Trust Board meeting 25 March 2010

2010/11 budget

1. Introduction

This paper summarises the Trust's financial plans, comprising revenue budgets, capital programme, cash flow/liquidity and statement of position, for 2010/11.

Contract negotiations for next year have not yet been finalised and these plans are based on the Trust's contract proposal to the Hertfordshire PCTs which is some £11m more than the PCTs' offer. This means that there is still considerable uncertainty about income in 2010/11 and therefore about the scope of the internal actions needed to live within expected income and achieve required financial performance.

Having said that, considerable progress has been made in reviewing budgets to get them onto a realistic baseline and developing savings plans to bring them down to an affordable level.

2. 2009/10 forecast outturn

As members of the Board are aware, the Trust is forecasting that it will achieve a surplus of £5.2m which will enable the last £4.6m of the historic deficit to be covered and the statutory break even duty to be met.

3. Planned revenue surplus for 2010/11

The planned surplus shown in Appendix A is £8.6m. This is required to enable loan repayments to be made and to make a small improvement in liquidity. Whilst the level of planned surplus appears high, it is important to be clear that this is largely non discretionary as the Trust must generate a surplus in order to make loan repayments of £6.6m for the Acute Admissions Unit capital loan and two working capital loans.

As part of its medium term financial strategy, the Trust also has to improve its liquidity position which has historically been very weak. £2.0m has been included in the target surplus above, which will increase liquidity by approx 3 days.

4. Income budgets

Details of the factors affecting income are set out below.

4.1 Tariff changes

Income for patient care is based on the national tariff and the HRG4 classification. As reported to the board in January, the tariff includes an assumption that 3.5% efficiency savings will be made to fund cost increases so the cash level of the tariff is largely unchanged from 2009/10. There are also some changes built in for emergency activity, where activity above 2008/09 outturn levels will only be funded at 30%. The net effect of tariff changes, excluding CQUIN, is a net reduction of £0.4m or 0.2%. CQUIN, the payment for quality, has been increased from 0.5% in 2009/10 to 1.5% in 2010/11 and, as outlined below, some of this is currently at risk.

4.2 Contracts with Hertfordshire PCTs

Contract negotiations with the Hertfordshire PCTs have been more challenging than last year and are still not finalised. The PCTs are spending more on hospital services in 2009/10 than planned and this is a pattern across most of their acute services contract portfolio. The percentage level of overperformance at this Trust is lower than at many other hospitals the PCT contracts with and it is clear that the number of patients being referred by GPs is increasing across the board.

2010/11 is the third and last year of the current comprehensive spending review so, despite the economic downturn, Hertfordshire PCTs will continue to receive growth funding next year, at the minimum level of 5.5% reflecting their over capitation funding position. This growth equates to £45m for West Hertfordshire which the PCT plans to use to address non recurrent issues, contingencies and other investments. Spending on secondary care is expected to reduce and the PCT is developing ambitious plans to do this but as yet it is too early to see what impact these plans will have.

The Trust's contract offer to the PCT reflects a reduction in new outpatients of approximately 10% in most specialties, a reduction in the follow up ratio for outpatients (where we are already at the East of England average rate) from a ratio of 1.8 to 1.7 and a reduction in the number of low priority treatments (including oral surgery, cosmetic surgery, minor orthopaedic procedures, hernias and dermatology). This is partly offset by an increase for population change, in line with the PCTs' estimates. The net effect of these factors is a reduction in income to the Trust of £2m below forecast outturn.

The Hertfordshire PCTs' proposal to the Trust is £11m below this, largely due to much higher aspirations for the reduction in out patient referrals as a result of demand management and service redesign proposals. The PCT proposal is £11m below expected outturn and also below planned activity in 2009/10.

4.3 Other PCTs

Only one proposal has been received and agreed so far and this is based on forecast outturn activity. There is no evidence that other, non local, PCTs will make any significant changes to activity from 2009/10 outturn.

4.4 Education and training

No proposals have been received from the Deanery yet, advice from the SHA is to assume that income will be the same as in 2009/10.

4.5 Contract terms and payments for quality (CQUIN)

CQUIN has been referred to above and the current estimate is that, without further investment, the Trust is likely to secure around half of the 1.5% or £3.3m maximum. Some quality requirements are nationally set, some regional and some are local. Whilst the Trust accepts the principle that CQUIN payments should be linked to increased quality, it is also important that targets are attainable otherwise CQUIN simply becomes another financial pressure on the organisation. CQUIN is still under discussion with the PCT. The Trust will assess what it would need to do differently to achieve a greater proportion of CQUIN funding, some improvements could be achieved with additional investment but other targets are not accepted by clinicians.

The national acute services contract includes a range of performance targets covering areas from infection control to waiting times to data quality and patient/staff survey results. The Hertfordshire PCTs are proposing to attach financial penalties to many of these requirements over and above what is prescribed nationally and this is an issue that is also still under discussion. Based on current performance, the scale of the financial risk associated with currently proposed penalties is circa £1m.

5. Expenditure budget setting

Internal expenditure budget proposals from divisions have been reviewed to establish a realistic baseline prior to the application of savings plans in the 'Big Ask'. A number of previously unfunded pressures have been addressed and vacancy factors have been built into areas where it is very unlikely that funded establishments will be filled.

Work is required to finalise the calculation of budgeted capacity needed to deliver the lower level of activity proposed to the PCTs, this particularly relates to theatres and outpatient clinics. It is essential that there is a clear methodology for assessing capacity and to translate this into staff establishments and budgets. Some adjustments has been made within the initial theatre budget to remove spend on outsourced work and weekend working but this needs to be refined as part of the 'Big Ask'.

Within proposed budgets, some increase has been made to midwifery staffing but this does not go as far as the 1:30 ratio that the Department of Health has targeted.

6. Savings – The Big Ask

An internal project has been established to identify the savings needed to set a balanced budget and the focus is on achieving £21m, which was based on the Trust's contract offer to PCTs. This will need to be revised in the light of contracts finally agreed.

Staff across the Trust have generated a large number of ideas for reducing costs, these have been prioritised and project managers identified to work up each proposal into a deliverable plan. Project leads are currently completing Gateway 2 forms which will confirm the values of savings, provide timescales and assess risks. In advance of this, a high level review indicates that schemes to date will deliver £15m in a full year and some £12.5m in 2010/11 and so work is ongoing to increase these values. A table summarising progress to date is shown below.

The Big Ask - Summary Position				
Title	**Number of schemes**	**Gross value £k**	**In-year savings £k**	**%age**
Income	24	2,400	1,950	16
Pay	35	3,200	2,700	22
Procurement	34	5,450	4,650	37
Efficiency/Innovation	24	4,300	3,200	26
Other	0	0	0	0
Totals	**117**	**15,350**	**12,500**	100

An individual has also been identified to review the impact of each scheme and ensure that quality of service is not compromised and that risks are managed. It is also important that staff do not assume that financial savings automatically translate into quality reductions as in many cases improving efficiency saves money and has a positive impact on quality and patient experience.

The overall budget summary attached shows that, based on the current contract proposal and after review of budgets, cost pressures and reserves, the total needed is £20m.

7. Reserves

Reserves of £7.9m have been provided to cover expected pay increases and inflation, the plan also includes a general contingency of £2.1m.

8. Capital programme

In view of the overall size of the financial challenge facing the Trust it is proposed to limit capital spending to the £8.6m generated by depreciation charges (excluding £0.2m depreciation on donated assets). The Capital Planning Group has reviewed requirements for backlog maintenance, legislative compliance and IM&T to prioritise the most essential items.

Revised management arrangements are proposed with allocations provided to the heads of different areas within which they have to prioritise smaller schemes. The Director of Delivery will manage £0.5m for critical replacement of equipment, the Head of Estates £0.5m for critical estates work and Head of IT £0.2m for critical IT infrastructure. These are minimal allocations because the majority of funding is committed to completing schemes already in progress.

The capital programme detailed in Appendix B is overcommitted by £1.8m and earmarks only £0.5m for new initiatives. Slippage will be managed by the capital programme group through the timing and phasing of all projects, the level of slippage built into the plan is in line with experience in recent years.

9. Cash flow and liquidity

The cash flow statement is shown in Appendix C. This includes a high level estimate of the phasing of savings throughout the year. The minimum cash balance (£1.8m) in September is after the first instalment of loan and dividend payment. The balance in March 2011 is nil as this retains maximum cash flow flexibility otherwise restricted by the Trust's External Financing Limit (EFL). A nil cash balance as at 31st March 2011 is planned through reducing creditors.

As shown in the financial risk rating (FRR) table, in the following section, the proposed plan delivers a liquidity risk rating of 2. This is dependent on the maximum working capital facility of £18.9m which is 30 days of operating expenditure.

10. Statement of financial position

The planned statement of financial position (Appendix D) illustrates the following:

- £4m increase in non current assets resulting from anticipating inflation
- £1.7m decrease in cash balance as explained above
- £4m decrease in current liabilities mainly non NHS trade payables linked to the cash reduction
- Reduced loan liabilities reflecting in year repayments
- £8.6m operating surplus reflected in retained earnings

11. Financial Risk Rating (FRR)

The following shows the FRR based on the current plan and forecast outturn for 2009/10. This shows an achievement of the minimum rating of 3 required by Monitor.

Financial Risk Ratings - Monitor

Criteria	Metric	Weight	5	4	3	2	1	Annual Plan 2010/11
Underlying performance	EBITDA margin %	25%	11	9	5	1	<1	4
Achievement of plan	EBITDA achieved %	10%	100	85	70	50	<50	3
Financial efficiency	Return on assets %	20%	6	5	3	2	<-2	5
	I&E surplus margin %	20%	3	2	1	-2	<-2	5
Liquidity	Liquid ratio days	25%	60	25	15	10	<10	2
Average								3.80
Overall rating	Overall rating	The overall rating can only be one above the lowest scored rating						3

12. Risks

The Trust faces a number of financial risks in 2010/11 which need to be managed, through the remainder of the planning process and by rigorous financial management throughout the year. The main risks are:

- Delivery of the Big Ask - £21m is a significant challenge of some 8% and delivery of this will require robust planning, commitment across the organisation and strong performance management.

- Scale of income reduction and deliverability of savings above the £21m currently targeted in the next 12 months and without significant rationalisation of services/sites

- Capacity to meet activity if demand management plans do not deliver – this will require phasing of contracted activity and close scrutiny of changes in referral rates. There are both financial risks and quality/waiting time risks if activity differs significantly from plan, and the greater risk is if activity is greater than expected.

- Penalties attached to contract requirements and CQUIN targets and contract management challenges.

- Maintaining adequate liquidity.

- Management of expenditure in line with budgets

- Estates/equipment/IT issues over and above those covered in the capital programme which may require urgent investment in year.

13. Conclusion

2010/11 will be a challenging year for the Trust. Although all NHS organisations are feeling resource pressures, at the same time as quality requirements and patient expectations are increasing, the scale of the challenge locally is greater than many.

There is much greater uncertainty about income and activity levels than in previous years and £20m, or 8%, is around the maximum level of savings that can realistically be achieved in one year.

Finalising a financial plan for the new year is likely to require input from the SHA and further negotiation with the PCT as well as delivery of the internal plans outlined in this paper.

The Trust must also engage in a more strategic discussion with the PCT about future services, how these can be provided within more constrained funding beyond next year and how these changes can be managed and supported.

Anna Anderson
Finance Director

18 March 2010