

Monitor

Making the health sector
work for patients

Consultation on changes to the risk assessment framework: June 2015



About Monitor

As the sector regulator for health services in England, our job is to make the health sector work better for patients. As well as making sure that independent NHS foundation trusts are well led so that they can deliver quality care on a sustainable basis, we make sure: essential services are maintained if a provider gets into serious difficulties; the NHS payment system promotes quality and efficiency; and patients do not lose out through restrictions on their rights to make choices, through poor purchasing on their behalf, or through inappropriate anti-competitive behaviour by providers or commissioners.

Contents

1. Introduction	4
2. Changes to Monitor’s risk assessment framework.....	4
2.1. Proposed re-introduction of measures of foundation trust deficits and variance from plan	6
2.1.1. I&E margin measure	6
2.1.2. Additional measures of variance from plan	7
2.2. New sustainability and financial performance financial risk rating	8
2.3. Changes related to value for money	10
2.3.1. Value for money measure added to the governance rating	10
2.3.2. Changes to the NHS foundation trust accounting officer memorandum	10
2.4. Changes to national defined outcome and access measures	11
3. Responding to the consultation	11
3.1. Confidentiality.....	11
4. Next steps.....	12

1. Introduction

The NHS faces a continuing and significant challenge to simultaneously improve quality, meet access targets and drive up productivity. Meeting this challenge means there can be no let-up in the pace and scale of change in provider organisations.

Last year was the first year that the foundation trust sector as a whole ended the year in deficit. 77 out of 152 trusts lost money. Although this year's plans are more realistic than last year's, they would result in a worse performance for the sector. Put simply, this is unaffordable.

Given this challenging context we are proposing a number of measures to strengthen our regulatory regime so that we can help foundation trusts live within their means and support improvements in financial efficiency across the sector.

These measures include proposed changes to the risk assessment framework and the NHS foundation trust accounting officer memorandum described in this consultation document. We are proposing these changes to enable us to take regulatory action earlier if a foundation trust is in deficit, failing to deliver its financial plan, or not providing value for money.

This consultation seeks views from interested parties and stakeholders on the proposed changes. **Please respond to the consultation by 5pm on 1 July 2015.** See section 3 for more details.

The risk assessment changes outlined in this document apply to foundation trusts only.

2. Changes to Monitor's risk assessment framework

Since 1 April 2013 all NHS foundation trusts have needed a licence from Monitor (the NHS provider licence) stipulating specific conditions that they must meet to operate. These include financial sustainability and governance requirements:

- The Continuity of Service Licence Condition (CoS 3) requires that foundation trusts remain financially solvent so that they can continue to provide essential services to patients.
- Condition FT4 sets out broad-ranging governance requirements for all foundation trusts. They must apply the principles, systems and standards of good corporate governance which reasonably would be regarded as appropriate for a provider of NHS healthcare services. Specifically, they must establish and effectively implement systems and/or processes to ensure:

- compliance with the trust's duty to operate efficiently, effectively and economically (reflecting the legal duty on foundation trusts to exercise their functions generally in this way)
- effective financial decision-making, management and control (including but not limited to appropriate systems and/or processes to ensure the trust's ability to continue as a going concern).

As foundation trusts will be aware, we have made significant use of FT4 to enforce compliance with healthcare targets and standards, and where there is ineffective financial decision-making, management and control.

Monitor's [risk assessment framework](#) sets out the financial and governance metrics that we monitor and the thresholds that prompt us to assess whether we should investigate a foundation trust for a potential breach of these licence conditions.¹ If we find that a foundation trust has breached its licence we are able to take action. How we investigate potential breaches, prioritise and take regulatory action is set out in Monitor's [enforcement guidance](#).² It is within the licensing context that we propose to extend and strengthen the metrics we use to drive efficient, effective and economic use of resources by foundation trusts and ensure that foundation trusts act quickly when financial problems are anticipated.

Specifically we are proposing:

- re-introducing two previously used measures: one tracking foundation trust deficits and another the accuracy of planning
- combining a trust's rating on these new measures with its existing continuity of service ratings (COSRR) to produce a new four-level financial sustainability and performance risk rating, with appropriate regulatory responses to each rating level
- making two further changes to ensure trusts make sure they deliver value for money.

Lastly, we are aware of speculation about potential future national announcements on outcome and access measures. If these happen, we may subsequently issue supplementary questions to this consultation to ensure the risk assessment framework is suitably aligned with relevant national policy. We will publish further details to the sector if this is the case.

¹ www.gov.uk/government/uploads/system/uploads/attachment_data/file/421204/RAF_update_revmar15.pdf

² www.gov.uk/government/publications/monitors-enforcement-guidance

2.1. Proposed re-introduction of measures of foundation trust deficits and variance from plan

We propose to retain the existing continuity of service measures (liquidity and capital service capacity) and introduce the following additional measures into the risk assessment framework:

- income and expenditure (I&E) margin
- two additional measures of variance from plan: variance of I&E margin and variance of capital expenditure.

A trust's ratings on these additional measures will feed into its new overall financial sustainability and performance risk rating (see section 2.3).

2.1.1. I&E margin measure

The number of foundation trusts running a financial deficit has increased this year. We recognise that there have been specific quality and operational challenges facing the sector in the wake of the Francis and Keogh reviews and in some instances it may be appropriate for a foundation trust to have a short-term financial deficit as part of a longer term strategic plan. However, running a sustained and/or substantial deficit may also indicate a foundation trust is not operating as efficiently, effectively or economically as it could and tracking deficits can flag early signs of future financial issues and subsequent solvency issues. Therefore, we are proposing to introduce an I&E margin measure into the risk assessment framework.

I&E margin (%) will be calculated as: surplus/(deficit)/total operating and non operating income. Surplus/(deficit) will be calculated before impairments, transfers by absorption, gains/losses on asset disposal and restructuring costs to provide a reasonable approximation of underlying performance without being unduly influenced by one-off items or accounting adjustments. The proposed rating thresholds for I&E margin are as follows:

Table 1: Proposed rating thresholds for the I&E margin

Rating	I&E margin threshold
1	Worse than and including (1%)
2	Between (1%) and up to 0%
3	Greater than or equal to 0% up to 1%
4	1% or greater

1. Do you agree that we should monitor I&E margins? If not, why?
2. Do you agree with our proposed definition of I&E margin? If not, why?
3. Do you agree with the proposed rating thresholds? Please give reasons for your answers.

2.1.2. Additional measures of variance from plan

Currently if a foundation trust's actual performance in either revenue available for debt service or capital service costs or liquidity deteriorates against its plan agreed at the annual plan review by 20% or more, Monitor can ask the foundation trust to reforecast its plan. Depending on the results of the new forecast, we may also subsequently investigate under the governance risk rating.

We are proposing in addition to monitor foundation trusts' variance from plan in:

- I&E margin: calculated as I&E operating surplus(deficit)/total operating income
- capital expenditure: absolute variance as a percentage of planned capital expenditure.

The proposed rating thresholds are outlined in Table 2.

Table 2: Proposed rating thresholds for the variance from plan measures: I&E margin and capital expenditure

Rating	Threshold – I&E margin	Threshold – capital expenditure
1	Worse than and including (2%)	25% or higher
2	Between (2%) up to (1%)	20% and up to 25%
3	Greater than (1%) up to 0%	20% and up to 10%
4	0% or higher	10% or lower

To determine a foundation trust's prospective ratings on the variance from plan measures at the start of each financial year, we will use its achievement against the previous year's plan as a proxy. This will be updated with the actual variance from plan during the quarterly and monthly reporting process. However, if a foundation trust's prospective rating triggers potential investigation considerations, in deciding whether to investigate we will consider to what extent the deterioration in the trust's rating is caused by historical variance from plan. Furthermore, we do not propose to apply the override mechanism (see below) to the variance from plan measures when calculating a foundation trust's prospective risk rating.

- 4. Do you agree that we should monitor these new measures of variance from plan? If not, why?**
- 5. Do you agree with the proposed definitions of the measures? If not, why?**
- 6. Do you agree with the proposed rating thresholds? If not, why?**

2.2. New sustainability and financial performance financial risk rating

The existing continuity of service risk rating highlights the risk of short-term insolvency and financial risk. Including the additional measures proposed above means we will be monitoring a number of measures that link to financial risk. To provide a simpler overview of a foundation trust's financial risk we are therefore proposing to combine the COSRR with the new financial metrics to create a new sustainability and financial performance risk rating.

The proposed new risk rating has a four-point rating scale. A trust's rating will be calculated by combining the existing COSRR elements (ie liquidity, capital service capacity), with the re-introduced I&E margin, and variance from plan measures, with a fixed weighting for each component. An overall rating of 2 is likely to lead to investigation. If a trust's overall rating is higher than 2 but it is rated as 1 on any of the individual measures, except variance in capital expenditure (due to its volatility), the trust's overall risk rating will be subject to an override and capped at a 2, triggering likely investigation. Figures 1 and 2 show how the new combined metric would be structured.

While there are additional measures that can trigger a potential investigation under this amended financial risk rating, as before we will judge on a case-by-case basis whether we should investigate a foundation trust for a potential licence breach and what, if any, action is required. As outlined in a letter sent to the sector from Monitor's Chief Executive, David Bennett, on 2 June 2015, we will also be increasing the improvement support we provide to the sector to help trusts adopt best practice and improve their financial efficiency, reducing their risk of breaching their licence.

Given the extent of the financial challenges over the coming year, we are considering what reporting requirements and frequency of data collection we need to monitor foundation trust performance effectively without overburdening trusts. Where possible, we will seek to consolidate existing reporting so that it minimises the reporting burden while giving us sufficient assurance and the ability to act quickly. We will provide guidance on any revised reporting arrangements after the consultation closes.

Figure 1: New sustainability and financial performance risk rating

		Financial criteria	Weight (%)	Metric	Rating categories			
					1 ²	2	3	4
No change	Continuity of Service	Balance sheet sustainability	25	Capital Service Capacity (times)	Less than 1.25x	1.25x – 1.75x	1.75x-2.5x	Greater than 2.5x
		Liquidity	25	Liquidity (days)	Worse than (14) days	(14)-(7) days	(7)-0 days	Greater than 0 days
New triggers	Financial efficiency	Underlying performance	25	I&E margin ¹ (%)	Worse than (1)%	(1)-0%	0-1%	Greater than 1%
		Variance from plan	25	15 Variance in I&E margin as a % of income ¹ 10 Variance in capital expenditure	Worse than (2)% Greater than 25%	(2)-(1)%	(1) - 0%	Greater than 0%

¹ calculated as I&E operating surplus(deficit) / total operating income

² scoring a '1' on any metric except variance in capital expenditure will cap the weighted rating to 2, leading to potential investigation

Figure 2: Overall sustainability and financial performance risk rating

Sustainability and financial performance risk rating	Description	Regulatory activity
4	No evident concerns	None
3	Emerging or minor concern potentially requiring scrutiny	Potential improvement support
<hr/>		
2	Material risk	Likely investigation Potential improvement support
1	Significant risk	Investigation (in all but exceptional circumstances) Potential improvement support

- 7. Do you agree with the proposal to develop a single sustainability and financial performance risk rating using the existing continuity of service risk rating and the additional financial governance measures? If not, why?**
- 8. Do you agree with the proposed weighting of measures within the single financial risk rating. If not, why?**

2.3. Changes related to value for money

We also propose two changes to help trusts make sure they deliver value for money:

- an additional measure within foundation trusts' governance rating
- a change to the accounting officer memorandum.

2.3.1. Value for money measure added to the governance rating

We propose including an additional measure within foundation trusts' governance rating linked to value for money. We may consider investigating if a foundation trust demonstrates inefficient or uneconomical spend (actual or forecast) against published benchmarks. Such demonstrations could include examples of inefficient operational performance; for instance, poor control over input costs such as agency and management consultancy spend. We will publish further details in due course.

- 9. Do you agree in principle with the proposed inclusion of a value for money measure? If not, why?**

2.3.2. Changes to the NHS foundation trust accounting officer memorandum

We also intend to change the NHS foundation trust accounting officer memorandum for foundation trusts to strengthen the requirement to consider value for money. We will make the following changes:

- update paragraph 7 to set out that the accounting officer must ensure:
 - the foundation trust delivers efficient and economical conduct of its business and safeguards financial propriety and regularity throughout the organisation
 - financial considerations are fully taken into account in decisions by the NHS foundation trust

- update paragraph 8 to reference the accounting officer's duty to deliver prudent and economical administration in line with the principles set out in 'Managing public money'.³

We will also review the existing obligations to ensure they require foundation trusts to deliver effective management systems, including financial monitoring and control systems.

10. Do you have comments about the proposed changes to the accounting officer memorandum?

2.4. Changes to national defined outcome and access measures

Lastly, we are aware of speculation about potential future national announcements on outcome and access measures. If these happen we may subsequently issue supplementary questions to this consultation to ensure the risk assessment framework is suitably aligned with relevant national policy. We will publish further details to the sector if this is the case.

3. Responding to the consultation

We ask all interested parties and stakeholders to respond to the consultation by **5pm on 1 July 2015**. To respond to the consultation please use the following link: <https://www.research.net/s/LGF8DXM>. If you have trouble accessing the survey link above please email RAF@monitor.gov.uk.

The duration of the consultation period reflects the urgency and the desire to see measurable improvement by the end of 2015/16.

3.1. Confidentiality

You can request to keep your name and/or organisation confidential and excluded from the published summary of responses on the online form. If you send your response by email or post, please don't forget to tell us if you wish your name or your organisation's name to be withheld from any published documents.

If you would like any part of the content of your response (instead of or as well as your identity) to be kept confidential, please let us know and make it obvious by marking it in your response which parts we should keep confidential. We will do our best to meet your request, but because we are a public body subject to Freedom of Information legislation we cannot guarantee that we will not be obliged to release your response even if you say it is confidential.

³ www.gov.uk/government/publications/managing-public-money

4. Next steps

After considering feedback from this consultation, we will update and publish a revised risk assessment framework in Q2 2015/16. The changes will take effect from publication of the updated risk assessment framework. If the updates require changes to quarterly reporting templates we will issue an update to these as appropriate and notify trusts of the changes as soon as feasible. At the same time we will publish changes to the NHS foundation trust accounting officer memorandum.



Making the health sector
work for patients

Contact us

Monitor, Wellington House,
133-155 Waterloo Road,
London, SE1 8UG

Telephone: 020 3747 0000
Email: enquiries@monitor.gov.uk
Website: www.gov.uk/monitor

This publication can be made available in a number of other formats on request. Application for reproduction of any material in this publication should be made in writing to enquiries@monitor.gov.uk or to the address above.