



24 Cathedral Road / Heol y Gadeirlan
Cardiff / Caerdydd
CF11 9LJ
Tel / Ffôn: 029 20 320500
Fax / Ffacs: 029 20 320600
Email / Epost: wales@wao.gov.uk
www.wao.gov.uk

Ms Jocelyn Davies AM
Chair of the Finance Committee
National Assembly for Wales
Cardiff Bay
Cardiff CF99 1NA

Date: 16th October 2013
Our ref: HVT/1975/fgb
Page: 1 of 5

Dear Jocelyn

NATIONAL HEALTH SERVICE FINANCE (WALES) BILL

Thank you for your letter of 30 September 2013, in which you sought my views on the National Health Service Finance (Wales) Bill (the Bill) which was introduced by the Welsh Government on that date, using the fast-track legislative procedure.

I am grateful for the opportunity to comment, and trust that my views will be of assistance to your Committee during the scrutiny process.

In overall terms I welcome the intentions behind the Bill, which seeks to address concerns that I have raised repeatedly in my annual reports on the Finances of NHS Wales¹ and also previous recommendations made to the Welsh Government by your own Committee and also by the Public Accounts Committee.

In particular, I commend the Welsh Government's announced intention to create a requirement for Local Health Boards (LHBs) to develop, scrutinise and approve integrated medium-term plans, including balanced medium-term financial plans, and thereby to introduce a degree of managed flexibility. The lack of fully-integrated plans within NHS Wales, bringing together service delivery, finance and workforce planning, has long been a major weakness and it is good that this is to be addressed. The requirement for those integrated LHB plans to be approved by the Welsh Government should help to ensure that appropriate rigour and challenge is built into the planning process, and should also assist in addressing pan-Wales issues and minimising silo-based thinking.

¹ **Health Finances 2012-13 and beyond** (published 16 July 2013)
http://www.wao.gov.uk/assets/englishdocuments/NHS_Finances_English_web.pdf

Health Finances (12 July 2012)
http://www.wao.gov.uk/assets/englishdocuments/NHS_Finances_167A2012_English_2.pdf

It is important to recognise that NHS finances are complicated and that relatively straightforward accounting changes are unlikely, in themselves, to provide complete solutions. I do therefore have some comments about the nature of the proposed changes to the financial regime, and I note that these mirror to some extent various points that were raised by Members during the Plenary Debate on the general principles of the Bill that took place on 8 October.

It has long been my view that the existing financial regime for the seven LHBs in Wales is not fit for purpose. I consider that requiring each LHB to live within predetermined annual revenue and capital resource limits is unsuitable as a financial discipline for complex organisations delivering front-line healthcare services that are mainly driven by demand-led clinical assessments of need.

At present, any breach of a resource limit (even by just £1) would result in an automatic qualification of my regularity audit opinion on the annual accounts of an LHB, whilst any under-spend by an LHB cannot be rolled forward to the next financial year and instead has to be surrendered. The resultant focus amongst the LHBs on what is often referred to as *'landing a jumbo jet on a postage stamp'* leads to unintended consequences and drives inappropriate behaviours. For example:

- Every LHB looks first to securing its own annual financial position, rather than working collaboratively with other NHS bodies to deliver better patient outcomes;
- The use of annual resource limits compels each LHB to focus on the short-term, and this has been generally at the expense of much-reduced Board and senior management consideration of medium-term and strategic financial planning;
- The historic provision by the Welsh Government of additional in-year resource funding for LHBs has led to instances of inappropriate behaviour in the forecasting of year-end out-turns, in the apparent belief that the forecasts themselves will drive higher levels of additional funding support;
- The same pattern of repeated in-year 'bail-outs' has also led to the LHBs not driving through the delivery of planned savings as rigorously as would otherwise have been the case, again in the belief that additional funding will be provided; and
- The inability to retain unspent capital funds to the following year can lead to a 'use it or lose it' attitude when LHBs face year-end spending decisions, which can jeopardise the achievement of good value for money in NHS procurement and capital contracting.

For these reasons, I support the Welsh Government's intention to move away from the use of an annual resource limit for each LHB, and to replace this with a rolling three-year limit with effect from the 2014-15 financial year.

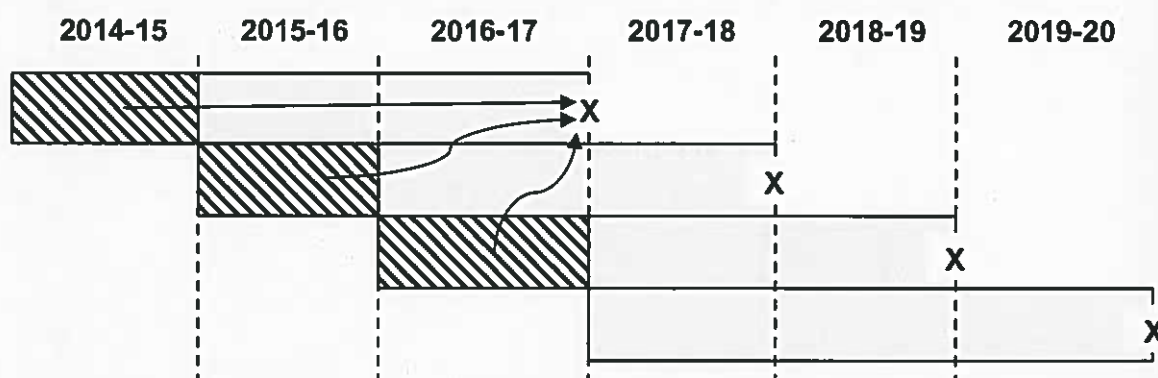
However, there are some practical limitations to the proposed new arrangements. This is because, from the third year onwards (ie from 2016-17), each LHB will always find itself in the third year of any single three-year funding cycle. An LHB's available resources for that financial year will essentially be the balance of allocated resources that remain unspent from the preceding two years of the three-year plan, after taking account of any uplifts in funding for years 2 and 3 of that planning period that may be provided by the Welsh Government when approving subsequent three-year plans. It would therefore appear that the scope for financial flexibility under the arrangements set out within the Bill will, from 2016-17 onwards, be only very slightly greater in practice than that currently available to the LHBs. It should be noted, however, that under the new arrangements it will be possible for LHBs to carry-forward any under-spends to future years, rather than having to surrender these back to the Welsh Government as at present.


The practical effects of the proposals within the Bill on the audit assessment of compliance with the prescribed resource limits (the 'regularity' audit opinion) are set out in **Exhibit 1**.

Exhibit 1: Three-Year LHB financial planning and the impact on the Regularity audit opinion

In this illustrative timeline, 'X' indicates the point at which an audit assessment is made as to whether an LHB has lived within its three-year resource limit.

The first such audit assessment will therefore be made at 31 March 2017, in respect of the three-year period 2014-15 to 2016-17, and then at every 31 March thereafter.



At 31 March 2017, the three-year resource limit that is used in the audit assessment will be the mathematical sum of the resources approved by the Welsh Government for the first year of each of the rolling three-year plans from 1 April 2014 (these are shown as  above timeline).

Any breach of a three-year resource limit will result in qualification of the Regularity audit opinion.

It follows that the main practical effect of the Bill will be to provide the LHBs with two years of 'breathing space' (in 2014-15 and 2015-16) during which there will be no requirement to live within an annual resource limit, and no external audit assessment of financial performance against a statutory resource limit. From 2016-17, the existing annual audit assessment recommences, but now looking back at each LHB's total expenditure over the preceding three years, rather than at its annual expenditure.

In my view, it will be imperative that all of the LHBs make best use of this 'breathing space' period to drive through the necessary changes in service transformation, in order to place future NHS service provision onto a financially sustainable cost base. I note the recent announcement by the Finance Minister in her draft 2014-15 Budget of significant additional funding for NHS Wales, and I would urge that these funds, once allocated, are used to maximum effect by each LHB in support of their respective (and their collective) transformation, reconfiguration and delivery agendas.

It will of course remain possible, as now, for the Welsh Government to provide LHBs with additional funding during the financial year and to adjust each LHB resource limit accordingly. Such adjustments to resource limits are a normal working practice, arising as they do from in-year 'Barnett consequentials' from the Chancellor's Autumn Statement etc, and so these adjustments do not currently just arise from 'bail-out' funding flows.

As at present, it will be the final resource limit approved by the Welsh Government for an LHB which will be the limit against which the auditor will assess whether any expenditure breach has occurred. It will therefore remain effectively for the Welsh Government itself to determine (by either granting, or withholding, an adjustment in the resource limit) whether it wishes to see an LHB have its accounts qualified for a breach of the resource limit, since the external auditor has no discretion in this regard. I note that, to date, I have not had to qualify my regularity audit opinion on the accounts of any of the seven LHBs, as the Welsh Government has always opted to make additional resources available to over-spending LHBs.

There are no specific amendments to the Bill that I wish to propose for consideration by your Committee. My intention, once the Bill has been enacted, will be to issue a narrative report alongside my audit opinion on the annual accounts of each LHB from 2014-15 onwards, commenting on the current status of their integrated three-year service, financial and workforce plans, the progress being made against those plans and any corrective measures being taken, either to bring identified variances into line with those plans or to revise the plans themselves and to resubmit them to the Welsh Government for approval.

I anticipate that this independent commentary from the external auditor will assist each of the LHBs themselves and also be of value to the Welsh Government in its oversight of NHS Wales. My reports on the LHBs' annual accounts will also serve to enhance the ability of the National Assembly for Wales and its Committees to scrutinise the performance of each LHB and to hold them to account.

Finally, I note from the 8 October Plenary debate on the Bill that the Minister has undertaken to explore whether there may be scope for the introduction of 'end of year flexibility' or 'tolerance' arrangements within the provisions of the Bill. My staff are discussing these issues with Welsh Government officials, but I think that it may prove very difficult to blend any degree of flexibility with the necessary rigidity that comes with the imposition of formal resource limits, on either an annual or a three-year basis. Similarly, detailed consideration of suggestions that LHBs should be granted borrowing powers will, I suspect, have to await the outcome of the UK Government's response to the Silk Commission, as this will in part depend on whether or not the Welsh Ministers are themselves to be given greater borrowing powers than those that they currently enjoy by virtue of the Welsh Development Agency Act 1975.

I hope that this letter is of assistance to you and your members, and I stand ready to give oral evidence to your Committee during its consideration of the Bill if that would be helpful.



HUW VAUGHAN THOMAS
AUDITOR GENERAL FOR WALES