



National Audit Office

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## **Report**

by the Comptroller  
and Auditor General

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**Department of Health**

# Financial sustainability of the NHS

## Key facts

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**£1.85bn**

net deficit of NHS bodies (NHS England, clinical commissioning groups, NHS trusts and NHS foundation trusts) overall in 2015-16

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**£2.45bn**

net deficit of NHS trusts and NHS foundation trusts in 2015-16

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**66%**

percentage of NHS trusts and NHS foundation trusts (156 out of 238) in deficit in 2015-16

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**32 out of 209 (15%)** number of clinical commissioning groups reporting a cumulative deficit in 2015-16

**£2.4 billion** additional funding given to NHS trusts and NHS foundation trusts in financial difficulty as a cash injection, loan or other financial support in 2015-16

**£1.8 billion** funding for financial sustainability available for trusts in 2016-17 from the £2.14 billion Sustainability and Transformation Fund

**£461 million** net deficit reported by NHS trusts and NHS foundation trusts in the first three months of 2016-17

**£14.9 billion** savings that NHS trusts, NHS foundation trusts and clinical commissioners need to make by 2020-21 to help close the estimated £22 billion gap between patients' needs and resources

# Summary

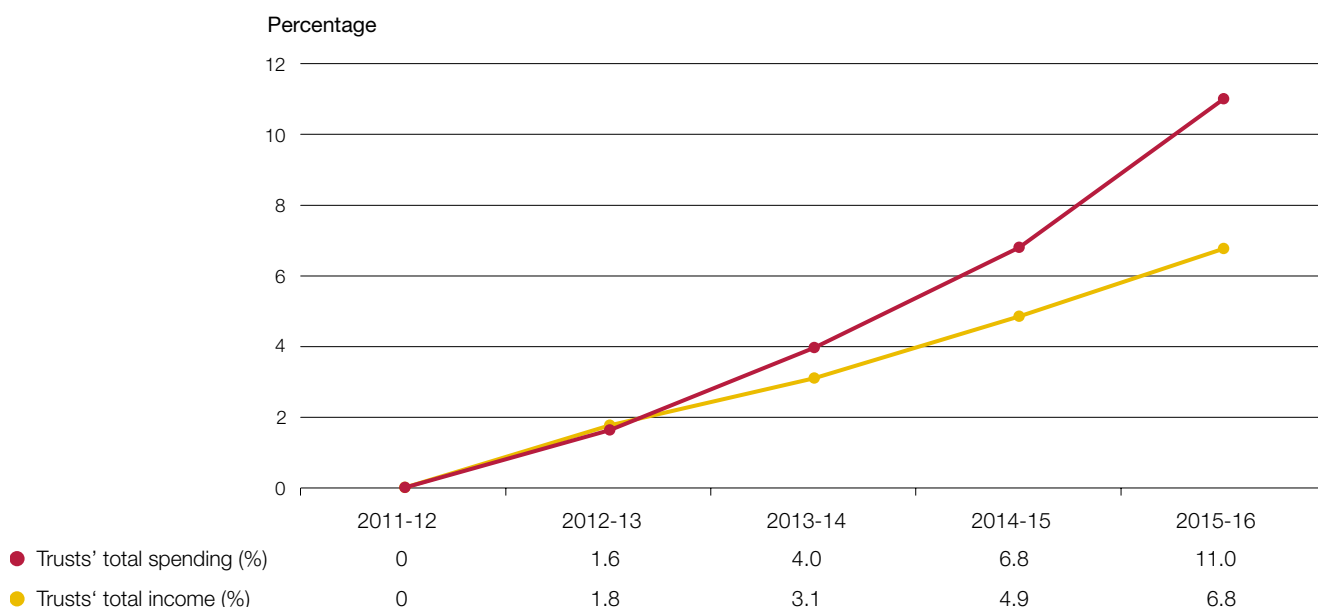
**1** This is our fifth report on the financial sustainability of the NHS. The health service must be financially sustainable to provide high-quality services for patients both now and in the future. Health is an area of public spending that has been protected in recent years. However, finances have become increasingly tight.

**2** NHS bodies achieve financial sustainability when they are able to successfully manage activity, quality and financial pressures within the income they receive. In recent years, the financial performance of NHS trusts and NHS foundation trusts has significantly declined. **Figure 1** shows that the growth in spending by trusts has outpaced growth in their income.

## Figure 1

Cumulative increase in NHS trusts' and NHS foundation trusts' income and spending since 2011-12

Growth in trusts' income has not kept pace with growth in spending



### Notes

- 1 NHS trusts' and NHS foundation trusts' spending and income figures are adjusted to remove the effects of impairments of assets, transfers of functions from or to other health bodies and charitable funds.
- 2 Figures are adjusted for inflation using the GDP deflator with the base year in 2015-16, as used by HM Treasury in setting departments' budgets.

Source: National Audit Office analysis of trusts' financial data

**3** In December 2015 we concluded that this continued deterioration in financial performance was not sustainable and that financial problems were endemic. The Department of Health (the Department) has overall responsibility in central government for healthcare services. The Department is accountable to Parliament for ensuring that all spending by the Department, NHS England, NHS Improvement, other arm's-length bodies and by local NHS bodies is contained within the overall budget authorised by Parliament. It is responsible for ensuring that those organisations perform effectively and have governance and controls in place to ensure value for money. The Department has made NHS England and NHS Improvement responsible for ensuring that the NHS balances its budget in 2016-17.<sup>1</sup>

**4** The NHS *Five Year Forward View*, published in October 2014, set out proposed changes to healthcare services. The *Five Year Forward View* estimated that there would be a £30 billion gap between resources and patients' needs by 2020-21. It estimated that if the NHS had £8 billion more funding, the gap between resources and patients' needs would be £22 billion by 2020-21 if no action was taken. In November 2015 the government committed to increasing funding for the NHS by £8.4 billion by 2020. Included in this is £2.14 billion that the Department, NHS England and NHS Improvement set aside for the Sustainability and Transformation Fund in 2016-17, of which £1.8 billion will be used to help trusts sustain services and reduce deficits.

**5** In this report on financial sustainability in the NHS:

- We give a summary of the financial position of NHS England, clinical commissioning groups, NHS trusts and NHS foundation trusts (Part One).
- We look at what the Department, NHS England and NHS Improvement have done to develop a plan for achieving financial sustainability, and how they are managing the risks in implementing their plans (Part Two).
- We examine the support the Department, NHS England and NHS Improvement have given to local bodies, including NHS trusts, NHS foundation trusts and clinical commissioning groups, to ensure the future sustainability of the NHS (Part Three).

**6** We set out our audit approach in Appendix One and evidence base in Appendix Two. Technical notes explaining how we have used financial data are in Appendix Three. The report does not look in detail at primary care, social care, public health or similar services, although the transformation of primary care and public health and the need to sustain social care services are key elements of the *Five Year Forward View*.

<sup>1</sup> NHS Improvement includes Monitor, the regulator of NHS foundation trusts, and the NHS Trust Development Authority, which oversees NHS trusts.

## Key findings

Trends in the financial performance of NHS bodies

**7 In 2015-16, NHS commissioners, NHS trusts and NHS foundation trusts reported a combined deficit of £1.85 billion.** This was made up of:

- NHS trusts and NHS foundation trusts reporting a combined deficit of £2.45 billion against their total income of £75.97 billion;
- clinical commissioning groups together achieving an overspend of £15 million, against the £72.24 billion available for locally commissioned services; and
- NHS England achieving an underspend of £614 million, spending £28.02 billion of the £28.64 billion available for its national functions and centrally commissioned services (paragraph 1.3).

**8 The financial position of NHS bodies overall has continued to decline.**

The £1.85 billion deficit in 2015-16 reported by commissioners, NHS trusts and NHS foundation trusts together, shows that the financial position has worsened since a £574 million deficit was reported in 2014-15 and a £234 million surplus in 2013-14 (paragraph 1.3).<sup>2,3</sup>

**9 The number of NHS bodies reporting a deficit rose significantly between 2014-15 and 2015-16.**

In 2015-16 two-thirds of NHS trusts (65%) and NHS foundation trusts (66%) reported deficits, up from 44% of NHS trusts and 51% of NHS foundation trusts in 2014-15. The number of clinical commissioning groups reporting cumulative deficits was 32 in 2015-16, up from 19 in both 2013-14 and 2014-15 (paragraphs 1.5 and 1.9).

<sup>2</sup> The total deficit reported by NHS bodies in 2014-15 is different from that reported in our report *Sustainability and financial performance of acute hospital trusts*. This is because Doncaster and Bassetlaw Hospitals NHS Foundation Trust restated its 2014-15 position during 2015-16 (see paragraph 7, Appendix Three). The restated figures for 2014-15 are used throughout this report.

<sup>3</sup> The financial performance of NHS bodies in 2013-14 and 2014-15 is different from that reported in our report *Sustainability and financial performance of acute hospital trusts*. This is because for consistency with NHS England's Annual Report and Accounts for 2015-16, we have restated the commissioner figures to use NHS England's non-ring-fenced budget. The non-ring-fenced budget excludes depreciation and impairment charges. Previously reported figures use NHS England's ring-fenced budget, which includes depreciation and impairment charges.

**10 Trusts' overall deficit grew by 185% to £2.45 billion, up from £859 million in 2014-15.**<sup>4</sup> This continued trusts' sharp decline in financial performance from a £91 million deficit reported in 2013-14, and a £592 million surplus in 2012-13. At 30 June 2016, trusts reported a deficit of £461 million and forecast an end-of-year deficit of £644 million (paragraphs 1.10 to 1.11).

**11 Trusts' performance against important indicators of financial health continued to decline in 2015-16.** Trusts' overall margin of average earnings before interest, tax, depreciation and amortisation (EBITDA) fell for the fifth consecutive year. EBITDA is used as a measure of operating efficiency and underlying financial sustainability. At the end of 2015-16 the average EBITDA margin for NHS trusts fell sharply to 0.8% from 3.5% in 2014-15; for NHS foundation trusts, it had fallen from 3.6% to 2.2%. In 2015-16 trusts' balance of net current assets, showing how much capital trusts are generating and using, was negative for the first time. This suggests trusts are finding it difficult to finance their day-to-day operations. Trusts are increasingly struggling to pay suppliers on time with 77% paying their invoices within 30 days in 2015-16, compared with 81% in 2014-15 and 82% in 2013-14, against the Department's target that 95% of invoices are paid on time (paragraphs 1.12 to 1.15).

#### Reliance on financial support

**12 NHS trusts and NHS foundation trusts under financial stress continue to rely on financial support from the Department and NHS England.** The Department provides additional funding, mainly in the form of loans, so that trusts in difficulty have the cash they need to pay creditors and staff and to fund essential building works. NHS England provides income support to trusts to cover historically agreed transactions and private finance initiative payments. In 2015-16 the total amount of financial support funding provided by the Department and NHS England was £2.4 billion. This was an increase of 32% from £1.8 billion in 2014-15 (paragraph 1.17).

<sup>4</sup> Trusts' 2014-15 deficit is different from that reported from our report *Sustainability and financial performance of acute hospital trusts*. Doncaster and Bassetlaw Hospitals NHS Foundation Trust restated its 2014-15 position during 2015-16 (see paragraph 7, Appendix Three).

## Achieving NHS targets and meeting quality requirements

**13 There are indications that financial stress is having an impact on access to services and quality of care.** Trusts' performance against important NHS access targets has worsened. For example, the target that a minimum of 95% of patients attending accident and emergency departments (A&E) must be discharged, admitted or transferred in under four hours was not met in 2015-16, with 91.9% spending fewer than four hours in A&E compared with 93.6% in 2014-15. We found an association between trusts' financial performance and trusts' overall Care Quality Commission rating (which does not include measures of actual financial performance). The trusts that achieved lower quality ratings also reported poorer average financial performance. We found that the five trusts rated 'outstanding' between December 2013 and August 2016 had a net deficit equal to 0.02% of their total income in 2015-16. The 14 trusts rated 'inadequate' had a net deficit equal to 10.4% of their total income in 2015-16 (paragraphs 1.18 to 1.20).

## Impact of interventions to manage the 2015-16 financial position

**14 The growth in trusts' spending on agency and contract staff has slowed, although their spending on these staff is still significant.** Trusts spent 7.6% of their total staff costs on agency and contract staff in 2015-16, up from 7.1%, 5.6% and 4.8% in 2014-15, 2013-14 and 2012-13 respectively. The Department, Monitor and the NHS Trust Development Authority introduced controls on agency spending in October 2015. However, the amount trusts spent on agency and contract staff remained high. They spent £3.7 billion in 2015-16, compared with £3.3 billion in 2014-15. It may take years to resolve workforce issues that affect the successful recruitment and retention of permanent staff, and reduce the need for agency staff (paragraphs 1.22 to 1.25).

**15 The Department has transferred funding for capital to funding for day-to-day spending; this has helped it to manage the NHS' financial position in 2015-16, but could risk trusts' ability to achieve sustainable service provision.** In February 2016 the Department transferred £950 million of its £4.6 billion budget for capital projects, such as building works and IT, to revenue budgets to fund the day-to-day activities of NHS bodies. Of this, £331 million was exchanged for revenue support for 93 trusts, to fund healthcare services. The Department did not assess the long-term effects of transferring this funding to cover day-to-day spending. This means it does not know what risks trusts may face in future as a result of addressing immediate funding needs (paragraphs 1.27 to 1.29).

## Managing financial sustainability

**16 The Department, NHS England and NHS Improvement have a shared plan to close the estimated £22 billion gap between patients' needs and resources by 2020-21.** Together, the Department, NHS England and NHS Improvement estimate that they can make £6.7 billion of efficiencies by capping public sector pay, renegotiating contracts, implementing income-generating activities and reducing running costs. They estimate that trusts and commissioners can make a further £14.9 billion by moderating the growth in demand for healthcare services and achieving 2% productivity and efficiency improvements (paragraphs 2.2 and 2.3).

**17 Plans to close the estimated £22 billion gap have not been fully tested.** The Department, NHS England and NHS Improvement used a financial model to estimate the gap between patients' needs and resources by 2020-21, and the savings their programmes need to achieve to close this gap. We found limited testing by the Department, NHS England and NHS Improvement of their estimates of how much they expect to generate from their savings programmes. This raises concerns about whether planned savings can be achieved. For example, plans assume that growth in trusts' acute activity (including specialised acute services) will be reduced from 2.9% to 1.3% through transformation and efficiency programmes such as Right Care, new care models and the Urgent and Emergency Care programme. However, NHS statistics show this will be challenging as hospital admissions, a key driver of activity, grew by 2.8% a year between 2013-14 and 2014-15 (paragraphs 2.4 to 2.7).

**18 The NHS is implementing its plans to make the NHS financially sustainable from a worse than expected starting point.** Plans to achieve financial sustainability were based on trusts ending 2015-16 with a combined deficit of £1.8 billion. The fact that trusts ended the year with an even larger deficit means that the level of deficit to be recovered is significantly greater than expected. This means that the trusts affected will need to catch-up by making more savings than planned to reach the intended starting position. For example, trusts with deficits greater than expected at the end of 2015-16 will need to make operational efficiencies above the 2% savings level applied to all providers of healthcare services in 2016-17 or subsequent years (paragraphs 1.8 and 2.8).



**19 National bodies have not assessed the impact of all the wider cost pressures faced by local NHS organisations in plans for achieving financial sustainability.**

The Department, NHS England and NHS Improvement expect trusts and commissioners to invest in transformation programmes. But they do not yet know what level of investment is required or whether local bodies will be able to make the changes at the scale and pace needed. Furthermore, the government has made a commitment that the health and social care system in England will be fully joined together by 2020. We have previously reported that local authority spending on adult social care fell by 10% in real terms between 2009-10 (£16.3 billion) and 2014-15 (£14.6 billion). The accounting officer for NHS England told the Committee of Public Accounts that “over the next two or three years, there is likely to be a widening gap between the availability of adult social care and the need for social care. That, will, inevitably show up as delayed discharges and extra pressure on hospitals.” However, in our review of the plans for financial sustainability, we did not see any estimate of the impact of pressures on social care spending on NHS bodies (paragraphs 2.6 to 2.13).

Supporting local NHS organisations to achieve financial sustainability

**20 NHS England’s and NHS Improvement’s financial ‘reset’ announced in July 2016 outlined the steps they are taking to cut trusts’ deficits.** NHS Improvement placed five trusts in ‘financial special measures’ and it continued to monitor trusts against the financial targets (control totals) that it introduced in January 2015. Trusts must meet these targets in order to access the £1.8 billion of sustainability funding from the Sustainability and Transformation Fund. In 2016-17 NHS England and NHS Improvement continued to implement their controls on trust spending that began in 2015-16, for example by limiting spending on agency staff (paragraph 3.2).

**21 Despite efforts by NHS England and NHS Improvement to join up to support local NHS bodies, a lack of incentives and unrealistic targets remain.** We heard from five of the 21 local bodies we spoke to that the pressure to meet the financial targets set by NHS Improvement for their individual organisation did not incentivise them to work with other bodies in their local area to develop sustainability and transformation plans as required by NHS England and NHS Improvement. Furthermore, in May 2016 the Committee of Public Accounts concluded that the 4% efficiency target for trusts set by NHS England and Monitor (now NHS Improvement) in 2015-16 was unrealistic and damaging to trusts’ finances. For the 2016-17 financial year, NHS England and NHS Improvement reduced the efficiency target to 2%. But, by July 2016, NHS Improvement said it expected that trusts will need to achieve an efficiency target greater than 2%, partly because of the higher than expected trust deficit at the end of 2015-16 (paragraphs 3.4 and 3.7 to 3.10).

## **Conclusion on value for money**

**22** The messages in our two previous reports on NHS financial sustainability have been consistent and clear in stating that the trend in NHS trusts' and NHS foundation trusts' declining financial performance was not sustainable. In 2015-16 trusts' financial performance worsened considerably. Efforts to get NHS finances on track, such as large savings and efficiency targets, have damaged trusts' financial positions and contributed to the current situation. With more than two-thirds of trusts in deficit in 2015-16, we repeat our view that financial problems are endemic and this is not sustainable.

**23** Delivering financial stability in 2016-17 will be vital if the NHS is to make the changes needed to improve the quality and timeliness of healthcare services. The Department, NHS England and NHS Improvement must make sure their plans for restoring NHS finances to a stable position are achievable. They have put considerable effort and funding toward stabilising the system, but the starting position in 2016-17 was considerably weaker than assumed. The Department, NHS England and NHS Improvement have a way to go to demonstrate that they have balanced resources and achieved stability as a result of this effort. Therefore, value for money from these collective actions has not yet been demonstrated.

**24** The National Audit Office (NAO) perceives differences in the position articulated by the Department – which views the funding for the NHS as having been adequate over the last few years, and in line with what NHS England set out it would need to deliver the NHS *Five Year Forward View* – and NHS England itself. Confronted as NHS England is by the pressures of rising demand for services, these signs of differences do not help build a confident feel about the future of the NHS.

## **Recommendations**

- a The Department, NHS England and NHS Improvement should test the assumptions in both national plans as well as local sustainability and transformation plans.** The Department, NHS England and NHS Improvement have identified savings programmes for closing the estimated £22 billion gap between patients' needs and resources by 2020-21. They should test national plans as well as local sustainability and transformation plans and use this testing to identify the risks that need to be managed. They should be clear on who these risks are owned by.
- b NHS England and NHS Improvement should set realistic efficiency and savings targets for local bodies to achieve.** Setting overly optimistic efficiency and savings targets for local bodies could result in short term and ineffective interventions. NHS England and NHS Improvement should set informed efficiency and savings targets for providers and make sure the combined effect of these targets is achievable.

- c The Department should evaluate the impact and risks to future financial stability of the one-off measures used to manage the 2015-16 financial position, including the transfer of capital funding to resource.** The Department, NHS England and NHS Improvement took action to manage the financial position of the NHS in 2015-16 and address the growing deficit of trusts. While their measures are technically justifiable, they should not form the basis of a credible plan to secure the financial sustainability of the NHS in England. It is unclear what impact one-off measures will have on the future sustainability of the NHS or whether there is sufficient capital to renew existing assets and support the vision in the *Five Year Forward View*. The Department should assess its capital requirements and evaluate the impact and risks of transferring capital budgets to support routine spending.
- d The Department, NHS England and NHS Improvement should analyse the impact to the NHS of pressures on social care funding, and the cost of implementing seven-day services.** Local bodies are faced with wider cost pressures in addition to the need to achieve financial sustainability. However, not all of these have been taken into account in national plans for financial sustainability.
- e NHS England and NHS Improvement should assess whether current and planned incentives are helping local bodies to work together, plan for and achieve long-term financial sustainability.** The legislative and accountability framework for local NHS organisations is seen by some as a barrier to helping local bodies to work together. But NHS England and NHS Improvement could do more within the existing regulation and accountability framework to create the incentives for local bodies to collaborate. They should evaluate whether recent changes to the financial planning process for local bodies are working effectively and should have alternative plans if new approaches do not work as intended.