Oxford University Hospitals NHS
NHS Trust

Trust Board meeting: Thursday 1 March 2012

TB2012.21

Title	**Opening Financial Plan 2012/13**

Status	A paper for discussion and agreement of recommendations.
History	Update on the paper presented to Trust Management Executive Committee on 24 November 2011

Board Lead(s)	Mr Mark Mansfield, Director of Finance and Procurement			
Key purpose	Strategy	Assurance	Policy	**Performance**

Summary

1. This paper outlines the Trust's revenue plans for the 2012/13 financial year. It reflects the Department of Health (DoH) Operating Framework principles, local guidelines set by the Strategic Health Authority (SHA), NHS South of England, and the budget setting policies agreed by the Trust's Management Executive at its meeting on 24 November 2011.

2. At this stage and in accordance with planning expectations from the DoH and the SHA, the Trust is planning a surplus of 1% of turnover, or **£7.4m**, for 2012/13.

3. The main uncertainty at this stage in the budget setting process relates to the on-going negotiations with commissioners, particularly NHS Oxfordshire & Buckinghamshire (NHSOB), and this may materially impact on the level of the budgeted surplus, and risk, in the final agreed budgets.

4. The Board is asked to approve the opening financial plan for 2012/13. This will enable expenditure plans to proceed with effect from 1 April 2012. The Board is asked also to note the next steps for developing final targets for the year.

1. Introduction

1.1 This paper sets out the opening financial operating plan for 2012/13. It is the responsibility of the Trust Board to scrutinise, and approve, the Trust's financial plans ahead of the financial year to which they relate.

2. Background

2.1 There is a continuing requirement for the NHS as a whole to make efficiency savings of £15-20 billion by 2014/15 for re-investment back into services. This is usually referred to as the Quality, Innovation, Productivity & Prevention (QIPP) challenge and 2012/13 will be the second year for the delivery of these plans.

2.2 Within this context the NHS Operating Framework for 2012/13 was published in late November 2011. As well as setting out the agenda for quality and reform for the coming year, the Framework also lays out the financial and business rules within which the NHS is to operate. It emphasises that strong financial management and control needs to continue to be exercised. The Board received a paper on the Operating Framework at its meeting in January 2012 (see TB2012/06).

2.3 The DoH published the tariff for NHS services on 16 February. The tariff reflects a reduction in prices of 1.8% (see also 3.1 c) below) and the introduction of a wider range of Best Practice tariffs foreshadowed in the Operating Framework. The implications of these new tariffs for contracts with the commissioners of Trust services are being addressed in the current negotiations for 2012/3.

3. The Regional Planning Context

3.1 On 20 December 2011 NHS South of England issued their own guidance on the principles that should form the basis for operating plans in NHS organisations for 2012/13. These principles complemented the matters set out in the over-arching NHS Operating Framework but included the following additional matters that need to be taken into consideration by Trusts when planning for 2012/3:

a) PCTs will be required to levy mandatory fines that are included in the NHS standard national contract on providers that fail to meet key performance targets.

b) Guidance was proposed as to what might be included within the measures that would attract additional CQUIN payments.

c) The notional tariff uplift for 2012/13 was to be 2.2%, with an efficiency target of 4%, meaning that **tariffs were to be reduced by at least 1.8%** (see also 2.3 above)

3.2 In his letter of 14 December 2011 Sir David Nicholson confirmed that all PCT revenue allocations would be increased by 2.8% in 2012/13. NHS Oxfordshire and Buckinghamshire, in common with a number of other local commissioners, had been planning for an uplift below this level. This has therefore been an additional factor in negotiations for 2012/3.

3.3 During 2012/13 the PCT will be supporting the development of the CCGs and it is currently unclear how commissioning intentions may change when budgets are devolved fully to these consortia in the future.

4. The OUH's own Planning Context

4.1 The Trust is forecasting the delivery of a £7.14m surplus against its break even duty in the current financial year 2011/12.

4.2 The Trust also needs to demonstrate on-going financial stability, and to strengthen its liquidity position, as part of its preparation for Foundation Trust (FT) status. The Trust therefore believes it should plan to generate a 1% retained surplus on its turnover. Based on its current estimates of planned revenue, this equates to **£7.4m**.

The Board is asked to endorse the plan to set a target surplus of £7.4m, or 1% of planned turnover.

4.3 Next year's financial plans have to take into account the following the following previously agreed service developments:

i. Vascular surgery, with the centralisation of activity from Thames Valley District General Hospitals (DGHs) and the repatriation of work from London;

ii. Cardiac surgery, with the repatriation of London activity for Thames Valley PCTs;

iii. Neonatology, and the expansion of Intensive Care cots as part of being designated a Level 1 unit for South Central SHA, with work diverted from non-Level 1 units in the SHA and the repatriation of out-of-area transfers;

iv. Trauma & Orthopaedics, with the designation of Major Trauma Centre within South Central SHA.

4.4 Financial pressures will also arise next year where:

a) Savings targets in 2011/12 have been met only through the identification of non-recurrent schemes and so new schemes to identify recurrent savings need to be found in 2012/13.

b) There are inflation increases to agreed contract values – for example, there will be annual increases to the three private finance initiative (PFI) contracts that are linked to the retail price index (RPI). RPI is higher than the level of inflation assumed within tariff.

c) It costs more to provide the same level of service as a result of (for example) incremental pay drift; expenditure on agency staff; patient, clinical or quality decisions leading to an increased use of high cost drugs; backlog maintenance needing to be carried out; making higher payments into the clinical negligence scheme (CNST) as a result of increased claims nationally; and the reduction in NHS education funding to support the training of junior doctors and other clinical professionals.

d) Capital charges rise, partly as a result of increases in the value of the Trust's land and buildings as assessed by District Valuer, and partly from the investment the Trust makes in fixed assets through its capital programme.

e) Levels of over-performance against contracted levels are paid at marginal rates.

f) Penalties are applied by PCTs because key quality and other performance measures are not met.

g) Not all criteria are met for receiving full CQUIN payments from commissioners.

4.5 The financial context within which the Trust will operate next year presents significant challenges. It is therefore considered prudent that reserves are put in place in 2012/13. It is recommended that the Trust identifies a contingency budget of 1% of turnover to mitigate against risk.

The Board is asked to endorse the initial plan to include a contingency budget of 1% of planned turnover within its 2012/13 budgets.

5. Budget Setting Principles 2012/13

5.1 The approach taken for the setting the 2012/13 budget has been as follows:

a) The starting point is the 2011/12 budget from which any non-recurrent budget adjustments made in the current year have been removed.

b) The full year effect of any 2011/12 budget adjustments, where there was only a part-year impact in the year, has been made. This includes the full year effect of any savings plans started in the current year.

c) Adjustments have been made for budget pressures known, or expected, to arise next year. These include inflationary changes to agreed contracts and any known losses of non-PCT funding.

d) Pay budgets have been set "bottom up" using actual staff in post in October 2011 as the starting point. Adjustments have also been made to take account of incremental drift. Staff establishment vacancies have been funded at bottom of the salary scale.

e) Non-pay expenditure budgets have been adjusted to forecast outturn where this is materially different to budget and where the variance appears to have been generated by changes in the levels of clinical activity.

f) Estimates for capital charges have been made based on the planned capital programme for 2011/12 and 2012/13, together with an estimate of the change in the value of the Trust's estate that will occur when the District Valuer re-values it as at 31 March 2012.

5.2 The results were shared with budget managers, who either agreed the draft figures or asked for further amendments and information to be taken into consideration. An iterative process of discussion and amendments was followed until a baseline was established.

5.3 Within each Division, the Divisional Directors, General Managers and Business Partners have drawn up a list of cost pressures and developments that they believe need to be funded. These will be subject to discussion at meetings with the Director of Finance & Procurement in early March, and those that are agreed should be considered further will be presented to the Trust Management Executive (TME) for approval at its meeting on 22 March.

5.4 Where additional expenditure budget is required but no additional funding has been identified to finance it, or where it is believed that an existing income target is unrealistically high, then these financial pressures will increase the savings that need to be found next year.

5.5 Adjustments still need to be made for any differences that arise between the contracts finally agreed with PCTs and those assumed in the budget.

5.6 The resulting Income & Expenditure (I&E) Account budget is shown in Appendix A. It is compared to the annual I&E budget, and forecast outturn, for 2011/12.

The Board is asked to endorse the overall approach of this methodology for setting the 2011/12 operational budgets.

6. Savings Plans

6.1 In order to meet the financial challenges for 2012/3 the Trust expects to be required to develop a savings programme of at least £49m for 2012/13, which is 6.7% of planned turnover. The final startpoint budget for the year is likely to confirm or extend this target, dependent on the outcome to the issues outlined in sections 3,4 and 5 above.

7. Capital Plan 2012/13

7.1 It is assumed that the sum invested in new capital projects in 2012/13 is equal to the cash generated from depreciation less the repayments of principal that the Trust has to make on its loans, PFI contracts and finance lease agreements.

7.2 It is currently also assumed that funds generated from the surplus will not be invested in capital expenditure but will be used to strengthen the Trust's liquidity position.

7.3 A more detailed capital plan will be considered by the Trust's Strategic Planning Committee and TME in March, and presented for final approval at the Board's April meeting.

8. Balance Sheet

8.1 The forecast balance sheet for the start, and end, of 2012/13 is shown in Appendix B.

8.2 The increase in property, plant & equipment reflects the investments the Trust plans to make through its capital programme next year, and an increase in the asset values of land and buildings of 3.5% that is estimated to occur next year.

8.3 The fall in borrowings is due to the repayments the Trust will make against the amounts owed on the working capital loans, capital loans, PFI contracts, and other finance lease contracts for equipment items. The repayment on the working capital loan will be the final payment to clear the amount outstanding.

8.4 The movement in retained earnings reflects the planned retained deficit for 2012/13.

8.5 The Revaluation Reserve has increased to reflect the assumption of a 3.5% increase in land & building values next year.

The Board is asked to note the opening planned balance sheet positions for the Trust in 2012/13.

9. Cashflow 2012/13

9.1 The forecast annual cashflow position for 2012/13 is shown in Appendix C.

9.2 It is anticipated that the Trust will end next year with £7.4m more cash than at the start of the year. This is because the cash generated through the I&E surplus is not being fully committed on capital expenditure next year but instead is being used to strengthen the Trust's liquidity position.

9.3 If there are no significant changes to debtor and creditor levels, it is forecast that the Trust hold at least £48.9m in cash and cash equivalents at 31 March 2013.

The Board is asked to note the opening planned cashflow position for the Trust in 2012/13.

10. Monitor Financial Risk Ratings 2012/13

10.1 Although the financial regimes for NHS Trusts and Foundation Trusts are different, it is regarded as good practice for NHS Trusts to have certain policies and systems that meet the Foundation Trust regime where appropriate. One way of doing this is for the Trust to calculate the ratios used by Monitor to assess an organisation's financial risk rating.

10.2 Monitor uses a number of financial ratios to measure risk as follows:

a) *EBITDA (Earnings before interest, tax, dividends and amortisation)*

The EBITDA margin is calculated by reference to the surplus achieved before dividend, interest payable and receivable, depreciation and impairments. This is expressed as a percentage of income for the period.

b) *Return on Assets*

The return on assets, as measured by Monitor, is different to the 3.5% return that NHS Trusts pay as Public Dividend Capital. This measurement of risk is based upon a surplus figure that excludes the PDC dividend payment.

c) *I&E Surplus margin*

The I&E surplus margin is calculated by adjusting the surplus for any impairments and then expressing this as a percentage of income. It should be noted that the "technical adjustment", used by NHS Trusts to take into account the impact of bringing PFI schemes on to the balance sheet when assessing their duty to break even, is *not* taken into account under Monitor's assessment of financial risk.

d) *Liquidity ratio*

The liquidity ratio is based on the bank balance plus any unused working capital facility, adjusted for current debtors and creditors, and expressed as the number of days' operating expenses (excluding depreciation) that can be covered by this balance. NHS Trusts do not have a working capital facility. Therefore, in calculating this ratio, it has been assumed that a notional 30-day working capital facility is available to the Trust.

10.1 The risk rating scores for the Trust based on its financial operating plans for 2012/13 are shown in Appendix D.

10.2 Monitor weights the individual metrics to produce an overall risk rating for each Foundation Trust. Using the same weightings, the Trust's overall rating for 2012/13 would be **2.9** based on its financial plans for next year.

10.3 Because the score for liquidity is "1", the maximum score the Trust would be able to achieve is "2" under Monitor's over-riding rules.

The Board is asked to note the Trust's financial risk ratings for 2012/13 as calculated from the opening plans for the year.

11. Risks

11.1 The main uncertainty at this stage in the financial planning process relates to the on-going negotiations with commissioners, particularly NHS Oxfordshire & Buckinghamshire. The results of these negotiations could materially impact on the final financial plan.

11.2 There is a risk that Commissioners will not agree to pay for activity over & above contracted levels, or will only pay at marginal rates that are below the additional costs incurred by the Trust. This would mean that, if the Trust were to over-perform against contracted levels in 2012/13, it would be providing additional activity at a financial loss.

11.3 Commissioners are likely to exercise financial penalties more robustly. It will therefore be more important than in previous years to ensure that the Trust delivers against access, infection control and other quality targets.

11.4 Because the proportion of funds allocated to CQUINs has been increased in 2012/13 then the risks associated with full receipt of these monies have increased. It will be more important that the Trust meets the targets associated with these payments.

11.5 The Trust is still required to find savings of at least £49m. The achievement of this, in an environment where the generation of additional income is likely to be more difficult, represents a major challenge both for 2012/13 and beyond.

11.6 Although the Trust has seen the generation of new streams of income in recent years, these sources of funding will remain high risk until regular patient referral flows have become fully established.

11.7 Changes to tariffs may mean that the Trust's financial position is more understated than currently estimated. If this is the case there will be further pressure on the financial position.

11.8 Partly to offset these risks the restoration of the 1% contingency budget, and a £3.5m "cost of change" reserve, has been proposed in these plans.

12. Next Steps

12.1 The opening financial operating plan shows a retained surplus of £7.4m or 1% or planned turnover.

12.2 A key feature of the budget setting process is the requirement for a formal sign off of final budgets by budget holders. An initial sign off of baseline budgets is in process, with final sign off not being achievable until contracts have been agreed with commissioners.

12.3 Once contracts have been agreed the implications of changes to contracted activity can be attributed to individual Divisions and Directorates.

12.4 At its meeting on 22 March TME will consider options for dealing with Divisional cost pressures. It should note the progress on establishing the financial plans for next year, as set out in this paper, and be prepared to approve the budget to go forward to the Board.

12.5 At the same meeting TME will also consider separate papers on the savings programme, and capital programme for 2012/13.

12.6 At its meeting on 5 April the Board will receive the plan as approved by TME and as amended for any agreements reached with commissioners. The Board will be asked to approve any amendments to the financial plan that differ from the opening plans set out in this paper.

12.7 If, by 5 April, agreement with commissioners on 2012/13 contracted levels has not been reached then the Board will be updated on the latest position regarding contract negotiations. Once discussions on key contracts have been finally concluded the Board will be presented with an updated and final financial plan at its first meeting thereafter.

The Board is asked to approve the opening financial plan for 2012/13 as set out in Appendices A to D, taking full account of the assumptions and level of risk identified within it, and to agree the next steps for approving the final financial plan once contracts with commissioners are agreed.

13. Recommendations

a) The Trust Board is asked to:Endorse the plan to set a target surplus of £7.4m, or 1% of planned turnover for the 2012/13 financial year;

b) Endorse the plan to include a contingency budget of 1% of planned turnover, within its 2012/13 budgets;

c) Endorse the overall approach of this methodology for setting the 2012/13 operational budgets;

d) Note the opening planned balance sheet positions for the Trust in 2012/13;

e) Note the opening planned cashflow position for the Trust in 2012/13;

f) Note the Trust's financial risk ratings for 2012/13 as calculated from the opening plans for the year;

g) Approve the opening financial plan for 2012/13 as set out in Appendices A to D, taking full account of the assumptions and level of risk identified within it, and to agree the next steps for approving the final financial plan once contracts with commissioners are agreed.

Mr Mark Mansfield, Director of Finance and Procurement

Mr Kevin Davis, Senior Business Partner

Appendix A – Statement of Comprehensive Income 2012/13

	Plan 2011/12 £000	Forecast 2011/12 £000	Opening Plan 2012/13 £000
Income			
Commissioning & RTA	606,584	625,506	**627,503**
PP & Overseas	11,350	10,967	**12,182**
Other Income	111,505	121,621	**104,532**
Total Income	**729,439**	**758,094**	**744,217**
Expenditure			
Pay	(402,821)	(420,723)	**(410,842)**
Non-Pay	(255,702)	(268,518)	**(263,311)**
Total Expenditure	**(658,523)**	**(689,241)**	**(674,153)**
EBITDA	**70,916**	**68,853**	**70,064**
Depreciation	(34,694)	(33,006)	**(32,208)**
Impairments	(308)	(524)	
Investment Revenue	115	141	**141**
Other Gains & Losses	(179)		
Finance Costs	(21,369)	(21,708)	**(20,680)**
PDC Dividend Payable	(8,404)	(8,780)	**(9,875)**
Retained Surplus	**6,077**	**4,976**	**7,442**
IFRIC12 Technical Deficit	526	526	**536**
Impairments	308	437	
Donated Asset Addns.	(2,560)	(1,141)	
Donated Asset Depn.	2,790	2,343	**2,031**
Break Even Surplus	**7,141**	**7,141**	**10,009**

Appendix B – Statement of Financial Position 2012/13

	Forecast 01-Apr-12	Forecast 31-Mar-13	Movement
NON-CURRENT ASSETS			
Property, Plant and Equipment	717,793	723,155	5,362
Intangible Assets	6,692	7,293	601
Trade and Other Receivables	4,222	4,222	
NON-CURRENT ASSETS	**728,707**	**734,670**	**5,963**
CURRENT ASSETS			
Inventories	13,501	13,501	
Trade and Other Receivables	30,363	30,363	
Cash and Cash Equivalents	41,620	48,915	7,295
CURRENT ASSETS	**85,484**	**92,779**	**7,295**
CURRENT LIABILITIES			
Trade and Other Payables	(97,970)	(97,970)	
Borrowings	(17,149)	(12,419)	4,730
Current Provisions	(1,754)	(1,754)	
CURRENT LIABILITIES	**(116,873)**	**(112,143)**	**4,730**
NET CURRENT ASSETS/(LIABILITIES)	**(31,389)**	**(19,364)**	**12,025**
NON-CURRENT LIABILITIES			
Borrowings	(303,353)	(291,476)	11,877
Trade and Other Payables	(601)	(601)	
Non-Current Provisions	(4,251)	(4,251)	
NON-CURRENT LIABILITIES	**(308,205)**	**(296,328)**	**11,877**
TOTAL ASSETS EMPLOYED	**389,113**	**418,978**	**29,865**
FINANCED BY TAXPAYERS EQUITY			
Public Dividend Capital	203,912	203,912	
Retained Earnings	20,724	28,019	7,295
Revaluation Reserve	162,734	185,304	22,570
Other Reserve	1,743	1,743	
TOTAL TAXPAYERS EQUITY	**389,113**	**418,978**	**29,865**

Appendix C – Statement of Cashflows 2012/13

	2012/13 £000
Cash Flows from Operating Activities	
Operating Surplus/(Deficit)	37,856
Depreciation and Amortisation	32,208
Interest Paid	(20,680)
Dividend Paid	(9,875)
Net Cash from Operating Activities	**39,509**
Cash Flows from Investing Activities	
Interest Received	141
(Payments) for Property, Plant and Equipment	(15,000)
(Payments) for Intangible Assets	(601)
Net Cash from Investing Activities	**(15,460)**
NET CASH FLOW BEFORE FINANCING	**24,049**
Cash Flows from Financing Activities	
Capital Loans - Repayment of Principal	(1,404)
Working Capital Loans - Repayments	(3,326)
Capital Element of Finance Leases and PFI	(11,877)
Net Cash Flow from Financing	**(16,607)**
Net Increase/(Decrease) in Cash	**7,442**
Forecast Cash at 1 April 2012	41,620
Forecast Cash at 31 March 2013	**49,062**

Appendix D – Financial Risk Rating 2012/13

			Scores					Plan 2012/13	
Financial Criteria	**Risk Rating**	**Weight**	**5**	**4**	**3**	**2**	**1**	**Metric**	**Score**
Underlying Performance	EBITDA margin	25%	11%	9%	5%	1%	<1%	9.4%	4
Financial Efficiency	Return on Assets	20%	6%	5%	3%	-2%	< -2%	5.4%	4
	I & E Surplus Margin	20%	3%	2%	1%	-2%	< -2%	1.0%	3
Liquidity	Liquid ratio (days)	25%	60	25	15	10	<10	-18	1
Weighted Average									**2.94**
Overall Rating (see rules below)									**2**

Note: If the Trust had a notional 30 days' working capital facility (which many Foundation Trusts arrange), then the metric for Liquidity would be 12, giving a risk rating of 3 against that criterion. This would produce an overall weighted average score of 3.5

Monitor - Rules Used to Adjust the Financial Risk Rating

Situation	Maximum Rating
Plan not submitted on time	3
Plan not submitted complete and correct	3
PDC dividend not paid in full	2
One financial criterion scored at '1'	2
One financial criterion scored at '2'	3
Two financial criteria scored at '2'	2
Two financial criteria at '1'	1
Unplanned breach of Prudential Borrowing Code (PBC)	2
Previous year's annual rating worse	No more than 2 points better than previous year
Less than 1 year as an NHS Foundation Trust	4
Deficit forecast in year 2 or 3	3
Deficit forecast in both years 2 and 3	2