

**EXAMINATION OF SELECTED AUDITOR-GENERAL'S FINANCIAL AUDIT
REPORTS 2021**

Organisation: NSW Health
Date Received: 7 October 2022

Mr Greg Piper MP
Chair, Public Accounts Committee
NSW Parliament
Email: pac@parliament.nsw.gov.au

Your ref D22/50202
Our ref H22/88733

Dear Mr Piper,

Thank you for your letter dated 29 September seeking additional information from NSW Health regarding the Auditor-General's Financial Audit Report on Health 2021.

Further to my last update in June, Mr Garth Worboys, A/Chief Executive, HealthShare NSW, has advised that work continues to be carried out to further enhance stocktaking and inventory management practices and impairment considerations for Whole of Government Warehouse operations, in accordance with the Audit Office's recommendations.

I enclose a table providing detailed responses to the Committee's questions and appreciate acceptance of this information as a supplementary submission.

For more information about impairment, please contact [REDACTED]

For more information about inventory management, please contact [REDACTED]

[REDACTED]

Susan Pearce
Secretary, NSW Health

PAC Question	Health Response
<p>1.1 NSW Health's submission states that 'the validation of inventory inputs was approached on an ad hoc basis during FY21'. Can you elaborate on what is meant by this comment and why validation was ad hoc?</p>	<p>Significant volumes of stock were being received and dispatched across 22 different warehouses during FY21 to support the pandemic response through Whole of Government Warehouse operations, managed by Linfox. A number of these facilities were temporary and variations in inventory processes existed at that time. This is no longer the case and there is now increased control and direction over the Linfox processes and controls for NSW Health.</p>
<p>1.2 NSW Health's submission states that the Audit Office of NSW suggested that HealthShare NSW incorporate a review of best before dates into their stocktaking methodology for 30 June 2021. Can you clarify why this feedback was not adopted in 2020-21?</p>	<p>In its Management Letter dated 15 November 2021, the Audit Office of NSW recommended that management should:</p> <ul style="list-style-type: none"> perform regular checks of the Best Before Date (BBD) information entered by Linfox warehouse staff to ensure they are correct; and incorporate the validation of BBD information as part of the stocktake methodology and procedure. <p>Consistent with the recommendations, during FY22:</p> <ul style="list-style-type: none"> a full BBD validation program was undertaken, and improved monitoring was delivered; and the 2022 Linfox Stocktake Management Procedure incorporates the validation of BBD information as part of the stocktake methodology and procedure. <p>HealthShare was unaware that the Audit Office of NSW had suggested HealthShare incorporate a BBD review into the stocktaking methodology before the Management Letter dated 15 November 2021. Our focus for FY21 was to consolidate the Whole of Government Warehouses and complete a full stocktake to validate stock on hand, which was in line with the recommendations by the Audit Office for FY20. Therefore, a review of BBDs was not incorporated into the stocktaking methodology in 2020-21.</p>
<p>2.1 NSW Health's submission states that it is working with suppliers to obtain formally documented extensions to expiry dates. Can you outline:</p> <p>2.1.1. What is the process for this?</p> <p>2.1.2. What lines of inventory has HealthShare NSW been able to obtain extensions for?</p> <p>2.1.3. How much (cost value) of its inventory has HealthShare NSW been able to obtain formal expiry date extensions for?</p>	<p>2.1.1 HealthShare has written to 18 companies that supply 34 products to investigate expiry date extensions. Extension of expiry dates would allow NSW Health and other Clusters to continue to use these products. Typically, there would also be costs involved in relabelling the</p>

		<p>products. This cost sometimes exceeds the value of the products and is not viable.</p> <p>2.1.2 A total of 8 suppliers offered extensions across gowns, face shields, goggles and sanitiser. None have been exercised as the extension came with a transfer of liability to HSNSW, which was not acceptable.</p> <p>2.1.3 \$0 at this stage. While extensions were granted, none have been exercised as the extension came with a transfer of liability to HSNSW, which was not acceptable.</p>
2.2	<p>Have any discrepancies in best before dates been identified as part of the 2021-22 financial audit? If so:</p> <p>2.2.1. How significant were identified discrepancies?</p> <p>2.2.2. Why did the updated stocktaking procedures fail to prevent or detect identified discrepancies?</p>	<p>HealthShare is yet to receive the 2022 Audit Office of NSW Management Letter, however the Engagement Closing Report received on 28 September 2022 did not report any BBD findings.</p>
3.1	<p>How have the new stocktaking procedures improved the accuracy of HealthShare NSW's inventory data?</p>	<p>The 2021-22 stocktake result showed an improvement in inventory accuracy leading to an adjustment of only -0.04% (-\$435,000) compared with -0.06% in FY21 (-\$718,000).</p>
3.2	<p>Have any subsequent changes been made to the new procedures since they were rolled out?</p>	<p>No.</p>
3.3	<p>Can you provide an update on how the 30 June 2022 live stocktake went using the new procedures, including, the details of any significant deficiencies identified?</p>	<p>The year-end stock count commenced in June and was completed by 30 June 2022. It counted 100% saleable inventory and a sample of the quarantined and non-saleable inventory. Accordingly, it was timelier and more comprehensive than FY21. The 2022 Stocktake Management procedure was developed by HealthShare NSW and Linfox, independently reviewed by PwC, and submitted to the Audit Office of NSW for review and acceptance.</p> <p>Post-audit feedback from the Audit Office of NSW regarding the stocktake has been positive and the Engagement Closing Report Issued by Audit Office on 28 September 2022 does not report any findings about the stocktake.</p>
4.1	<p>How have the new stocktaking procedures improved the accuracy and estimation uncertainty in assessing impairment of COVID-19 inventories?</p>	<p>The HSNSW impairment model calculates the impairment value of the Whole of Government Warehouse PPE inventory. The model uses multiple data input feeds from the inventory sub ledger into an electronic model.</p> <p>The stocktaking procedures and the reviews that have been completed in the Whole of Government Warehouse have</p>

		<p>improved the quality of the inventory data which in turn improves the accuracy of the impairment calculation.</p> <p>The key area of estimation uncertainty in this case relates to another key input used in the impairment model, which is “estimated future consumption rates”. The new stocktake procedures do not influence or improve how well we can estimate this input. Therefore, estimation uncertainty remains high in this case, due to uncertainty around when and how big future COVID-19 outbreaks could be, impacting future PPE consumption.</p>
4.2	NSW Health's submission states that a systematic automatic calculation model was introduced to replace the manual calculation model to calculate inventory impairment. How has this improved the process for assessing inventory impairment and what are the benefits of the new model?	<p>A systematic automatic calculation model was built and implemented during FY22. The model has provided a number of benefits. These include:</p> <ul style="list-style-type: none"> • substantial reduction in worker hours each month in processing the data in Microsoft Excel. • reduction in the probability of human error in processing or calculating the model. • the previous Microsoft Excel model had data capacity limitations.
4.3	Was the new automated model used to assess inventory impairment as at 30 June 2022? If it was, can you outline how the new model performed?	<p>The model was built, implemented and operational for the FY22 year-end calculations. The model performed as intended and enabled the HSNSW Corporate Finance team to process the calculation within the timeframe and meet the year-end financial statements deadline. The model enables large amounts of data to be imported into the model and many calculations to be processed in an efficient manner.</p> <p>As per Question 4.5 below, the only issue identified by HSNSW during the external audit was an understatement error of \$7.7 million due to one part of one input not being considered. Management corrected this error in the FY22 financial statements. Rapid Antigen Tests (RATs) were not included in the impairment automated model and were calculated separately.</p>
4.4	NSW Health's submission states that the new impairment assessment process considers external factors, such as National Medical Stockpile inventory donation requests. Can you clarify what these are?	<p>NSW Health received a request from the Commonwealth to supply PPE back to the National Medical Stockpile (NMS) for Residential Aged Care as part of the winter preparedness plan. The PPE inventory to be supplied to the Commonwealth in FY23</p>

		was excluded from the calculation in the <i>systematic automatic calculation model</i> in the FY22 financial statements.
4.5	Can you provide an update on the outcome of HealthShare's 30 June 2022 inventory impairment assessment? Were any material errors or issues identified? If so, can you provide details?	<p>For the FY22 impairment assessment, an understatement-of \$7.7 million was identified by HSNSW during the external audit and advice was provided to the Audit Office of NSW. That is, the consumption data, which is a key input into the impairment model, did not consider the stock being returned to the warehouse by Health entities when calculating items consumed. Management corrected the misstatement in the FY22 financial statements.</p> <p>HSNSW has implemented a number of other reconciliations to ensure accuracy in the impairment calculation.</p> <p>An understatement-of \$186.7 million, identified during the external audit, was attributed to the impairment of RATs. HSNSW had not considered that the RATs required impairment given the current usage rate and relatively long best before dates. However, as the Audit Office of NSW took a different view, HSNSW subsequently impaired the RATs.</p>
5.1	What does HealthShare NSW do with expired inventory and inventory which does not meet regulatory requirements?	HealthShare quarantines this inventory to ensure it is not used. HealthShare is currently working with several parties to recycle this inventory wherever possible.
5.2	<p>Since the beginning of the pandemic what is the cost value of:</p> <p>5.2.1. COVID-19 inventory which expired before use?</p> <p>5.2.2. COVID-19 inventory which did not meet regulatory requirements?</p>	<p>As at 30 June 2022:</p> <p>5.2.2 \$179.5 million (Masks-\$158.8 million, Ventilators -\$20.7 million).</p>
5.3	<p>If there is any expired or non-compliant inventory still warehoused by HealthShare NSW:</p> <p>5.3.1. What is the cost value of this inventory?</p> <p>5.3.2. What is the monthly warehousing cost of this inventory?</p> <p>5.3.3. What are the future plans for this inventory?</p>	<p>As at 30 June 2022:</p> <p>5.3.2 \$836,000 per month</p> <p>NSW Health has made sustained efforts to reduce the volume of expired or non-compliant inventory in its warehouses. While HSNSW has a dedicated team tasked with managing the inventory, in terms of sustainable solutions, the Australian market is not sufficiently mature to process the volume of inventory needing to be disposed, including that held by NSW Health.</p>

		<p>However, this market is maturing quickly, and further sustainable solutions are expected to come online and become viable for the broader suite of PPE products over the next 6-12 months.</p> <p>HSNSW is also temporarily prohibited from disposing of certain stock which is the subject of litigation with suppliers, including, masks to the value of \$159 million and ventilators worth \$21 million.</p> <p>The continued efforts to extend product expiry dates, described in section 2.1 above, may also reduce this volume.</p> <p>5.3.3 The expired inventory or inventory that does not meet the regulatory requirements is written-off.</p> <p>Where legal action is underway to recover the cost from the vendor for supplying "not fit for purpose" PPE, the stock is kept and quarantined in the warehouse.</p> <p>In other cases, options to utilise the inventory are analysed and considered including to donate, repurpose, recycle, and dispose with consideration on the financial cost and the impact on the environment.</p>
5.4	<p>For inventory currently held by HealthShare NSW and assessed as unlikely to be consumed prior to its Best Before Date:</p> <p>5.4.1. What is the cost value as at 30 June 2022?</p> <p>5.4.2. What is the monthly warehousing cost of this inventory?</p> <p>5.4.3. What are the future plans for this inventory?</p>	<p>As at 30 June 2022:</p> <p>5.4.1 The cost value is \$246.7 million.</p> <p>5.4.2 \$356,000 per month</p> <p>5.4.3 Options to utilise the inventory are analysed and considered including to donate, repurpose, or seeking alternative usage through NSW state Government entities. If inventory cannot be consumed the focus will be on environmentally friendly and financially responsible disposal methods.</p>