



# Achieving first-class financial management in the NHS

A sound basis for better healthcare

*The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local and national services for the public. Our work covers local government, housing, health, criminal justice and fire and rescue services.*

*As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we monitor spending to ensure public services are good value for money.*

- 1 The NHS spends £1 million every 10 minutes, and between now and 2008 expenditure on the NHS in England will increase by £40 billion. At the same time, the Government has set ambitious service targets and has started major reform and modernisation programmes to improve NHS services and to devolve responsibility to individual NHS bodies. The size of the spending increase and the complexity of the challenges faced by the NHS are unprecedented. Financial management is about how the finances of an NHS body are directed and controlled to meet these challenges.
- 2 Making sure that these large sums of public money translate into the maximum improvement in services requires astute investment as well as excellent financial control. Within the NHS, every clinical decision has financial implications and every financial decision has clinical implications. Financial management is central to all key decision-making and is an essential part of performance management.
- 3 Financial control is not sufficient on its own. Significant devolution of responsibilities requires excellence across the whole range of financial management activities. This is common across the public sector. Even the best managed organisations, such as applicants for NHS foundation trust status can find that their current approach to financial management needs to improve.

## Key findings and messages

- 4 This paper reviews the current state of financial management in the NHS, drawing on case studies and information provided from local audits. It identifies where and how improvements need to be made and sets out for chief executives and board members the major challenges in financial management that the NHS will face over the next few years. We also outline our work programme on NHS financial management for the next three years – which we see as being a key area for continuing attention by both auditors and the Audit Commission.

### Our key findings are:

- the basics of financial management at most NHS bodies are sound and provide effective financial control for today's health service, but financial management is broader and when it is at its best it can do more to enable improvements in patient services;
  - financial failures are rare, but they do occur and they provide important lessons for all NHS bodies;
  - financial planning, budget profiling, forecasting financial outturn, the quality of financial information and its use in decision-making all need to be improved;
  - to implement the modernisation programme, NHS bodies will need better financial management arrangements and a wider range of financial management skills. Some will struggle to meet these new challenges; and
  - the current financial management capability of most primary care trusts (PCTs) is inadequate to meet the challenges they face.
- 5 First-class financial management plays a key role in securing improvements in patient services. To deliver the greatest benefit to users from the available resources,

everyone needs to be aware of the financial consequences of their decisions and to seek good value for money. Clinicians, as well as managers, need to play their part in ensuring that good financial management exists throughout their organisations. Quality services must be delivered within budgets – achieving one at the expense of the other is not an option.

- 6 Getting the basics right is crucial. Effective decision-making processes supported by sound information, robust planning and budget-setting, strong internal controls, monitoring, forecasting and reporting are firm foundations that are essential for improving services. Where financial management is good, NHS bodies can focus on quality and improving services; where it is poor, services are provided in an atmosphere of crisis and retrenchment that undermines day-to-day quality and inhibits change and development.
- 7 But the scale and pace of developments in the NHS will mean that the systems, structures and skills needed to use the growing resources to the best effect will look very different from those we have been used to in the past. Financial management means more than the financial control process of monitoring and recording expenditure, although the stewardship of resources remains a key responsibility for NHS bodies. Financial management involves not only planning to meet new challenges, but also knowing how money is being spent, whether it is giving good value and how extra investment can best be used to improve services.

## The basics of financial management

- 8 The basics of financial management and financial control in the NHS are generally sound. The great majority of NHS bodies meet their statutory financial duties, resources are applied to key priorities to meet organisational objectives, boards are kept informed of their financial position through regular reports, and there are effective systems of internal control.
- 9 However, some bodies struggle to achieve these basic financial management requirements. There have also been a small number of significant failures in stewardship and financial control, with one case where a trust incurred an in-year deficit of £44 million (15 per cent of turnover). These cases have involved fundamental failures of governance, with boards failing to receive appropriate information and lacking the necessary skills to challenge effectively what they were being told. All NHS bodies need to learn from these failures and ensure that their processes and capabilities are fit for purpose. This is relevant too for NHS foundation trusts, which will have new governance arrangements where both the elected boards of governors and the directors they appoint will have financial responsibilities that must be discharged effectively.

## Achievement of financial balance

- 10 In financial terms the NHS overall breaks even; so do the majority of NHS bodies. Within this bigger picture, accounting arrangements and the ability of strategic health authorities (SHAs) to organise financial support for NHS bodies with financial problems can mean that underlying deficits can be hidden and continue in

subsequent years. The Department of Health (DH) has introduced greater transparency over end-of-year support to individual organisations, enabling such deficits to be identified more easily. This is welcome. In 2002/03 18 per cent of trusts incurred an in-year deficit, which in total was some £176 million, or 0.53 per cent of total operating expenditure. This was after receipt of financial support of £116 million to assist in managing financial problems, and without which one-quarter of all trusts would have shown deficits. Forty per cent of trusts and 31 per cent of PCTs included a disclosure note in their accounts drawing attention to uncertainties surrounding their future financial position. Although the aggregate size of deficits is small in comparison with the total sums available to the NHS, there are problems in particular areas including Avon, Kent and the Thames Valley.

- 11 The manipulation of activities at the year-end to bring forward income from, or delay expenditure to, the following financial year can only provide a short-term solution and stores up problems for the future. While these practices are not widespread, they do occur and NHS bodies that adopt these measures should take steps to address the underlying financial problems.

## Improving forecasting

- 12 Forecasting of the year-end outturn financial position needs to improve in order to move away from the current fairly typical annual cycle: at worst, this means that little attention is given to the outturn at the start of the year; this is followed by forecast overspend and crisis management, eventually leading to a balanced position at year-end. Breaking this cycle should allow more effort to be put into using resources more effectively throughout the year. This would be helped by greater clarity and precision from the DH about their assumptions and information on costs, whether any additional resources are to be made available in-year, and the earlier release of such resources. NHS trusts would also be helped by similar longer-term, and earlier, clarity about the funds available from PCTs.

## Improving capacity and capability

- 13 There are weaknesses in the capacity and capability of the finance function in some NHS bodies, especially in PCTs. In 2003 auditors expressed concern about inadequate finance staffing and management capacity in 34 per cent of PCTs, 21 per cent of SHAs and 14 per cent of NHS trusts. This was reflected in the poor quality and late submission of the 2002/03 accounts in about one-half of all PCTs and in just under one-half of SHAs.

## Improving financial planning

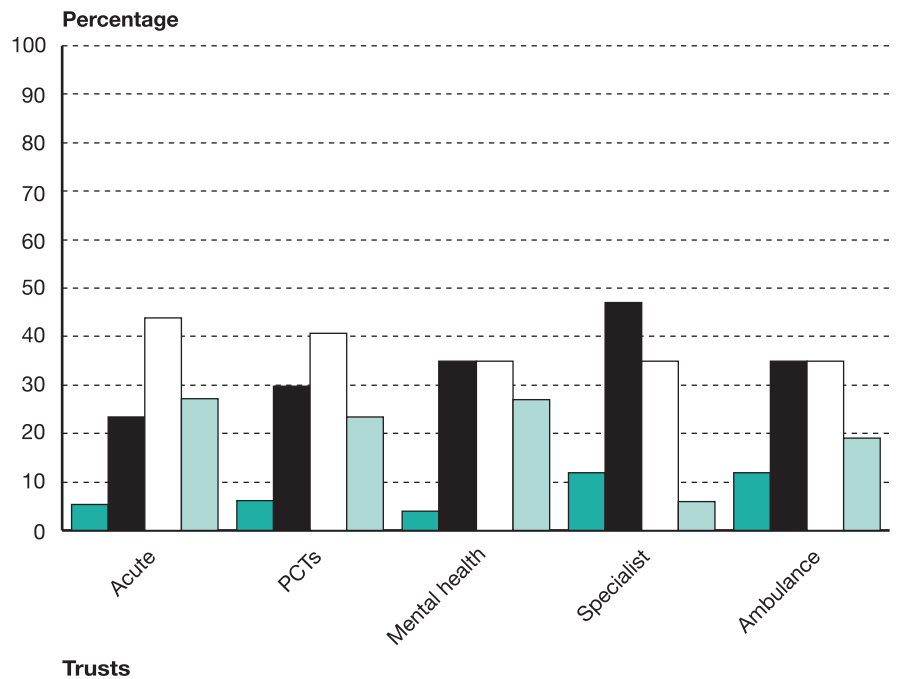
- 14 Longer-term financial planning, the quality of the information on which decisions are taken and knowledge about the use of resources need to be strengthened to make better use of current and additional funding. Auditors reported concerns about the financial element of the local delivery plans (LDPs) at over 60 per cent of PCTs and NHS trusts (**Exhibit 1**).

### Exhibit 1 The financial stability of LDPs

Based on auditors' assessments, the financial stability of LDPs is a cause for concern.



**Note:**  
**Strong:** There are strategies in place to resolve underlying financial pressures. There is a clear link between LDP trajectories and the financial plan. There is investment in place to support the achievement of trajectories.  
**Fairly strong:** There is reasonable confidence that financial balance will be achieved. The link between LDP trajectories and financial position could be clearer.  
**Fairly weak:** There is a high risk of required savings not being achieved. There is uncertainty about the availability of funds to support LDP trajectories.  
**Weak:** Financial pressures are unresolved. Recovery plans are not robust. There is little confidence that financial resources will be sufficient to support LDP trajectories.



Source: Audit Commission

- 15 Furthermore, our study *Transforming Primary Care* (published March 2004) showed only limited awareness of the reasons for the current funding of GPs, with the level of resources available to practices not related obviously to indicators of need.

## New challenges

- 16 The NHS is facing new challenges, which will put added pressure on financial management, most notably the introduction of the initiatives payment by results and patient choice, new contracts of employment and the creation of foundation trusts. All new systems contain some risks and NHS bodies will need to ensure that appropriate internal controls are in place to mitigate these risks. Foundation trusts will have greater financial independence from the DH, and legally enforceable contracts with PCTs, and will require strong financial management arrangements to support corporate borrowing. The introduction of payment by results will bring together the need for good financial management arrangements and timely and accurate activity data. Together these challenges will also require more sophisticated financial management skills to be available at all NHS bodies, including a better understanding of risk, resource usage, costs, input/output linkages, financial modelling and option appraisal allied to a more intelligent use of timely and accurate performance data, and workforce and service planning. On the basis of current performance, some NHS bodies will struggle to meet these new challenges.

## Notes

This paper is based on research carried out at ten NHS bodies – including SHAs, PCTs and NHS trusts. We were assisted by an advisory group whose membership was drawn from a wider range of NHS bodies, the DH and auditors. The paper also draws on an analysis of NHS audited accounts for 2001/02 and 2002/03 and information gathered from a questionnaire that auditors are required to complete for every NHS audited body. Audit reports, annual audit letters and public interest reports have been reviewed for details of financial management activities, both good and bad.

Under the new regulatory regime for the NHS, overseen by the newly established Commission for Healthcare Audit and Inspection, the Audit Commission retains responsibility for national and local work on financial management.

📄 Copies of this report are available at:

[www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

or to order a printed copy telephone:

0800 502030

Stock code: HXB3212

For further information on the work of the Commission please contact:

Steve Bundred, Audit Commission,  
1st Floor, Millbank Tower, Millbank,  
London SW1P 4HQ

Tel: 020 7828 1212

Textphone (minicom): 020 7630 0421

## What should NHS boards do?

- 17 NHS bodies need to act now to improve their financial management arrangements to ensure that they can meet the new challenges of the future, most notably the introduction of payment by results, patient choice, the new contracts of employment for NHS staff and the creation of foundation trusts. All board members – both non-executives and executives – need to have the necessary knowledge, skills and approach to discharge their financial management responsibilities effectively. Many boards struggle to do this and all need to develop further in the light of the new challenges. Without demonstrable commitment from the board towards strong and effective financial management, sustainable improvements in patient services will not happen. Some key questions for board members to consider are set out at the back of this briefing.

## The Audit Commission's work programme on NHS financial management

- 18 The Commission is committed to helping NHS bodies with the considerable challenge of improving the quality of their financial management arrangements. As part of this, we will shortly consult stakeholders on a programme of national studies focusing on financial management issues. We will also produce briefing material for boards and focus attention on the capacity of local financial management arrangements.

## Conclusion

- 19 Overall, this paper lays down a challenge to the NHS (and to ourselves as regulators) to set and reach standards for financial management that meet the demands of the future rather than those of the present. Making the necessary progress will not be easy, nor will it be achieved overnight. This report does not claim to provide all the answers. But by identifying the challenges ahead and highlighting good practice and ways to improve, it provides the first steps towards achieving major advances in the quality, consistency and sophistication of financial management in the NHS for the long-term benefit of patients and taxpayers.

# Questions for board members

## Financial planning

- How does the organisation integrate service and financial planning and how well does it do it?
- How is expenditure tracked to services and outputs or outcomes?
- How are spending decisions underpinned by analysis of service or population need?
- How are the costs of in-year developments or pressures such as National Institute for Clinical Excellence (NICE) guidance forecast and planned for? Are they accurate when compared with outturns?
- Are new service developments costed? Are they accurate when compared to outturns?
- How does the organisation respond to changes in demand and target resources to areas of need?
- How do financial data and management information support good strategic decision-making and performance management?
- How do medium-term financial plans get produced? Are they accurate when compared with outturns? How are lessons learnt from variations?

## Budget setting

- How are budgets set? Are they in accordance with the aims and objectives of the body?
- How are budgets profiled? Do they reflect patterns of expenditure?

## Budget reporting and monitoring

- How accurate and timely are the budget monitoring reports?

- How consistent are the financial forecasts made during the year with the actual year-end position? How are lessons learnt from the variations?
- How are budgetholders held accountable for managing their budgets?
- How are variances from budget identified and investigated? What corrective action is taken? Is it successful?
- How are service delivery staff helped to understand budgets and monitoring reports?
- How are service delivery staff helped to understand the costs of different options?
- How are budgetholders made aware of the effect of their decisions on the financial position of the organisation?

## Financial control

- How does the organisation ensure that it has an effective framework of internal financial control?
- How are key business risks identified and managed?

## Treasury management

- Are the treasury management functions (for example, managing cashflow, borrowing and lending) accurate, timely and efficient? What is the basis for this assessment?

## Ensuring value for money

- How are alternative options for achieving the most cost-effective service outcome considered?
- How are reviews of services undertaken? Are benchmarks used to assess any activities?

## Board reporting

- Does the board receive regular and accurate accruals-based financial information, including the risks to the financial position?

- How are the risks to the financial position managed?
- Does the board receive regular and accurate balance sheets? If not, why not?
- Are cost improvements identified as part of the budget-setting process? How are they tracked? Is performance against them reported to the board?
- How is investment in service improvement tracked? How is performance against planned outputs and outcomes reported to the board?
- Does the board receive reports that link financial and activity data?

### Financial reporting

- Are statutory and other financial duties achieved? If not, why not?
- Are external audit reports free from concerns about the quality and timeliness of final accounts and supporting working papers? If not, why not?
- Are the same systems and processes used to produce both the management accounts and the financial accounts? If not, why not?

### General

- Are all finance positions filled by appropriately trained staff? If not, why not?
- How does the organisation ensure that managers, clinicians and budgetholders are provided with information about how well service policies and priorities are being delivered?
- How are financial management arrangements reviewed to ensure 'fitness for purpose'? How regularly is this undertaken?
- How are opportunities and threats to good financial management identified in a rapidly changing environment? If they are not, why not?

- How are future developments identified that will impact on financial management, including the wider health agenda? In particular:

### Payment by Results

- What is the likely impact of the introduction of Payment by Results?
- What risks does your organisation face, and how are they being managed?
- Are activity costs likely to be above or below the standard tariff?
- What are the consequences of this?
- Has the accuracy of reference costs been reviewed? If not, why not?
- What is being done to improve the quality of the data used to calculate reference costs?

### Bringing forward the accounts timetable

- When were the accounts and supporting working papers given to the auditor?
- Were they of an appropriate quality?
- What steps have been taken to comply with the new accounts timetable?

### New contracts of employment

- What are the financial consequences of implementing the new consultant contract, GPs contract and Agenda for Change?
- What has been done to ensure that the financial systems can support the new contracts?