



National Audit Office

Releasing resources to the frontline: the Department of Health's Review of its Arm's Length Bodies

SUMMARY

The Department's progress in delivering the targets of the Review

1 The Department of Health (the Department) funds arm's length bodies (ALBs), such as NHS Blood and Transplant and the Healthcare Commission, to deliver specialised services and functions. In 2004 the Department announced its ALB Review, which aimed to reconfigure and streamline the ALB sector so that it would be able to deliver its services more efficiently. As a result of this more efficient configuration, the Review would deliver, by 2008-09:

- savings of £0.5 billion (comprising £250 million savings in ALB operating costs, and £250 million savings in procurement of items across the NHS secured through the National Contracts Procurement programme run by the NHS Purchasing and Supplies Agency);
- a 25 per cent reduction of the number of posts in the sector; and
- a reduction in the number of bodies from 38 to 20.

The Department would also ensure that 850 posts in the ALB sector would be relocated out of London and the South East by 2009-10.

We examined the Department's management of the Review and its progress towards these efficiency targets. Our methodology is summarised in Appendix 2.

2 We found that, over the four years 2003-04 to 2007-08, the number of ALBs in the sector, and the total resources devoted to them, in terms of their funding from central government and the number of whole time equivalent posts they employ, has decreased. There have also been increasing procurement savings in NHS Trusts year on year on the items covered by the National Contracts Procurement programme.

3 Using the metrics set for the Review the Department has already achieved expenditure cuts of £555 million, exceeding the target of £0.5 billion. This is made up of a £207 million reduction in grant-in-aid compared to the baseline in 2003-04, and procurement savings of £348 million, as shown in [Figure 1](#).

4 The Department has reduced grant-in-aid funding by £207 million by setting up appropriate governance arrangements for delivering the Review, which have led to tighter financial management across the ALB sector than had been the case before the Review. It has ensured the efficiency programmes that ALBs had in place or had planned were actually delivered, so that ALBs could operate within reduced central funding limits. Considerable savings have also been made by closing down some ALBs.

5 The Department has, through the NHS Purchasing and Supply Agency, encouraged NHS Trusts to make greater use of centrally negotiated contracts for procurement in areas such as pharmaceuticals, telecommunications equipment and laundry services, with the total spend on such contracts rising from £202 million in 2005-06 to a projected £1.7 billion in 2007-08, yielding total savings of £348 million in comparison with baseline expenditure in these areas, as [Figure 1](#) shows.

6 The Department has encouraged ALBs to make use of its provider of shared financial services to deliver efficiencies. ALBs were expected to use this service unless they could demonstrate that alternative arrangements would be more efficient. Most ALBs are not currently using the shared financial services, for example because their transaction volumes are too small to realise efficiencies through moving to shared services, or because their specialised requirements would involve the shared services provider in prohibitive development costs. In all cases the ALBs provided evidence to justify the value for money of retaining their existing arrangements.

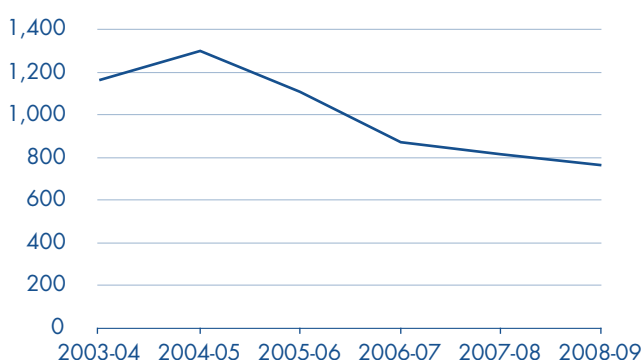
7 The Department has also put in place arrangements to monitor ALBs' performance on a consistent and regular basis, allowing the ALB Business Support Unit within the Department to identify issues or concerns relating to the performance of the sector as a whole, and to inform regular accountability meetings between ALBs and their departmental sponsors on operational and financial performance, and on future business planning. It was beyond the scope of our study to examine the performance of individual ALBs in detail. Our examination of the Department's performance monitoring system did not reveal evidence of a decline in performance, since the monitoring was brought in, across the ALB sector as a whole; and our discussions with the larger ALBs also confirmed that they were managing to deliver their services and functions within the budgetary constraints imposed by the Review. The Department collected substantial

information on the performance of ALBs before and during the Review. But it would have been helpful if it had collected baseline information for the complete set of metrics it is currently using to measure performance to provide an assessment of any overall change in performance across the sector for the complete period of the Review.

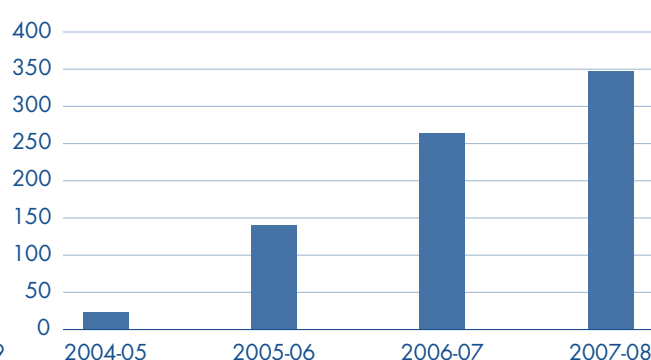
8 The expected number of ALBs in place during 2008-09 will be 22 (**Figure 2**), plus a new ALB, the Alcohol Education and Research Council, which was transferred from the Department of Culture, Media and Sport to the Department of Health in 2007. The Department plans to reduce the number of ALBs by a further 3 by the end of 2008-09, which would mean that the number of ALBs in place by 2009-10 would be 20, the original target number of bodies envisaged in the Review.

1 Central funding for ALBs has reduced, and procurement savings have been made

Total grant-in-aid (£m) to ALBs over the Review period



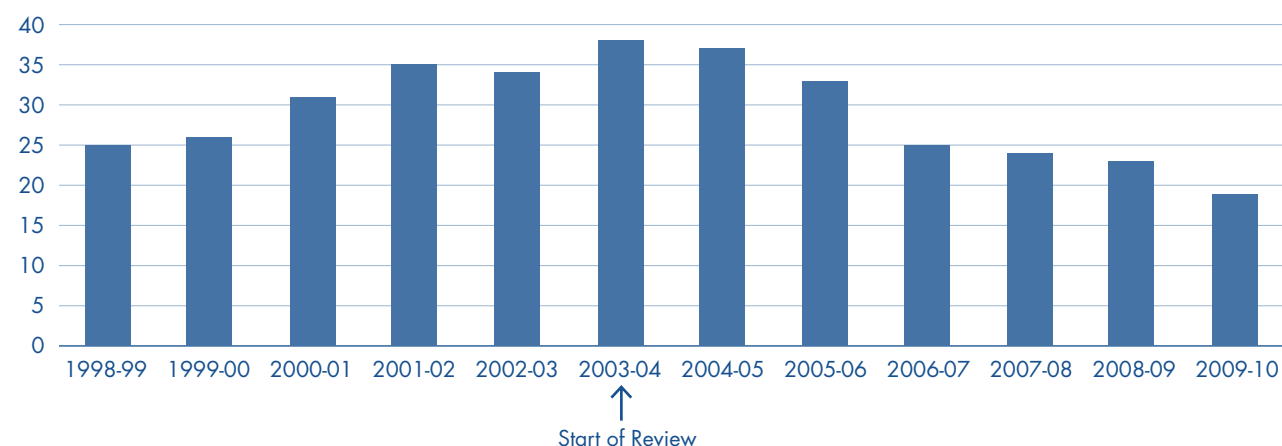
Procurement savings from the National Contracts Procurement programme during the Review (£m)



Source: National Audit Office analysis

2 The number of ALBs has reduced since the start of the Review

Number of ALBs over time



Source: National Audit Office analysis

9 The principal reasons that the reduction in the number of ALBs to 20 will not be achieved until 2009-10 are:

- the time required to create the planned new overarching health and social care regulator through the merger of the Commission for Social Care Inspection, the Healthcare Commission and the Mental Health Act Commission;
- delays in obtaining the necessary primary legislation for the transfer of the National Institute for Biological Standards and Control to the Health Protection Agency; and
- the cancellation of the planned merger of the Human Fertilisation and Embryology Authority and the Human Tissue Authority.

10 The Department is making good progress towards its target for relocating ALB staff outside London and the South East. By December 2007 it had achieved 745 post relocations, against the target of 850 to be achieved by 2009-10, and it has identified further potential relocations. There will be risks to be managed in delivering these, with concerns being raised by some of the ALBs concerned about business continuity if the proposals go ahead. The Department is working to identify further relocations in ALBs that have already contributed to the target and in the others.

11 There have been costs associated with implementing the Review. The Department spent £61 million over the Review period, over and above grant-in-aid to ALBs, in transition costs. Redundancy costs arising from headcount reductions accounted for £47 million of this (and some ALBs met additional redundancy costs from within their grant-in-aid allocations). Ring-fenced transitional funding was made available to ALBs for the period of the Review, and further funding will be provided in 2008-09 for a final year. From 2009-10 onwards transitional funding will cease and the full savings achieved through the Review will be realised.

12 Headcount reductions have been achieved across the sector, as shown in **Figure 3**. Many of these are transfers of staff to other parts of the NHS. For example, around half of the total headcount reduction in the ALB sector has come from changing the status of NHS Direct from an ALB to an NHS Trust. NHS Direct employees, many of whom are nurses, remain Government employees, and continue to provide the same services to patients, but are now defined as frontline staff rather than as part of the ALB sector.

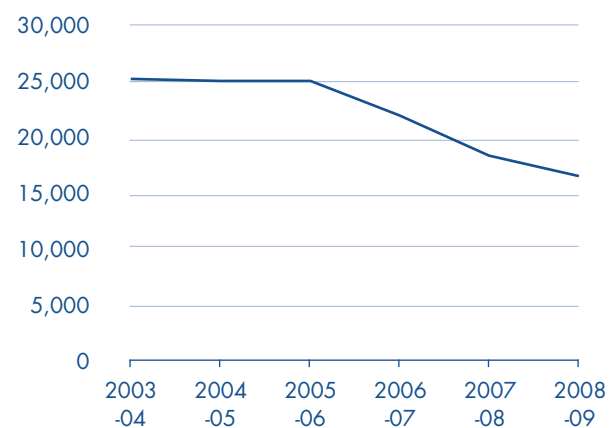
Wider efficiency issues across government

13 To assess the effectiveness of the ALB Review as an efficiency programme, rather than simply checking whether the targeted levels of savings and post reductions were delivered, it is necessary to consider the extent to which any of the savings or headcount reductions would have occurred, in any case, had the programme not taken place – the so-called counterfactual scenario.

14 In defining how the targets for the programme would be realised, the Department used as its counterfactual for grant-in-aid reductions a constant year-on-year total grant-in-aid allocation to the sector at 2003-04 levels, to make it clear to ALBs what the baseline figure was against which savings would need to be delivered. This is equivalent to assuming that, without the Review, there would have been an annual real-terms decrease in total grant-in-aid from 2004-05 to 2006-07. This is a conservative estimate of what would probably have happened, during a period of increasing expenditure on the health sector, if the Review had not taken place. Indeed, Treasury guidance for counting efficiency savings suggests that inflation effects should normally be factored in. Assessing against a counterfactual that was adjusted for inflation would have suggested a higher level of grant-in-aid savings attributable to the Review.

3 Number of posts in the ALB sector over the Review period

Number of posts in ALB sector over the Review period



Source: National Audit Office analysis

15 On the other hand, the counterfactual used to assess procurement savings assumes that none of the savings that have arisen as a result of NHS Trusts' changing to cheaper, generic versions of pharmaceutical products when they come off patent would have occurred without the National Contracts Procurement programme. It seems likely that at least some hospitals would have realised some of these savings if the programme had not been in place. Assessing against a counterfactual that takes account of this would have suggested a lower level of procurement savings attributable to the Review. However, NHS PASA has worked with NHS Trusts and other organisations to deliver savings by ensuring that purchasing is responsive to price movements in the pharmaceuticals market.

Conclusion on value for money

16 The Department is on track to meet the key targets set for the ALB Review in 2004. Definitions of how the Review's targets would be measured were clear, agreed with Ministers, and in conformity with the prevailing criteria for assessing efficiency savings at that time.

Figure 4 summarises the high-level results so far.

4 High-level results of the ALB Review so far

The targets set were to reduce, between 2003-04 and 2008-09:

- expenditure by £500 million (£250 million on centrally funded operating costs and £250 million on procurement costs);
- the number of posts in the sector by 25 per cent; and
- the number of ALBs in the sector from 38 to 20.

By the end of 2007-08, and by the metrics set for the exercise:

- expenditure will have been cut by £555 million (£207 million in centrally funded operating costs and £348 million on procurement);
- the number of posts in the sector will have decreased by 27 per cent; and
- the number of ALBs will have reduced, through mergers and reconfigurations, from 38 to 23.

In terms of target achievement the exercise has been a success.

Source: National Audit Office Analysis

NOTE

Figures exclude the Alcohol Education and Research Council, which did not form part of the original Review.

17 In the years since the 2004 Comprehensive Spending Review, guidance on measuring efficiency savings in the public sector has been developed to include requirements to consider alternative counterfactuals when necessary, and to measure efficiency gains net of the costs of achieving them. The Department of Health spent £61 million over the Review period on implementation costs – such as redundancy costs – associated with the Review, and expects there will be further costs in 2008-09. According to current guidance on measuring efficiencies, these would be deducted from the savings figures. Transition funding will cease from 2009-10, so the full recurrent savings will be achieved from that year onwards.

18 In order for the savings that have been achieved to count as efficiency improvements, it must be demonstrable that the quality of performance in the ALB sector has been maintained since the beginning of the Review. Our examination of the Department's performance monitoring system did not reveal evidence of a decline in performance, since the monitoring was brought in, across the ALB sector as a whole; and our discussions with the larger ALBs also confirmed that they were generally managing to deliver their services and functions within the budgetary constraints imposed by the Review. The Department did collect significant performance data from ALBs, however, not always in a form which permits direct comparison of current and baseline performance, so that it is not always possible to establish whether performance has been maintained in comparison with 2003-04.

19 Around half of the reduction in posts has been achieved by reassigning existing posts to new categories. Nurses working for NHS Direct who have been reassigned to the 'frontline' count as staff reductions even though their duties remain as they were.

20 Consequently, the exercise has certainly cut costs, posts and the number of bodies, and in this sense has improved value for money in ALB sector and secured some notable savings. In the wider context of developments in efficiency measurement since 2004, there remain some areas in which further evidence would be required to quantify unequivocally the overall value for money achieved.

21 For the future, to ensure that further efficiencies are delivered in accordance with the requirements of the 2007 Comprehensive Spending Review, the Department will have to work within the tighter requirements for demonstrating efficiency gains that have been announced by the Government since the previous Spending Review. We make a number of recommendations below to help in taking this forward. These will also be of interest to other government departments in managing their arm's length bodies to deliver efficiencies.

Recommendations

For departments generally, on using targets to deliver efficiencies

If targets are used to deliver efficiencies they should be clear, unambiguous and informed by sector knowledge, focused on delivering value for money improvements and measurable.

- a The value for money improvements delivered by the ALB Review have largely been driven by the savings target, less by the headcount reduction or number of bodies target. The headcount reductions have been achieved partly by redefining organisations; and the number of bodies itself is not key to delivering value for money in the sector. **If targets are used in efficiency programmes they should focus on value for money defined in terms of total resources used and performance quality, rather than on input measures.**
- b Initially the targets lacked clarity and caused some confusion over what they would mean in practice. This meant that there was uncertainty in the ALB sector and delays in getting started on the necessary reforms. However, once the Department ensured that the definition of the targets was clear ALBs began working towards them. **Departments must be clear about what targets mean in practice, including how they will be calculated and what the counterfactual will be, when announcing them to bodies responsible for their delivery.**
- c The need to meet a predetermined target for the number of ALBs has led to instances where, in the opinion of the ALBs concerned, mergers have taken place without a clear business logic. **Decisions to merge or reconfigure bodies should be based on an Impact Assessment, which identifies and assesses the costs and benefits of change. Moreover, post merger, work should be carried out on the merged organisations to determine what costs and benefits have arisen from their reconfiguration.**

- d Savings and headcount reductions targets for individual ALBs were sometimes less challenging than they might have been, for example where ALBs had internal change programmes aimed at delivering greater savings than their allocated targets. **Departments intending to deliver efficiencies through their arm's length bodies should map out their ALB sector and understand the individual circumstances of their ALBs, to maximise the effectiveness of targets that are cascaded to bodies.**
- e As the Department does not have a set of comparable performance metrics for the full period of the Review we cannot reach a definitive conclusion on changes on performance in the sector during the Review. **When undertaking major change programmes, Departments should establish baseline performance and financial metrics, in order to assess the 'before and after' effect. In the case of the ALB Review, this would have provided a greater level of assurance that savings achieved represented genuine efficiencies, and not just reductions in expenditure.**

For the Department of Health, on managing the arm's length relationship

Efficiency improvements have to be delivered by the ALBs themselves. The role of the Department should be to create the right environment for efficiencies to be realised.

- f If sponsors ask ALBs to take on extra work without approaching the central ALB finance team to secure and agree funding, it will not have been allowed for in ALB budgets. This may result in sponsors finding funding through other routes, which can lead to confusion for ALBs as to who within the Department has overall operational responsibility for their budgets. **Sponsors or other parts of the Department should not commission new work from ALBs without prior discussion with the central ALB finance team to ensure that funding is available.**

- g It is clear that prior to the ALB Review the Department's financial scrutiny of ALBs was variable. There were also mixed standards in business planning and performance monitoring. The implementation of the ALB Review has improved the Department's overall governance of its ALBs. **The Department should ensure that ongoing efficiency requirements on ALBs and the existing good practice governance arrangements are maintained after the conclusion of the ALB Review in 2008-09. This might entail, for example, ensuring that the current ALB Business Support Unit continues to provide independent challenge to future business plans and budgets proposed by ALBs and their sponsors.**
- h Between 1999 and 2004 the number of Department of Health ALBs grew from 25 to 38. The ALB Review called into question the value for money of several of the bodies established during this period and recommended their closure. **After the ALB Review concludes in 2008-09, the Department should ensure that the robust arrangements now in place for assessing the purpose and value for money of ALBs are applied whenever new bodies are proposed. The current ALB Business Support Unit could take on this gatekeeper role.**
- i The Department has made good progress towards its relocation target, however some risks remain to be managed if the full quota of relocations is to be delivered by 2009-10. **The Department should continue encouraging ALBs to identify potential relocations and ensure that ALBs are committed to those identified within the programme.**