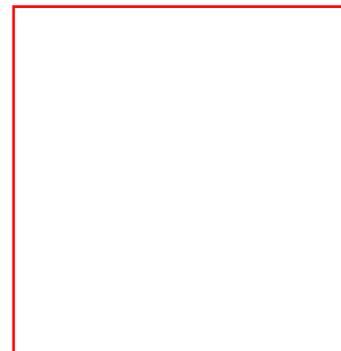


Audit Committee AC 03-03(P3)

Date: 27 March 2003
Time: 09:10
Venue: Committee Room 2, National Assembly for Wales



Memorandum by the Auditor General for Wales

NHS Wales Structural Change Programme: Review of the transitional and running costs of the new structures

■ *January
2003*

NHS Wales Structural Change Programme: Review of the transitional and running costs of the new structures

Introduction

1. In May of last year, I was asked by the Director of NHS Wales to review the transitional and running cost budgets of the new NHS structures that will come into effect on 1 April 2003. My findings, as set out in my letter of 6 December 2002 (Appendix A) and the Director of NHS Wales' response dated 12 December (Appendix B) were debated by the Health and Social Services Committee and by the Assembly in plenary on 18 December 2002. The Audit Committee subsequently asked me to advise on the aspects of my letter that it might usefully pursue.

Background

2. The Minister for Health and Social Services has stated that the running costs of the new structure will not exceed those of the existing structure. She has further stated that the costs of the transition, which will be additional to the on-going running costs, are likely to be between £12.5 million and £15.5 million. The budget is a matter for the Finance Minister and ultimately for the Assembly to agree in plenary. Such matters are not within my remit.

3. My review sought to verify the composition of the existing running cost envelope for comparison with the planning budget for the running costs of the new structures. I also examined the composition of the budget for the transitional costs. This work was valuable in that these budgets will provide a baseline for comparison with the

eventual outturn. I intend to comment on the outturn in my annual reports on the finances of NHS Wales.

4. My findings are set out fully in the letter but can be summarised briefly as follows:

- the running costs of the existing structure have been estimated by the NHS Wales Department at total £71.1 million. I am content with the basis of this estimate although some additional public health costs may still need to be added;
- the planning budget for the running costs of the new structures totals £79.6 million, meaning that savings of £8.5 million - some 10.7% of the planning budget - are needed to achieve cost neutrality;
- it was not clear to me how these running costs savings will be achieved in practice as they have been set as targets and there is no certainty that those targets will be met. The NHS Wales Department and Health Commission Wales have now identified the necessary savings to their budgets, but additional operational planning work is needed to identify savings for the other parts of the structure. The achievability of these savings will depend on the number and grading of staff in the new organisations and on their accommodation costs, which are particularly tight for the LHBs. Also, additional investment may be needed for the Business Services Centre in order to realise efficiencies over the medium term;
- the NHS Wales Department estimates that transitional costs will be between £12.5 million and £15.5 million, mainly for redundancy and infrastructure costs associated with accommodation moves; and
- there are major uncertainties with many of these transitional costs, especially for redundancies and accommodation. These areas need to be reviewed, as staffing structures and accommodation requirements become clearer, but it would be good practice to include a contingency budget to allow for unforeseen events.

5. In my letter, I made six recommendations to the NHS Directorate covering:

- the need to review the level of accommodation and IT costs in the light of emerging information on staff requirements;
- the need to complete as quickly as possible the necessary operational planning work to ensure that the £8.5 million savings can be achieved without jeopardising the delivery of the planned functions;
- the need to review in more detail how the Business Services Centre and the National Public Health Service will operate in practice, within their revised budgets and without jeopardising service delivery;
- the need for a more detailed review of transitional staff costs when the main determinants of those costs become clearer;
- the need for tightly controlled contingency provisions; and
- the development of procedures for monitoring running costs so that the financial impact of the Structural Change programme can be fully assessed.

The Director of NHS Wales has accepted all of my recommendations (see Appendix B)

Issues for possible consideration by the Audit Committee

6. The Audit Committee may wish to consider taking evidence from the Director of NHS Wales on the key financial management issues identified by my examination. These are:

- the progress made in identifying all the running costs of the existing structure (some public health expenditure had not been identified at the time of my examination);
- the progress made in completing the operational planning work for those parts of the new structure which had

not, at the time of my examination, identified the necessary savings to operate within their revised budgets. In particular, the Committee may wish to focus on the critical areas identified in my letter such as the Business Services Centre and accommodation costs for the new Local Health Boards;

- how the NHS Department will manage the risks to service delivery (much of the £8.5 million required saving is due to the higher than expected cost of Board members and executive directors for the Local Health Boards, which is £5.4 million higher than in the Health Authorities).

7. I should, of course, be happy to assist the Committee in taking this matter forward.

John Bourn
Auditor General for Wales
16 January 2003

3-4 Park Place
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Appendix A

Letter to the Director of NHS Wales

Mrs Ann Lloyd
Director of NHS Wales
Welsh Assembly Government
Cathays Park
CARDIFF
CF10 3NQ

6 December 2002

NHS Wales Structural Change Programme: Review of the transitional and running cost budgets of the new structures

In your letter of 24 May 2002 you invited me to review the transitional and running cost budgets of the new NHS structures. Naturally, I was happy to undertake this work. I am now writing to you with my comments, under the terms of reference agreed between you and Ian Summers in October (Annex A). My comments are based on the main features of the Structural Change Programme outlined in *Improving Health in Wales: A Plan for the NHS with its partners* issued in July 2002. This will involve abolition of the five Health Authorities in Wales and the transfer of their functions to:

- 22 Local Health Boards (LHBs) contiguous with the boundaries of the unitary authorities;
- a Business Services Centre within Powys Local Health Board to provide shared services for and on behalf of LHBs;
- a new National Public Health Service, hosted by Velindre NHS Trust; and
- Health Commission Wales (Specialist Services), an executive agency of the Welsh Assembly Government, to provide specialised health commissioning services.

The role of the NHS Wales Department will also be expanded to create three regional offices to support and oversee the NHS bodies in their areas.

The Minister for Health and Social Services has stated that the running costs of the new structures will not exceed those of the existing structure, and that transitional costs – which will be additional to running costs – are likely to be between £12.5 million and £15.5 million. I have reviewed the costs in each of the three components, and my principal findings are set out below. I must point out that I have not undertaken a detailed review of the costs and therefore it would not be proper for me to comment on whether they will be sufficient to deliver a viable service under the new structure.

Running costs of the existing structure (the "financial envelope")

The Minister reported to the Health and Social Services Committee in July (HSSC 16/02, p.1) that the running costs of the existing structure totalled £73.6 million. This has since been revised to £71.1 million following additional validation work by the NHS Finance division (Annex B). This is the "financial envelope" within which the running costs of the new structures must be contained in order to achieve cost neutrality. Your policy is to include all public health expenditure by Health Authorities within the envelope, on the basis that the expenditure mainly comprises running costs, will be transferred in the first instance to the new National Public Health Service, and should be dealt with on the same basis as other parts of the new structure. However, it has proved difficult to identify all the relevant public health costs and your officials expect the envelope to rise as additional expenditure is identified from programme budgets. Other than this, however, your officials are confident that the £71.1 million is a materially accurate reflection of current running costs.

The envelope has been derived from two sources:

- the running costs included in the 2001-02 audited accounts of the Health Authorities and Powys Health Care NHS Trust. I agree that this is the appropriate period, as significant structural change has begun in 2002-03 and it is not, therefore, an appropriate period to use as a base for comparing the costs of the existing and new structures. Your officials have adjusted the 2001-02 costs for expected inflation and pay rises to make them a valid base for comparison with the first year of the new structure (2003-04). I agree that this is necessary and can confirm that the indexation has been correctly calculated and consistently applied; and
- the direct running cost budget of the NHS Wales Department for 2003-04, on the basis that this was set before the structural changes were announced and accurately reflects the current structure after allowing for inflation and pay rises.

The envelope includes the following costs:

- salaries and related costs such as National Insurance and pension contributions;
- accommodation costs (including rent, rates, security, utilities) other than those for the Assembly Government's offices at Cathays Park in Cardiff;
- information technology (IT) costs, except for the costs met by the National Assembly for Wales under its service contract with Siemens Business Services; and
- other miscellaneous expenditure (for example, consultancy, travel and subsistence, office supplies).

I am satisfied that the costs included in the financial envelope are relevant management costs and have been correctly extracted from the relevant accounts and budgets. However, as explained above, it is not yet clear that the financial envelope includes all the relevant costs. Work is still underway to identify all public health costs. Also, the

envelope does not include those overheads for the Cathays Park site, which are currently met by the central administration budget rather than the health and social services budget. These are substantial, but are difficult to quantify because they are not currently allocated to separate divisions within the Assembly. Officials are confident that the NHS Wales Department overheads attributable to the Cathays Park site will not change significantly as a result of the Structural Change Programme, and I am satisfied that current estimates support this position. I am therefore content for these overheads (mainly accommodation and IT service costs) to be excluded from both the financial envelope and the running costs of the new structures.

Running costs of the new structures

Annex B sets out the planning budget for the running costs of the new structure and the savings of £8.5million that will be needed to bring them within the cost neutral envelope of £71.1 million (subject to any additional public health costs that remain to be identified). The planning budget continues to develop as new information becomes available, and I have reviewed the position at 25 November 2002.

The planning budget is a combination of estimated costs for the new structure (individual LHBs, Health Commission Wales (Specialist Services) and the NHS Wales Department – totalling £44.5 million or 56 per cent of the total) and the straightforward transfer of existing Health Authority budgets to the LHB shared services centre and the National Public Health Service (£35.1 million). The National Audit Office has reviewed the schedules supporting these estimates and is satisfied that they have been correctly calculated and, where applicable, derived from original budgets uprated for inflation and pay rises.

The required savings of £8.5 million to achieve a cost neutral budget have been applied in proportion to the planning budget, except for Health Commission Wales where the NHS Wales Department considered that a larger reduction of 22.7 per cent was appropriate. The reductions for the other parts of the structure are 10.3 per cent. These targets are based primarily on the need to achieve cost neutrality rather than a detailed assessment of future needs and how savings can be achieved from the current position. Nevertheless, progress has been made on planning operations that can work within the budgets set. Health Commission Wales and the NHS Wales Department have both developed a staffing structure within the reduced budgets, within which they expect to deliver the full range of their functions. I recommend that a similar plan be prepared without further delay for the National Public Health Service, which will be expected to deliver savings of 10.3 per cent in the first year of its operation. The position for the Local Health Boards and the Business Services Centre is considered below.

Local Health Boards

The largest part of the budget is £29.4 million for the Local Health Boards. This includes £8.9 million for Board members (including executive directors), £16.1 million for other salaries and £4.4 million for non-staff costs. The budget estimates were prepared by officials in consultation with Health Authority finance staff and a working group of Local Health Board Chief Executive Officers designate. They reflect current expectations of the number, grade and pay of the staff needed to fulfil the functions of the Local Health Boards, as set out in the consultation document issued on 1 October. The result of this work has been to divide the 22 Local Health Boards into five running cost bands with budgets ranging from £1,225,000 to £1,565,000. The running costs budgets have been allocated on the basis of population and commissioning complexity, using GP Numbers, Resident Population and Multiple Deprivation Index within the Local Health Board areas as key indicators. However, the Assembly Government recognises that each LHB will be autonomous and will develop a budget and staff structure to suit its own needs.

The non-staff costs are likely to vary depending on the size of the LHB, and I note that your costings take account of

this. However, accommodation costs will depend on local market conditions, the quality of the premises and the number of staff employed. The provision of £945,000 for the 22 Local Health Boards averages £1,450 per capita based on the indicative staff structure. Whilst I recognise that not all Local Health Boards will be housed in commercial properties, this is a tight budget when business rates, service charges and utilities are included and is a lot less than the per capita estimates for Health Commission Wales and the new regional offices of the NHS Wales Department. I appreciate that it is difficult to prepare reliable estimates while the structure and location of the Boards remains uncertain. However, it is important that estimates are based on realistic benchmarks of likely costs, adjusted as appropriate for local market conditions, and that these are compared with the accommodation costs envisaged for other bodies involved in the Structural Change Programme so that any under-or over-budgeting can be identified and put right. I recommend that you undertake a review of accommodation costs in the New Year, when the future operations of the LHBs should be clearer, and adjust the budget accordingly.

Business Services Centre

To achieve economies of scale, and to drive a more efficient, cost effective, standard service to NHS Wales, the LHBs will receive support from a shared services centre for many financial, contractor, IT and human resources services. The planning budget is based on the current budgets of the Health Authorities for carrying out the same functions. This is consistent with the policy of the Assembly Government, which is for minimal change initially so that the risks to financial control and business continuity are minimised. Accordingly, you expect the Business Services Centre to achieve the 10.3 per cent savings target by 2004-05 and not in the first year of its operation. During this transition period, the transition costs budget will be used to fund the higher level of staff consistent with minimising risk.

Work is currently underway to assess how the new organisation will operate in the medium term so as to provide a viable service and deliver the necessary savings, and extend its role to encompass other NHS services as determined by policies that are in the course of development. I agree with your overall approach; it would be unwise to expect savings from Day 1 without careful business planning. A recent report by the District Auditor on shared services in Bedfordshire underlines the need to plan and resource such changes adequately to avoid a breakdown in services and financial control. It is certainly feasible to realise savings from the amalgamation and standardisation of business systems, but these will take time to deliver and may well require substantial investment in new business systems. To estimate accurately the full cost of these changes, you will need to identify options and carry out an investment appraisal over an appropriate period, which is likely to be considerably longer than the two-year transitional period that you are currently working to. I know that you are aware of this, but I would like to emphasise that the achievement of the 10.3 per cent savings target will require a greater reduction in like-for-like running costs to offset the cost of additional investment and the higher workload inherent in fully servicing the LHBs.

Transitional costs

The Minister for Health and Social Services has advised the Health and Social Services Committee that the total transition costs will be in the range £12.5 million to £15.5 million over the four years to 31 March 2005. The principal components of the cost estimates, and the main assumptions made in their preparation, are listed in Annex C to this letter.

The costs are inherently uncertain at this stage as the staffing and accommodation requirements of the various parts of the new structure have not yet been finalised. Consequently, a large part of the transitional costs budget comprises broad estimates by managers and officials based on their judgement of what will be needed to implement the new structure. Although there are no grounds to doubt the reasonableness of these estimates and they appear to encompass all the main types of cost that will be incurred, they are necessarily less reliable than costings based on an

objective appraisal of business needs. In these circumstances, it is appropriate that the Welsh Assembly Government has sought to reflect these uncertainties by providing a range of possible costs rather than a specific figure.

The largest part of the transitional cost budget is for redundancy, protected salaries and excess fares – between £7.6 million and £8.4 million. The project team has made broad estimates about the number of people who will be left without posts, and how many of those will be eligible for redundancy. The estimated costs of making these staff redundant is £5 million, but the Assembly Government hopes to reduce this by guaranteeing continued employment to all staff until 31 March 2004, i.e. one year after the new structure is officially established. The project team estimates that the cost of paying salaries to surplus staff for one year is £3.1 million, and that the scheme will yield a net saving if more than half the employees find jobs in the new structure and their redundancy costs are avoided. The worst case scenario is that none of the staff find jobs, in which case the overall cost will exceed the upper estimate of £8.4 million by about £1.7 million. The outcome depends very much on the grade and length of service of the individuals concerned. Other factors that will affect the final cost are the level of normal staff turnover during the period, the availability of jobs elsewhere in the NHS, the level of excess fares payable to staff who have to travel further to work at their new employer, and the precise terms of any redundancy scheme (currently the subject of a staff consultation). The broad estimates that have been made can only become firmer once the staff consultation is complete and decisions have been made on the number and grade of staff in the new organisations. The final cost will not be known until the protected employment period has ended and all staff have either found new jobs, retired early or been made redundant. There are therefore uncertainties here and I recommend that you undertake a more detailed review of the likely transitional staff costs as the posts in the structures are filled.

Infrastructure costs (accommodation and IT) have been estimated at between £1.9 million and £3.6 million. Both figures include £1.3 million for establishing the three regional offices of the NHS Wales Department, and a range of £0.6 million to £1.3 million for the LHBs. The £1.3 million for the regional offices is the more reliable figure, as there has been a formal appraisal of costs and options. The figures for the LHBs are very broad estimates of the costs, based on the number of additional staff required for LHB-related functions compared to existing Local Health Group staffing levels, and fitting-out costs for three to seven LHBs at £80,000 each (it is assumed that the other 15 will use existing premises of the Local Health Groups). The fitting out cost of £80,000 for each LHB is substantially less than the £360,000 for each regional office, which will have a similar number of staff, and suggests that the estimates for fitting out may not be sufficient. I recommend that you revisit these costs once the staff requirements and accommodation plans of the shadow LHBs are known, and prepare revised estimates based on a more rigorous appraisal of costs and options.

The lower figure of £1.9 million for total infrastructure costs excludes any provision for Health Commission Wales (Specialist Services) on the basis that, at the time the budget was set, it was not certain whether Health Commission Wales would move to new accommodation. The lower figure also excludes costs associated with the possible relocation of Business Services Centre staff from the Bro Taf and Iechyd Morgannwg Health Authority sites, as the future use of the accommodation has yet to be finalised. The higher range figure includes relocation costs in the event that this accommodation is vacated. It is possible, therefore, that infrastructure costs will be towards the higher figure of £3.6 million and may well exceed this once the estimates for LHB accommodation have been firmed up.

The National Audit Office Wales has reviewed the other costs on the schedule and is generally content that the estimates are reasonable based on the best information currently available.

I note that there are no contingency provisions to deal with unforeseen events. It is good practice to set aside tightly controlled financial provisions to support contingency plans, and this was recommended by the Audit Committee in their report on the 2001-02 Summarised Accounts. Given the uncertainty affecting the transitional cost estimates, I recommend that you consider adding a reasonable contingency to the budget.

Financial control and monitoring

Costs should become progressively clearer as the Structural Change Programme proceeds and business decisions are made. It is important that the main budgets are reviewed on a regular basis as new information becomes available, and that actual costs are monitored to identify any significant departure from the budget. Your officials have developed procedures for controlling and monitoring the transitional costs budget, which will be held centrally, but it is equally important to have procedures in place for the running cost budgets that will be managed by the various organisations that comprise the new structure. It is also important that information requirements are clear and are disseminated to all relevant organisations so that costs can be reported to the NHS Wales Department in a consistent format and to an appropriate level of detail.

Conclusion

I am satisfied that the financial envelope of £71.1m is a materially accurate reflection of current running costs, although it should be adjusted to include any additional public health costs identified from programme budgets. Nevertheless, the inclusion of such costs is unlikely to make a major difference to the overall savings requirement and the £71.1 million provides a sound basis for comparison with the running costs of the new structure. I am also content that the transitional cost budget includes all cost elements appropriate to the transition, and does not include costs that should properly be included in the running costs budget.

There are major uncertainties with many of the estimated transitional and running costs, particularly for redundancy and accommodation costs. Many costs cannot be finalised until staff structures and business premises have been selected, and terms of employment or redundancy have been agreed. The Assembly Government should take the earliest opportunity to develop firmer estimates once the key decisions affecting the costs have been made.

The planning budgets for the running costs of the new structure were designed to be challenging but achievable. This is clear from the small departments within each LHB (with a consequent emphasis on senior staff in the workforce) and the tight non-staff costs, particularly for accommodation. Despite this, the overall planning budget exceeds the financial envelope by £8.5 million or 10.7 per cent of the budget. This is largely due to the £5.4 million increase in the cost of board members and executive directors in the LHBs over the existing structures, and the costs of accommodation for Health Commission Wales (Specialist Services) and the NHS Wales Department's three Regional Offices. It is not immediately clear how savings of £8.5 million necessary to achieve cost neutrality will be made; they have been set as a target and considerable work will be needed to identify the necessary economies. I am also concerned at the lack of detailed business planning in arriving at the savings targets and some of the cost estimates.

In my view, it is not good practice to embark on a programme of major structural change within a pre-determined budget without considering in some detail the potential impact on the viability of the organisations that are affected. At the present time management cannot be certain that cost neutrality will be achieved. However, the necessary operational planning work is underway and revised staff structures have been identified for the NHS Wales Department and Health Commission Wales, which indicate that their savings targets are achievable. The achievability of savings for the other parts of the structure will become clearer once the number and grading of their staff has been finalised, and accommodation options have been more fully assessed and costed. I am also concerned at the absence of contingency provisions to deal with unforeseen events.

My recommendations for the NHS Wales Department are:

Running costs

- to review the level of accommodation and IT costs in the light of emerging information on staff requirements. This should involve an assessment of likely space requirements, typical unit costs and local market conditions. It should also involve a review to ensure that differences between the various parts of the new structure can be fully justified;
- to complete as quickly as possible the necessary operational planning work in order to confirm that the required £8.5 million targeted savings in order to achieve cost neutrality can be achieved whilst delivering the full range of planned functions;
- to review in more detail how the Business Services Centre and the National Public Health Service will operate in practice and deliver their new functions and the required savings without jeopardising service delivery. If significant new capital investment is required, this should involve a full investment appraisal of options in accordance with the guidance issued by the Treasury. The costs and benefits should be assessed over an appropriate period of time, which should not be constrained to the transition period over which cost neutrality is currently being assessed;

Transitional costs

- to implement its plan to undertake a more detailed review of transitional staff costs (redundancy, early retirement, protected salaries and excess fares) when the main determinants of the costs become clearer. This should be possible when the number, grade and location of jobs in the new structure are identified;
- to consider the need for tightly controlled contingency provisions to deal with unforeseen events, as recommended by the Audit Committee in their report on the 2001-02 NHS Wales Summarised Accounts; and

Financial control and monitoring

- to develop procedures for monitoring running costs so that the financial impact of the Structural Change Programme can be fully assessed. Guidance should be issued to all of the NHS bodies directly involved in the programme to ensure that costs are reported regularly, consistently and in sufficient detail.

I hope that this letter is helpful, and that you will be able to address the recommendations that I have made. I will continue to take an interest in the progress of the Structural Change Programme as part of my work on the NHS Summarised Accounts and am more than happy to discuss with you any of the issues raised in this letter. I am particularly grateful for the positive and open way in which Assembly Government and Health Authority officials have co-operated with this review.

JOHN BOURN

○ ANNEX A

Terms of reference

To comment on the assumption that the running costs of the new structure will not exceed the running costs of the

existing structure. This will involve:

- a review of the estimated transitional costs, current running costs and future running costs to assess whether all necessary costs have been included and in the right category (for example, that transitional costs – which are not subject to the Minister’s cost neutrality requirement – do not include elements that should properly be included in ongoing running costs);
- verification of current running costs by reviewing supporting documentation, checking to the Health Authorities’ accounts, and reviewing the underlying charts of accounts to ensure that costs are consistently treated;
- a review of the estimated running costs of the new structure. This will include a review of the supporting documents, consideration of the assumptions made and an assessment of the level of uncertainty at the present time; and
- concluding on whether the published cost estimates are materially complete and reasonably stated, the uncertainties which remain, and whether the overall figures point to cost neutrality being achieved.

This exercise covers a very wide range of costs and significant uncertainties remain about the new structure. We do not plan to undertake at this stage a detailed examination of the costs; we will focus instead on what you have done to satisfy yourselves that the costs are robust, whether this accords with good practice, and point out any significant changes or risks that we think need to be considered.

ANNEX B

Running Costs

Existing Structure

Health Authorities	£61.0m
Powys NHS Trust	£0.7m
NHS Wales Department	£9.4m
Total: cost-neutral envelope	£71.1m

Costs are shown in £ million, based on actual costs from the 2001-02 audited accounts of the Health Authorities and Powys Health Care NHS Trust, adjusted by standard uplifts for inflation and pay rises to give a comparable base cost for 2003-04. Powys Health Care NHS Trust costs represent Board costs and audit fees only. The running costs for the provision of healthcare services by the Trust are excluded as they are assumed to be cost neutral within the new structures. The costs of the NHS Wales Department are based on the 2003-04 running costs budget.

New Structure

	Planning budget (£m)	Required saving (£m)	Cost neutral budget (£m)
Local Health Boards:			
Individual LHBs	29.4	3.0	26.4
Business Services Centre	19.4	2.0	17.4
Total for LHBs and shared services	48.8	5.0	43.8
Health Commission Wales (Specialist Services)	2.2	0.5	1.7

NHS Wales Department:

Centre	9.9	1.0	8.9
Regional Offices	3.0	0.3	2.7
Total for NHS Wales Department	12.9	1.3	11.6
National Public Health Service	15.7	1.7	14.0
TOTAL	79.6	8.5	71.1

The planning budget has been derived as follows:

- *Local Health Boards: indicative staff structure developed by a working group of senior NHS managers. Round sum estimates have been made for non-staff costs*
- *Business Services Centre: based on Health Authorities' 2002-03 budgets for delivering shared services (finance, contractor services, IT and human resources)*
- *Health Commission Wales (Specialist Services): based on revised staff structures and new accommodation considered necessary to operate with the new structures*
- *NHS Wales Department: based on revised staff structures considered necessary to operate with the new structures, and estimates for new accommodation for the regional offices*
- *National Public Health Service: Health Authorities' 2002-03 budgets for public health services.*

The savings required are the reductions needed to achieve the cost neutral budget, i.e. to bring costs within the financial envelope of £71.1 million. Savings of £0.5 million (22.7%) were required from Health Commission Wales (Specialist Services); the residual saving required was distributed proportionally among the other bodies, accounting for a 10.3% cut in their budgets.

ANNEX C

Transitional costs

These include all costs that are specific to the restructuring period, as opposed to the ongoing costs of the new structure.

	Lower estimate (£m)	Higher estimate (£m)
Project management costs:	0.8	0.8
Infrastructure costs (accommodation and IT):		
Local Health Boards	0.6	1.3
NHS Wales Department (including regional offices)	1.3	1.3
Public health	0	0.2
Health Commission Wales	0	0.3
Possible relocation of Business Services Centre regional offices from Bro Taf and Iechyd Morgannwg Health Authority sites	0	0.4
Computer software	0	0.1
Total infrastructure costs	1.9	3.6
Human resource costs	0.3	0.4
Training costs	0.2	0.3

Shadow running costs (mostly LHBs)	1.7	1.7
Staff-related costs		
Excess fares	0.5	0.5
Redundancy / early retirement	5.6	6.4
Protected salaries	1.5	1.5
Total staff-related costs	7.6	8.4
Miscellaneous	0	0.3
TOTAL	12.5	15.5

Transitional cost estimates have been prepared on the following basis:

- *Three regional offices of the NHS Wales Department will be established, requiring accommodation and incurring protected salary costs for NHS staff transferring to less favourable Civil Service terms*
- *Three to seven LHBs will require new accommodation at an average cost of £80,000 each*
- *Health Commission Wales (Specialist Services) will be created as a new executive agency and will require new accommodation*
- *Two of the six Business Services Centre regional offices may need to be relocated*
- *Redundancies will be minimised by guaranteeing employment for all existing permanent staff until 31 March 2004, and by using TUPE provisions to transfer staff to jobs in the new structure*
- *Local Health Boards and Health Commission Wales (Specialist Services) will begin setting-up in the six months before 1 April 2003 and will incur running costs for senior staff.*

Appendix B

Response from the Director of NHS Wales

**Mrs Ann Lloyd
Director, NHS Wales**

Sir John Bourn KCB
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CF10 3DP
Eich cyf . Your ref:
Ein cyf . Our ref: AL\sp\12\1273

12 December 2002

budgets of the new structures

Thank you for your letter of 6 December received 9 December in which you set out your conclusions following the NAO review of the transitional and running costs budgets of the new NHS structures. I am very grateful to you and the NAO for undertaking this important piece of work on our behalf.

I am please to confirm that I accept all your helpful recommendations. I shall prepare regular reports for the Minister on the progress I make in implementing the recommendations.

I note that in terms of the financial envelope the NAO is satisfied that the costs identified are relevant management costs and have been correctly extracted. I am grateful for this reassurance.

I am happy to accept your recommendations in respect of the accommodation costs that are included in the running costs. It is a matter of some concern to me that there is such a great variation in accommodation costs – not attributable to the size of the LHB but to the commercial rate in the area. I shall be looking with finance colleagues to ensure that the burden of higher accommodation costs do not unfairly affect the ability of the LHB to deliver on the operational and policy agenda set for them.

I take your point about the need for detailed business planning to make the savings necessary to contain the management costs within the cost envelope. I am currently reviewing the submissions made by the various organisations to contain their running costs within the given allocation. I am assessing them to ensure that each organisation remains able to deliver the required agenda. I am still of the view that targets set should be stretching but achievable. As you will be aware, there is an ongoing dialogue about running costs with the LHB's designate and we are making rapid progress towards a satisfactory conclusion.

I also note that you do not consider it to be good practice to embark on organisational change within a predetermined budget without considering the impact on the viability of the organisations that are affected. It is for this reason that I have insisted throughout this change programme that the individual core project teams should have, as a continuing priority, a rolling assessment of the functions, accountability and processes as they emerged for each part of the structure. At the beginning of the programme I directed a piece of major analysis with the Health Authority Chief Executives to ensure that all the functions of the new structures were identified and the accountabilities were quite clear. I am undertaking the of exercise with the acting Regional Directors in respect of each of the individual LHB structures and will continue to do so with the permanent Regional Directors as soon as they take up their posts.

I believe strongly that all parts of the structure must have from the outset an understanding that they will be required to work within the discipline of an agreed fixed management cost budget.

Management costs have been applied to the NHS for many years and it would require a major change in policy to remove such regimes from the NHS in Wales. The application of limits also accords with the Ministers' policy wishes that a review should be undertaken into the ways that the bureaucracy costs might be reduced in the NHS in Wales and the need to contain management expenditure within an agreed upper limit. With the aid of the NAO team I shall keep under constant review the cost effectiveness and viability of the structure as the reorganisation of the NHS in Wales proceeds.

The question of a contingency was considered in drawing up the initial transition budget. In one sense the contingency is contained within the range that has been allowed for in the uncertainties we have identified. I agree that it might be most appropriately managed as part of your recommendation on the period of time over which

transitional costs might be required. As you rightly point out, the scale of the transitional costs will be unknown until all the posts in the new structures have been filled and the final calculations have been established. In such calculation I would be grateful for the continuing scrutiny of the NAO on this issue.

I am most grateful for the care, time and degree of professional scrutiny that the NAO team has given in preparing your guidance to me. This restructure will contain many wider lessons and it is good to know that you are alongside us in advising on this programme.

Yours sincerely

ANN LLOYD
Director, NHS Wales