

# Who manages Hospitals in Croatia?

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*Source / Izvornik:* **Press releases, 2013, 6, 1 - 3**

**Journal article, Published version**

**Rad u časopisu, Objavljena verzija rada (izdavačev PDF)**

<https://doi.org/10.3326/pr.2013.53>

*Permanent link / Trajna poveznica:* <https://um.nsk.hr/um:nbn:hr:242:164797>

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*Download date / Datum preuzimanja:* **2024-07-26**



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# PRESS RELEASES

## Who manages hospitals in Croatia?

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**The State Audit Office's *Financial Audit Report on Hospitals for 2011* is currently in parliamentary procedure. Hospitals in Croatia are in a poor financial position and their uncontrolled management should as soon as possible be replaced by a regulated financial management system.**

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The State Audit Office has audited 30 hospitals. Of eight clinical hospitals, seven are state-owned and one is in the ownership of the City of Zagreb. The remaining 22 hospitals are county-owned. The main goals of the audit have been to assess the financial performance, establish the authenticity and credibility of financial reports and assess the efficiency of fund utilisation.

**Status.** The financial position of hospitals is weak. They have been in debt for many years now, with their annual revenues insufficient to finance the expenditures. In 2011, total revenues were HRK 9.447bn and total expenditures HRK 9.832bn, with the result that all the hospitals incurred deficits totalling HRK 385m. Admittedly, three hospitals reported surpluses in the observed year, but these surpluses were questionable, given the deficits they had accumulated in the previous period. The poor financial performances led to an increase in total liabilities which stood at HRK 4.8bn in 2011. Particularly strong was the growth in accrued liabilities to suppliers. Hospitals are a classic example of creating a chain of accruals, occasionally broken by the government which settles the liabilities to suppliers by borrowing in the domestic or foreign financial markets. This, of course, leads to public debt growth. Every 5 to 6 years a need arises for new hospital rehabilitations. In November 2012, the Government even passed a law on the rehabilitation of public institutions, primarily intended for health care facilities, i.e. hospitals. Regrettably, the rehabilitations carried out so far have failed to resolve the crucial problems of inefficient management of hospitals and health care facilities.

**Causes of growth in hospitals' expenditures and financial liabilities.** The upward trend in health care expenditures, observed globally, is due to the population ageing, improved health protection, a higher educational level of health service beneficiaries, higher prices of services and technological progress. In addition to these factors, the weak financial position of hospitals in Croatia is also the result of slack financial discipline and administrative inefficiency. Uncontrolled expenditure growth in hospitals and the health system is primarily due to inadequate management. The main financial challenges to hospitals relate to employment and salaries, drug expenditure records, revenues and the payment of fees for medical product testing, receivables and liabilities and the establishment of the actual financial position of hospitals. Let us say something about each of these items:

- **Employment and salaries.** Employment expenses represent the largest expenditure item of hospitals and they stood at HRK 5.4bn in 2011. At the end of the year, there were 39,964 employees in hospitals (29,060 health workers and 10,904 non-health workers). Despite the decision of the then Ministry of Health and Social Welfare from 2009, on the prohibition of employment, new

435 employees were hired (390 health and 45 non-health workers). Most of the hospitals failed to obtain approvals for new hirings and to announce vacancies. Moreover, the number of employees exceeds that planned in the job classification. *Salary calculation is complicated and non-transparent*, and is governed by a number of laws, regulations and collective agreements.<sup>1</sup> Due to institutional complexity, a commission was set up to interpret the provisions of the Collective Agreement, which, in the period from 2005 to 2010, issued as many as 368 resolutions on the method of calculation and payment of salaries and salary bonuses. Additionally, irregularities have been established in the application of job complexity coefficients and calculation of emergency service compensation and salary bonuses.

- **Problems with records and drug expenditures.** Expenditures for drugs and medical supplies represent the second largest expenditure item, standing at HRK 2.5bn (63% of total material expenses). In most of the hospitals, no analytical records of the consumption of drugs and medical supplies are kept, nor are any inventories of supplies made at the end of each year. Drugs and medical supplies are procured through central hospital pharmacies which supply the organisational units of hospitals (departments, clinics and laboratories). The value of hospitals' drug inventories stood at HRK 50.4m at end 2011, up HRK 12.5m (33%) from 2010. Inventories cover between 14% and 144% of average monthly drug consumption. Thus, in some hospitals they only suffice for a few days, whereas in others for more than a month. Liabilities to drug suppliers account for the bulk of hospitals' arrears.
- **Revenues and the payment of fees for medical product testing.** The largest portion of hospitals' revenues comes from the state budget and the Croatian Health Insurance Fund (CHIF). However, irregular payment of these revenues results in hospitals' claims against their founders. In addition to revenues from the budget, hospitals also generate own revenues in the amount of HRK 214m. One of the most significant revenue sources is the clinical testing of medical products performed for pharmaceutical companies. These revenues are distributed between the hospitals and testing teams (hospital employees) on the basis of clinical trial agreements, internal bylaws, decisions of hospital managers and contracts for the payment of fees to investigators. There are considerable differences among hospitals regarding the distribution of these funds: some hospitals get 5% and others 40% of the revenues. The forms of paying fees to trial teams also vary: from authors' fee royalties to temporary service contracts, supplements to salary, etc.
- **Receivables.** The bulk of hospitals' receivables are receivables from the government (CHIF), arising from contracts between the hospitals and the CHIF for the implementation of health protection under the compulsory and supplementary insurance schemes, in the amount of HRK 2.8bn. The receivables of clinical hospital centres and clinical hospitals (HRK 2.2bn) predominate in total receivables. Due to the lack of a uniform methodology for reporting on receivables, their exact amount is questionable (the amount specified in the data submitted by hospitals to the CHIF is lower by HRK 600m than that reported in their financial statements). The CHIF should determine the methodology and bring it into line with the regulations governing budget accounting and financial reporting.
- **Growth in liabilities.** Total liabilities of hospitals were HRK 4.8bn in 2011, up HRK 408m from 2010. Only four hospitals recorded a decline and all the others an increase in liabilities. The liabilities of all the hospitals to the suppliers (for drugs, medical supplies, blood and blood components) were HRK 2.35bn, and credit liabilities to banks stood at HRK 1.36bn. The credit and loan liabilities relate to long-term loans from previous years, used for the construction and upgrade of facilities, procurement of medical equipment and, in small part, for the settlement of liabilities to suppliers. The largest credit liabilities (HRK 926.3m) are those of the Clinical Hospital Centre Zagreb. Regrettably, hospitals frequently use the receipts from borrowing for the financing of current expenditures, despite the obligation and the decision of the founders to use them for capital investment financing. Some hospitals enter into credit agreements without the approval of their founders. This is contrary to the Budget Act which allows them to take out long-term loans only for investments and subject to approval of the majority owner, i.e. founder.

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<sup>1</sup> The Act on Salaries of Civil Servants; Decree on Civil Service Job Titles and Job Complexity Coefficients; Collective Agreement for Public Employees and Civil Servants; and Collective Agreement for Health Care and Health Insurance Employees.

- ***Problems with establishing the financial position.*** The records of business events are uneven and are not kept in compliance with the accrual-basis accounting principle, which makes it impossible to establish the exact financial position. Moreover, the financial plans of most of the hospitals are not accompanied by projections for the next two budget years. There is often a mismatch between the data provided in the analytical records and those in the general ledger and sub-ledgers, while some business events are inappropriately recorded in the chart of accounts.

The State Audit Office' report reveals the poor financial position and inadequate management of hospitals. Considerable savings could already be achieved by complying with the laws and regulations, while responsible and prudential management of hospitals would contribute significantly to the financial stability of the health system. The Ministry of Health, hospitals and the CHIF should, with no extra costs and in the short run, resolve the issue of the calculation and level of employees' salaries, introduce a uniform methodology for submitting reports by hospitals to the CHIF, set up systems for ongoing monitoring of drug and medical supplies consumption, improve auxiliary analytical records of assets and liabilities, consolidate public procurement and put in place internal control and audit systems.