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Implementation of the NHS Finances (Wales) Act 2014



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU



I have prepared and published this report in accordance with the Government of Wales Acts 1998 and 2006.

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Mae'r ddogfen hon hefyd ar gael yn Gymraeg.

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Summary

- 1 The NHS in Wales spends over £6 billion a year and accounts for almost half of the Welsh Government's revenue spending. In previous reports on health finances, and on the picture of public services, the Auditor General expressed concern about the short-term focus of financial planning across Wales' NHS. Other commentators also raised similar concerns, including three committees of the National Assembly for Wales¹.
- 2 In response to these issues, in September 2013 the Welsh Government brought forward the NHS Finance (Wales) Bill and in January 2014 the NHS Finance (Wales) Act (the Act) received Royal Assent². The Act introduced two new duties for the seven health boards in Wales:
 - a to break even over a rolling three-year period – replacing the previous requirement to break even every year; and
 - b to have a three-year integrated plan that is submitted to and approved by the Welsh Ministers.
- 3 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. In this report, we therefore refer to the three trusts also having a requirement to meet the duties of the Act, even though the Act itself does not directly refer to the three trusts.
- 4 The three-year time period for planning and breaking even operates on a rolling annual basis. So there is not a three-year plan and period to break even, followed by another three-year plan and period. Instead, NHS bodies must break even each year taking account of the position at the end of the previous two years. Also, NHS bodies must produce a new three-year plan for Ministerial approval every year.
- 5 The three-year integrated plans are about much more than finances. They should be based on the NHS body's strategic plan for meeting the health needs of the local population. That should include plans for the workforce, for the estate and for service delivery, as well as financial plans. The aim, purpose and intended benefits of the Act are set out in the Explanatory Memorandum that accompanied the draft legislation when it was scrutinised by the National Assembly for Wales in 2013-14 (summarised in [Box 1](#)).

1 See the Health and Social Care Committee's **Letter to the Finance Committee on scrutiny of the draft budget 2013-14** (October 2012) the Finance Committee's report **Scrutiny of the Welsh Government's Second Supplementary budget 2012-13** (February 2013); and the Public Accounts Committee's report **Health Finances** (February 2013)

2 The National Assembly's Business Committee had previously approved a fast track procedure for the Bill so that it could be introduced at the earliest possible opportunity.

Box 1: Welsh Government's aim, purpose and intended benefits of the Act

Aim: to improve the health outcomes of the Welsh population (in the short, medium and long-term) by targeting NHS funding towards those services and interventions that provide the best value for money.

Purpose: to make provision in relation to the financial duties of health boards in Wales. The Bill provides for each health board in Wales to secure that its expenditure does not exceed its funding over a period of three years, instead of applying to each financial year.

Benefits: Financial flexibility within a rolling three-year period will:

- allow health boards to focus their service planning, workforce and financial decisions over a longer period and is expected to result in better decision making and optimal solutions by health boards; and
- remove a significant challenge within the current regime which encourages short-term decision making around the financial year-end, which may not be in the longer term interests of the organisation.

- 6 In addition to the Act, other legislative changes are also driving a shift towards longer-term thinking and planning. The Well-being of Future Generations (Wales) Act 2015 is intended to integrate longer-term planning across the Welsh public sector. The Act requires the main public services, including the NHS and councils, to work together through Public Service Boards across Wales to build up a collective understanding of the needs of their populations and to develop long-term plans to improve wellbeing.
- 7 Although the Act specifically refers to integrated planning by health boards, this planning does not take place in a vacuum. The Welsh Government has a vital role in overseeing the strategic direction, governance and accountability of the whole system. It sets out the framework for integrated planning, reviews NHS bodies' plans and determines whether they are approved or not. The Welsh Government also determines the level of funding available to each NHS body. Nevertheless, the legal duty to produce a good-quality plan remains with the NHS bodies themselves.

- 8 On behalf of the Auditor General, we have undertaken an early high-level review of the implementation of the Act. In particular, this report focuses on whether the Welsh Government has developed sound arrangements to support the implementation of the NHS Finances (Wales) Act to achieve the intended benefits. This report is not intended to provide a comprehensive commentary on the current state of NHS finances or service delivery. We have not sought to establish conclusively why individual NHS bodies have or have not met their duties under the Act. However, we have drawn on our local audit work to identify some common themes on planning and financial management across the NHS. That local audit work also informs the Auditor General's input to the NHS Escalation and Intervention Framework. That framework is a key part of the way in which the Welsh Government has responded to the Act.
- 9 We found that:
- in response to independent reviews, the Welsh Government has increased planned health spending but has continued to rely on additional in-year funding;
 - the Welsh Government's oversight and accountability arrangements for integrated planning are generally sound; and
 - while there are signs of a greater focus on the longer term, at the end of 2016-17, four of the seven health boards failed to meet the duties under the Act.
- 10 The funding environment provides important context to the duties of the Welsh Government and NHS bodies under the Act. Because of uncertainty over its own future budgets for a variety of reasons, the Welsh Government has not set out indicative future revenue budgets in recent years. However, the Welsh Government has sought to mitigate this uncertainty for NHS bodies by providing them with indicative allocations or planning scenarios. The Welsh Government has expected NHS bodies to develop plans on the basis of those indicative settlements.

- 11 Work by the Nuffield Trust and the Health Foundation reinforces that the NHS faces significant financial pressures. In response, the Welsh Government has increased health spending in real terms. In the three-year period since the Act came into force, 2014-15 to 2016-17, real-terms health-revenue spending has increased by an average of 2.9% each year; a real-terms rise from £6.2 billion in 2013-14 to £6.7 billion in 2016-17. Some of the additional funding has been allocated in a planned way, through the budget ahead of the start of the financial year. However, the Welsh Government has increasingly used in-year funding. This in-year funding has partly been for specific initiatives, such as the New Treatment Fund for new drugs, but it has also been required in response to in-year pressures and priorities.
- 12 The Welsh Government has also strengthened its national approach to efficiency. It has set up a national Efficiency, Healthcare Value and Improvement Group, led by the Chief Executive of NHS Wales. This group aims to identify practical initiatives to make 'allocative' savings from service transformation, particularly through the prudent healthcare approach, as well as incremental 'technical' efficiency savings.
- 13 The Welsh Government's planning guidance has generally been clear, although in our view it could explain better some aspects of the break-even duty for NHS bodies. Specifically, the implications of NHS bodies incurring unapproved overspends. The guidance has linked the three-year planning process to the wider strategy for the NHS. There is an independent Parliamentary Review underway and the Welsh Government intends to produce a new NHS strategy once that review is completed. In our view, and in light of independent reviews including by the Organisation for Economic Co-operation and Development (OECD), there is scope for the Welsh Government to be more directive about strategic change across the NHS, notwithstanding NHS bodies' responsibilities to plan and deliver service change.
- 14 The Welsh Government is supporting NHS bodies to improve their capacity to produce good plans. For example, working with Academi Wales to develop a new post-graduate diploma in planning. The Welsh Government has a good process for reviewing the quality of NHS bodies' plans. In particular, it has developed a revised and much strengthened approach to linking NHS bodies' three-year plans to the planning of capital projects. In reviewing three-year plans, the Welsh Government draws on a range of internal expertise to understand and challenge the assumptions in plans and has built its internal capacity by bringing in staff through secondments.

- 15 The Welsh Government has been resolute in only approving plans it has confidence in, including some with particular financial challenges where the health boards concerned had included substantial 'unidentified savings'. The Welsh Government considers that while these plans had particular financial risks, the health boards' plans to manage those risks and their track record gave the Welsh Government confidence that the health boards could ultimately manage within their budgets.
- 16 Alongside the three-year planning process, the Welsh Government has made use of the NHS Escalation and Intervention framework to strengthen accountability across the NHS. The six NHS bodies with approved plans during 2016-17 are all at the lowest 'routine' level of escalation status, although having an approved plan is just one factor in the escalation status. The four health boards that did not have approved three-year plans during 2016-17 are at heightened levels of escalation, with one in special measures. The Welsh Government's interventions in these cases have included support from management consultants on financial governance.
- 17 The in-year financial position necessarily remains an important focus of Welsh Government monitoring, although there is scope to adapt the monitoring information to more fully reflect the changes introduced by the Act. There has, meanwhile, been a shift towards a longer-term focus in the Welsh Government's wider monitoring of and dialogue with NHS bodies.
- 18 Our local audit work also shows that NHS bodies have strengthened their approach to planning, and that they are increasingly aware of the gaps in their capacity to plan. However, financial data shows that NHS bodies' spending profiles still follow an annualised pattern with most savings achieved at the end of the year and a growing reliance on short-term one-off savings. Despite welcoming the financial flexibility afforded by the Act, no NHS body has yet made planned use of it.
- 19 At the end of March 2017, three out of seven health boards and all three NHS trusts met the twin statutory duties of breaking even over three years and having an approved three-year plan. The four health boards that did not meet the duties face a significant challenge to recover their financial position. Our local work points to some significant contributory factors in those health boards that have not met their duties:
 - a over-optimistic savings plans, including not identifying sufficient sources of potential savings and failing to deliver identified savings;
 - b clinical and service plans not in place to support necessary transformation of services;

- c workforce pressures in some health boards resulting in reliance on costly locum and agency staff;
 - d concerns about performance that have required additional service investment and cancelling of savings schemes; and
 - e concerns about capacity to deliver strategic changes.
- 20 At present there is some variation between the amounts of funding the Welsh Government allocates to health boards per head of population. The Welsh Government has completed work to update the data that underpins its funding formula but has yet to complete work to assess whether the formula still fully reflects the different needs and cost drivers for each health board area.

Recommendations

- 21 In addition to the three specific recommendations below, there are two broader areas where we think changes in the wider financial and strategic environment could create better conditions for NHS bodies to meet their duties under the Act:
- 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.

Recommendations

- R1 The Welsh Government's extant guidance is largely silent on the implications of NHS bodies not meeting the financial duty under the Act by incurring an unapproved overspend over a three-year period. Also, the Welsh Government's monitoring return reports do not routinely monitor NHS bodies' progress against the three-year rolling periods. **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.**
- R2 The Welsh Government's formula for funding health boards has led to differences in the amounts each health board receives per head of population. The Welsh Government accepted a 2013 Public Accounts Committee recommendation to review its formula, but has not yet completed this important and complex work. **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.**

Part 1

In response to independent reviews, the Welsh Government has increased planned health spending but has continued to rely on additional in-year funding



- 1.1 This part of the report considers the funding environment in which NHS bodies operate. It looks at the Welsh Government's budget setting process for health services. It also looks at changes in the levels of funding for health, including in response to independent reviews of the cost pressures facing the NHS in Wales. These issues provide important context to the duties of the Welsh Government and NHS bodies under the Act.

A range of factors hamper the Welsh Government's ability to set future revenue budgets although it has provided NHS bodies with indications of future funding

- 1.2 The Welsh Government provides almost all of the funding for NHS bodies in Wales³. The Welsh Government's approach to financial planning has a significant knock-on impact for NHS bodies' ability to plan their finances. Prior to 2014-15, Welsh Government budgets had included 'indicative allocations' for at least two future years. So, for example, the 2010-11 budget included indicative plans for 2011-12 and 2012-13 for all areas, including spending on health.
- 1.3 For a variety of reasons, the Welsh Government has not set indicative future budgets for revenue in recent years. For 2014-15 the Welsh Government only gave an indicative settlement for one future year. Since then, its annual budget settlement announcements have not contained any future allocations at all for revenue funding, although the 2017-18 budget has included indicative capital allocations for future years. The Welsh Government's rationale for not currently providing indicative allocations in the formal budget is as follows:
 - a When the Welsh Government produced the 2015-16 budget, in the autumn of 2014, the UK Government had published no spending plans for future years.
 - b The 2016-17 budget was produced in December 2015 within weeks of a new UK Government publishing its spending review. Like the Scottish Government and Northern Ireland Executive, the Welsh Government only published a one-year budget due to time constraints.
 - c For 2017-18, the Welsh Government's budget has been produced against the context of the result of the referendum on the UK's membership of the EU. Given this uncertainty, the Welsh Government has chosen to only set a single-year revenue budget, although it has set indicative future capital budgets for three years.

³ NHS bodies also raise small elements of income from other sources, including the use of their facilities for private healthcare, from treating patients from outside Wales and also from charitable activities.

- 1.4 The Welsh Government has sought to mitigate this uncertainty for NHS bodies by providing them with indicative settlements or scenarios, even though these are not set out in the formal budget. The Welsh Government has expected NHS bodies to develop their three-year plans on the basis of those indicative settlements.

Work by the Nuffield Trust and the Health Foundation reinforces that the NHS faces significant financial pressures

- 1.5 There have been two recent reports on the scale of pressures facing the NHS in Wales, which have influenced the Welsh Government's decisions on health finances. Both reports – the first by the Nuffield Foundation in 2014 and the second by the Health Foundation in 2016 – paint a very similar picture of cost pressures⁴. They set out that the NHS in Wales faces demand pressures equivalent to an annual real-terms increase of 3.2%. The Health Foundation notes that this 3.2% is the funding required simply to sustain services in their current form and at their current level. If the NHS is to benefit from technological advances and improve, then it needs an additional 0.7% a year in real terms – taking the total cost pressure to 3.9% a year on top of inflation.
- 1.6 The Health Foundation report provides an analysis of the options for managing the short-term pressures to 2019-20 and the longer-term pressures to 2030-31. Their analysis also points to the potential short-term financial savings from the pay restraint across the NHS. The Health Foundation notes that changes to pension rights⁵ mean that, despite the pay restraint, NHS bodies faced a real-terms increase on the pay bill in 2016-17 and another increase in 2017-18 as a result of the apprenticeship levy⁶. But it points to real-terms savings of around 1.8% on the pay-bill in 2018-19 and 2019-20, assuming the pay restraint is sustained.
- 1.7 Both the Health Foundation and the Nuffield Trust concluded that the NHS in Wales can be put on a sustainable financial footing over the long term. However, both found that achieving this over the longer term will require sustained real-terms increases in funding in the order of 2.2% to 2.9% a year, on top of annual efficiency gains of 1%. The Health Foundation reported that the funding requirement could be reduced if the NHS made significant savings from more transformational change ([paragraphs 1.11 to 1.12](#)).

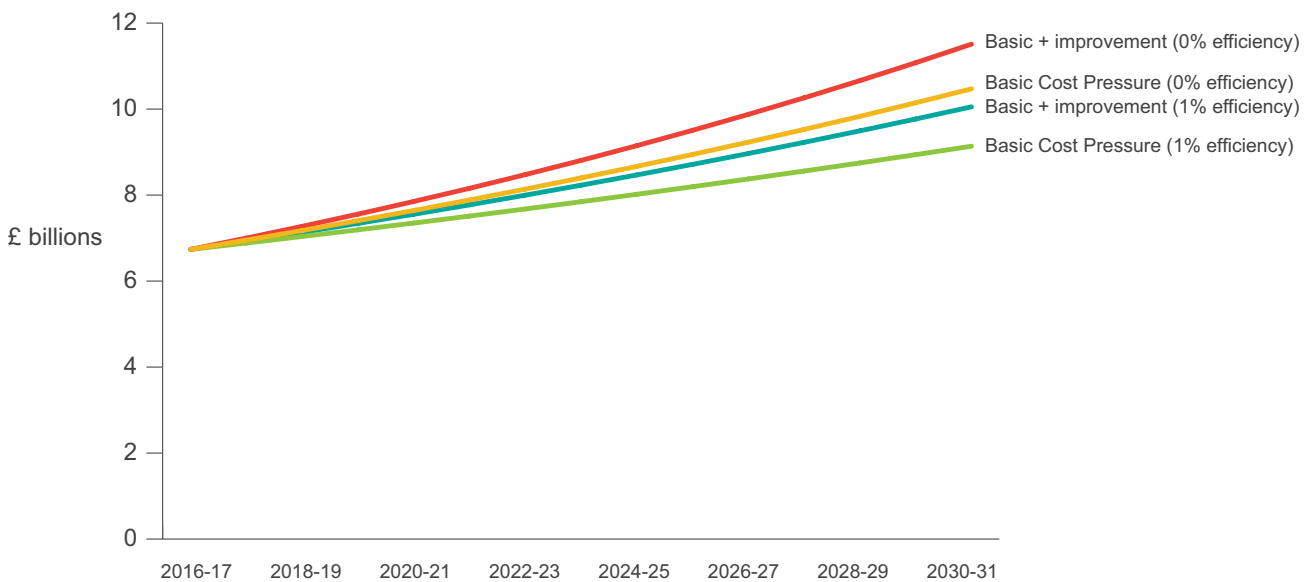
⁴ Appendix 1 provides full references for these independent reports.

⁵ From 2016-17 onwards, employers pay an additional national insurance contribution as part of reforms to the state pension.

⁶ The apprenticeship levy is a levy on employers introduced by the UK Government to fund an increase in the number of apprenticeships in England. The Welsh Government receives a share of the funding through the Barnett formula and is not obliged to spend it on apprenticeships.

1.8 **Figure 1** updates the Health Foundation projections in light of Welsh Government budget changes. It shows that, in order to meet cost pressures, the health budget for 2019-20 could be somewhere between £8.9 billion and £11.1 billion (in 2015-16 prices), depending on the extent of productivity improvements, technological changes and service improvements.

Figure 1: increases in health spending needed to meet anticipated cost pressure, 2016-17 to 2030-31



Note: This chart projects the rise in health spending required to meet cost pressures in four scenarios. The 'Basic Cost pressure' scenario refers to the 3.2% real-terms cost pressure. 'Basic + improvement' is the 3.9% real-terms cost pressure if the NHS also invests in technological developments and improvement. The efficiency scenarios cover the scenario where the NHS continues the historic 1% productivity trajectory or does not improve efficiency at all.

Source: Wales Audit Office update using Health Foundation projections

Despite increases in planned funding and a strengthened focus on efficiency, the Welsh Government has still needed to allocate further funding to address in-year pressures and priorities

The Welsh Government has responded to the issues raised by the Nuffield Trust and Health Foundation by providing additional funding and through an increased focus on improving efficiency

- 1.9 The Welsh Government responded to the short-term challenges posed by both of these reports by allocating additional funding to the NHS as well as focusing on improved efficiency. It announced real-terms increases to spending for 2014-15 and the following two years in response to the Nuffield Trust report. It subsequently announced further increases for 2016-17 and 2017-18 in response to the Health Foundation work. In the 2017-18 Draft Budget, the Welsh Government said:
'The Welsh Government is responding to the Nuffield Trust and Health Foundation analysis by continuing to invest in the Welsh NHS. In this draft Budget, we are investing an additional £240 million in 2017-18. This will enable NHS organisations to continue to meet the ongoing growth in demand and costs of services. This includes meeting the costs of pay awards for NHS staff; delivering more care in primary and community care; maintaining investment in new drugs and treatments and ensuring high-quality of care for all.'
- 1.10 The extent to which the Welsh Government can afford the long-term pressures on the NHS will depend in large part on the future state of public finances in Wales. Welsh public finances largely depend on decisions about public spending taken at a UK level, although fiscal devolution gives the Welsh Government more options over policies on taxation and borrowing which potentially affect the level of available funding. The immediate prognosis is for UK public spending to be constrained at least until 2019-20, and Office for Budget Responsibility economic forecasts suggest there may be tight budgets or even continued spending cuts after 2019-20. The Health Foundation's work found that the NHS in Wales would be sustainable if funding rose in line with projected longer-term UK GDP growth. However, there is inherent uncertainty in forecasts for future economic growth and public spending, not least in the context of the potential impacts from exiting the European Union.

1.11 The Welsh Government has introduced and supported a range of national initiatives for improving efficiency. In the early years of the Act each NHS body has been charged with producing its own annual savings plans under common themes. However, the Welsh Government is leading the NHS towards a more coherent national approach. It has set up the national Efficiency, Healthcare Value and Improvement Group, led by the Chief Executive of NHS Wales. This group aims to identify practical initiatives to make 'allocative' savings from service transformation, particularly through the prudent healthcare approach (Box 2), as well as incremental 'technical' efficiency savings. Its work draws in part on research on efficiency savings and the funding gap from the Public Policy Institute Wales. The Group has produced an Efficiency and Productivity Framework and issued efficiency targets to LHBs and NHS Trusts for incorporation into NHS bodies' plans.

Box 2: Prudent Healthcare

The Welsh Government defines Prudent Healthcare as 'Healthcare that fits the needs and circumstances of patients and avoids wasteful care.' It is informed by the work of the Bevan Commission and others around the world. There are four Principles of prudent healthcare, which state that any service or individual providing a service should:

- achieve health and wellbeing with the public, patients and professionals as equal partners through co-production;
- care for those with the greatest health need first, making the most effective use of all skills and resources;
- do only what is needed, no more, no less; and do no harm; and
- reduce inappropriate variation using evidence-based practices consistently and transparently.

Prudent healthcare aims to create a patient-centred system. An NHS based on prudent healthcare principles ensures patients receive the most appropriate agreed treatments. This will reflect the contribution individuals can make to their own health and wellbeing.

Source: [Welsh Government website](#)

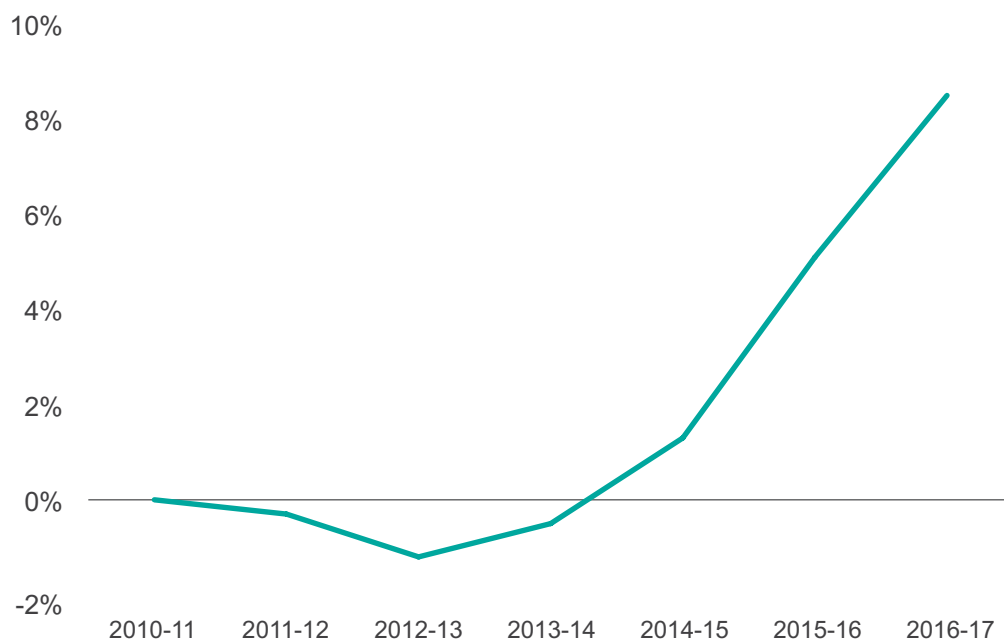
- 1.12 The Welsh Government intends that the prudent healthcare work in particular will strengthen NHS bodies' focus on getting value from their day-to-day spending on clinical services. During 2016 the Welsh Government produced a plan for prudent healthcare, setting out priority actions for the 12 months ahead in specific service areas. It is also supporting NHS bodies to work with the International Consortium for Health Outcomes Measurement (ICHOM). The partnership approach will be to develop population based volume, cost and outcome data across an entire patient pathway. The initial work programme in 2017-18 will include value based assessments in two clinical areas; lung cancer and one other area to be determined locally by each health board.
- 1.13 The strengthening of the national focus on NHS efficiency is a positive step forwards. Some of our recent reports on specific service areas have identified scope for a greater national focus. For example, our 2016 report on medicines management recommended that the Efficiency, Healthcare Value and Improvement Group take forwards work on identifying cost and quality improvements. The Welsh Government accepted the recommendation and work on medicines management is included as part of the Group's 2017-18 programme of work. Our 2016 report on operating theatres found that there had been a loss of national focus on theatre efficiency and productivity in previous years. The Welsh Government accepted our recommendation to introduce a national forum and reported that it would do so through the national Efficiency, Healthcare Value and Improvement Group.

Despite increasing planned funding for health, the Welsh Government has still had to provide further funding to address in-year pressures and priorities

- 1.14 Our reports on a **Picture of Public Services** and health finances over recent years have painted a picture of the broad financial challenges faced by the NHS in Wales⁷. At the start of the period of austerity in 2010-11, NHS Wales faced real-terms spending cuts. However, since 2013-14 that picture has turned around, with the NHS in Wales having real-terms increases in health revenue budgets (**Figure 2**). In the three year period since the Act came into being, 2014-15 to 2016-17, real terms health revenue spending has increase by an average of 2.9% each year; a real terms rise from £6.2 billion in 2013-14 to £6.7 billion in 2016-17.

⁷ Appendix 1 provides further detail about relevant audit reports.

Figure 2: 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 2016-17 spending was 8% higher than in 2010-11.

Source: Wales Audit Office analysis of Welsh Government budgets

1.15 Comparative analysis shows that revenue spending on health in Wales has been rising in line with the rest of the UK since 2013-14. HM Treasury's Public Expenditure Statistical Analysis data shows that revenue spending on health fell faster during the earlier period of austerity than the rest of the UK but this changed from 2012-13 onwards. Nevertheless, in 2015-16 total spending per head of population on health (including capital expenditure) remained higher in Wales (£2,127) than England (£2,106) but was lower than in Scotland (£2,258) and Northern Ireland (£2,178)⁸.

⁸ Our report **A Picture of Public Services 2015** published in December 2015 sets out the Welsh Government's preference to include health and social care in UK-wide comparisons and provides a more detailed comparison of spending trends in the different parts of the UK.

- 1.16 The Welsh Government's health revenue budget has been subject to regular updates to include additional⁹ funding. The Welsh Government has allocated some of the increased funding in a planned way through the budget agreed ahead of the start of the financial year. This includes the funding announced in response to the Nuffield and Health Foundation reports ([paragraph 1.9](#)). The Welsh Government also allocates funding in the year, through supplementary budgets. This in-year allocation includes funding for specific priorities as well as funding to cover forecast or actual overspends at NHS bodies. Such funding is in part intended to enable NHS bodies to avoid having to take short-term financial decisions that could impact on the quality of care.
- 1.17 The Welsh Government has added in-year-funding to the health revenue budget since 2014-15, when the Act came into force. In the three-year period starting in 2014-15, the Welsh Government has allocated more in-year funding to the health revenue budget, than in the previous three years. Our previous reports on health finances have set out how this cycle causes challenges for financial management in the Welsh Government, which has to find this funding from other spending areas or its reserves. The approach also risks contributing to a public perception that NHS spending is rising by more than it actually is. The timeline below is an example of how the short-term cycle works in practice.
- a **December 2015:** The Welsh Government published its budget for 2016-17 in December 2015. That budget showed that the health revenue budget would increase by 2.4% in real terms compared to 2015-16¹⁰.
 - b **February 2016:** In a supplementary budget, the Welsh Government provided £127 million additional funding for the 2015-16 financial year. By increasing the 2015-16 baseline, what was a 2.4% year-on-year real-terms increase for 2016-17 became a 0.4% increase.
 - c **February 2017:** The Welsh Government increased the health revenue budget by around £185 million¹¹, for 2016-17. This took the real-terms increase between 2015-16 and 2016-17 up from 0.4% to 3.2%.

9 By 'additional' we mean funding on top of previous indicative plans or agreed budgets rather than additional when compared to previous years.

10 The 2015-16 baseline in the 2016-17 budget included £84.6 million allocated to the health revenue budget in the June 2015 supplementary budget.

11 The £185 million includes £76 million added to the health revenue budget to cover deficits at four NHS bodies. This funding was not allocated to the NHS bodies (see paragraphs 3.23 to 3.24) but was required to balance the Department of Health and Social Services' budget.

- 1.18 The Welsh Government told us that while the amount of in-year funding has increased, it has used this funding in a more focussed way. In particular, more of the funding has been allocated to specific initiatives such as the Integrated Care Fund¹² and primary care. The Auditor General plans to carry out detailed work looking the Integrated Care Fund and primary care over coming years. Those pieces of work will provide an opportunity to consider how this in-year funding has worked its way through to local services. The Welsh Government has also made some of the additional funding conditional on meeting certain objectives in relation to improving performance.
- 1.19 The Welsh Government intends in future to develop a transformation fund which it can use to support innovative change programmes. In our view, the principle of a transformation fund is sound. However, to date the Welsh Government has struggled to find the budgetary headroom to create such a fund. In part this is due to the cycle where many NHS bodies start the year headed towards a deficit. As a result any contingency within the Welsh Government's health revenue budget, which could potentially form a transformation fund, is instead used to manage the immediate pressures.

¹² This programme was previously called the Intermediate Care Fund and provides funding for initiatives to integrate services across health and social care.

Part 2

The Welsh Government's oversight and accountability arrangements for integrated planning are generally sound



- 2.1 As a consequence of the NHS Finances (Wales) Act 2014, each NHS body is required to have an approved integrated medium-term plan and to achieve financial break even over a three-year rolling period. It is therefore the duty of each NHS body to produce a good-quality plan. The Welsh Government has a vital role in overseeing the strategic direction, governance and accountability of the whole system. This part of the report considers the Welsh Government's guidance to NHS bodies and its approach to reviewing and deciding whether to approve plans.

Welsh Government planning guidance is generally clear although there is scope for greater clarity in some areas

The Welsh Government's guidance on medium-term planning has generally been clear but could have better explained some aspects of the break-even duty

- 2.2 The Welsh Government has produced detailed planning guidance on developing integrated medium-term plans. Overall, the guidance has been clear and covers the key ground that we would expect to see, including:
- a clear timeframe from first draft through to approval decisions ([Appendix 2](#));
 - clarifying roles and responsibilities for developing, considering and approving plans; and
 - expectations for particular service areas, such as emergency care and elective care.
- 2.3 In some areas, the guidance has included templates, notably for financial planning elements, specifying exactly what information NHS bodies must provide to the Welsh Government. Some key stakeholders felt that these detailed requirements were overly prescriptive. However, such templates have the benefit of ensuring that plans are consistent and comparable and have been welcomed by others. The Welsh Government has updated its guidance for the 2017 to 2020 planning round to make it shorter and less prescriptive, as part of its ongoing refinement of the guidance and engagement with NHS bodies. The Welsh Government also considers that NHS bodies have built up an understanding of what it expects to see in plans, so some of the detail is no longer necessary. The Welsh Government intends to revise the guidance again in the autumn for the 2018 to 2021 planning round.

- 2.4 The Welsh Government's guidance refers to 'financial flexibility'. We have identified that in practice there could be two types of financial flexibility:
- a Planned financial flexibility, where the Welsh Government approves flexibility between years and adjusts the allocation to the NHS body through 'recoverable revenue resource' in year one which is then recovered in years two or three. This ability to adjust funding for NHS bodies flexibly within its overall budget was available to the Welsh Government as an option prior to the introduction of the Act.
 - b Unplanned financial flexibility, where the NHS body underspends or overspends against its approved annual limits and can balance these over a three-year period to break even. This ability to overspend against the approved annual limit, while balancing over three years, was a new feature introduced by the Act.
- 2.5 The guidance has emphasised the planned element of financial flexibility and the need for health boards to plan on the basis of breaking even over the coming three years. However, in our view the guidance has not been clear that in order to meet both duties, NHS bodies must also plan on the basis of breaking even retrospectively where there has been an overspend that has not been approved and funded by the Welsh Government. The retrospective element introduces some potential challenges for NHS bodies in different scenarios. For example we are aware from our local audit work that some members of health boards that have delivered small surpluses in recent years have been unclear as to whether the health board can exceed their authorised spending limit during 2017-18 and potentially 2018-19.
- 2.6 There are also tensions between ambition and realism which the Welsh Government is seeking to address through the guidance. In the planning round for 2014-15, the Welsh Government required NHS bodies to produce plans showing that they would meet all of the national performance targets. We consider that initially requiring all targets to be met was over-optimistic. For example, our 2015 report on elective waiting times described the trend of optimistic performance trajectories constantly being missed and updated. From 2015-16 onwards, the Welsh Government has instead required that NHS bodies' plans show improvement towards the national targets. Each NHS body therefore has its own targets to be met by the end of each year. This approach is more realistic. While the retention of a numerical end-of-year target risks creating perverse incentives that drive short-term decision making to meet the target, the Welsh Government considers that its approach has contributed to an improvement in performance across a range of key measures.

The Welsh Government has clearly linked its planning guidance to the wider strategy for the NHS although there is scope for the Welsh Government to provide a clearer and longer-term vision for future service reform

- 2.7 The Welsh Government set out a strategic vision for the NHS in the 2011 document **Together for Health**. Together for Health was developed as part of the previous Welsh Government's 'Programme for Government'. The strategy built on previous visions of world-class and improving services. In its detailed guidance to NHS bodies, the Welsh Government has linked the development of three-year plans to the key themes and aims of Together for Health. It has also ensured that the guidance reflects key developments, notably the Prudent Healthcare approach, that came after Together for Health.
- 2.8 For the 2017-18 to 2019-20 round, the Welsh Government has updated its guidance to emphasise that each three-year plan should be informed by, but separate to, the NHS body's longer-term strategic plan. Some NHS bodies have such plans in place already, whereas others are in the process of developing them. The Welsh Government has emphasised the need for the longer-term plans and three-year plans to be aligned to the wider duties under the Well-being of Future Generations (Wales) Act 2015. The different timing cycles for planning between the Well-being of Future Generations Act and the timescales for developing three-year plans create additional complexity.
- 2.9 In the period since the NHS Finances (Wales) Act came into force, two significant reviews have suggested that the Welsh Government needs to be more directive in its vision for NHS services. In April 2015, the Welsh Government set up a Review Panel to look at a range of issues related to the NHS workforce in Wales, including the future shape of the workforce in light of changing service models. The Review Panel reported in February 2016¹³ but struggled to identify the future requirements for the NHS workforce in the absence of a clear direction as to what services will look like in the future. It found that 'The widely held view across the service is that we currently lack an agreed strategic vision of what the NHS is intended to look like in Wales in ten years' time, regardless of what may be thought about Together for Health, and that this inhibits the planning of new workforce models, new skill mixes and new roles.'

13 Review Panel, **NHS Wales Workforce Review** (February 2016)

- 2.10 In February 2016, the Organisation for Economic Co-operation and Development (OECD) published an independent, authoritative and in-depth review of the quality of healthcare in the four nations of the UK¹⁴. The OECD report had many positive things to say about the NHS in Wales and the way it is organised. It pointed in particular to the potential benefits of:
- a Wales' combined Health Boards, set up in 2009, that bring together primary care and secondary care and do away with the commissioner-provider split; and
 - b the Prudent Healthcare agenda (Box 2), which the OECD says is a way of 'balancing equity and the constraints of austerity'.
- 2.11 However, the OECD found that health boards had not yet delivered the kinds of change and innovation in service delivery that might be expected of them. The OECD suggested that clearer direction from the Welsh Government was required. It concluded that Prudent Healthcare needed a 'detailed roadmap . . . containing a clearer vision for what services will look like¹⁵'. It also reported that the Welsh Government needed to be clearer about 'exactly what is expected – in terms of finance and budget allocation, performance and efficiency and quality achievement and improvement'.
- 2.12 Our own reports have similarly identified concerns about the pace of strategic service change and reconfiguration by health boards. In addition, following the introduction of the Act, our local audit work has identified that some of the earlier approved three-year plans were not well integrated with wider regional service reforms.

The Welsh Government is developing a new strategy for NHS Wales and expects an independent review currently underway to contribute to a clearer direction in key areas

- 2.13 The Welsh Government has set up an independent 'Parliamentary Review' of health and social care, led by experts in the field. The Welsh Government expects the Parliamentary Review to report by December 2017. The review, which has cross-party support, is intended to help provide direction on some of the most difficult and long-term challenges facing the NHS in Wales. Maintaining effective cross-party political engagement is important if the review is to ultimately help circumvent the political disagreements that have hampered previous efforts to reform NHS services across Wales.

14 OECD, **OECD Reviews of Healthcare Quality: United Kingdom** (February 2016)

15 The Welsh Government considers its 2016 publication *Prudent Healthcare: securing health and well-being for future generations* (see paragraph 1.12) as its response to the OECD call for clearer direction.

- 2.14 The Welsh Government intends to produce an updated strategy for the NHS in Wales. Understandably, the Welsh Government is awaiting the the outcome of the Parliamentary review. Nonetheless, there is a clear need to update the vision and strategy, in particular to reflect the Prudent Healthcare agenda. This agenda is now driving much of the current thinking about NHS reform.
- 2.15 The Parliamentary review, the development of a new strategy and the fact that many NHS bodies are working on longer-term plans provide an opportunity for a strengthened approach to transforming NHS services. We note that since the OECD carried out its work in 2016, the Welsh Government has become more directive in its oversight of NHS bodies and in holding them to account (paragraphs 2.27 to 2.28). In our view there is scope for the Welsh Government to provide a more directive strategic steer, particularly on national and regional services. However, it is ultimately for the Welsh Government to decide on the appropriate balance between providing a high-level direction and a detailed blueprint for NHS Wales.

The Welsh Government is supporting NHS bodies to improve their capacity to produce good plans

- 2.16 The Welsh Government is putting in place support for NHS bodies to develop their capacity to develop high-quality medium-term plans. The Welsh Government's Department of Health and Social Services has been working with Academi Wales to develop a post-graduate diploma in NHS planning, with a view to training 25 people a year across NHS Wales. This initiative should generate a significant strengthening of capacity in a short time. Also, the NHS Wales Delivery Unit has provided specific training on key areas such as demand and capacity planning. The NHS itself is also working together to strengthen capacity through a group of Directors of Planning, with some Welsh Government involvement. The Directors of Planning group carries out peer reviews of plans and holds shared learning events.
- 2.17 The Welsh Government is also supporting work to strengthen NHS bodies' financial planning capacity. In particular, it has worked with partners to set up the NHS Wales Finance Academy. The Finance Academy leads work on developing and buiding the finance profession in NHS Wales. It provides support to strengthen the financial skills of non-finance staff. It also runs programmes of work on research and innovation, improving the efficiency and quality of core finance systems and processes and developing partnership working, externally and within the NHS between finance staff and clinicians.

The Welsh Government has a good process for reviewing the quality of NHS bodies' plans, including a much strengthened approach to capital planning

- 2.18 In reviewing the quality of NHS bodies' three-year plans, the Welsh Government draws on a range of evidence about each NHS body's past performance. Policy leads from across the Welsh Government's Department of Health and Social Services review the plans, to add expertise in key areas such as finance, workforce planning, unscheduled care, elective care, and primary care. The Welsh Government also draws on the expertise of staff in the NHS Wales Delivery Unit – particularly those with expertise in understanding demand and capacity modelling – to test whether the projections in the plan on performance and delivery are realistic.
- 2.19 The Welsh Government has strengthened its own capacity to review the plans. It has brought in staff on secondment from health boards with approved three-year plans. These seconded staff have taken a lead in bringing together the analysis and challenge provided to the plans by those with expertise from across the Department of Health and Social Services to form an overall opinion on the quality of plans. They are also involved in the support work to help NHS bodies strengthen their planning capacity ([paragraph 2.6](#)). The Welsh Government intends to further strengthen its reviewing capacity with the creation of a Finance Delivery Unit. As well as monitoring progress, the Unit will provide assurance on the financial elements of the three-year plans.
- 2.20 The Welsh Government has also taken steps to significantly strengthen its review of capital projects in the plans. It introduced a new approach to capital planning in 2015. The criteria for assessing capital expenditure business cases are now much more clearly focused on the service delivery aims rather than simply on constructing new buildings. NHS bodies must set out the impact of regional and all-Wales services on their plans. The links between the NHS Wales capital programme and each NHS body's medium-term plans are also now much clearer. No project will be considered for inclusion in the national capital programme unless it is clearly linked to the NHS body's overall strategic direction.
- 2.21 Although not directly driven by the Act, the new approach to capital demonstrates clearly how a mature approach to planning and funding can drive a step change in strategic thinking. A combination of autonomy, challenge and practical support at all stages has resulted in much improved business cases which should deliver sustainable capital investment on a local, regional or 'all-Wales' basis as appropriate. There are significant lessons and good practice that can be learnt from the approach taken in the Welsh Government's NHS capital programme.

The Welsh Government has been resolute in only approving plans it has confidence in, including some with particular financial challenges, and holding NHS bodies to account

- 2.22 With the exception of Betsi Cadwaladr University Health Board, all NHS bodies have submitted a three-year plan for Ministerial approval at some point since the Act came into force (Figure 3). Following detailed scrutiny, the Welsh Government has approved several NHS bodies' plans while not approving others. As at 31 March 2017, three out of seven health boards and three NHS trusts had approved plans. Two health boards that had approved plans previously – Abertawe Bro Morgannwg and Cardiff and Vale – did not have their 2016-19 plans approved. Cwm Taf University Health Board and Velindre NHS Trust are the only organisations to have had approved plans from the outset.
- 2.23 That the Welsh Government has not approved the plans of some of the largest NHS bodies, including bodies that previously had approved plans, is evidence that it is prepared to take a tough line where plans do not meet its expectations. Those NHS bodies that do not submit a three-year plan, or do not have their three-year plan approved, work instead to one-year plans whilst developing three-year plans for submission in future years.
- 2.24 The Welsh Government has not approved some three-year plans for a number of different reasons, not solely because the NHS body was unable to produce a balanced financial plan. The Welsh Government told us that in many cases, an NHS body's inability to produce a balanced financial plan reflects deeper problems with the underpinning clinical, service and workforce plans and some weaknesses in governance. Our local audit work at the four NHS bodies without an approved plan generally supports the Welsh Government's view, and also identified concerns about those NHS bodies' capacity to implement the necessary changes.
- 2.25 The Welsh Government has approved some three-year plans even though they did not have a fully balanced budget at the start of the financial year ahead. In one case, we found that the financial plans made an assumption of additional funding that was not confirmed at the time of approval. In other cases, we found that financial plans were only 'balanced' because the health boards concerned had included substantial 'unidentified savings'. The Welsh Government considers that while these plans had particular financial risks, the health boards' plans to manage those risks and their track record gave the Welsh Government confidence that the health boards could ultimately manage within their budgets. In approving NHS bodies' plans, the Welsh Government has made clear that aspects of the plan will be, understandably, subject to further scrutiny and approval processes.

Figure 3: The Welsh Government's approval of NHS bodies' three-year plans

NHS Body	Was their 2014-2017 three-year plan approved?	Was their 2015-2018 three-year plan approved?	Was their 2016-2019 three-year plan approved?	Was their 2017-20 three-year plan approved?
Health boards				
Abertawe Bro Morgannwg	Yes	Yes	No	Not submitted
Aneurin Bevan	Not submitted	Yes	Yes	Yes
Betsi Cadwaladr	Not submitted	Not submitted	Not submitted	Not submitted
Cardiff and Vale	Yes	Yes	No	Not submitted
Cwm Taf	Yes	Yes	Yes	Yes
Hywel Dda	No	No	No	Not submitted
Powys	No	Yes	Yes	Yes
NHS trusts				
Public Health Wales	No*	Yes	Yes	Yes
Velindre	Yes	Yes	Yes	Yes
Welsh Ambulance Services	No	Not submitted	Yes	Yes

Note: 'Not submitted' covers instances where the NHS body did not submit a plan for final approval and were working instead to a one year plan (paragraph 2.23)

*Public Health Wales' 2014-15 to 2015-16 plan was approved by its Board but the Welsh Government asked it to produce a one year plan because the interdependency of services provided by the Trust to others and the Trust's dependency on health boards to deliver some of its services meant some aspects of the plan could not be finalised.

Source: Wales Audit Office

- 2.26 The Welsh Government is using the process of reviewing and approving (or rejecting) plans as part of a wider strengthening of accountability across the NHS. In March 2014, the Welsh Government introduced a new Escalation and Intervention Framework setting out four levels of escalation and intervention:
- a Routine
 - b Enhanced Monitoring
 - c Targeted intervention
 - d Special measures¹⁶
- 2.27 All of the NHS bodies with approved plans as at the end of 2016-17 are classed as 'routine' although having an agreed plan is only one factor in their escalation status. Of the four health boards that did not have an approved plan in place for 2016-17, one was in special measures and the other three targeted intervention. A key reason that three health boards were escalated to 'targeted intervention' was concerns around their ability to produce and deliver a three-year plan. The Welsh Government has dedicated significant senior leadership resource and capacity to the escalation process. The Welsh Government's interventions have included support from management consultants on financial governance, intended to enable the health boards to produce a three-year plan that the Welsh Government considers robust and achievable. The Welsh Government expects to receive and consider reports on this financial governance work shortly.

¹⁶ The full definition of each stage can be found in: Welsh Government guidance, **NHS Wales Escalation and Intervention Arrangements**, March 2014

Part 3

While there are signs of a greater focus on the longer term, at the end of 2016-17 four of the seven health boards failed to meet the duties under the Act



- 3.1 In introducing the NHS (Wales) Finances Act, the Welsh Government wanted to shift the NHS to a longer-term focus in its planning and delivery. Making that shift requires changes in thinking and in behaviour across the NHS, including the Welsh Government. In this context, this part of the report looks at the Welsh Government's arrangements for monitoring NHS finances, NHS bodies' approaches to medium-term planning and whether financial and performance data suggests a change in patterns in the NHS. Finally it considers whether, ultimately, NHS bodies have met their duties under the Act and draws on our local work to identify some of the issues for those bodies that have not met the duties.

Despite the Act, the in-year financial position necessarily remains an important focus of Welsh Government monitoring

- 3.2 One of the key intended benefits of the Act was to remove a significant challenge within the current regime which encourages short-term decision making around the financial year-end, which may not be in the longer-term interests of the organisation. The Welsh Government acknowledged the difficulty that an annual target imposed in terms of 'landing a jumbo jet on a postage stamp'. It also recognised the risk that short-term decisions to save relatively small amounts of funding in order to break even could have negative consequences.
- 3.3 Despite the rolling three-year planning and reporting period introduced by the Act, the 'in-year' position remains important to the Welsh Government for a variety of reasons. Key among these is that the financial position of health boards in particular directly impacts on the Welsh Government's own finances. As a result, all overspends in a financial year must be covered from the Welsh Government's budget. So there is a real risk that overspending at health boards could ultimately result in the Welsh Government exceeding its annual budget. Therefore, the annual position across health boards is a matter of significant focus and concern for the Welsh Government.
- 3.4 In addition, the way the Act is worded means that the position at the end of each financial year is critically important. [Paragraph 2.4](#) explains that the Act requires health boards to break even over a rolling three-year period. The 'rolling' three-year requirement means health boards must break even taking account of any overspends and underspends in the previous two years. By making the three-year period a rolling one, the Welsh Government gave health boards some freedom for the first two years of the Act. However, from year three (2016-17) and going forwards, health

boards continue to face the challenge of meeting a fixed spending target at the end of each year. For example, if Hywel Dda University Health Board is to meet its duty at 31 March 2018, it will need to underspend in 2017-18 by around £80 million; this being the total amount by which it overspent in 2015-16 and 2016-17 (Figure 8).

- 3.5 The Welsh Government requires all NHS bodies to report on a range of financial indicators each month. It then collates the data into an overall assessment of the position across the NHS. We have previously reported in our work on health finances that the quality of the data and analysis in the monitoring returns has improved over time. The Welsh Government monitors progress against the key specific savings schemes and the detailed analysis takes account of previous years' progress against financial targets and savings plans. Individual NHS bodies remain responsible for monitoring and challenging their own progress against financial targets and savings plans. The Welsh Government intends to strengthen its monitoring through the Finance Delivery Unit (paragraph 2.19). The Unit will monitor and manage more closely financial risk in NHS Wales, and enable the Welsh Government to respond at pace where organisations are in financial failure.
- 3.6 The focus of the data in the monitoring returns is the in-year position, in particular whether the NHS body is likely to deliver its annual savings plan, and ultimately, break even for that particular year. There are good reasons for this, including to ensure that the Welsh Government's own budget is not at risk of being exceeded and to check that NHS bodies are on track with their financial plans. However, we consider that there is scope to adapt the information to more fully reflect the changes introduced by the Act. The Welsh Government's analysis does not include the NHS bodies' performance against their three-year financial plans. Nor does it include any assessment of what current financial performance indicates about each body's likelihood of meeting the three-year duties under the Act.

There has been a shift towards a longer-term focus in the Welsh Government's wider monitoring of delivery and dialogue with NHS bodies

- 3.7 Some of our reports have highlighted that previously aspects of the Welsh Government's management of NHS bodies' performance have been narrowly focused on short-term delivery pressures. The Workforce Review Panel made a similar point in its February 2016 report that 'NHS Wales is generally seen as being driven on a day-to-day basis to achieve immediate improvements against measures and targets that are largely process orientated and acute care focused'. Nonetheless, both our work and that of the Review Panel noted that there had been a shift, notably in developing more outcomes-based measures and targets.
- 3.8 Our analysis of some of the key meetings¹⁷ between the Welsh Government and NHS bodies in 2012-13 and 2015-16 also suggests that there had been some shift of focus towards strategic and medium-term issues. While the discussions were primarily focused on short-term challenges, we found that conversations about performance were starting to be framed by a broader context of service reform and medium-term planning.
- 3.9 Most recently, we have also observed a strengthened focus on longer-term issues in other meetings between senior Welsh Government officials and NHS bodies, related to escalation and planning as well as routine meetings. For example, the Joint Executive Team meetings between the most senior Welsh Government and NHS body officials now have a two-part structure which focuses on medium and longer-term strategic change as well as the detailed performance and delivery issues.

¹⁷ Joint Executive Team meetings and Performance and Delivery meetings (Appendix 1)

NHS bodies have strengthened their approach to planning but spending profiles remain in an annual pattern and none have yet made planned use of financial flexibility

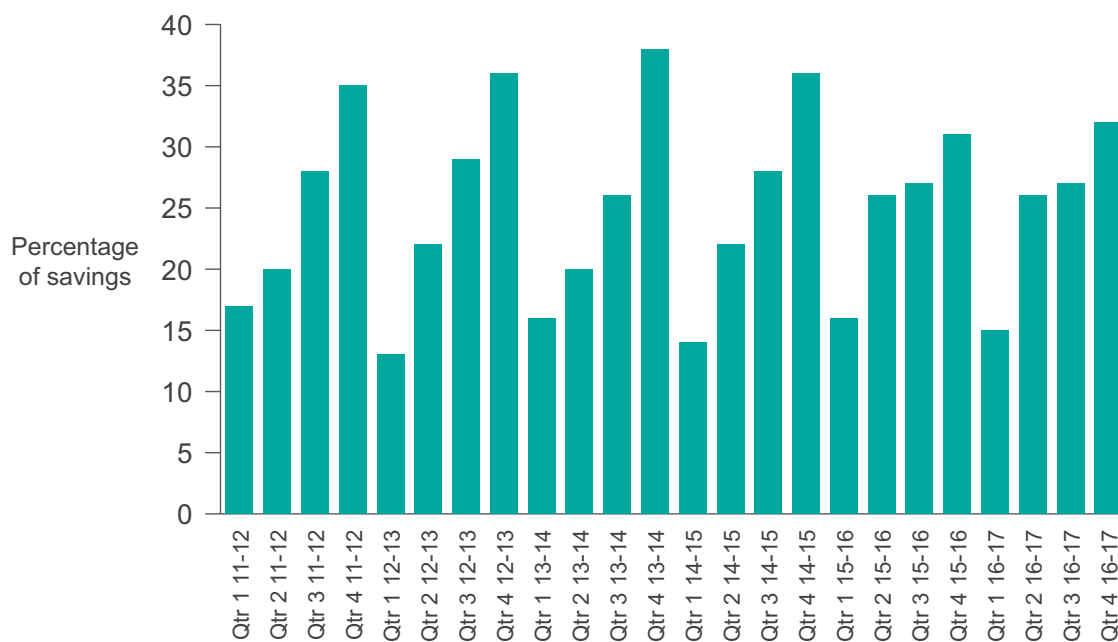
Overall, NHS bodies are strengthening their approach to planning as a result of the Act

- 3.10 Our local audit work has found that in general, NHS bodies are strengthening their arrangements to support integrated planning. NHS bodies are increasingly involving staff in developing, and taking ownership of, medium-term planning. In addition, the fact that gaps in planning capacity are being identified and addressed is a positive impact of the increased focus on planning brought about as a result of the Act. Nonetheless, there are some important areas around programme management and progress reporting that need addressing in many organisations. Also, we found that NHS bodies are often not meeting the Welsh Government's timelines and are submitting 'work in progress' documents whereas the Welsh Government expects them to provide complete plans in January.
- 3.11 Despite their positive overall view of the Act, several NHS board members commented in our survey to the effect that the requirement to produce a plan each year meant that they were still stuck in an annual cycle. Those making such comments included board members from organisations with approved three-year plans.
- 3.12 A little over half of board members who responded to our survey agreed with the statement that 'short-term issues (in-year) account for more of the Board's business than medium and long-term strategy and plans'. Just one in six disagreed, with the rest neither agreeing nor disagreeing. Some suggested that while they agreed with the statement, the position in their organisation was improving. Others said it is reasonable that short-term issues take up more time, but the key is to ensure that they do not crowd out time for the longer-term issues.

The Welsh Government’s monitoring reports show that NHS bodies’ spending profiles still follow an annualised pattern with most savings achieved at the end of the year and a growing reliance on short-term one-off savings

3.13 Our review of annual savings patterns shows that there is still a pattern whereby most savings are achieved at the end of the financial year (Figure 4). This pattern suggests an annual approach to making savings, which starts over for each financial year. However, there are signs of a smoothing out in the pattern over time, with a smaller proportion of annual savings being achieved in the fourth quarter of 2016-17 compared to the fourth quarter of 2011-12.

Figure 4 – percentage of annual savings delivered in each quarter across NHS Wales, 2011-12 to 2016-17

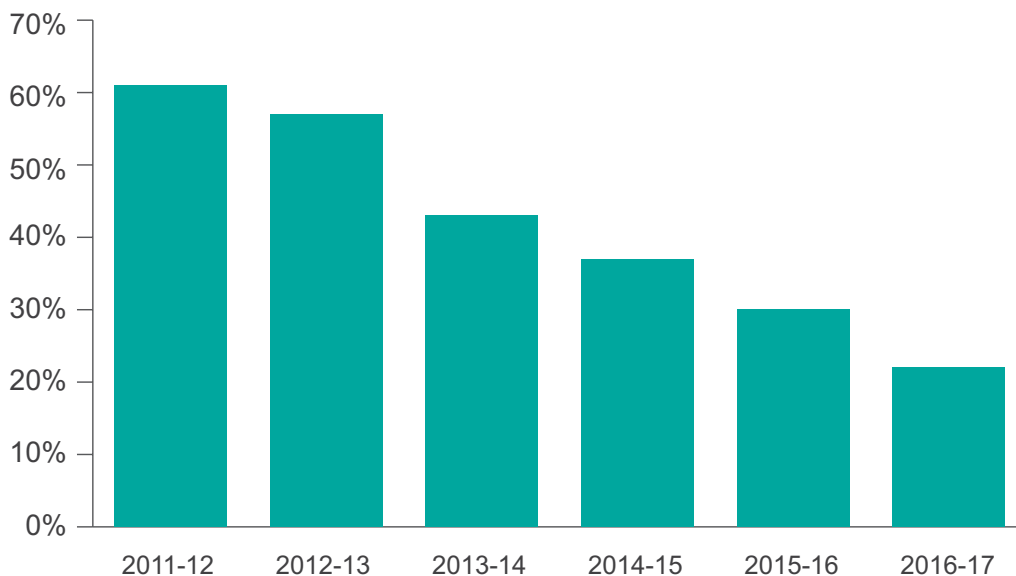


Note: This figure shows the percentage of the total savings over the year that were delivered in each quarter.

Source: Wales Audit Office analysis of NHS body monitoring returns

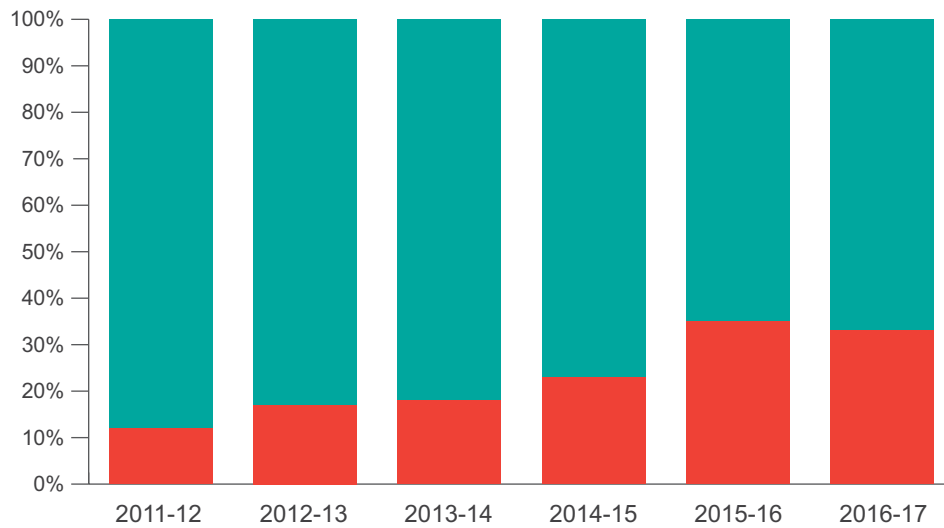
- 3.14 The amount of savings that NHS bodies report having achieved has fallen substantially. The total amount of savings fell from £285 million in 2011-12 to £137 million in 2016-17. As a result, the extent to which savings, as opposed to spending reductions or funding increases, have been able to bridge the gap between cost pressures and available funding has fallen considerably. In 2011-12, savings bridged 61% of the funding gap but by 2016-17 that had fallen to 22% (Figure 5).
- 3.15 The balance between recurrent and non-recurrent savings has also changed. 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. Between 2011-12 and 2016-17, non-recurring savings as a percentage of total savings have increased from 12% to 34% (Figure 6).

Figure 5 – percentage of total funding gap across NHS bodies that is bridged through savings, 2011-12 to 2016-17

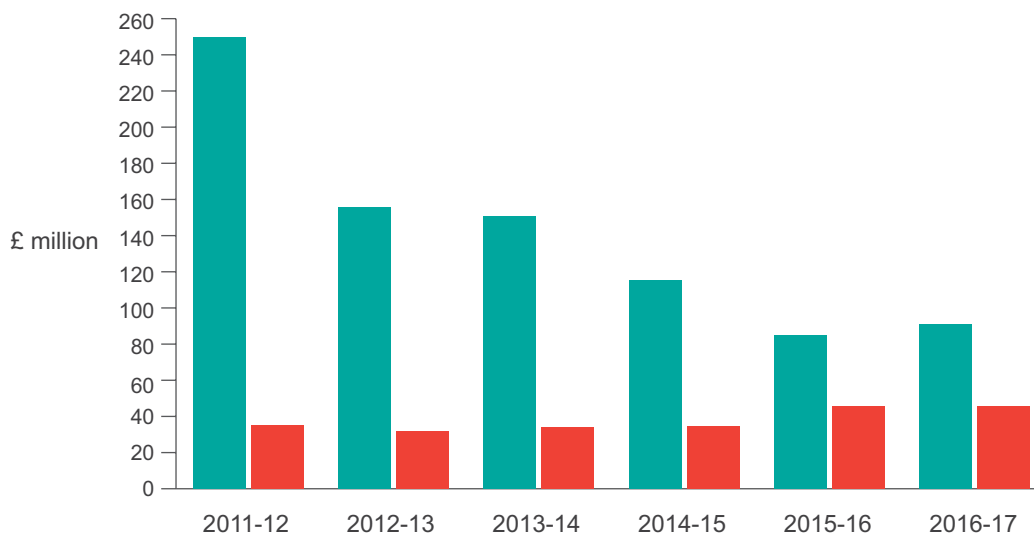


Source: Wales Audit Office analysis of NHS body monitoring returns

Figure 6 – breakdown of NHS bodies’ recurrent and non-recurrent savings between 2011-12 and 2016-17



■ % recurring
■ % non-recurrent

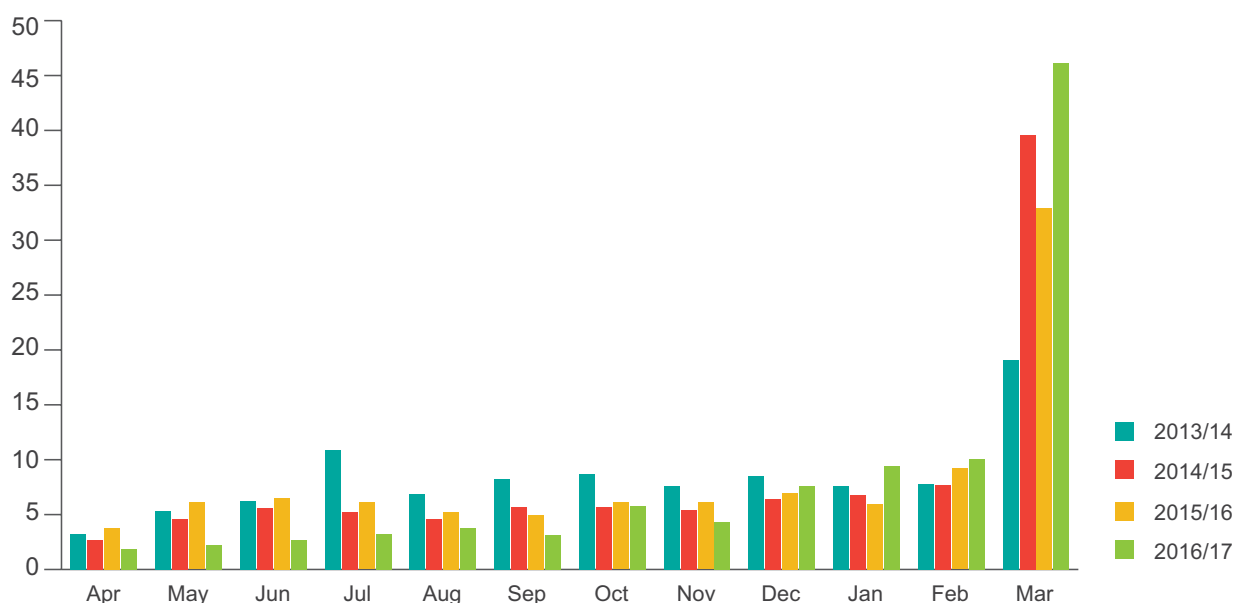


■ Recurring
■ Non-recurrent

Source: Wales Audit Office analysis of NHS body monitoring returns

- 3.16 The patterns described above indicate an increasing difficulty to find savings, a growing reliance on non-recurrent savings, and a continuing focus on ‘annual’ savings. We observed this pattern of a very short-term approach to delivering savings before the introduction of the Act and the evidence suggests that while there are some indications of a smoothing out, it has not changed substantially following the introduction of the Act.
- 3.17 While we found that the approach to planning capital projects is improving ([paragraph 2.20](#)) spending of capital remains in a short-term cycle. [Figure 7](#) shows that the NHS spends the majority of its capital in the last few months of the year. In 2016-17 this pattern was more pronounced than previous years. This pattern of a disproportionate use of capital at the end of the year poses a potential risk to value for money.
- 3.18 As well as financial information, we looked at the pattern of activity and performance data covering NHS services. Our analysis of the data showed that there was generally not yet a significant change in the annual pattern of performance or activity. Annual patterns on workforce size and use of agency staff have persisted, although they may be explained in part – or even entirely – by seasonal factors such as winter illness impacting on demand and performance.

Figure 7 – percentage of capital spent in each month 2013-14 to 2016-17



Source: Welsh Government Monthly Monitoring Returns

3.19 One area where there is a deepening annual pattern is elective waiting times. There has been a recent improvement in performance. Of course, an improvement in performance is positive, not least for those patients who have been seen and treated more quickly. We are aware that the Welsh Government and NHS bodies are starting to take steps to develop a sustainable approach to elective waiting times, partly in response to the recommendations in our 2015 report. There have been substantial improvements in the length of time patients wait for diagnostic tests. However, the recent improvement in waiting times for referral to treatment has been driven in large part by short-term funding for extra operations at weekends and in the private sector, particularly in the final quarter of the financial year. This pattern goes back to a short-term cycle, previously described in the then Auditor General for Wales' 2005 and 2015 reports on waiting times¹⁸.

Despite welcoming the financial flexibility afforded by the Act, no NHS body has yet made planned use of it

- 3.20 Board members told us that they understood and welcomed the purpose and intentions behind the Act. In particular, their responses suggest a recognition that the NHS needs to strengthen planning, notably financial planning, beyond the demands of meeting the end of year targets.
- 3.21 Financial flexibility is one of the core intentions of the Act, aiming to facilitate sustainable approaches to service delivery: where an NHS body has an approved three-year plan, it may request a draw forward of funding from subsequent years. The extent to which NHS bodies can draw forward funding is limited by the fact that the Welsh Government's Department of Health and Social Services would need to cover that initial draw forward from within its own fixed budget.
- 3.22 So far, no NHS body has actually sought to make planned use of financial flexibility¹⁹. Cardiff and Vale University Health Board developed a three-year plan for the period 2013-14 to 2015-16, a year ahead of the Act coming into force, with an overspend in year one that would be made up over the following two years. That plan did not require Welsh Government approval. While there was an overspend in year one, subsequent underspends were not achieved. Cwm Taf University Health Board initially developed a plan in 2014-15 based on some use of planned financial flexibility (paragraph 2.4) but this was not subsequently required due to the additional funding brought forwards in response to the Nuffield Trust review (paragraph 1.9). There are several possible reasons to explain why NHS bodies have not used the financial flexibilities. Explanations include a possible reluctance to be the first to take the risk and the possibility that three years is actually too short a timeframe to realise significant savings from upfront investment.

¹⁸ National Audit Office (Wales), **NHS Waiting Times in Wales** (2005) (Volumes 1 and 2); Wales Audit Office **NHS Waiting Times for Elective Care in Wales** (2015)

¹⁹ By 'planned' use we mean the approved use of financial flexibility see paragraph 2.4

At the end of 2016-17, three out of seven health boards and all three NHS trusts met the duties under the Act

- 3.23 At the end of March 2017, Powys, Cwm Taf and Aneurin Bevan health boards and all three NHS trusts met the two duties (Figure 8). The other four health boards – Abertawe Bro Morgannwg, Cardiff and Vale, Hywel Dda and Betsi Cadwaladr received qualified audit opinions on the regularity of their expenditure from the Auditor General due to their unauthorised overspends. Figure 8 demonstrates that the four bodies that did not meet the duty for 2014-15 to 2016-17 face a significant challenge to recover the position and meet their duty in the coming years. In order to meet the duty at 31 March 2018, they will need to underspend in 2017-18 by the equivalent of their net overspends in 2015-16 and 2016-17.
- 3.24 The Welsh Government had sufficient central funding to cover the in-year overspends in order to balance its own books, using the additional funding allocated in the second supplementary budget of February 2017 (paragraph 1.17). However, it had to provide additional repayable cash support of £100 million to those four health boards to enable them to pay staff and contractors.
- 3.25 Our local work points to some significant contributory factors in those health boards that have not met their duties:
- a over-optimistic savings plans, including not identifying sufficient sources of potential savings and failing to deliver identified savings;
 - b clinical and service plans not in place to support necessary transformation of services;
 - c workforce pressures in some health boards resulting in reliance on costly locum and agency staff; and
 - d concerns about performance that have required additional service investment and cancelling of savings schemes.
- 3.26 We found no clear correlation between the degree to which spending had increased in the period since the start of the Act and whether a health board met its financial duty. The average real terms increase in annual spending by health boards has varied between 2.6% and 3.3% in the period 2014-15 to 2016-17²⁰.

²⁰ The figures on the average increase exclude depreciation and impairments

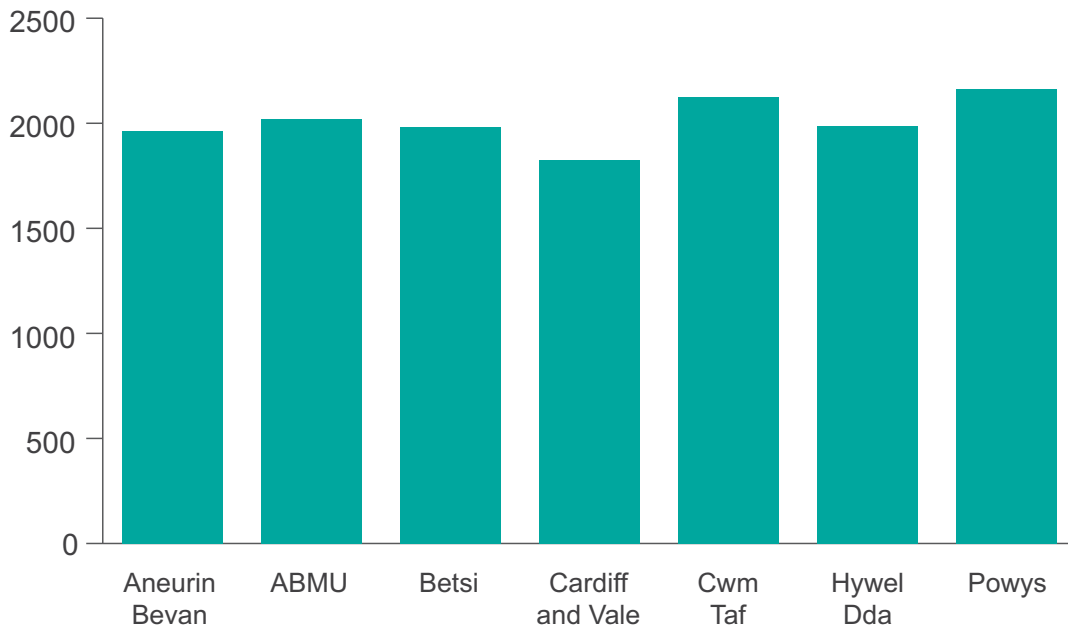
Figure 8 – health board finances over the first three-year period of the Act

NHS Organisation	Retained Surplus (Deficit) 2014/15	Retained Surplus (Deficit) 2015/16	Surplus / (Deficit) 2016/17	Accumulated Surplus / (Deficit) 2014/15-2016/17	Did the body meet its duty under the Act?
	£000	£000	£000	£000	
Health Boards					
ABMU	99	86	(39,316)	(39,131)	No
Aneurin Bevan	409	214	49	672	Yes
BCU	(26,616)	(19,525)	(29,784)	(75,925)	No
Cardiff and Vale	(21,364)	68	(29,243)	(50,539)	No
Cwm Taf	30	22	18	70	Yes
Hywel Dda	(7,474)	(31,199)	(49,613)	(88,286)	No
Powys	39	40	85	164	Yes
NHS Trusts					
PHW	35	17	16	68	Yes
Velindre	39	40	35	114	Yes
WAST	148	49	44	241	Yes
Total	(54,655)	(50,188)	(147,709)	(252,552)	

Source: Welsh Government

- 3.27 The 'baseline' allocation for each health board was set when they were set up in 2009 and based on the historical funding of the 22 former local health boards. Any increases since then have been allocated through a formula which takes account of a complex range of factors such as health need and population age. These factors mean that there is inevitably some variation in the amount allocated to each health board per head of population (Figure 9). Some of the variation may also reflect that some health boards' allocations include funding for services they provide on behalf of other health boards. Cardiff and Vale University Health Board had the lowest level of funding per head of population (£1,826) in 2016-17; 19% less per head of population than Powys Teaching Health Board (£2,165).
- 3.28 In response to a recommendation made by the Public Accounts Committee in 2013, the Welsh Government said it would review the basis of the allocations to the health boards. The Welsh Government has completed the first phase of that work by updating the underlying data on which its calculations are based. It is yet to complete the wider work on whether the formula does indeed ensure a good match between resources, population need and other determinants of healthcare cost. The Welsh Government has also commissioned work looking at the specific rural issues in the Hywel Dda area and whether that necessitates any changes to the funding formula. Any update to the formula may, or may not, result in changes to the level of funding for individual health boards.

Figure 9 – Welsh Government revenue allocation to health boards per head of population 2016-17



Note: health board allocations are based on a formula reflecting a complex range of factors such as health need and population age. These factors mean that there is inevitably some variation in the amount allocated to each health board per head of population. The figures above do not take account of some health boards' allocations including funding for services it provides on behalf of other health boards.

Source: Wales Audit Office analysis of health board allocations and Office for National Statistics population data mid-2015 estimates

Appendices



Appendix 1 – audit methods

For this study we used a range of methods, listed below

Document review

We drew on a range of documents. These include our own previous reviews of health finances, NHS performance and wider public finances, including:

- a **Health Finances 2011-12** (July 2012)
- b **Health Finances 2012-13 and Beyond** (July 2013)
- c **NHS Wales: Overview of financial and service performance 2013-14** (October 2014)
- d **A Picture of Public Services 2011** (October 2011)
- e **A Picture of Public Services 2015** (December 2015)
- f **NHS Waiting Times for Elective Care in Wales** (January 2015)

We reviewed Welsh Government documents including:

- a NHS Planning Frameworks for 2014-2017; 2015-2018; 2016-2019; 2017-2020.
- b Welsh Health Circulars WHC (2015) 014 and WHC (2016) 055
- c **Together for Health: A Five Year Vision for the NHS in Wales** (2011)

We also drew on independent reviews of the NHS including:

- a **A Decade of Austerity in Wales? Nuffield Trust** (June 2014)
- b **The Path to Sustainability: fiscal projections for the NHS in Wales to 2019-20 and 2030-31** Health Foundation (October 2016)
- c **OECD Reviews of Healthcare Quality: United Kingdom** (February 2016)
- d **NHS Wales Workforce Review** (2016)

Financial analysis

We used several sources to prepare our financial analysis, including Welsh Government budgets, NHS bodies' accounts and the monthly monitoring returns that NHS bodies produce for the Welsh Government. Our analysis of 'health revenue' is consistent with the approach we have used for previous reports on Health Finances. 'Health revenue' is the sum total of the health-related elements from the Welsh Government's second supplementary budget. For earlier years we have made adjustments to account for movement of responsibilities and associated budgets and to remove some non-cash items.

We have also used analysis of spending trends and savings from a combination of monthly financial monitoring returns supplied to the Welsh Government by NHS bodies and the NHS bodies' annual accounts.

Activity and performance analysis

We looked at a range of performance and activity data to test whether there was a notable change in annual trends. The sources of data included statswales datasets covering elective activity and emergency activity and the Welsh Government's efficiency dataset, which includes data on activity and bed use (length of stay).

Review of governance meeting minutes

We selected a sample of three health boards – Cwm Taf, Cardiff and Vale and Aneurin Bevan. We reviewed a sample of the minutes and notes of key conversations between NHS bodies and the Welsh Government. Our aim was to examine whether the nature of the conversation showed signs of changing from a focus on short-term issues to medium and long-term change. We reviewed notes from 2012-13 and 2015-16 of:

- a Joint Executive Team meetings, which are meetings between the Chief Executive and Deputy Chief Executive of the NHS, who are Welsh Government officials, and the Chief Executives of NHS bodies; and
- b Quality and Delivery meetings, which are meetings of senior Welsh Government officials from the Department of Health and Social Care and directors from NHS bodies.

Survey of NHS board members

In December 2016, we surveyed executive and non-executive members of NHS boards. The survey included questions related to the implementation of the duties in the Act as well as their NHS body's approach to integrated medium-term planning. We used the survey to inform this report and our local work as part of our annual 'structured assessment' at each NHS body (see below). We sent the survey to 209 board members. We received 119 responses; a response rate of 57%.

Semi-structured interviews

We carried out semi-structured interviews with Welsh Government officials who lead on key areas, including those responsible for finance, different elements of service plans and workforce planning. We also interviewed the NHS Confederation, which represents the NHS bodies.

Local audit work

We took account of the findings of our local audit work, in particular work carried out as part of our regular structured assessment at each NHS body. The structured assessment examines the financial and governance arrangements at each NHS body.

Appendix 2 – timetable for producing and approving three-year plans

Action	Timescale	WG	NHS
Plan Development			
NHS Planning Framework developed between Welsh Government and NHS	June – October 2016	✓	✓
NHS Planning Framework 2017-2020 issued	October 2016	✓	
NHS organisations develop 2017-2020 IMTPs, informed by cluster plans, local health plans and wider population needs assessments	October 2016 – January 2017		✓
Outline financial assumptions to NHS organisations	October 2016	✓	
Indicative financial allocation letters issued to NHS organisations	December 2016	✓	
NHS peer review - draft organisational plans ready for sharing	November 2016		✓
Health Board/Trust Board/Committee scrutiny process	October – December 2016		✓
Health boards and trusts to share draft or outline plan with templates for early policy input and plan development	October – December 2016	✓	✓

Action	Timescale	WG	NHS
Plan Approval			
NHS Boards approve final draft version of IMTP and submit to Welsh Government	27 January 2017		✓
Welsh Government scrutiny process and feedback provided to NHS to strengthen plans	February 2017	✓	
Boards respond to feedback from scrutiny process and amend plans accordingly. Boards then approve final versions	February – March 2017		✓
NHS organisations submit the final Board-approved plans to Welsh Government	31 March 2017		✓
Welsh Government assessment process and Cabinet Secretary approval	April – June 2017	✓	

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