Trust Board meeting 31 March 2011

Agenda Item 41/11

2011/12 Budget

1. Introduction

This paper summarises the Trust's financial plans, comprising revenue budgets, capital programme, cash flow/liquidity and statement of position, for 2011/12.

At the Finance Committee on March 21st 2011 three scenarios for 2011/12 were discussed based on a range of contract income and expenditure and loan refinancing assumptions. This paper sets out the proposed budget for 2011/12 based on the assumptions agreed at the Finance Committee.

2. 2010/11 forecast outturn

As members of the Board are aware, the Trust expects to achieve a surplus of £7.5m. The size of the surplus was largely driven by the need to finance loan repayments and to increase the level of liquidity.

3. Planned revenue surplus for 2011/12

The target surplus is based on anticipated lower loan repayments and an improvement in the level of cash holding to 10 days as summarised below

	This includes the Trust's preferred refinancing option **£m**
Principal Loan repayment	1.1
Improvement in cash balance (over and above cash from increasing creditors)	2.9
Planned reduction in cash relating to use of working balances (Medirest & provisions)	0.4
Target Surplus	**4.4**

The assumption included here is based on the original proposal the Trust submitted to the SHA last summer and the preferred option is the same as that included in the earlier resource outlook and the updated LTFM. i.e. a new loan to repay the Trust's outstanding loan balance over 25 years at an interest rate of 1.89% in line with that for the most recent working capital loan. The final resolution of this is still awaited.

As part of the agreement to refinance the loans, the Trust will need to improve its cash position. The plans discussed in this paper enable the Trust to have 10 days of cash, equivalent to £6.5m, at year end.

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. The PbR tariff for 2011/12 was outlined in the Operating Framework published in December 2010 and includes the following:

- A reduction of 1.5% overall, prices outside the tariff regime are also expected to reduce by 1.5%. With provider inflation assumed at 2.5%, this results in a 4% efficiency requirement

- Hospitals will be not be paid for elective patients who are readmitted within 30 days, and the target is to reduce these by 25%
- Payments for quality through CQUIN remain at 1.5%.
- The number of best practice tariffs will increase
- Prices will be adjusted to reduce payments for patients with a long length of stay
- A&E tariff will move to HRG 4
- The 30% marginal tariff for emergency admissions remains, with a 2008/09 baseline

The Trust has run the 2010/11 activity through the new tariff grouper and instead of a 1.5% tariff reduction and a 0.7% reduction on the Market Forces Factor (MFF), which had not been expected, the Trust believes the actual reduction in tariff income for both these elements is a combined 1.2%.

4.2 Contract with NHS Hertfordshire

The LTFM and Resource Outlook planning assumptions for the value of SLA income from NHS Hertfordshire was £201.4m which was based on a proposal put to the PCT and is close to the value implied in the QIPP. The Trust has received a contract offer from the PCT, of £194.7m, with a maximum of £200.6m, The proposal includes £9.5m of activity reductions relating to demand management, restrictions on joint replacements, reduced emergency admissions as a result of falls prevention work and other smaller reductions in line with the QIPP. The PCT has also offered £5.9m to 'manage and support demand in a more effective manner', which would increase the contract value to £200.6m, however as this is based on a non PbR contract it is not acceptable to the Trust. The Trust has written back to the PCT with a counter offer of £203m. Negotiations are ongoing and a further update will be provided at the Board meeting.

For the purposes of setting a budget a contract income of £200.6m has been assumed. This was agreed by the Finance Committee at its meeting held on 21st March 2011.

In addition to SLA income, the PCT have stated they will support a £2m bid against the Transformation Fund to cover existing double running costs and Big Ask costs in support of the county wide QIPP agenda. This is included in 'other' income.

4.3 Other PCTs

There is no evidence that other, non local, PCTs will make any significant changes to activity from 2010/11 outturn. For 2011/12 the Trust has assumed £22.8m of income which is slightly below forecast out turn.

4.4 Other income

Other income covers income received for a variety of purposes, the main one is Training & Education, and others include: rental income, car parking and staff accommodation and the tablet packing unit. The proposed 2011/12 budget is based on recurrent forecast out turn plus the £2m Transformation Fund income mentioned in section 4.2.

5. Expenditure budgets

5.1 Pay and non pay expenditure

Draft pay and non pay budgets for 2011/12 are largely based on forecast outturn and current activity levels adjusted for non recurrent items and areas where management control of spend is being improved. The main areas where spend has been significantly higher than plan have been theatres, midwifery, medical locums and maternity pay across the Trust. The majority of these costs will need to be funded and have been included in the relevant Division's budgets. Further testing of some of these pressures is being undertaken so that detailed budgets can be finalised in early April 2011. Appendix A contains the detail of the budgets for 2011/12 and compares them with the forecast out turn position for 2010/11.

5.2 2010/11 non recurrent and full year effect savings

The total amount of non recurrent savings in 2010/11 was £8.7m. Of this, the Divisions are converting £2.7m into recurrent savings, mainly from delivering permanent headcount reductions where pay vacancy savings have been delivered. Of the remainder, £1m relates to non recurrent SLA income, leaving a balance of £5m of non recurrent expenditure issues.

Offsetting this position there are full year effects of 2010/11 savings of £1.3m, of which £0.7m is SLA income related, leaving £0.6m expenditure related. Therefore, the net effect on expenditure of 2010/11 non recurrent and full year effect savings is £4.4m (£5m - £0.6m). £4.4m of funding has been included in the Divisional base budgets for 2011/12 as shown in Appendix A.

5.3 Cost pressures

These are new cost pressures for 2011/12, i.e. additional costs the Trust will incur in 2011/12 over and above those in 2010/11. A number of these pressures reflect external requirements, for example the requirement to meet a minimum level of medical staff hours on the Labour Ward and the Carbon Tax, which is part of the Government's sustainability agenda. From a planning perspective a sum of £2.5m has been included in the 2011/12 budgets. The following table provides some detail:

2011/12 Cost Pressures	
Full year effect of investments in 2010/11	**£'000**
Combined screening (W&CS)	50
MRSA screening	30
Non recurrent reserves - spent on pay arrears in 10/11 not required in 11/12	(490)
Medicine - additional beds to support emergency pressures, and support services	700
Women and Children - additional labour ward cover	150
Clinical Support - equipment, software licences, therapists for stroke services	150
Estates & Hotel Services - lift maintenance, security, apprentices	300
Corporate - Funding IiYH posts, cancer staff, IT licences	650
Medirest - Agenda for Change compliance for outsourced staff	500
Decontamination - based on August 2011 implementation	300
Impact of additional bank holiday in April 2011 (Royal Wedding)	330
Endoscopy decontamination based on August 2011 implementation	150
Carbon Tax - change to be implemented in 2011/12	250
Expected slippage	(500)
Total	**2,570**

5.4 Inflation assumptions

Inflationary pressures have been revised to take account of a number of factors. The following table shows the inflationary pressures the Trust faces in 2011/12:

2011/12 Inflation	
Full year effect of investments in 2010/11	**£'000**
Medirest - balance of 10/11 inflation (7 months to be paid in 11/12)	170
Preceptorship - 45% of outstanding payment due in 2011/12	110
VAT increase (9 months)	300
Non pay inflation risks	640
Wage award for staff earning below £21,000 (0.3% of pay bill estimate)	490
Incremental drift	820
National insurance	500
Drugs (2.5% Price Increase & 7.5% re NICE etc)	500
Energy & Water	320
Rates	80
Medirest inflation Nov-Mar	120
Clinical Excellence Awards to for Medical Staff	250

Clinical Negligence Scheme for Trusts - increased charges	240
Total	**4,620**

5.5 Capacity reduction

Based on PCT commissioning intentions activity is expected to be lower than forecast out turn. Therefore some capacity reductions, mainly relating to new outpatient referrals and elective orthopaedic work have been built into the plans. For reduced levels of activity it has been assumed that only 65% of the costs will be released. Our current expectation is that this will be c£2m. These savings will be made in the specialty areas affected.

6. Savings – The Big Ask 2

The 2010/11 savings programme was very successful and a similar approach to the delivery of savings will be taken in 2011/12. The appointment of divisionally based project managers helped to ensure ownership and to achieve savings throughout the year.

The savings target for 2011/12 is £13.5m plus £2m capacity reduction, shown above, a total of £15.5m (6.1%). Plans for the delivery of this target have already commenced and will pick up on the plans included within the LTFM / IBP submitted to the SHA at the end of January, 2011. The current apportionment of savings to divisions is detailed in the following table:

	Medicine £m	Surgery £m	Women's & Children's £m	Clinical Support £m	Estates & Hotel Services £m	Corporate £m	Total £m
Corporate / Estates & Hotel Services 1% target					0.2	0.3	0.5
Targeted improvement in contribution	0.9	0.4	0.7	0.3			2.3
Balance pro-rata to 2010/11 budgets	2.9	2.6	1.5	1.4	1.1	1.2	10.7
Total 2011/12 Savings	**3.8**	**3.0**	**2.2**	**1.7**	**1.3**	**1.5**	**13.5**
% of 2011/12 turnover	***5.4***	***4.9***	***6.0***	***4.8***	***6.0***	***5.2***	***5.3***

The Trust has started to use SLR data to target savings in areas where contribution is lowest. Recognising that SLR data is still being refined, it has been applied at divisional level and only a proportion of savings is linked to contribution. In line with Q2 performance, the contribution improvements have been targeted as follows: Surgery 0.5%, Medicine 1%, Women's 1.5% and Clinical Support 2%.

Of key importance is the profiling of savings throughout the financial year as this has implications for management of the Trust's cash flow. The value of schemes already being worked up and historic profiling has been used to set the target per month throughout 2011/12 and has been included within the cash flow attached at Appendix C.

The Director of Nursing has a key role to review the impact of each scheme and ensures that patient safety is not compromised and that risks are managed.

The following table summarises the current savings themes:

Scheme	**Estimated Saving £'000**
Admin staff reductions	700
CNST Level 2	173
Corporate / Estates & Hotel Services efficiency	500
Diagnostics reductions	600
Divisional temporary staffing savings	600
Drugs procurement and management	543
Medical job planning	1,010
Other schemes to Be Financially Sound	1,038
Other schemes to Improve Patient Experience	80
Other Workforce schemes	506
Outpatient efficiencies	300
Private facility	800
Procurement - HSMC	600
Procurement - Hub	500
Reduce Length of Stay	1,300
Schemes to Work in Active Partnership	350
Shared services	600
Site rationalisation and redesign	600
Surgical redesign	1,300
Targeted improvement in contribution	1,400
Total Savings Target	**13,500**

In addition c£2m of capacity reduction will be allocated to the appropriate Divisions once the final activity schedule is agreed with the PCT, giving an overall savings target of £15.5m. If, however, the activity reduction is smaller the capacity reduction will be reduced accordingly leading to a lower than £15.5m overall savings target.

7. General Contingency

The plan also includes a general contingency reserve of £1.2m.

8. Capital programme

The capital programme is detailed in Appendix B. Proposed capital spending totals £9.3m. £7.2m is funded from forecast depreciation (excluding £0.2m related to donated assets); £1.6m from the sale of assets and the £0.5m balance relating to on-going schemes which will be funded from the cash balance at the end of 2010/11.

Two major capital projects relating to decontamination are planned. £2.1m is required to be spent on facilities and equipment at both Watford and Hemel to deliver compliance with CQC in respect to decontamination of endoscopes and £1m relates to decontamination of surgical instruments.

The Capital Planning Group has reviewed requirements for backlog maintenance, legislative compliance and IM&T to prioritise the most essential items. For the balance of the capital programme similar management arrangements to those of 2010/11 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 Associate Director of Estates £3.3m for critical estates work and Head of IT £0.75m for critical IT infrastructure. £0.85m is allocated to the Director of Strategy and Infrastructure to facilitate departmental moves in order to free up buildings for disposal and reprovide facilities where appropriate.

The remaining funding of £0.8m relates to on-going schemes and deployment of Trust staff in the delivery of capital projects.

9. Cash flow and liquidity

Liquidity and cash continue to be key issues for the Trust. If current loans are refinanced as proposed this will increase the level of cash to £6.5m or 10 days at the end of the year. The liquidity risk rating for 2011/12 is fixed at the start of the year and will not be affected by the refinancing. Liquidity is measured by the opening net current assets (excluding inventories) plus the working capital facility divided by the planned operating expenses for the year. This is expressed in the number of days cover that the Trust has for its operating expenses. At 31/03/2011 the plan is for 12 days of cover which is a liquidity risk rating score of 2.

The cash flow statement is shown in Appendix C. This includes a high level estimate of the phasing of savings throughout the year split between those relating to receipts (additional income) and payments (reduced cost).

The cash flow shows that there are key repayment dates in September and March relating to the loans, the current cash flow assumes that the Trust's proposed change to loan repayments is agreed before the next payment in September 2011. After the loan repayment the September month end cash balance will be £4.3m. If the loan is not refinanced by September and this results in cash flow issues then the Trust will need further discussions with both the SHA and PCT regarding opportunities for cash support.

The cash flow plan shows a balance in March 2011 is £6.5m which is 10 days of cash the likely requirement should the revised loan terms be agreed.

10. Statement of financial position

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

- £3.8m reduction in non current assets reflecting capital expenditure in line with depreciation, asset sales and an in year impairment
- An increase in cash balance to £6.5m at year end
- Reduced loan liabilities reflecting in year repayments
- £4.4m 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 2011/12. This shows an achievement of the minimum rating of 3 required by Monitor.

Financial Risk Ratings 2011/12

Criteria	Metric	Weight	5	4	3	2	1	Forecast rating 10/11
Underlying performance	EBITDA margin %	25%	11	9	5	1	<1	3
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	3
Liquidity	Liquid ratio days	25%	60	25	15	10	<10	2
Average								3.25
Overriding rules	Overriding rules	The overall rating can only be one above the lowest rating						
Overall rating	Overall rating							3

12. Statutory and Other Duties

The Trust will ensure that it meets the following statutory duties in 2011/12:

- External Financing Limit (cash balance at year end)
- Capital Resource Limit (capital spending net of asset sales), and the
- Break even duty (achieve a surplus)

In addition the Trust will submit its FIMS plan for 2011/12 to the national timetable and report on a monthly basis on in year performance. With regards to the EFL the Trust will continue to take a prudent approach and assume a nil cash balance at year end. This will provide maximum flexibility in respect to meeting the external financing limit in 2011/12.

13. Risks

The Trust faces a number of financial risks in 2011/12 which need to be managed through the remainder of the planning process and by rigorous financial management throughout the year. The biggest risks are:

- Loan refinancing: if the loans are not refinanced an additional £3.1m of savings and a higher surplus will need to be generated. In addition the year end cash balance would be £2.9m lower. This would lead to cash flow issues if the additional savings were not achieved. This issue has been discussed with the Finance Committee at their March 2011 meeting
- Nature and value of the PCT contract
- The level of activity, savings and capacity reductions
- Managing cash, and
- Managing capital investment and backlog maintenance pressures within the finances available.

14. Conclusion

The budget for 2011/12 is challenging, but the level of savings required is more in line with other acute providers than it was in 2010/11. It is essential that the contract with NHS Hertfordshire is now finalised quickly. We will also continue to liaise closely with the SHA about revising loan arrangements. Internally the focus must be on completing and implementing Big Ask schemes and plans to reduce capacity in line with a realistic assessment of the impact of the PCT's commissioning intentions.

The Board is asked to approve the budget and other elements of the financial plan for 2011/12 as set out in this paper.

Anna Anderson
Finance Director

March 2011