Purpose

This paper briefs you on the:

- Revision of Health NZ's budget target upwards for 23/24 year; and
- Forecast year-end position and risks to delivering a break even target against Statement of Performance Expectations (SPE) operating budget.

23/24 Budget Target Revision

In October 2023 (post year-end), Health NZ realised a deficit of $1.013 billion. This was agreed with Ministry of Health and the Treasury to reflect the following adjustments:

a) $859 million for pay equity settlements for nursing, midwifery and Allied health staff accounted for in 2022/23, with funding to offset this expected in 2023/24; and

b) $284 million of COVID-19 stock written down in 2022/23. This left a balance of COVID-19 stock of $255m that would impact 2023/24 and/or outyears.

Without these adjustments, Health NZ would have posted a surplus position.

The flow on effect is that a surplus is expected in the 23/24 year, reflecting those year-end adjustments from 22/23. Management KPIs are set against the original SPE break-even operational budget.

Over November 2023 – February 2024, however, the Ministry of Health and Treasury are considering a revised budget target. They suggest a preliminary figure of $650 million surplus, but this has not been formalised in writing.

Their assumptions include an adjustment for the balance of COVID-19 Stock ($255 million), and an estimated capital charge upside of estimated $50 million (assumed to arise from the deficit reducing our Crown Equity balance).

Our view is that an appropriate target to reflect the above assumptions should be $583 million surplus. This is because there has been no reduction in Capital Charge due to the $1 billion deficit impact on Crown Equity being fully offset by a $1 billion increase in Crown Equity due to the asset revaluation gain. In fact, we have been advised this month that we will receive $21 million less than expected for Capital Charge compensation.

Board reporting in January shows a $507 million surplus.

The table below illustrates the difference in views.

Table 1: Reconciliation of initial budget to revised targets under discussion

	Initial Ministry view of revised budget target ($ millions)	Health NZ updated view of revised budget target based on same logic ($ millions)
Initial bottom-line budget result for 2023/24	0	0
Adjustments:		
Pay Equity improvement	859	859
COVID Stock downside	-255	-255
Capital Charge	50	-21
Restated bottom line surplus	654	583

As yet, there has been no formal communication about a revised target and discussions are being held internally at the Ministry. Our view is that a surplus of $583 million would be seen as the target but this does not change our operating assumption that we are working to the published SPE as per our operational budget.

23/24 financial position as at end February 2024 and implications for year-end forecast against SPE budget

We were tracking to meet savings and break-even budget as per SPE operational budget up to end of December 2023. There are six areas where expenditure is tracking outside budget expectations and management interventions are in place to oversee.

- **Internal Personnel over-recruiting, specifically nursing:** the success of recruiting campaigns means that we are now reporting lowest vacancy rate for employed nursing, at 6.2%, for the month of February. The January year-end forecast was premised on assumptions that nursing FTEs would be within budget for the balance of the year and the financial impact of vacancies would remain at the same level. The recent nursing FTE growth is attributed to new graduate nurses and was expected to come back into line. We have not, however, seen the requisite reduction in outsourcing costs as expected. Hospital and Specialist Services leadership has issued instructions to intervene in FTE recruitment that is outside establishment. Controls are being asserted on outsourcing (e.g., overtime, additional hours) while balancing against operational delivery.
- **Clinical supply savings not realised:** the underperformance of procurement and supply chain has made little progress on savings that will be banked this current year (some outyear savings indicated) at the scale expected. s 9(2)(g)(i) [redacted] Further analysis of

medication costs that would be met by Pharmac, which are included in this cost, is under way to support negotiation with Pharmac on the likely impact on rebates.

- **Infrastructure:** a deep dive of over-expenditure in this area is focused on approval of maintenance works over budget, primarily in three local hospitals. The team are reviewing plans to prioritise this work, balancing against health and safety and delivery risks. Although a worse case deterioration of $30 million was forecast at end of January, February results show some improvement with month expenditure being on budget.
- **Leave revaluation following pay equity and Holidays Act**: although assumptions of leave revaluation were built into budget, the impact of Holidays Act and pay equity on payments that have already been made is more than we have assumed. When extrapolated to all payrolls there is a difference of over 10% across all payrolls in the February year-to-date result, and the overall leave revaluation movement is $120 million above the budgeted 6.5% level of $65 million. Further analysis to understand attribution of pay equity and Holidays Act to this issue is in progress. We have, however, raised an issue with the Ministry that pay equity funding does not cover the uplift cost for leave revaluation, including the large leave revaluation uplift for the three metro Auckland districts relating to the Holidays Act that has been paid. We believe the target should be reduced to reflect this cost.
- **Capital Charge:** as described above, there has been no reduction in Capital Charge due to the $1 billion deficit impact on Crown Equity being fully offset by a $1 billion increase in Crown Equity due to the asset revaluation gain. We have been advised this month that we will receive $21 million less than expected for Capital Charge compensation.

Focus on financial & non-financial performance

The Board and management take financial and non-financial performance very seriously, including the current financial position. There are several actions under way to bring Hospital and Specialist Services and maintenance costs back within budget. These include reclarifying and reinforcing accountability at all management levels. Weekly intensive review and intervention has been put in place; this cascades up from the “shop floor” to a meeting of the Chief Executive with key executive team members and all nursing leadership.

Our actions include control of major expenditure areas, notably nursing, clinical supplies and maintenance costs. Examples of the expected actions include bringing paid nursing staff hours back to the agreed budget, reducing overtime and additional payments for all staff, accelerating initiatives to improve national procurement deals and harmonise products, and decisions being taken to bring maintenance back within budget levels.

As part of this focus, we continue to push for further improvements in financial and non-financial performance as we deepen our understanding of running Health NZ as a single entity.

Next steps

All other areas of Health NZ expenditure are tracking at or below budget. With the management interventions summarised above we are tracking indicators of expenditure weekly, with executives accountable. The Board will receive updates in between Board meetings on the trajectory for improvement.

There are a range of other actions that, when consolidated overall, may mitigate these areas of overspend at year end. However, our preferred position is that savings and/or adjustments that free up funding are applied to new investments as agreed between Board and Minister. These actions include ongoing review of accruals, revaluation of balance sheet liabilities and provisions.

There is an underlying increased cost structure of hospital & specialist services against declining productivity that will be addressed over time. It is important to note that a large driver of cost increase is the settlement of pay equity and Holidays Act (impact on leave valuation) entitlements for large portions of the workforce (i.e., nursing, allied health). Addressing this, however, needs to occur with engagement of frontline workforces at a pace that does not compromise quality, safety and service coverage. A whole of system approach that invests in primary and community services to reduce pressure on demand growth (that then drives hospital costs) is a key part of our strategy to achieve this.

Recommendations

Health New Zealand Te Whatu Ora recommends that you:

Note that the Ministry of Health and Treasury are considering a revised 23/24 budget target for Health NZ	Noted
Note that Health New Zealand considers a surplus of $583 million to be an appropriate 23/24 budget target	Noted
Note that the Health NZ Board and management have a range of actions underway to bring Hospital and Specialist Services and maintenance costs back within budget, and a strong focus on strengthening financial controls and accountability for performance.	Noted

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Date:

Margie Apa
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Date: