HFMA introductory guide to NHS finance

Chapter 14: Revenue planning and budgeting

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Overview

NHS organisations are responsible for spending taxpayers' money to ensure that patients have access to high quality care, free at the point of delivery. As this is taxpayers' money there is an absolute requirement to demonstrate that the money is used well and for its intended purpose. Every NHS organisation also has a specific statutory duty to make 'proper arrangements for securing economy, efficiency and effectiveness in its use of resources'. To be able to meet this requirement, each organisation needs to plan the activities it will deliver or commission and establish the associated resource implications – not just in terms of money but also in relation to staffing, equipment, supplies and so on.

Planning and budgeting take place in two areas – revenue and capital – that are then brought together in an overall plan. This chapter focuses on the revenue side – in other words, how NHS organisations plan and budget for their day-to-day activities. Capital planning is covered in chapter 15.

14.1 Why are revenue planning and budgeting important?

Revenue planning and budgeting are integral parts of an organisation's business planning process and help it by establishing:

- an agreed way ahead
- key aims and objectives
- how those aims will be achieved and by when
- a framework for day-to-day operations and decisions
- a performance management and accountability framework.

14.2 What the planning process involves – key documents

The planning process enables the NHS to allocate its resources to meet both national and local priorities. It is designed to facilitate the efficient and effective delivery of high-quality services, demonstrate accountability and ensure consistency with national policy and local plans, targets and outcomes frameworks. It also supports integrated care systems (ICSs) to work together to develop joint plans to improve population health, through ensuring that system wide priorities are agreed, and all partners are resourced appropriately. To find out more about the role of the ICS, see chapter 5.

During the Covid-19 pandemic the normal planning process was suspended. However, full planning guidance has been issued for 2022/23[198], supported by a number of other supporting guidance documents, covering revenue finance and contracting[199], capital[200], and elective recovery[201]. These

[198] NHS, *2022/23 priorities and operational planning guidance*, December 2021
[199] NHS, *2022/23 priorities and operational planning guidance: revenue finance and contracting guidance*, April 2022
[200] NHS, *2022/23 priorities and operational planning guidance: capital guidance for 2022-25*, April 2022
[201] NHS, *2022/23 priorities and operational planning guidance: elective recovery planning support guidance*, April 2022

four documents work together to provide the information that local systems and organisations need to develop their plans for 2022/23 and beyond.

There are several key documents that are required as part of the planning process:

- a NHS long term plan[202] implementation plan (to 2023/24) at a system level.
- an annual system operating plan for the local health economy, covering shared priorities and parameters for organisational planning to meet the implementation plan. This is supported by system level activity, financial and workforce plans.
- an annual organisational operating plan to support the delivery of the system operating plan. This is supported by organisational level activity, financial and workforce plans.
- a long-term (usually 3 to 5 years) strategic business plan for the organisation. This is sometimes referred to as the integrated business plan (IBP).
- a long-term financial plan for the organisation that looks at best case and 'downside' scenarios.

NHS long term plan implementation plan

The *NHS long-term plan* implementation plan sets out what the system plans to deliver over the next five years, linking to the priorities set out in the *NHS long term plan implementation framework*[203]. Current plans cover the period from April 2020 to March 2024. The plan includes a description of local need and how services will be developed to address this need.

Plans are expected to align with the following principles:

- **clinically-led**: In practice this means that systems will need to identify and support senior clinicians to lead on the development of implementation proposals for all NHS long term plan commitments that have clinical implications and on the totality of their plan.
- **locally owned**: Build on existing engagement with local communities to ensure they can meaningfully input into the development of local plans.
- **realistic workforce planning**: Systems should set out realistic workforce assumptions, matched to activity and their financial envelope.
- **financially balanced**: Systems need to show how they will deliver the commitments in the plans within the resources available.
- **delivery of all commitments in the *NHS long term plan* and national access standards**
- **phased based on local need**: Whilst the *NHS long term plan* must be delivered in full, this does not mean that all initiatives should be implemented simultaneously everywhere. The scale and pace of local implementation should be based on local need and priorities.
- **reducing local health inequalities and unwarranted variation**: System plans should set out how they will use their allocated funding to deliver tangible improvements in health outcomes and patient experience and help reduce local health inequalities.
- **focussed on prevention**: System plans must consider not just how to deliver health services but how to prevent ill health.
- **engaged with local authorities**: System plans should expect to be developed in conjunction with local authorities and with consideration of the need to integrate with relevant local authority services.
- **driving innovation**: All system plans must consider how to harness innovation locally.

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[202] NHS, *The NHS long term plan,* January 2019
[203] NHS, *Long term plan implementation framework,* June 2019

Strategic business plan

Each individual NHS organisation also has its own individual long term strategic business plan. The business plan is the written end product of a process that identifies the aims, objectives and resource requirements of the organisation over a three-to-five-year period. It is a detailed document that sets out the assumptions that underlie service plans and budgets for the period covered.

What a business plan includes

- an activity and income and expenditure plan, together with cashflow plan
- details of planned service developments
- savings / waste reduction or cost improvement plans (CIPs)
- performance measures
- workforce implications
- a strategy for the organisation's support services (for example, the estate and information technology)
- an analysis of the needs and priorities of the wider health community and how and where the organisation fits in; it is particularly important that this is in line with the requirements set out by the ICS.

The business plan is considered and approved by the organisation's governing body/ board and then used as a benchmark against which to measure progress towards achieving the organisation's aims and objectives. In practice, this means that the business plan is kept under constant review and updated to reflect the impact of external changes (for example, Government announcements) and internal developments (for example, new clinical techniques).

Long term financial plan

Accompanying the business plan, a long-term financial plan is used by NHS organisations to look at the financial impact of achieving their goals over the medium to long term (again over a three to five year period). This plan focuses on the assumptions made in the business plan and enables the organisation to see how potential changes (for example, in local demographics) could affect financial viability. The long-term financial plan also includes an analysis of best case and 'downside' scenarios – enabling the organisation to anticipate what might happen if things do not go as planned and have strategies in place to mitigate the impact if they do.

Operational plan

Operational plans show how national targets (for example as set out in the *NHS constitution*[204] and the *NHS long term plan*) and local priorities (for example, as set out in Joint Health and Wellbeing Strategies and Joint Strategic Needs Assessments developed by Health and Wellbeing Boards – see chapter 8) will be delivered within available resources. They are used by commissioners and the ICS to outline how they intend to address health inequalities, improve health outcomes and better focus healthcare provision in line with ICS intentions and strategies, national and local priorities. For providers, the focus of an operational plan is how they will deliver the services agreed with commissioners and the ICS as well as meet their own objectives and priorities (for example, the need to achieve required cost improvements or carry out service re-design or integration).

[204] Department of Health and Social Care, *The NHS constitution for England*, March 2012 (updated January 2021)

Operational plans are reviewed regularly throughout the year and if significant issues arise that affect progress, adjustments are made – for example, if serious financial problems develop in the health economy.

Financial plan

Alongside the operational plan, all NHS organisations must produce an annual financial plan (usually referred to as the budget) that shows the expected income and expenditure of its planned activities for the coming year (both revenue and capital) and demonstrates that the organisation will achieve its financial duties. Chapter 11 looks in detail at these duties but in relation to the budget, the key statutory requirement for NHS providers and commissioners is that they must not spend more money than they have coming in – in other words, they must at least break even (achieve a 'balanced budget') or deliver a surplus. Although NHS foundation trusts do not have a specific statutory duty to break-even, they must remain solvent if they are to continue as going concerns.

To assess the financial position accurately, the budget must cover all expected sources of income and expenditure across the full range of activities for which the organisation is responsible and take account of other non-financial information, such as activity levels, savings schemes and staffing requirements. The budget is approved by the governing body/ board in March and is then used to monitor progress and performance throughout the year so that an organisation knows how much income it is receiving, what it is spending and how much it is overspending or saving at any point in time.

For commissioners, the expenditure side of the budget is based on the activity levels that they have commissioned from providers to meet their commissioning intentions. For providers, the expenditure budget is based on the capacity and workforce they need to have available to meet these levels of activity – this will include the costs of running a service, department or organisation on a day-to-day basis (for example, to meet the costs of staff pay, travel expenses, overheads, drugs and other consumables). Providers will also have a budget for income – for example, split between income for patient care activity, teaching and education, and other areas such as research and development activity and commercial activities such as catering and the treatment of private patients.

The capital budget is based on plans for major spending on land, buildings, equipment and other durable items that are expected to be used for more than one year and have a value of £5,000 or more. This expenditure is subject to separate funding and regulations – see chapter 15 for details.

14.3 Budgeting in practice

Approaches

Although organisations refer to their 'budget' (singular), it is actually made up of a series of separate budgets for each activity, service, department or practice. Each part of the organisation develops its own financial, workforce and activity plans to indicate how it will use its share of the money to meet needs and priorities within the overall strategy. There are three basic budgeting approaches – historic, zero-based and activity-based. The NHS tends to use a combination of all three.

Historic or incremental budgeting – this uses the previous year's budget, adjusted for known savings (for example, as required in cost improvement programmes); cost rises (for example, pay awards and other inflationary factors) and developments (for example, if a new service is introduced or another discontinued or if National Institute for Health and Care Excellence (NICE) guidance changes). Allowance is also made for the financial consequences of any new policy developments.

Zero-based budgeting – this involves starting with a blank sheet of paper each year and results in a completely fresh financial plan. It tends to be used for the introduction of new services or when activities are under review.

Activity-based budgeting – this approach looks at what drives costs and is linked to activity levels. It requires those involved in setting the budget to know and understand the costs of delivering particular activities and services – for example, being clear about what costs are fixed and those that are variable (i.e. costs that will increase or decrease as activity increases or decreases – see chapter 17 for more on costing). The aim is to ensure that no matter what the actual level of activity, the correct resources are available to fund it.

Budget management

Another important feature of any budget in the NHS is that it is not the sole responsibility of the finance experts. Instead, it is essential to have a single named individual responsible for developing and managing each budget (the 'budget holder' or 'budget manager'). That person uses their knowledge and experience to help develop the budget and has the authority to take decisions relating to it. This means that responsibility for a budget must be aligned with the ability to control income and expenditure (i.e. the ability to take decisions that will incur a cost or result in a flow of income). To be effective, a budget holder must understand what needs to be delivered and which organisational, local and national objectives they contribute to.

In practice, this means that each budget is managed at the lowest practicable level in the organisation by the person who understands the activity or service covered and who is responsible for committing the expenditure. This is what is known as 'devolved budget management'.

Budget monitoring

Once a budget is agreed, it is used by the budget holder to monitor how the budget is performing via regular (usually monthly) monitoring. In other words, actual performance is compared with what was planned so that, when necessary, corrective action can be taken. For example, there may be an unexpected increase in the cost of equipment, or a new initiative may fail to deliver the level of savings expected.

14.4 The planning process – key external constraints

Given that all NHS organisations are statutory bodies, they do not have a free hand when it comes to developing their plans. Instead, they must follow national planning guidance, reflect national policy imperatives, meet targets and financial duties set by Government and reflect local priorities. The main factors that directly affect revenue planning are:

- the *NHS constitution*
- the *NHS outcomes framework*[205] ('the outcomes framework')
- the *NHS long term plan*
- annual planning guidance
- efficiency requirements
- quality, innovation, productivity and prevention (QIPP) plans
- allocations – the money received from the Treasury via the Department of Health and Social Care or NHS England

[205] NHS Digital, *NHS outcomes framework*, February 2021

- the national tariff document
- National Institute for Health and Care Excellence (NICE) guidelines.

The *NHS constitution* and the *NHS outcomes framework*

The *NHS constitution* and the *NHS outcomes framework* are key documents for all NHS organisations as they set out overall objectives and responsibilities that apply across the board. The Constitution's focus is on overarching rights, values and principles. The *NHS outcomes framework* has a more direct impact on day-to-day planning as it sets out what NHS organisations are expected to achieve in terms of healthcare outcomes for patients across five broad domains. For each domain a number of areas for improvement are identified but there are no set targets associated with them.

NHS outcomes framework – the five domains

1. Preventing people from dying prematurely
2. Enhancing quality of life for people with long term conditions
3. Helping people to recover from episodes of ill-health or following injury
4. Ensuring people have a positive experience of care
5. Treating and caring for people in a safe environment and protecting them from avoidable harm.

Annual planning guidance

The current planning guidance, *2022/23 priorities and operational planning guidance*, covers the period during which CCGs will be abolished and integrated care boards (ICBs) will be established. The planning guidance states that CCGs will remain as statutory organisations until the end of June 2022, meaning that CCGs are required to work closely with designate ICB leaders to develop plans.

Plans for 2022/23 will use local systems as the key unit for financial planning, with every NHS provider fully mapped to a single system. This means that each organisation's financial position will contribute to the achievement of financial balance for a single system. Trusts are also required to submit organisational plans, which are in line with the system plan submission.

Five-year system plans will be required from ICBs in March 2023. During 2022/23, ICBs are expected to undertake preparatory work to ensure that system plans reflect local priorities, with specific objectives aligning to the four primary purposes of an ICS:

- improving outcomes in population health and healthcare
- tackling inequalities in outcomes, experience and access
- enhancing productivity and value for money
- helping the NHS support broader social and economic development.

ICB plans are also expected to reflect national priorities for the NHS and consider the additional responsibilities that ICBs will take on for commissioning primary care and some specialised services.

Efficiency requirements

The NHS budget is now growing at a much slower rate than over recent years but demand for its services continues to rise. This means that all NHS organisations must deliver year on year real cost savings (or 'on-going 'efficiencies' every year) and reflect this in their annual plans. During the Covid-19 pandemic, the efficiency requirement was removed, however a 1.1% efficiency target has been set for 2022/23.

Organisations also experience inflationary pressures such as the rising cost of utilities or consumable items, meaning that further efficiencies are required to address these financial demands, if not funded through increases in their allocation or income.

At a more detailed level, if the cost of an organisation's plans to purchase and/ or deliver services exceeds its anticipated levels of income, further savings must be included within the budget to bring it back in line with the available resources.

QIPP plans

To help achieve efficiency targets whilst maintaining and improving quality, the Department of Health and Social Care introduced the 'quality, innovation, productivity and prevention (QIPP) challenge'. In practice, this means organisations seek to follow the 'lean management principles' of avoiding duplication, preventing errors that need to be corrected, and stopping ineffective practices. International evidence has shown that it is possible to improve the quality of care and patient experience while reducing costs. CCGs are responsible for leading the QIPP agenda, but all NHS organisations have a role to play in its delivery.

Allocations

As mentioned earlier in this chapter, all non-foundation NHS organisations must achieve a balanced budget each year (and FTs must remain solvent) and so the income level they receive is of critical importance. For commissioners the key factor is the funding allocation they receive from NHS England and for providers, the income secured through contracts with commissioners. The 2022/23 financial framework is system-based with a funding envelope issued to cover all organisations within an ICS. For more about the allocation process and how services are funded, see chapter 10.

The national tariff

Another set of guidelines that both commissioners and providers must take account of when preparing their plans relate to the national tariff – the NHS payment mechanism.

The *2022/23 national tariff payment system*[206] moves almost all secondary healthcare services, including acute, community, ambulance and mental health onto an aligned payments and incentive approach which builds on the blended payments introduced in 2019/20. The approach covers all contracts between providers and commissioners in the same system, as well as all contracts over £30m where providers and commissioners are in different systems. The £30m threshold is based upon ICB level contracts, requiring CCGs to work together in their ICB footprints. All specialised commissioning activity will be covered by these arrangements.

A blended payment is made up of a fixed and variable element. The fixed payment is to be locally determined and does not need to be built from individual prices/tariffs. Prices would still be published, as in previous tariffs, but they would mostly be used for guidance rather than mandated for use. The variable element can be used to incentivise specified activity or quality objectives.

[206] NHS, *2022/23 national tariff payment system,* March 2022

See chapter 19 for more about the national tariff.

NICE guidelines

NICE provides national guidance and advice that is designed to improve the quality of health and social care. Of particular importance in planning terms are its quality standards – these are developed by NICE in collaboration with relevant professions using a variety of evidence sources.

The quality standards are also used to inform payment mechanisms and incentive schemes such as the Quality and Outcomes Framework (QOF) – see chapter 6 for more details.

14.5 Planning process – other influences

As well as reflecting national guidelines in its annual financial and operational plans, an organisation must allow for a range of other factors including, for example:

- service developments (as outlined in its business plan)
- nationally agreed changes to pay and agreed increments for staff
- the impact of changes in clinical practice
- changes in drugs or medical devices used (NICE guidelines are relevant here)
- income streams that are no longer available or received
- changes in national and/or local priorities.

Key learning points

- The planning process is designed to ensure efficient and effective delivery of services, demonstrate public accountability, and ensure consistency with national and local plans and targets
- The *NHS long-term plan* implementation plan is designed to meet the needs of the health and social care system in a geographical area
- The business plan sets out the assumptions that underpin service plans and budgets
- The operational plan shows how national targets and local priorities will be delivered within the resources available and forms the first year of the NHS long-term plan implementation plan
- The financial plan or budget shows organisations' expected income and spending levels for the year ahead and demonstrates how their financial duties will be met
- Although organisations refer to the budget, it is made up of a series of separate budgets for individual activities or services
- There are three main budgeting approaches (historic, zero-based and activity-based), all of which are used in the NHS
- Budgets are managed by budget holders who monitor actual performance during the year and take corrective action when needed
- When NHS organisations develop their plans, they must take into consideration both external and internal requirements. Of particular importance are the *NHS constitution*, the *NHS outcomes framework* and the annual planning guidance.

Additional HFMA resources

The HFMA maintains a directory of resources which provides links to other HFMA outputs such as briefings and webinars across a range of subjects, including sections dedicated to the financial regime and the *NHS long term plan*. It also highlights e-learning courses that are available. The directory of resources can be found here.