Audit also found that a total of 1,898 transactions were deleted from the accounting system leaving no record of the original transactions. As a result Audit believes there is a complete breakdown of internal controls with the finance and payroll clerks and the administrator account deleting transactions. More concerning is the number of transactions that were changed and then deleted. Also a large number of transactions were deleted after bank reconciliations were undone by MYOB users.

MYOB Transaction ID

Audit also tested where the system records changes to the transaction id which is the key for identifying transactions and the associated reconciliation of those transactions. All transactions should be unique to ensure the integrity of the system.

There were 291 instances where changes to the transaction id occurred. An analysis was undertaken to see if the transaction id was reused in the system. In the majority of cases the transaction id was reused for unrelated transactions.

As a result Audit believes the integrity of the ledger has been compromised as the transaction identifiers are not unique.

MYOB Security Model

Audit then tested the system changes to the security model that prevents changes to the underlying data. Audit found that there are a number of users involved in changing the security model, which suggest that privileged access is widespread.

As a result Audit believes there are no or minimal internal controls to prevent staff making changes to the security model in MYOB.

MYOB Link Accounts

Audit then reviewed the link account changes. The system links different accounts to various asset, liability and equity accounts to correctly reflect the balance sheet and profit and loss. The system logs these changes.

Audit found that there are some very unusual linked account changes that would result in GST liabilities being used to pay other PAYE and payroll deduction liabilities.

Further testing indicated that a small number of transactions were affected by this change. The effect of these changes was that some liability accounts were over and understated. These details have been forwarded to the Commonwealth Fund Administrator for further investigation.

Additionally there were some unusual linkages that would have produced inconsistent results. For instance supplier discounts were being linked to the cash at bank.

As a result Audit believes the integrity of ledger has been compromised.

Overall Conclusion

Given the magnitude and nature of these changes Audit believes that no reliance can be placed on the integrity of the electronic accounting system and its associated reports, including acquittals. As a result Audit believes TAIHS is likely to be in breach of its service agreements, specifically clauses 5.3, 7.0, 8.1(a) (i) and (iii), 12.2(i), 12.3 and 21.1(a) of the standard Part A.

Service Delivery

The standard of service delivery, performed by TAIHS, was discussed with the Manager CCSQ Townsville and Manager Child Safety Services Townsville on Friday 17 June 2011. They advised that apart from some minor issues the delivery of services was of an acceptable standard and complied with the service agreement. These representations are supported by the brief that had been prepared by the Region for the Director General.

Audit reviewed the Assessment Compliance and Performance (ACAP) reports for CCSQ funded services and noted that while some issues were raised with respect to staff training, recruitment and conflicts of Interest declarations across all the Service Agreements, generally the ACAP did not report any significant items.

Audit reviewed the Annual Service Agreement Assessment (ASAA) reports for Child Safety Services funded services and noted that minimal or no issues were raised. Audit also noted that the ACAP process appears to be more rigorous.

With respect to the quality of service delivery by TAIHS, no significant issues were identified through the ACAP & ASAA review of services or through discussion with regional staff. This indicates that the quality of service delivery is at an acceptable standard to the Department.

Recommendations

1. That the Department enter into discussions with the Commonwealth Department of Health and Aging to develop a consistent approach to resolving the current financial and compliance issues at TAIHS.
2. That the Department immediately review the departments standard service agreements with a view to aligning the remedial provisions in the standard service agreement (Part A) with those remedial provisions in the Commonwealth Agreements. This will provide the department with the appropriate authority in the event it needs to take remedial action and provide consistency in the event remedial action is required to be taken in conjunction with the Commonwealth.
3. That the Department, in conjunction with the Commonwealth Department of Health and Aging, review what options may be available for funding indigenous organisations within the North Queensland Region including considering a model similar to the Palm Island Community Company.