



# **FINANCIAL TURNAROUND IN THE NHS**

**A REPORT FROM RICHARD DOUGLAS,  
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**TO THE SECRETARY OF STATE FOR HEALTH**

**25 JANUARY 2006**

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**FINANCIAL TURNAROUND IN THE NHS**

1. You asked for a report on the action being taken to achieve financial turnaround in the NHS covering both:

- i) the organisations that are currently overspending; and
- ii) the conditions required to deliver a sustainable financial position for all organisations.

This is the first formal report. It will be followed up by regular monitoring at official level and update reports to you and other Ministers

2. In summary:

- i) although the NHS as a whole has been in broad financial balance, at a local level we have seen a minority of organisations overspending by significant amounts whilst the majority deliver balance or better;
- ii) we need to focus our effort on those organisations with the largest financial challenges and we have begun to employ turnaround techniques that are more widely used in the private sector;
- iii) initial analysis – supported by KPMG - of the organisations with the largest deficits suggests that 18 require urgent intervention and a further 23 additional expertise or resources to help deliver turnaround. Where this is not already being provided it is being commissioned centrally;
- iv) although turnaround will not be achieved overnight, in most cases it will be delivered by getting the basic systems and controls in place and implementing known good practice rather than through any single action; and
- v) we need to provide the right focus on sustainable financial health across the NHS through the way we manage the system and the incentives we offer in 2006-07.

**Background**

3. In 2004-05 the NHS overspent for the first time since 1999-2000. Although the £250 million overspend was

relatively small in comparison with the sums managed it was a cause for serious concern because:

- i) it was arising at a time of significant sustained growth in resources;
- ii) for the first time in recent years there was a significant deterioration between financial forecasts and final accounts;
- iii) it was not evenly distributed across organisations and geographies, significant deficits in some organisations were being offset by surpluses elsewhere. As table one shows in 2004-05 the gross deficit was £760 million and was incurred in 28% of organisations. The remaining 72% of organisations delivered a surplus of some £510 million, resulting in a net deficit of around £250 million. 75% of the deficit was incurred by just 11% of organisations;
- iv) in some of the organisations with the largest deficits recovery plans were not delivering and we were seeing no sign of financial turnaround;
- v) there was a growing perception within the NHS that sound financial management was seen as less important than delivery in other performance areas by both NHS bodies and the Department of Health.

**Table one: Distribution of gross deficits 2004-05**

Cumulative % of gross deficit	Gross deficit £m	Number of organisations	% of all NHS organisations
25%	190	12	2%
50%	380	33	6%
75%	570	66	11%
100%	760	169	28%

Note: includes Foundation Trusts

4. In response to this we took a series of actions centrally, in particular:

- i) we reviewed the 2005-06 financial plans for each of the Strategic Health Authorities and, to provide a reasonable period for recovery in the most challenged organisations, agreed deficit plans

- to be covered by surpluses to be delivered centrally and in other NHS organisations;
- ii) you wrote personally to the Chairs of those organisations with deficits and Sir Nigel Crisp to the Chief Executives. Sir Nigel's letter set a requirement for an aggressive pursuit of efficiencies and drew attention to proven approaches to improve efficiency;
  - iii) we combined the operational performance and financial management responsibilities within the Department to ensure that there could be no trade-off between these;
  - iv) we increased the frequency and depth of the direct monitoring of deficit organisations; and
  - v) we facilitated the involvement of private sector turnaround specialists in the NHS.
5. By month 6, despite the action taken, we were still seeing no improvement in the financial position; with NHS organisations forecasting full year deficits for 2005-06 of £623 million net and £948 million gross.
  6. Following the month 6 results we agreed that we needed to establish a centrally managed turnaround programme co-ordinated by the Performance Directorate. The first stage of this was to commission an external assessment of the financial position of those organisations forecasting significant deficits. Initially this was to be the fifty largest deficits but we extended this to 62<sup>1</sup> organisations that were either forecasting significant deficits or where we were aware of underlying financial problems that had not yet come through in the forecasts. These organisations are listed at Annex A. They comprise:
    - i) twenty-eight PCTs with a combined turnover of some £5.6 billion who at month 6

- ii) were forecasting a deficit for 2005-06 of £264 million (5%); thirty-four NHS trusts with a combined turnover of £6.5 billion who at month 6 were forecasting a deficit for 2005-06 of £467 million (7%).

7. Following a competitive process, KPMG were appointed on 7 December and undertook the preliminary assessment using a team led by a corporate recovery specialist and drawing on expertise from both the NHS and corporate wings of the firm.

### **KPMG Approach and Findings**

8. The KPMG work was not an audit and should not be relied upon as such. It drew primarily upon information provided and representations made by NHS management. For those organisations where KPMG were potentially conflicted through their position as auditors the work was undertaken by Ernst & Young instead.
9. KPMG undertook their fieldwork over a two week period in the run up to Christmas and presented preliminary findings to us on 23 December. All Strategic Health Authorities with deficit organisations were visited and KPMG sought views on those organisations from senior Strategic Health Authority staff. The vast majority of the individual deficit organisations were also visited including all but one of the 11 organisations where KPMG carried out a desk top review making use of work already carried out by other advisory firms.
10. The KPMG review focussed on our immediate areas of concern:
  - i) clear analysis of the financial position;
  - ii) testing of the sufficiency of financial recovery plans;
  - iii) reviewing the capability of the management team to deliver turnaround;
  - iv) analysing the order of priority of actions; and
  - v) identifying opportunities that could yield immediate financial benefit.

<sup>1</sup> 64 statutory organisations were covered but Ipswich PCT and Suffolk Coastal are under joint management and treated as one for the purpose of this work (Suffolk East) as are Fareham & Gosport PCT and East Hampshire PCT.

11. Based on their experience of commercial organisations of a similar size and in similar circumstances for a number of organisations they concluded that:

- i) the capability of the management was inadequate to deal with the challenges of their current financial position. Although they could manage the organisation effectively in a steady state they would need support to deliver turnaround.
- ii) the quality of information would impede the turnaround process.
- iii) in some cases SHAs were allowing unproductive behaviour between Trusts and PCTs.

12. Across all the organisations reviewed KPMG observed slippage in the cost improvement programmes that had been introduced to help reduce spending; in particular they noted:

- i) failure to implement cost improvement programmes early enough with a lack of consideration for lead times;
- ii) lack of detailed implementation plans and unrealistic plans;
- iii) lack of ownership of plans within the organisation;
- iv) a simple assumption that savings would be delivered evenly, month by month across the year.

13. Within both trusts and PCTs they discussed with management performance in a number of key areas where action would have an impact upon their financial position. They then graded the action using a traffic light system<sup>2</sup>. Nine areas were discussed for trusts and four for PCTs. Table two below provides a summary of the assessment for Trusts and table three for PCTs.

<sup>2</sup> Green: substantial action has already been taken and substantial benefits are already flowing through.

Amber: issues are identified and action has commenced, but limited benefits expected in 2005-06.

Red: there is little evidence of material action having been taken in this area.

**Table two: Assessment of action on clinical and operational issues (% Trusts in each category)<sup>3</sup>**

	Green	Amber	Red
Control over pay	45%	48%	6%
Procurement opportunities	21%	64%	15%
Drugs and clinical supplies	30%	55%	15%
Workforce productivity	21%	61%	18%
Invoicing control	33%	36%	30%
Short term capacity controls	33%	64%	3%
Clinical service redesign	27%	52%	21%
Estate rationalisation	24%	45%	30%
Back office and overhead reduction	21%	52%	27%

Note: totals may not sum to 100% due to rounding.

**Table three: Assessment of action on clinical and operational issues (% PCTs in each category)**

	Green	Amber	Red
Robust demand management	29%	64%	7%
Robust performance review of service level agreements	25%	68%	7%
Full exploration of provider function efficiency	43%	54%	4%
Review and challenge of prescribing costs	79%	21%	

14. For Trusts KPMG drew particular attention to lack of control over headcount and high cost items such as prosthetics, drugs, bloods and implants. For PCTs: aspirational demand management plans, unsigned service level agreements and management capacity to focus on provider functions.

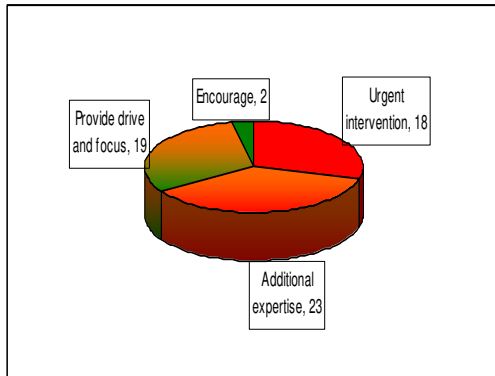
<sup>3</sup> Based on 33 of the 34 organisations

15 Following on from this they identified a range of potential improvement opportunities for 2005-06 including: improved budgetary control, capacity reductions, recruitment bans for back office functions, tighter authorisation controls for agency spend, improved control over high cost supplies and deferral of discretionary spend.

16. Finally KPMG categorised the 62 organisations as follows:

- Immediate priority. Need for urgent intervention to drive turnaround.
- Additional expertise/resource needed to support the turnaround.
- Drive/focus. Maintain high priority of actions. Regular challenge of management.
- Encourage to share what works and deliver easy wins.

**Chart One: Categorisation of the 62 organisations**



17. The organisations requiring urgent intervention are listed in table four below.

18. The categorisation does not necessarily reflect upon the quality of the management. For example organisations where the scale of the turnaround problems faced are such they would challenge the very best management.

**Table Four: Organisations requiring urgent intervention**

Hammersmith Hospitals
Barnet and Chase Farm
Mid Yorkshire
Royal West Sussex
Surrey and Sussex
Brighton and Sussex University Hospitals
University Hospitals North Staffordshire
Shrewsbury and Telford
George Eliot Hospital
Hillingdon PCT
Selby and York PCT
Cheshire West PCT
West Wiltshire PCT
Kennet and North Wiltshire PCT
Sheffield PCTs (four organisations)

**Action taken and planned**

19. The KPMG findings have been shared with the organisations concerned and the relevant Strategic Health Authorities and the findings checked against local intelligence. In general, they are accepted as a fair summary. Their overall conclusions are in line with our experience of organisations with financial problems.

20. Following on from this preliminary assessment:

- i) we are requiring the SHAs to ensure that the key actions identified by KPMG are in place and will monitor and performance manage against these;
- ii) where it is not already in place we are identifying turnaround expertise to put into the organisations categorised as requiring the most urgent intervention (for the purpose of this exercise we are treating the 18 as 15, handling the four Sheffield PCTs as one);
- iii) we have commissioned a further 35 baseline assessments to cover organisations that the department or the SHAs view as potentially at risk and who may benefit from early intervention;
- iv) we have established a formal process for the management of turnaround in the NHS run from a programme office in the

Department with specialists to be appointed in each of the Strategic Health Authorities linked to those organisations with the need for turnaround expertise. These will have direct responsibility for the organisations in category two, with categories three and four handled through the normal performance management process but monitored through the central programme office.

21. Turning around all of these organisations will not be achieved overnight. We will need to drive this process from the centre for a minimum of 18 months. At the same time we will need to build turnaround expertise within the NHS to reduce reliance upon external resource. Our aim should be to develop a panel of NHS turnaround experts that can be drawn upon quickly when required.

#### **Creating the right conditions for good financial management**

22. The organisations that have been covered by this first stage of the turnaround work represent 10% of NHS organisations, the additional work now commissioned will cover a further 6%. Although other organisations have managed the financial pressures successfully we need to ensure that we create the right conditions not only to turn around the organisations that are failing financially but also to place the entire NHS on a stable and sustainable financial footing. The following paragraphs summarise the action we have agreed to ensure this.

#### *2006-07 Planning and System Rules*

23. Next year needs to be managed as the year in which we re-establish financial stability across the system. And, this will be reflected in the rules and planning framework. In particular:
- i) across the NHS we should plan for a surplus to ensure that we have contingency and we should not accept plans with uncovered risk;
  - ii) each NHS organisation should plan for in-year financial balance

- and in most cases immediate recovery of 2005-06 overspends;
- iii) in exceptional circumstances and linked to formal turnaround plans the Department may agree to recovery of 2004-05 overspending over more than one year;
  - iv) plans should be agreed in good time and properly profiled across the year;
  - v) SHAs will be required to ensure consistency of commissioner and provider plans. With the agreement of the Department and where necessary Monitor they will be empowered to enforce this;
  - vi) financial plans should be supported by and in agreement with workforce plans;
  - vii) all organisations should plan for minimum level of 2.5% efficiency savings.

24. The planning and performance management framework should continue to be supported by a ratings system with no tolerance for overspending to ensure that there can be no trade off between finance and other aspects of performance.

#### *New Cost Pressures*

25. The 2004 Spending Review settlement and the subsequent allocations to PCTs provided resources that were estimated as sufficient to deliver the PSA targets, other service improvements and meet cost pressures. Growth in PCT revenue allocations next year will be £5.4 billion (9.2%).
26. Subsequently we know that in some areas – particularly pay – costs have exceeded our original estimates. Although these have been offset in other areas by lower than expected growth in hospital elective activity and reduced prescribing costs there is no financial slack in the system. In the coming year as we expect the NHS to restore financial balance it will be essential not to add additional costs to the system unless pressures can be released in other areas.

### *Supporting Efficiency Improvements*

27. We have developed with the NHS ten high impact changes that on reasonable estimates could save the NHS £1 billion by 2007-08 and we are providing support for delivery of these and the potential benefits of workforce reform and IT investment through an Integrated Service Improvement Programme. In addition to this we are improving our procurement to reduce the cost of supplies and have a successful joint venture with Xansa which delivers efficient and effective corporate functions for the NHS. We need to continue to pursue these and other efficiencies.

### *Financial Regime*

28. The financial regime and reporting arrangements for NHS organisations will be modified as appropriate to improve transparency of underlying financial performance.

**Richard Douglas**  
**Finance Director**  
**January 2006**

## ANNEX A

### Primary Care Trusts Covered by Baseline Assessment

Organisation Name	2005-06 Month 6 Forecast Turnover	2005-06 Month 6 Forecast Deficit	2005-06 Month 6 Forecast Deficit as % of Turnover
	£m	£m	%
CHELMSFORD PCT	109	(11)	-10%
HILLINGDON PCT	282	(26)	-9%
CAMBRIDGE CITY PCT	137	(12)	-9%
BEDFORDSHIRE HEARTLANDS PCT	231	(20)	-9%
KENSINGTON AND CHELSEA PCT	271	(21)	-8%
CHESHIRE WEST PCT	214	(15)	-7%
SUFFOLK EAST PCT	253	(17)	-7%
WEST WILTSHIRE PCT	121	(8)	-7%
SUFFOLK WEST PCT	232	(15)	-6%
NEW FOREST PCT	201	(12)	-6%
SOUTH CAMBRIDGESHIRE PCT	108	(6)	-6%
SEDFIELD PCT	117	(5)	-4%
HOUNSLOW PCT	272	(11)	-4%
WITHAM, BRAINTREE AND HALSTEAD CARE PCT	131	(5)	-4%
SOUTH WILTSHIRE PCT	133	(5)	-4%
FAREHAM AND GOSPORT & EAST HAMPSHIRE PCTS	400	(14)	-4%
NORTH STOKE PCT	168	(6)	-4%
BROADLAND PCT	119	(4)	-3%
SELBY AND YORK PCT	305	(10)	-3%
KENNET AND NORTH WILTSHIRE PCT	202	(6)	-3%
SOUTHERN NORFOLK PCT	211	(6)	-3%
SHEFFIELD WEST PCT	146	(4)	-3%
SHEFFIELD SOUTH WEST PCT	147	(4)	-3%
COTSWOLD AND VALE PCT	214	(5)	-2%
NORTH SHEFFIELD PCT	175	(4)	-2%
WANDSWORTH PCT	352	(8)	-2%
SOUTH EAST SHEFFIELD PCT	226	(4)	-2%
BLACKWATER VALLEY AND HART PCT	175	0	0%
<b>TOTAL</b>	<b>5,652</b>	<b>(264)</b>	<b>-5%</b>

## NHS Trusts Covered by Baseline Assessment

Organisation Name	2005-06 Month 6 Forecast Turnover	2005-06 Month 6 Forecast Surplus / (Deficit)	2005-06 Month 6 Surplus / (Deficit) as % of Turnover
	£m	£m	%
SURREY AND SUSSEX HEALTHCARE NHS TRUST	124	(41)	-33%
THE ROYAL WEST SUSSEX NHS TRUST	92	(17)	-18%
EAST CHESHIRE NHS TRUST	77	(14)	-18%
QUEEN ELIZABETH HOSPITAL NHS TRUST	133	(20)	-15%
SOUTHPORT AND ORMSKIRK HOSPITAL NHS TRUST	108	(15)	-14%
BEDFORD HOSPITALS NHS TRUST	96	(12)	-13%
WEST SUFFOLK HOSPITALS NHS TRUST	99	(12)	-12%
QUEEN ELIZABETH HOSPITAL KINGS LYNN NHS TRUST	101	(11)	-11%
ST GEORGE'S HEALTHCARE NHS TRUST	319	(34)	-11%
WEST HERTFORDSHIRE HOSPITALS NHS TRUST	204	(19)	-9%
HAMMERSMITH HOSPITALS NHS TRUST	401	(37)	-9%
NORTH TEES AND HARTLEPOOL NHS TRUST	173	(15)	-9%
NORTH WEST LONDON HOSPITALS NHS TRUST	266	(22)	-8%
EAST AND NORTH HERTFORDSHIRE NHS TRUST	235	(19)	-8%
WEST MIDDLESEX UNIVERSITY NHS TRUST	99	(8)	-8%
QUEEN MARY'S SIDCUP NHS TRUST	88	(7)	-8%
BROMLEY HOSPITALS NHS TRUST	153	(12)	-8%
SOUTH TEES HOSPITALS NHS TRUST	321	(21)	-7%
UNIVERSITY HOSPITAL OF NORTH STAFFORDSHIRE HOSPITAL NHS TRUST	293	(18)	-6%
GEORGE ELIOT HOSPITAL NHS TRUST	85	(5)	-6%
SHREWSBURY AND TELFORD HOSPITAL NHS TRUST	182	(10)	-5%
THE MID CHESHIRE HOSPITALS NHS TRUST	110	(6)	-5%
MID YORKSHIRE HOSPITALS NHS TRUST	291	(15)	-5%
THE LEWISHAM HOSPITAL NHS TRUST	145	(7)	-5%
ROYAL WOLVERHAMPTON HOSPITAL NHS TRUST	212	(10)	-5%
BRIGHTON AND SUSSEX UNIV HOSPS NHS TRUST	301	(14)	-5%
GOOD HOPE HOSPITAL NHS TRUST	111	(5)	-5%
SOUTHAMPTON UNIVERSITY HOSPS NHS TRUST	354	(14)	-4%
OXFORD RADCLIFFE HOSPITAL NHS TRUST	455	(15)	-3%
BARNET AND CHASE FARM HOSPITALS NHS TRUST	250	(8)	-3%
SANDWELL & WEST BIRMINGHAM HOSPS NHS TRUST	299	(5)	-2%
NORTH MIDDLESEX UNIVERSITY HOSP NHS TRUST	132	0	0%
NORTHERN DEVON HEALTHCARE NHS TRUST	75	0	0%
NORTH HAMPSHIRE HOSPITALS NHS TRUST	111	1	1%
<b>TOTAL</b>	<b>6,495</b>	<b>(467)</b>	<b>-7%</b>