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*Dear Nick*

The Committee has decided to take evidence from health boards and the Welsh Government on NHS bodies' financial position and to follow up on issues raised in my July 2017 report on the [Implementation of the NHS \(Wales\) Finances Act 2014](#) (the Act).

To support the Committee's scrutiny, I have updated the figures from my 2017 report as well as collating further information. These are contained in the Annexes to this letter.

In Annex 1, I have updated the figures on the overall budget for health. I have also set out the 2017-18 financial outturn position for each NHS body and whether they met their duties under the Act.

In Annex 2, I provide an update on work to deliver financial savings. I have updated figures on savings from my 2017 report. I have also included a summary of the key messages from my most recent round of 'Structured Assessment' work at NHS bodies, which included work on the delivery of savings plans. Following correspondence with the Welsh Government in the wake of the evidence that the Committee heard in July 2017, Members have expressed interest in issues around efficiency, the financial governance reviews that have taken place in the four health boards that are in escalated levels of intervention and the zero-based review in Hywel Dda UHB. My update notes the extent to which issues raised by the financial governance reviews chime with the findings from my own audit work.

Finally, Annex 3 sets out the Welsh Government's progress against the recommendations from my 2017 report, alongside my own observations.

I trust that the Committee will find this information helpful as it scrutinises health boards and the Welsh Government.



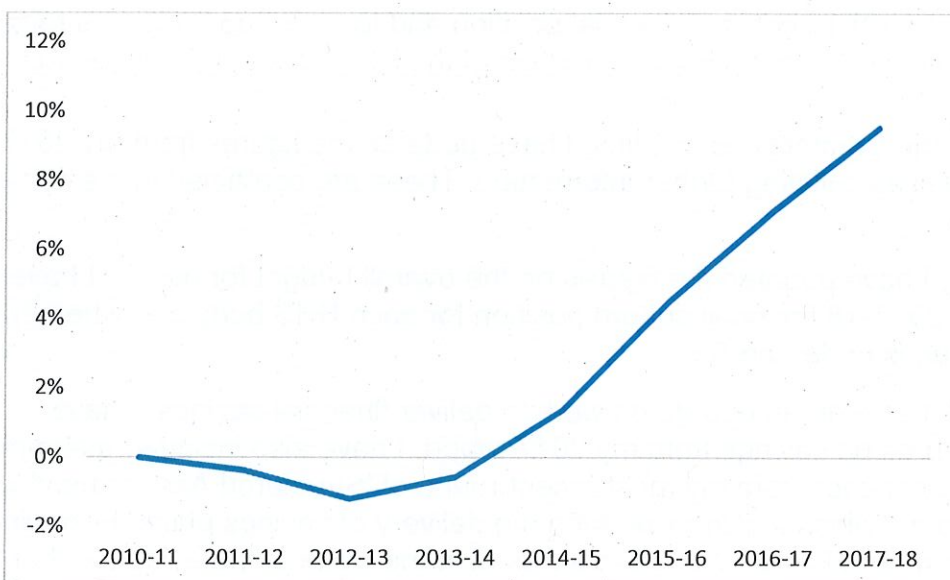
**HUW VAUGHAN THOMAS**  
**AUDITOR GENERAL FOR WALES**

## Annex 1: Financial position

### Health revenue budget over time

**Figure 1** provides an update on the health revenue budget over time. It shows that the recent trend of real terms increases in spending has continued. My 2017 report drew attention to the pattern of the Welsh Government providing in-year additional funding to the NHS. This pattern again continued in 2017-18, with an additional £85 million allocated to health from reserves in the second supplementary budget. The additional funding was intended to support improved performance<sup>1</sup> as well as to manage winter pressures and unexpected deficits at Hywel Dda UHB and Betsi Cadwaladr UHB<sup>2</sup>.

**Figure 1: real-terms changes in health revenue spending from 2010-11**



Note: This chart shows the change in health revenue spending from a 2010-11 baseline in real terms. So, for example, in 2017-18 spending was 10% higher than in 2010-11.

Source: Wales Audit Office analysis of Welsh Government budgets

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<sup>1</sup> The additional funding for performance was contingent on meeting specific performance targets. The Welsh Government reclaimed funding from three health boards – Abertawe Bro Morgannwg UHB, Betsi Cadwaladr UHB and Aneurin Bevan UHB - for failing to meet those targets.

<sup>2</sup> The funding added to the health revenue budget to cover unexpected deficits at Hywel Dda UHB and Betsi Cadwaladr UHB was not subsequently passed on to those health boards. However, it was required in order that the Health and Social Services' budget would break-even.



## NHS bodies' compliance with their duties under the NHS (Wales) Finances Act 2014

The Act introduced two new duties for the seven health boards in Wales:

- to break even over a rolling three-year period – replacing the previous requirement to break even every year; and
- to have a three-year integrated plan that is submitted to and approved by the Welsh Ministers.

The Welsh Government subsequently introduced policy guidance requiring the three NHS trusts in Wales to also comply with the two duties set out in the Act.

Figure 2 shows that four health boards failed to meet their first financial duty in 2017-18. These were the same four health boards that failed to meet the duty in 2016-17. These health boards face a significant challenge to recover the position and meet their duty in the coming years. I had noted in my 2017 report that in order to meet the duty at 31 March 2018, those health boards would have needed to underspend in 2017-18 by the equivalent of their net overspends in 2015-16 and 2016-17. Hywel Dda UHB and Betsi Cadwaladr UHB ended the year with larger in-year deficits than in 2016-17. Cardiff and Vale UHB and Abertawe Bro Morgannwg UHB ended 2017-18 with a smaller deficit than in 2016-17.

Figure 2: health board finances over the three years 2015-16 to 2017-18

NHS Organisation	Retained Surplus (Deficit)	Surplus / (Deficit)	Surplus / (Deficit)	Accumulated Surplus / (Deficit)	Did the body meet its duty under the Act?
	2015-16	2016-17	2017-18	2016-17 to 2017-18	
<b>Health Boards</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	
ABMU	86	(39,316)	(32,417)	(71,647)	No
Aneurin Bevan	214	49	246	509	Yes
BCU	(19,525)	(29,784)	(38,838)	(88,147)	No
Cardiff and Vale	68	(29,243)	(26,853)	(56,028)	No
Cwm Taf	22	18	23	63	Yes
Hywel Dda	(31,199)	(49,613)	(69,430)	(150,242)	No
Powys	40	85	96	221	Yes
<b>NHS Trusts</b>					
PHW	17	16	28	61	Yes

Velindre	40	35	49	124	Yes
WAST	49	44	70	163	Yes
Total	(50,188)	(147,709)	(167,026)	(364,923)	

Source: NHS bodies' audited accounts

The in-year deficit across the NHS, as set out in the accounts, has grown again this year to £167 million. It should be noted that Aneurin Bevan UHB and Cwm Taf UHB health boards actually delivered surpluses higher than those shown in the accounts by £2.4 million and £3 million respectively. However, the two health boards 'brokered' those surpluses back to the Welsh Government thereby reducing their spending limits (and therefore their recorded surpluses) for 2017-18 and adding the equivalent amounts to their spending limits for 2018-19. Had the spending limits not been adjusted, the overall deficit across the NHS for 2017-18 would have been £162 million.

The accumulated three-year deficit, as set out in the audited accounts, has risen from £253 million to £365 million. However, this figure excludes the deficit from 2014-15. Including that year, the total accumulated deficit across the NHS is £420 million since the start of the Act.

For 2017-18, six of the ten NHS bodies had an agreed Integrated Medium Term Plan (IMTP). The four that did not have an agreed three-year plan were the same that did not meet the duty to break-even over three years. Hywel Dda UHB; Betsi Cadwaladr UHB; Cardiff and Vale UHB and Abertawe Bro Morgannwg UHB were all working to a one-year plan in 2017-18.

I have issued a substantive report on the accounts of the four health boards that failed to meet their duties under the Act, with all four having a qualified regularity opinion on their accounts. In my substantive report on Hywel Dda UHB I noted the Cabinet Secretary's May announcement that factors related to demographics and scale contributing to the health board's financial position were outside of its control. This had been demonstrated by a zero-based review that Welsh Government commissioned Deloitte to carry out. The Cabinet Secretary announced an additional annual recurrent funding of £27 million to reflect these factors from 2018-19. The health board's financial position needs to be understood in the context of this announcement.



## Annex 2: Savings planning and delivery

My Structured Assessment work during 2017-18 included consideration of NHS bodies' approach to planning and achieving savings. While I found some specific issues at individual NHS bodies, there are some key themes which I think it would be helpful to share with the Committee. Wales Audit Office staff have already shared these observations with the NHS Wales Efficiency, Healthcare Value and Improvement Group and with the Chairs of the Audit Committees of all NHS Wales bodies. Those key themes are:

- The past track-record of savings delivery is good but savings approaches are no longer addressing the gap between financial resource and total expenditure.
- On the whole, NHS bodies are making savings through short-term schemes, as opposed to securing efficiencies through longer-term modernisation and transformation of services.
- When in-year cost pressures occur, there is a tendency to resort to short-term cost control measures and non-recurring savings.
- It was common to see NHS bodies apply a uniform savings target to all directorates, rather than adopt a scaled approach based on an analysis of where the greatest scope for securing efficiencies exists.
- The extent to which savings plans are integrated with IMTP or annual operational plans is highly variable. Health boards in targeted interventions are less likely to have integrated savings plans.
- While there was typically good support from finance departments to help the wider organisation plan and deliver savings, support from other 'corporate enabler' functions such as IT, HR and programme management offices was more variable.
- Overall, the arrangements to monitor the delivery of financial savings within NHS bodies are good, although the level of detail reported to boards and committees is more variable.

In presenting these findings to the NHS Wales Efficiency, Healthcare Value and Improvement Group, we also raised some questions for consideration at a national level, which the Committee may want to reflect on as part of its inquiry:

- What can be done nationally to encourage disinvestment in areas where there is little value demonstrated?
- If boards need to make difficult decisions on affordability of existing service models, what would encourage them to take a managed risk approach?
- What national approaches would help drive a more consistent focus on value and productivity when planning and commissioning services?

- Could 24 or 36 month savings targets be set for transformational schemes to encourage a longer-term focus?
- Are three-year financial flexibilities maximising the opportunity for longer-term financial sustainability?

The Committee is aware that the Welsh Government commissioned Deloitte to carry out reviews of financial governance at the four health boards that have not met their duties under the Act. The Welsh Government summarised the key messages in its update letter of 26 February 2018. It should be noted that the messages from the financial governance reports mirror messages that I have reported to health boards in recent years through my Structured Assessment work. The Committee has requested updates from the relevant health boards on the action they have taken in response to the Deloitte reviews. Similarly, it has requested details of the action taken in response to my Structured Assessment work, specifically with regard to savings planning and overall financial planning/management.

My 2017 report included some detailed analysis of the patterns of savings at NHS bodies. I have updated the charts (below). Overall the amount of savings increased compared from £137 million in 2016-17 to £169 million in 2017-18. There was a reduction in the reliance on non-recurrent savings. Nonetheless, the pattern of savings late in the year suggests there remains a continued problem with the short-term focus of savings plans:

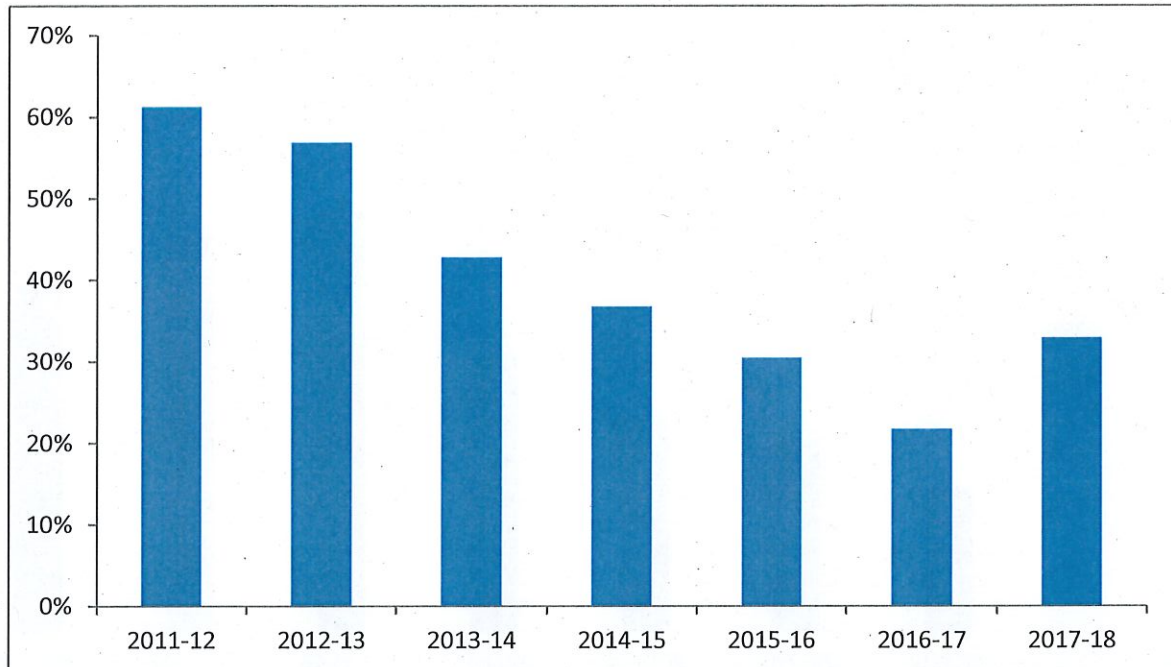
- The proportion of the funding gap bridged through savings increased from 22% to 33% although the underlying figures need to be treated with some caution(Figure 3)
- The proportion of non-recurrent savings<sup>3</sup> fell from 34% to 29% (Figure 4)
- The proportion of savings delivered late in the year increased with 36.5% of the total savings delivered in the final quarter of the financial year (up from 32% in the equivalent quarter for 2016-17). (Figure 5)
- While the overall proportion of capital spend in the final month (36%) is lower than in 2016-17 (46%), this pattern of high spending in the final month of the year still, in my view, potentially poses a risk to value for money (Figure 6)

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<sup>3</sup> Recurrent savings are long-term savings that permanently remove costs whereas non-recurrent savings do not provide benefits in future years. Examples of non-recurrent savings are delaying necessary procurement or recruitment until the next financial year.



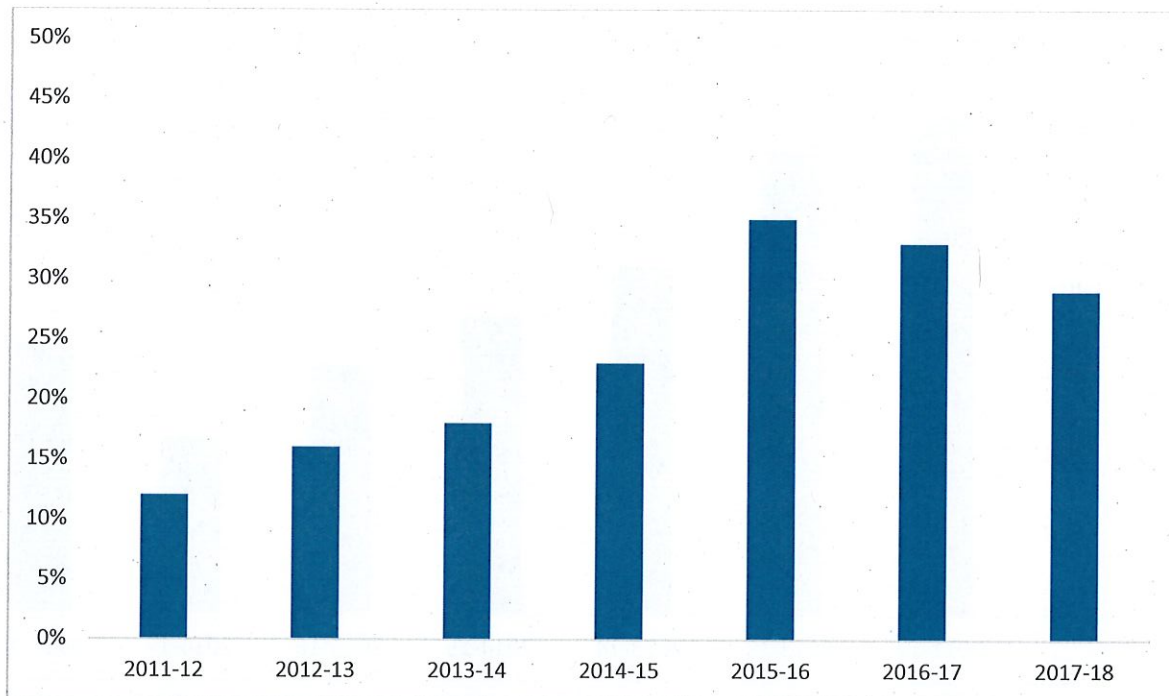
Figure 3: proportion of funding gap bridged through savings, 2011-12 to 2017-18



Note: These figures are taken from the returns that NHS bodies submit to the Welsh Government and is consistent with the figures presented in our 2017 report. However, the Welsh Government has recently advised that it considers that NHS bodies' calculations of their funding gap has not been consistent and that the figures therefore need to be treated with some caution.

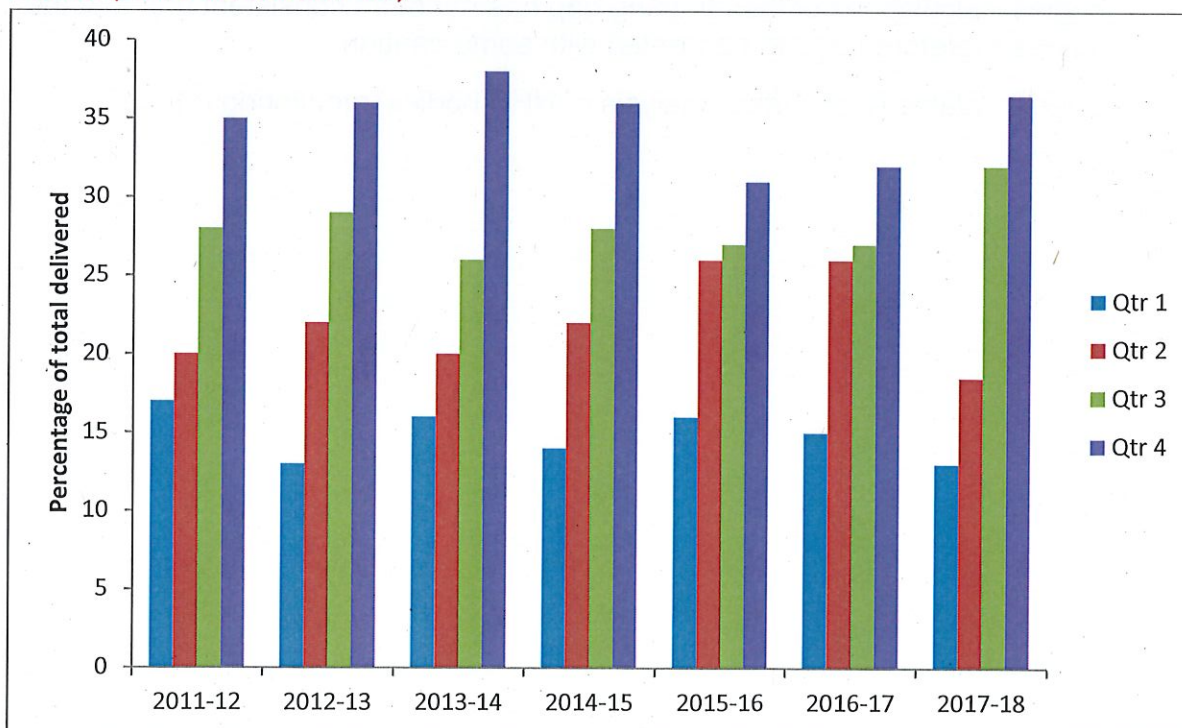
Source: Wales Audit Office analysis of NHS bodies' monitoring returns

Figure 4: proportion of savings delivered that are non-recurrent, 2011-12 to 2017-18



Source: Wales Audit Office analysis of NHS bodies' monitoring returns

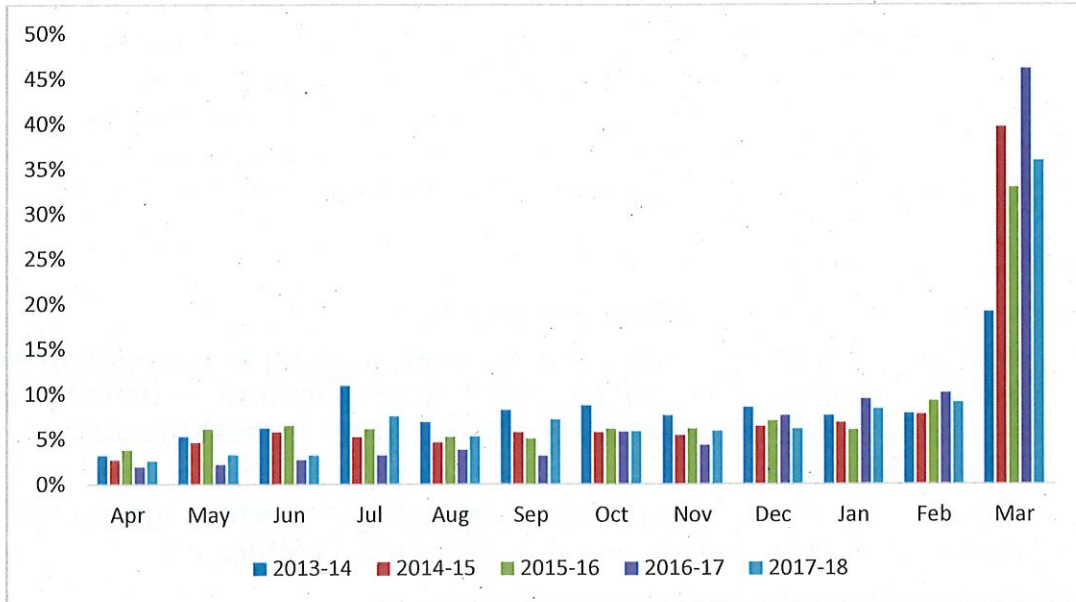
Figure 5: percentage of annual savings delivered in each quarter across NHS Wales (2011-12 to 2017-18)



Source: Wales Audit Office analysis of NHS bodies' monitoring returns



Figure 6: Monthly capital expenditure



Source: Wales Audit Office analysis of NHS bodies' monitoring returns

### **Annex 3: Welsh Government response to my recommendations**

I made two recommendations in my 2017 report and also identified two broad areas for the Welsh Government to focus on. The Welsh Government partially accepted the first of my recommendations and accepted the second. The Welsh Government's latest position against my recommendations and the two broad areas is set out below. The Committee will have the opportunity to put questions on the update to the Welsh Government in its evidence session on 16 July.

#### **Recommendation 1**

**We recommend that the Welsh Government:**

- a) **sets out more clearly in its guidance how, working in partnership with the Welsh Government, NHS bodies that have incurred a deficit should plan to recover their financial position in order to meet the duty in future years; and**
- b) **enhances its monitoring returns to include the position against the three-year rolling periods, not only the annual picture.**

#### ***Welsh Government Response (provided in July 2017):***

##### **Partially Accepted**

We do not accept that NHS bodies require additional guidance from Welsh Government on the action they need to take to recover a deficit in order to meet the duty in future years. The operation of the duty was detailed in the Explanatory Memorandum to the Act, and also has been set out in Welsh Health Circular (2016) 054 – Statutory Financial Duties of Local Health Boards and NHS Trusts. However, we recognise the need to ensure that all new board members fully understand the organisation's duties, and this requirement will be addressed in the Independent Member's Induction Programme.

We accept the recommendation that our regular monitoring process needs to include a three-year perspective as well as the annual position for those organisations working to approved three-year plans. We will consider the additions we need to make to the monitoring process to include this perspective. This will be completed by 31st October 2018.

#### ***June 2018 Welsh Government update:***

##### **Independent Members Induction**

Building on the successful Finance Academy arranged Independent Members Finance and Governance development session, in June 2016, Welsh Government Health and Social Services officials have been working with Academi Wales on:



- An Induction Guide for Independent Board Members
- An Independent Board Members' Induction Programme

Module 2 of the Induction Programme on "Planning, Resource and Delivery" included a specific session on NHS Wales Financial Duties, both the planning and break even duty. Module 2 also included presentations from NHS Director of Finance and Director of Planning, as well as a presentation from the Wales Audit Office. To support Independent members in their scrutiny and review of the respective draft Integrated Medium Term Plans being presented at the January Board meetings Module 2 was deliberately held on 16 January 2018.

The Academy Wales Independent Board Members' Induction Programme complements the locally arranged induction and development programmes at Local Health Boards and NHS Trusts.

### **Monitoring Returns**

Discussions were held with NHS finance staff in October 2017 regarding the potential introduction of three-year monitoring tables. At this stage, no specific requirements for three-year monitoring tables are planned for those organisations with approved medium term plans. The NHS Planning Framework requires health boards and trusts to undertake a Mid-Year Review of the plan delivery, with particular reference to a forward look on the implications, consequences and potential changes to years 2 and 3 of the plan. Welsh Government formally reviews progress in the bi-annual Joint Executive Team meetings with each organisation.

### **Recommendation 2**

**We recommend that the Welsh Government swiftly completes the review of its funding formula for health boards to ensure that variations in funding levels properly reflect differences in population health needs and other determinants of healthcare costs**

*Welsh Government response (provided in July 2017):*

### **Accepted**

Phase 1 of the resource allocation review was completed within the Finance Regime element of Together for Health. We intend to take forward Phase 2 in due course. Project proposals and timetable are under development and will be shared with the Cabinet Secretary for Health, Well-being and Sport.



### *June 2018 Welsh Government update:*

Proposals are being developed for Phase 2 of the Resource Allocation Review. This work will build on the expertise and lessons from Phase 1, the findings from the recent Zero Based Review in Hywel Dda Local Health Board, funding formula approaches in comparative countries, such as New Zealand, Scotland and England, and also Welsh Government policy priorities.

For example the context of the Zero Based Review was that the configuration of services in Hywel Dda generated excess costs for the Board, but the key findings identified that the population characteristics that is demographics rather than configuration of services was the main driver of excess cost. The implication, to be tested in the review work, was that the current formula may not adequately recognise and weight the age/sex needs and cost curve. Given the changing demographics and the projected changes within the population, both volume and age/sex mix, this will be a critical element of the review and formula development.

### *Auditor General for Wales's broad areas*

- a) addressing the funding cycle that sees significant amounts of funding being provided to NHS bodies towards the end of the financial year; we consider that continuing with this pattern is not sustainable; and
- b) using the opportunity provided by the Parliamentary Review of Health and Care, the development of a new NHS strategy and the development of local long-term plans by NHS bodies to provide an updated and clearer direction for NHS services, in particular the move to greater regional and national services.

### *Welsh Government response:*

- a. Welsh Government has moved away from a practice of issuing significant amounts of funding late in the year. In terms of 2017-18, all NHS organisations received a 2% uplift in funding to meet inflationary and other cost pressures which was confirmed before the start of the financial year. Further funding was provided to Aneurin Bevan and Cwm Taf UHBs in June 2017 in support of their approved medium term plans. Subsequent to this, the only additional funding provided to NHS bodies was for specific priorities. This included £50 million announced in August 2017 to improve waiting times, and £10 million announced in January 2018 in recognition of the extreme winter pressures that health and social services had experienced.
- b. *A Healthier Wales: our plan for health and social care* was published on 11<sup>th</sup> June. This sets out our response to the Parliamentary Review published in January, with specific actions that we will implement over the next three years. This includes a commitment to develop a national clinical plan for specialist health services setting out our strategic approach to delivering safe



and high quality health services which meet the needs of people across Wales by the end of 2019.