Canterbury District Health Board: Stage One Financial Review

Report to the Ministry of Health

CDHB Financial Review Report to the Ministry of Health

December 2015

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Ministry of Health
By email

Attention: Paki Ormsby, Manager Special Projects

cc: Michael Hundleby, Acting Director, National Health Board

2 December 2015

Financial Review of the Canterbury District Health Board

In accordance with our letter of engagement dated 30 June 2015, we attach our report setting out the findings of the financial review commissioned by the Minister of Health of the Canterbury District Health Board (CDHB). This report is supplementary to the draft presentations delivered to the CDHB Board on 15 October and to Minister Coleman on 16 October 2015. We now also attach a final presentation document.

We would like to acknowledge the cooperation of CDHB's governance and management team during our engagement.

This report should be read in conjunction with the terms of business set out in our letter of engagement and the restrictions set out at disclaimers in Appendix B.

Yours sincerely

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Table of contents

Summary Findings

Terms of Reference

The agreed scope of our review was to analyse:

- The assumptions and drivers of CDHB's current and forecast financial deficits.
- CDHB's financial and planning documentation for consistency with other key DHB's documentation in particular the Hospital Redevelopment Business Case (HRBC or DBC) with a specific focus upon the impact of:
  - Interest, depreciation and capital charges (**IDCC**);
  - Full time established positions (**FTE**); and
  - Clinical and non-clinical supplies and others.
- Information provided to the CDHB Board to inform financial and planning decisions from June 2014 onwards.
- CDHB's (internal) assumptions regarding revenue variance calculations based on population issues.

Our findings are based on our observations over July-September 2015. The findings have been derived from a number of one-on-one and group meetings with CDHB Board members and senior management, combined with analysis of various financial and non-financial information sets provided to us by the CDHB and other information which is also publicly available.

As a consequence of this analysis, we have been requested to provide high level commentary and recommendations about areas which may require further analysis as part of any agreed next stage of work.

Our engagement and findings are subject to the terms of business in our engagement letter dated 30 June 2015 and the restrictions outlined at Appendix B.

Background and context – delivering integrated health care in a post-natural disaster situation

The CDHB has a strategy to build a fully integrated public healthcare system whereby delivery is focussed increasingly around a community based setting rather than hospital-centred delivery. In this integrated health system all components of the system work together to manage demand on health care services and create better outcomes by placing the delivery closer to the patient and community. As well as improving healthcare outcomes this integrated approach is designed to be more financially sustainable at a time when all projections point to ongoing and sustained pressure on healthcare funding and service delivery.

The impacts of the multiple seismic events in Canterbury including the September 4 2010 and February 22 2011 events have been significant on both the CDHB and people of Canterbury. If the earthquakes had not occurred, CDHB is confident it would have eliminated the operating deficits it was experiencing at the time, and continued to deliver on the Government's qualitative expectations (e.g. lower waiting times, decreased bed days, elective surgery numbers).

Notwithstanding the impact of the earthquake and the subsequent need to manage a health system dealing with a natural disaster, the CDHB considers its qualitative outputs and outcomes over the last 5 years have been very good There is much evidence to support these claims, such as the CDHB's ability to meet increased demands; global recognition by other health providers of CDHB's excellence; and its recent successes at the Institute of Public Administration New Zealand awards. Furthermore CDHB's key stakeholders, its local people and communities see CDHB as being a success.

Managing financial performance post-major natural disasters

CDHB has continued to incur significant expenditure as a result of the Canterbury earthquakes, for which the government has provided funding in order to return the CDHB to a breakeven position on an annual basis with the exception of the FY2014/15 year where the support was provided as equity. At the time of the earthquakes the CDHB requested to mitigate these deficits by locking in funding for a 3-4 year period, whilst it worked towards stabilising its operations and implementing significant rebuild projects and other changes.

CDHB has done this with a measure of success, supported by the government, which has provided additional funding as noted above during this difficult period. We also note that with regard to the projections set out in the 2012 Detailed Business Case that approved the Government's investment in the hospital redevelopment, CDHB has supplied to us an internal reforecast for an outturn. This reduces the total quantum of the projected deficit path by $100m, albeit over a slightly longer time period.[1]

CDHB has always accepted the population based funding formula (PBFF) setting which underpins New Zealand's health system and within a "business as usual" context and views it as one of the best funding systems available globally. However, within the context of the natural disasters which beset Canterbury, the CDHB asserts that the applicability post-earthquake is marginal, and not flexible enough to deal with the unknown consequences which have arisen.

[1] However, as discussed later in this report we recommend that the original DBC projections be revisited to ensure a robust and agreed financial pathway forward for CDHB and to validate the forecasts undertaken by the CDHB.

With these sorts of issues at hand, we acknowledge the complexity of the environment that the CDHB is managing. However, we also note the current policy and funding frameworks that are in place, and we consider that they can possess the flexibility required to respond to the special circumstances brought about by a major natural disaster. Whilst recognising the challenges CDHB has managed, we also consider that going forward a sustainable financial path must be mapped out and agreed between the CDHB Board and relevant government agencies, including the Ministry of Health and the Treasury. In this regard we have focused our findings on:

- the need to revalidate the projected financial situation of CDHB for the Government and monitoring agencies in order to understand what the projected outturn for the CDHB looks like and if a break-even result can be achieved within the current forecast period of the District Annual Plan (DAP); and
- understanding the impact of the significant 'once-in-a-generation' capital programme for CDHB, and the effects this unprecedented level of capital expenditure has through added depreciation, interest and capital charge. Further, there is also the added complexity of managing a significant repairs and maintenance programme and the need to optimise the approaches for the drawdown and treatment of capital.

Our summary findings and recommendations

In undertaking our Financial Review we found:

- That CDHB has a relatively stable year on year financial performance with a historic c.$50 million operating surplus before capital driven costs are taken into account. This operating surplus is forecast to grow under the current DAP.
- Given CDHB's levels of revenue and expenditure, the deficits are marginal and ordinarily, in the first instance, can be managed through regular and expected financial management of key cost lines rather than through additional funding being made available to balance the deficits. In the event that all avenues to manage these cost lines are exhausted, then the government, including the Ministry of Health and the Treasury, will need to consider whether it provides additional funding and seek subsequent agreement from Ministers. Notwithstanding these scenarios we note that the CDHB internal reforecast supplied to us does not forecast a return to surplus until FY2021/22.
- The capital programme is significant and unprecedented, and capital driven costs (capital charge, interest and depreciation) are significant drivers of the CDHBs bottom line financial performance. This is evidenced by these costs being forecast to increase by c.85% over the next 6 years.
- CDHB has developed a range of plans and strategies to realise the benefits discussed in the 2012 Detailed Business Case (DBC) that finalised approval for the government's investment in the CDHB facilities rebuild. We note there have been key achievements, including a reduction in Aged Residential Care bed nights and a decrease in hospital based length of stay. However, we have not been able to sight a financial outturn scenario available to the CDHB Board that indicates the parameters under which a break-even scenario could be achieved within the forecast period of the current DAP. Following on from this point, such a scenario would also require the overlay of the potential approaches for optimising capital management and the flow-on effects of depreciation and capital charge. We note that the DBC did not project a break even financial year within the forecast period of the current DAP. However, it did forecast a projected breakeven financial year in FY2019/20 based on an earlier start to the build programme.

Given the difficult environment CDHB has been operating within and continues to operate within, we consider that the financial review, as commissioned by the Minister and the Ministry, is a good opportunity to take stock of the situation, and look to confirm the modelled financial projections that return the CDHB to break-even (post-capital driven costs) over an agreed period of time.

Given these findings our summary recommendations are:

1. Validate the current deficit forecasts by revisiting assumptions about depreciation and the timing of asset transfers (and the corresponding impact on the CDHBs capital driven operating costs).
2. Remodel the forecast revenue and expenditure assumptions underpinning the 2012 DBC for the CDHB redevelopment to provide an agreed medium term baseline financial position, an ongoing basis for monitoring progress and milestone achievement, and a clear framework for any potential adaptation required in response to any further changes in the capital works programme.
3. Use the revised assumptions and projections from above to revalidate CDHB's activity and implementation plans to return the CDHB to a breakeven financial position. These will focus on both managing key operational costs the CDHB can control and initiatives that the CDHB is already delivering to influence demand for demand-driven services.
4. We recommend that additional depreciation and capital charges continue to be offset, as planned, through productivity and efficiency gains, and where this is proven to be difficult or no longer possible, through the application of deficit/cash support for an agreed period of time based on revalidated financial projections. Ministers, the Treasury and the Ministry of Health will need to consider if this is appropriate.

The remainder of this report sets out our analysis and key findings on areas specified in our terms of reference.

Understanding the drivers behind the deficit

CDHB's position on the drivers of the deficit

We have had a number of discussions and interactions with CDHB governors and management. We have also been provided with and reviewed considerable analysis undertaken by the CDHB to clarify its financial position about why CDHB is running deficits now and into the DAP forecast period.

Key issues raised by CDHB include:

- The extent to which key social services including health have faced additional costs as a result of the recovery period following a natural disaster.
- That the Board and management's financial strategy remains to restore CDHB to breakeven or surplus. However, in their view the current funding parameters means that to incur deficits is an unavoidable reality and given various factors (in particular the earthquake impacts), additional funding should be provided by the government (noting that the government has already provided CDHB with deficit/cash support) or the funding formula requires urgent review to address any perceived inequity.
- Forecast deficits represent less than 1.5% of annual budget revenue, and current variances to budget represent less than 0.5%. For a social service provider of this size, CDHB considers that such variances are not significant and can be attributable to something such as a 1-2% movement in personnel costs, or a significant movement in depreciation and future capital charges.
- Deficits are seen as largely attributable to revenue shortfalls to cover the costs of delivery of services arising from increased demand (e.g. Mental Health and Electives delivery) and additional Earthquake related matters.
- The revenue provided to the CDHB under established funding arrangements is less that the revenue projections upon which the DBC was based.
- There have been considerable costs as a result of the earthquake which have been absorbed (c.$70m) from existing reserves or through ongoing savings generated by initiatives within the CDHB to improve efficiency and quality. Were it not for these savings initiatives, CDHB states that deficits would have been higher than those incurred, meaning greater requests for funding from the Crown.
- The rebuild of existing and new facilities and the ongoing repairs and maintenance programme of works, combined with movements in cash and related Crown revenue and equity funding have added cost to the CDHB. CDHB is required to deliver on a combined rebuild plan of c.$1.2b which is c.100% more than it had planned upon without the earthquakes. The financial and operational impacts of this are considerable.
- The impact of the rebuild and repairs and maintenance programme of works on existing and new fixed asset values has increased depreciation costs considerably (as above), and will increase capital charge, once the new assets are brought onto CDHB's books.

- Procurement directives from the centre, through the Health Benefits Limited initiative, added cost to CDHB of c.$3m-$6m per annum above what it believes it could procure/have procured for the same services under its own management.[2]

We have attempted to understand these views in more depth, and have used them to come to our conclusions regarding deficit drivers. In considering these views we are also required to take into account the wider context including existing policy settings and observations of the monitoring agency. In this regard we note that:

- Revenue is at levels based on an appropriate formulaic methodology coupled with deficit funding and capital contributions. Whilst there may be a forthcoming review of the methodology, MOH notes the historic calculations are correct and supported by census and Statistics NZ data. The CDHB notes that there has been a significant natural disaster which has created unprecedented changes in population.
- Budgets should be capable of being met and / or bettered in a business as usual environment. Additional funding has been provided to accommodate the additional costs incurred by the CDHB and it should be the aim of the CDHB to manage any further costs through an appropriate recovery plan. We note that the CDHB has a number of strategies and plans in place to manage operating costs. It is noted that key expenditure lines are adverse to budget (e.g. payroll and outsourced personnel, depreciation). A number of these costs are also adverse to DBC and Annual Plan assumptions.
- There remains an ongoing reliance on the projections within the DBC by both MOH and the wider government, with an ongoing expectation on the CDHB to reconcile its actual performance against the DBC. In this regard we also note that the CDHB has forecast an outturn that reduces the overall quantum of the deficit forecast in the DBC by $100m, albeit over a slightly longer timeframe.
- It is critical to ensure that the forecast financial performance and position of CDHB over the next 5 years is based on robust assumptions and analysis, the basis and outputs of which are agreed between the CDHB, MOH and Treasury, including in relation to revenue. In particular, whether there are likely to be any significant variances to current DAP projections, including CDHB's longer term forecasts and additional deficits that might be incurred, once the Burwood and Acute Services Building (ASB) facilities are integrated into business as usual. The Ministry as funder and monitoring agent needs to understand how robust CDHB's prospective financial projections are, and that these projections underpin a sustainable path back to a breakeven position, or whether there is an alternative agreed level of deficits which it can address through appropriate funding mechanisms.

Our conclusions regarding deficit drivers

We have a number of comments around the deficit drivers facing CDHB. However much of our commentary reflects the need to develop an agreed and robust forecast financial position and performance track for CDHB. As stated earlier in this report we note that CDHB has forecast a reduced quantum of deficits against the original forecasts in the 2012 DBC, albeit over a two year longer period.

[2] This particular issue is outside the scope of our Terms of Reference and at this time we have been unable to determine if this was in fact a genuine cost driver.

Noting these projections, we strongly recommended that CDHB develops a set of financial projections for consideration by the Board to show the interrelated financial, operational and quality impacts of a zero sum / balanced budget within a reasonable forecast period, and whether such a budget is achievable and acceptable to the Crown. As noted above, these projections will need to include agreed assumptions in relation to revenue.

This is critical to revalidating the current CDHB's deficit position and confirming that forecast projections can be achieved and appropriately managed through the annual planning process. In this regard we acknowledge that the DBC was an important planning document for both the Crown and CDHB, but the financial projections underpinning the DBC have not been updated. A number of assumptions within the DBC were made prior to the finalisation of key issues, including the scale of the damage and therefore the repair programmes, the associated insurance settlement, and the impact of the Canterbury Rebuild population. Accordingly it should be updated and used as a "living document" for future planning, monitoring and reporting in addition to the main statutory documents used for planning and monitoring (the Annual Plan, including the Statement of Intent and the Annual Report).

Our other key conclusions and observations are set out below:

- The impact of the rebuild of the new facilities, combined with the ongoing repairs and maintenance programme of works, is having a significant impact on the costs of CDHB, especially in terms of depreciation, net interest, capital charge and personnel costs (e.g. ongoing relocation of staff, sick leave and overtime). It will be important that the CDHB, Treasury and the MOH are well aligned in relation to these matters, and reporting will need to be on-going. We believe that additional work will be required to understand the full financial impact and responses to this. We would expect a remodelling of the financial projections underpinning the DBC will address this.
- However, we accept some of the views of CDHB and other stakeholders that for a social services provider of this size, the current and FY16 deficits represent less than 1.5% of annual budget revenue and variances less than 0.5% from budget, and are not considered significant. These can be easily attributable to, for example, a 1-2% movement in personnel costs. Additionally, a significant movement in depreciation and future capital charges over the next 5 years as the rebuilt or new assets are transferred onto CDHB's books has a very material effect. In both respects, however, this highlights the need for on-going stringent management of key expenditure items and improved transparency, visibility and planning around capital driven costs between the MOH, Treasury and the CDHB.
- Our initial analysis indicates that personnel costs are higher than forecast either under the DBC or subsequent CDHB planning documents. We note that whilst the variances are largely reconcilable, the early phasing of these costs in preparation for the new facilities that are being built has added cost to CDHB. At this stage we cannot quantify this and further work is required to determine the accuracy of, and impact on, personnel costs of the changed timing (compared with DBC) of the new facilities at Burwood and ASB being integrated into business as usual. This issue is further discussed on page 15 and in Appendix A.

Other observations we make with regard to the deficit and its drivers are:

- We note that CDHBs projected deficit track is lower in quantum than that set out in the original DBC, and that this is driven by the realisation of a number of benefits set out in that document. However, we are concerned that the financial projections provided to the Board over 2015/16 did not include a scenario where the CDHB returns to breakeven within the current forecast period without additional Crown funding being the means to reach breakeven. A projection achieving

break even should be included as part of the scenario modelling for revising the original DBC forecasts.

- We note that a significant proportion of CDHB's expenditure is as a funder of services – in this regard the CDHB is managing the risk of demand driven expenditure and absorbing national price increases that exceed the funding increase. Aligned with the Government's policy direction CDHB has been building community capability and capacity to reduce demand on the more expensive hospital and aged residential care capacity. The Benefits Realisation Report prepared by CDHB for the HRPG indicates that these strategies have been more successful than anticipated in the DBC.
- There is reference in various governance papers to the Board and Quality, Finance, Assurance, Risk Committee (QFARC) seeking a recovery plan and cash flow analysis from management, which does not appear to have been fully addressed other than through accessing additional funding to cover the deficits. As noted above, we recommend CDHB develop at least one "zero-sum" break-even scenario to illustrate the trade-offs that would be required by managing cost pressures only.
- We note there are some accounting issues that could have a future impact on the deficit, such as the treatment of the return of the insurance proceeds from the Crown to CDHB. There will need to be agreement between the Crown, CDHB and other stakeholders as to how these funds are treated (as revenue or equity) given the historic accounting recognition when they were first returned to the Crown.
- CDHB continues to undertake reconciliations of its actual performance against the DBC to provide to external agencies as requested. We consider this document now lacks current relevance and a complete remodelling of the DBC needs to be undertaken. This will enable:
  - CDHB's forecast financial projections to be revalidated and a deficit path between the CDHB and relevant government agencies and Ministers to be agreed upon, along with any required support.[3]
  - CDHB's key accountability documents, including the DAP, as well as rolling monthly forecasts to be compared against these re-validated forecasts so the CDHB's financial performance and position can be monitored from a mutually agreed position between the CDHB and monitoring agencies.

The underlying financial performance of the CDHB before capital driven costs appears stable

Notwithstanding the concerns raised above we do note that **at an EBITDACC[4] level the "business" of the CDHB remains relatively stable with surpluses of c.$50m over the last 2 years and a similar quantum forecast for FY2016[5]**. We note again the significant impact the rebuild and repairs and maintenance programme of works are having on CDHB's financial position and performance. This is especially relevant when the CDHB applies historic useful lives of 20-40 years on these new and / or refreshed assets, i.e. the net effect on depreciation costs.

[3] It will be critical in this regard to understand the CDHB's cash position as the key driver for understanding if deficits need to be funded particularly if the key drivers of forecast deficit are non-cash costs such as depreciation.

[4] Earnings before interest, tax, depreciation, amortisation, capital charge.

[5] We have comparative DHB performance metrics for FY14 and CDHB's EBITDACC was slightly better than average for both the similar sized and all DHBs.

Other observations we make with regard to the underlying performance of CDHB include:

- The increased demand for Mental Health services has probably added cost to CDHB's operations. We understand the Ministry is working with CDHB to further understand these patterns of demand.
- There is also evidence to suggest that the changes in the Canterbury workforce both from domestic and international migration has meant that CDHB has had to provide an increased level of other services at associated cost, without a commensurate level of revenue increase or recovery from ACC or the migrants home-based DHB (IDFs). Furthermore the makeup of the current workforce is significantly changed from pre-earthquake times (e.g. construction workers) meaning a greater demand for some related services with added cost.
- The impact of the rebuild and ongoing changes in operations has placed considerable stress on the CDHB's workforce, meaning that there have been increased costs resulting from sick leave, overtime and other related staffing matters.
- There is no empirical evidence immediately available to suggest CDHB is incurring excessive, unnecessary or unmanaged expenditure. Additional funding could be provided, so long as CDHB and monitoring agencies can come to a mutual agreement on the forecast outturn for the CDHB over the medium term and scenarios have been tested for achieving break-even in a reasonable time period. These scenarios would also be accompanied by the work the CDHB is currently doing to realise the benefits set out in the 2012 DBC, as well as continuing to examine how to best minimise the impact and maximise efficiencies going forward of the ongoing rebuild activities and taking account of the earthquake driven demand around Mental Health and other services.

Notwithstanding these issues, we reinforce our ongoing view that if the 2012 financial projections set out in the DBC are revisited and mutually agreed to by the funder and CDHB that this will:

- Revalidate and clarify the likely deficit track presently forecast by the CDHB; and
- Provide confidence to the government there is a sustainable pathway going forward for the ongoing provision of services by the CDHB with the potential for short term funding support through deficit/cash support.

Of equal importance is the difficulty that presents in attempting to reconcile these disparate issues as to whether they are in fact genuine cost pressures (see the section below on reconciliation of deficits) as there are complexities with calculating the net financial impact (e.g. additional vs replacement activity, methodology of identification and value application).

Updating the integrated financial model underpinning the DBC forecasts and future expected performance would bring consistency to this picture and then assist to validate an acceptable deficit funding track with a pathway to breakeven or better financial performance.

Reconciliation of deficits

As part of our analysis we undertook an exercise to understand the disparate positions regarding the historic and the projected deficit for the current financial year. We noted key variances in the following items:

- personnel costs and indirect costs which account for the total increased costs in delivery of services;
- timing of facility deliveries;
- insurance revenue; and

- Crown revenue and non-Crown revenue of interest, donations and Trust funds.

Our analysis raises some concerns as to whether the reconciliation provided by CDHB is the most appropriate means of analysing the FY15 deficit, and hence there may need to be an appropriate methodology agreed between CDHB and the monitoring agent for analysing any future variances.

Again we recommend that it is critical to ensure that the forecast financial performance and position of the CDHB over the next 5 years is based on robust assumptions and analysis agreed between the CDHB, MOH and Treasury including in relation to revenue. In particular, whether there are likely to be any significant variances to current DAP projections and additional deficits that might be incurred once the Burwood and ASB facilities are integrated into business as usual .

CDHB's governance and management teams have confirmed to us on a number of occasions that they are determined to live within their means, and prior to the earthquakes CDHB was on track to deliver a surplus.

One of the key drivers for CDHB, irrespective of the issues that have arisen from the earthquakes, is that it wants to stay committed to its strategy of a fully integrated health system for Canterbury that delivers the best health outcomes for its entire community. This is aligned with Government policy around the integration of health and social services.

CDHB notes that c.40% of its expenditure is being incurred in the community and almost 75% is demand driven (which means the CDHB can work with clinicians to influence the expenditure but cannot cap the expenditure).

CDHB's senior management was confident that it was on track to break even in FY2016 until changes were made to its PBFF and other funding. These issues are discussed later in this report.

We note the government's expectation of any CDHB to manage its mix of outputs to meet the needs of its population within the funding formula used to distribute scarce resources across the health sector. The CDHB notes that it is clear that this is its obligation, and it has continued to so, noting the significant and unprecedented impacts of the earthquakes. We note if there are extraordinary expenditure pressures, underpinned by a transparent rationale and plan for ongoing management, funding mechanisms such as deficit / cash support exist to manage these pressures. In this regard, the entire intent of the review and suggested redevelopment of the 2012 DBC financial projections is to understand these pressures more transparently and determine in the medium term what additional support may be required.

The comparisons of the variances between actual and budgeted performance for FY15 are shown in the next tables with further analysis of historical performance set out in Appendix A.

Figure 1: CDHB FY15 actuals vs budget

CDHB Reconciliation of FY15 Acutal vs Budget

	$m
Uplanned costs	
Mental health spend over prescribed ring-fence	(8.0)
Overseas eligible costs in excess of PBF funding	(8.5)
Bad debt write offs	(0.8)
ED costs related to increased workforce (no IDF wash up)	(2.2)
Impact of elective complexities	(7.0)
Further earthquake costs (primarily electives and acute services)	(17.3)
	(43.8)
Other costs	
HBL net financial impact	(6.0)
Unbudgeted depreciation costs on R&M	(3.0)
	(9.0)
Total additional costs	**(53)**
Savings and gains made	
Acute demand services	1.0
Pharmaceuticals	0.8
Other operations (e.g.e elderly pathways, theatre utilisation)	9.6
Laboratory services	3.3
ARC services	7.7
Total Savings and Gains	**22.4**
Net total of additional costs, savings and gains	(30.4)
Allowance for planned deficit	12.5
Actual Deficit	**(17.9)**

Financial Statements FY15 Actual vs Budget

	$m
Annual plan budgeted deficit	**(12.5)**
Unfavourable variances	
Interest income	(2.4)
Donations and trust funding	(3.6)
DSS community health services and support	(4.0)
Unbudgeted HBL (food and linen) and NIP costs	(1.9)
Unbudgeted depreciation	(2.9)
Adverse payroll and personnel costs	(3.9)
Other (e.g. phasing of R&M costs, internal revenue)	(5.4)
	(24.1)
Deficit after unfavourable variances	**(36.6)**
MoH devolved funding	8.9
Deficit after additional funding	**(27.7)**
Savings on personal health provider costs	9.8
Revised Actual Deficit	**(17.9)**

Funding issues

Overview

The scope of our review was to examine cost drivers of the deficit as well as the effect of the significant capital programme being undertaken at CDHB.

We note in our discussions with CDHB that a number of extraordinary items have occurred that the present funding regime does not, from CDHB's perspective, necessarily take into account. There are a range of issues raised by CDHB including population disruption as a result of the earthquakes; the changing nature of the workforce required for the Canterbury rebuild and issues around internal migration e.g. fly-in/fly-out workers. Our observation is that PBFF is an allocative formula which determines the share of funding available for each DHB based on the population living in its district. The formula is designed to fairly distribute available funding between DHBs according to the relative needs of their populations and the cost of providing services to meet those needs. It is based on providing each DHB the opportunity in terms of resources to respond to the needs of its population.

CDHB notes that PBFF is a good formula for 'business as usual'. In situations where there are unusual drivers or circumstances (for example Canterbury seismic events) there are other instruments and mechanisms that can be deployed to manage extraordinary cost pressures including the use of deficit / cash support to help DHBs smooth out extraordinary expenditure pressures. This is with the expectation that during the time an entity is in receipt of such support it needs to reorganise and respond to these pressures within existing funding envelopes. In Canterbury's case there is further uncertainty created over the timeline/impact of the seismic events given that they extended over almost two years which we understand is unusual in international literature on the impacts of natural disasters.

In this regard CDHB acknowledges that Government has provided additional funding over the last 4 years.

Can these funding issues be reconciled with present financial performance?

Being able to draw a conclusion on these funding issues is not a simple proposition and takes us beyond the parameters of our present terms of reference. We do acknowledge that the impact of the Canterbury earthquakes on the operational, service delivery and financial performance and position of CDHB will have added significant cost and strain on its facilities and personnel. There is some real evidence to support this such as capital and depreciation movements, additional personnel overtime, sick and other leave accruals, demand for additional services, and the ongoing changes to the Canterbury demographic and workforce.

Being able to determine whether or not the current PBFF calculations are accurate and cater adequately for CDHB's delivery of services would be a significant assignment beyond the initial scope of this engagement. Such an exercise would need to involve the services of a number of subject matter experts (e.g. actuaries, statisticians) and other Government agencies such as Statistics NZ, Immigration NZ and MBIE.

We do not think this exercise has merit as it would probably only be conducted with CDHB in mind (rather than across the whole New Zealand Health system) to resolve what might only be a short term issue. Accordingly we question the value of pursuing further analysis on this issue.

Re-modelling the DBC forecasts is a more viable approach to understanding funding pressures

An alternative way of resolving these questions and a more practical approach is to put in place an agreed (deficit) funding track for CDHB based on a set of remodelled projections from the 2012 DBC. This work would be undertaken alongside the development of a financial scenario to explore what the parameters would be for the CDHB to return to a break-even position within the forecast period of the current DAP.

Fixed Asset Management and Accounting

Clarifying financial impacts of the capital programme

We have had some difficulty in being able to determine the historic, current and future impact on the CDHB of the capital rebuild and recommend that further work be undertaken on this matter. The CDHB is singularly alone amongst the other DHBs in having to undertake over $1b of capital and repairs and maintenance spend at any one time and this has a profound and unprecedented impact on its financial performance and position i.e.:

- cash flow;
- operating costs and timing and management thereof (e.g. staffing, insurance etc);
- capital charge;
- contractor warranties and liabilities;
- defects maintenance period and management thereof; and
- depreciation charges.

The current financial model underpinning this complex array of transactions and relationships requires improvement. Exacerbating the situation is a lack of formal agreement between CDHB and the Crown (noted also by Audit NZ in its *Report to the Board on the audit of Canterbury District Health Board for the year ended June 2014*), which addresses the timing and funding for the rebuild and repairs and maintenance programme of works. We understand work is underway between MOH and the CDHB to resolve this. We strongly encourage the progression of this work to ensure a process is defined for handover, timing and impacts of timing, warranty process and defects management period responsibilities. This should include the full repairs and maintenance programme.

We also observed the pressures that emerge around the existing draw down process in terms of the "lag" that can occur between the application of the funds to deliver agreed programmes and projects and the drawdown of funds. We recommend further work is undertaken on how these processes can be optimised to improve efficiency of the use of funding and to ensure the CDHB is able to best manage its cash position[6].

One specific analysis we consider as absolutely critical is to understand the interrelationship between:

- the capital spend, timing of the spend and how its accounted for;
- equity and revenue injections from the Crown;
- any debt drawdowns;
- interest and capital charges; and

[6] We observe that the CDHB looks to optimise between the drawdowns of equity and revenue and the use of borrowing facilities. Whilst this existing approach may drive some savings on interest costs for the DHB in isolation, its removes funds from the overall health system by the payment of interest costs to third parties and it also places pressure on cash flows and cash flow analysis. If a better process could be developed to cater for lags in timing and phasing of drawdown and expenditure this approach may not be required.

- depreciation run off.

CDHB has a number of models, forecasts and other financial information which address the aforementioned, but not in an easily understood cohesive format for an external reviewer. This is exacerbated by the ongoing timing and quantum variances to the DBC and other original base documents. We note also that there has not been a full reconciliation of the entire Fixed Asset Register (more than 14,500 items) for some time, although the CFO for CDHB informs us that there is a future intention to attend to this. We are advised that with a regular high level reconciliation and spot-audits the CDHB has no concerns that the register is materially incorrect.

The immediate financial impact for CDHB is that its capital base is undergoing significant change with depreciation and capital charges forecast to immediately increase by up to c.50% and 100% respectively once the rebuild is complete. We have undertaken some initial analysis of these two costs and have concerns that:

- the useful life assumptions on CDHB's new and repaired facilities (which we are advised are currently validated by the use of independent valuers to ensure continued appropriateness) and Plant and Equipment could be revisited with the useful lives in the financial models ranging from 20-40 years.
- for the new facilities such as Burwood and ASB, we might expect useful lives closer to 80 years (based on benchmark accounting policies within the health and other public and private sectors). However, we acknowledge (and as confirmed by CDHB) that these will be determined by registered valuers and may only apply to the shell of the building rather than fit out and other components, meaning that a blended rate may be closer to 50/60 years (which was the useful life assumed under the DBC).[7] These assumptions will need to be confirmed or revised under any future modelling of the CDHB's overall financial position.

Nonetheless it is worth noting that for every 10 years the useful life of the new or rebuilt assets is extended (assuming a capitalised total spend of $1bn) the positive impact on annual depreciation charge is significant (initial estimate is c.$10m p.a.).

[7]CDHB note that significant expenditure on repaired buildings may not necessarily equate to a significant increase in a building's useful life.

People and structure

Overview/Findings

FTE numbers and costs have risen steadily over the last four years but CDHB is confident they are aligned to its strategy and are affordable.

There is a difference between actual, budget, reforecast, Annual Plan and DBC numbers but these are reconcilable and we have worked through this in some detail with the CDHB.

One of the key issues is that the various documents and budgeting / forecasting scenarios do not compare like-with-like.

The reconciliations are shown in the tables below and a more granular analysis is set out in Appendix A.

We note the forecast increase in costs over the next 4-5 years is c.9.5% and is attributable to:

- c.1% increase in actual FTE numbers
- c.8.5% increase in costs to accommodate CPI, MECA and other increases

CDHB appears to have financial tools to be able to monitor and reconcile the costs, as we note in Table 1 and Table 2, below. However, it is too early for us to say whether the forecast FTE's and associated costs will cater for the integration of Burwood and ASB into business as usual operations in FY16 and FY20 respectively. We recommend that additional work needs to be undertaken to confirm the forecast costs, and this would be accommodated through a remodelling of the DBC projections.

Table 1: Personnel costs

Personnel Costs $m	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Actual	540	559 *4%*	586 *5%*	614 *5%*	637 *3%*	661 *3%*	n/a
Budget	531	552 *4%*	590 *7%*	611 *4%*	624 *2%*	657 *5%*	679 *3%*
Original DBC (Sep 2010)	527	568 *8%*	579 *2%*	596 *3%*	614 *3%*	632 *3%*	655 *4%*
Revised DBC (Dec 2012)	n/a	n/a	n/a	598	611 *2%*	628 *3%*	645 *3%*

We note that Table 2 below sets out an expected decline in FTE numbers when compared to the December 2012 business case. Our concerns remain as to whether or not either basis is the correct one for comparison going forward, and reinforces the need to come to a mutually agreed set of forecasts as part of a wider integrated plan to achieve a breakeven or better position.

Table 2: FTE forecasts

FTEs DBC vs DAP	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Revised DBC (Dec 2012)	6,684	6,684	6,776	6,812	6,839	6,945	7,004	7,109
Excluded from base	*330*	*457*	*457*	*457*	*457*	*457*	*457*	*457*
Est. unanticipated in DBC	-	*139*	*282*	*364*	*317*	*369*	*365*	*394*
Adjusted DBC	**7,014**	**7,280**	**7,515**	**7,633**	**7,613**	**7,771**	**7,826**	**7,960**
CDHB Actual/DAP	**7,014**	**7,333**	**7,527**	**7,611**	**7,656**	**7,681**	**7,718**	**7,749**
Est. "like for like" variance	**-**	**53**	**12**	**(22)**	**43**	**(90)**	**(108)**	**(211)**

Information Technology/Clinical Costs and Procurement

Overview/Findings

We have been provided with a total breakdown of FY15 IT /Communications expenditure, the capital plan for IT capex and a matrix of the relationships between a number of the systems utilised by CDHB. We comment as follows on these matters.

- FY15 expenditure did not materially exceed the budgeted level, with the net $182k (1.3%) overrun primarily attributable to telecommunications costs.
- There is significant ongoing investment in IT and communications incorporated into CDHB's planning, and we are advised that each of the projects has specific cost allocations and are subject to full business case analysis and assessment prior to approval.
- Whilst an approval process for individual projects has been applied, in our view a more global review of the overall plan and associated dependencies could be undertaken to assess priorities and timeframes, particularly in light of changes to the programme of works, ASB and Burwood activities. CDHB advises that the Board has over-sight and a clinical leadership group operates to ensure that the ICT programme for ASB and Burwood is coordinated.
- We met with CDHB's head of procurement processes and discussed the current status of contractual arrangements/costs.
- Based on the financial information available, discussions held and, our understanding of the ongoing projects being undertaken at a national level to improve efficiencies across the DHBs, we do not believe there are material and immediate opportunities for financial performance improvement in addition to activities already being undertaken by the procurement team.
- There may be specific savings opportunities (e.g. theatre usage, leave/over-time) which CDHB advises are the subject of focussed strategies to convert.

Governance and Decision Making

Overview/Findings

Whilst we have met with various members of the CDHB's governance group and have reviewed Board, QFARC, Hospital Advisory Committee (HAC) agendas and related papers, we have yet not been fully exposed to these governance forums (i.e. attended any full meetings). Accordingly our observations are limited to the evidence we have so far sighted, noting that it would further assist our review if we could attend the next Board and QFARC meetings in full as observer, and meet with more of the members individually to obtain a better gauge of matters. In particular we would like to meet one-on-one with the Chair of QFARC but have been unable to do so as yet and consider this can be attended to as part of any agreed second stage of work.

Our particular focus has been on the QFARC, as this is the governance body which CDHB primarily relies on for financial oversight. This Committee has a wide and varied agenda whereby it deals with financial, operational, clinical, quality, risk, legal, business cases and other matters. We note also that the MOH only sights a precis relating to the QFARC meetings, and these should be provided in full in the future to create transparency of governance and financial matters.

We were also advised that the Chair of QFARC often spends 2-3 hours with the CFO prior to most meetings, reviewing the various financial information and papers and questioning any issues arising.

Whilst this pre-meeting review might seem acceptable, the minutes of the QFARC do not tend to indicate that there has been any significant level of inquiry, with many of the finance papers simply being "noted" without any issues arising. It is difficult therefore to understand how decisions are made or challenged but being able to observe a full meeting would assist us in determining this.

Planning for sustainability

Towards the end of Q3FY15 / beginning of Q4FY15, we note that the Board and QFARC were informed of the likely unbudgeted increase in the FY15 deficit to c.$19m along with pressures on CDHB's cash flow. Requests were made of the management team to prepare a recovery plan and also report on any cash flow issues.

These reports were requested for the March 2015 Board meeting, but subsequently deferred to April. We were not able to ascertain any evidence of any detailed plans or reports, but we have received the outputs of a planning session held with the Board in January 2015.

We raised this issue with the Board Chairperson who advised that there had been work undertaken looking at the recovery specifically in respect of the remainder of FY15, which had pulled back the deficit by c.$2m. This is not recorded in the minutes we sighted.

The focus into FY16 and beyond was addressed in a management briefing to the Board in June 2015, which was presented to PwC in July 2015. CDHB advise that considerable analysis was undertaken in this presentation on the PBFF drivers and the additional costs incurred by the CDHB as a consequence of the earthquakes.

Four scenarios, along with the current DAP draft budget, were summarised and presented to the Board and these are outlined in Appendix A. As we have discussed throughout this report we recommend that a zero-based/breakeven budget scenario should also be developed to enable governors and monitoring agencies to understand the potential trade-offs and consequences of achieving a break-even position within the forecast period of the current DAP.

Areas for improvement

As part of the review, various meetings were held with members of the CDHB's governance group and Board, QFARC and HAC papers were reviewed.

Our findings remain high level and as noted earlier, observation of a full Board and QFARC meeting and additional one-on-one discussions with key members would be beneficial in any subsequent stage two work should this take place.

The key findings and recommendations are set out below and are grouped based on suggestions for improvement:

- **Clarity on decisions:** It was difficult for us to ascertain how decisions relating to deficit management and expenditure management were being recorded /confirmed. The Board Chair, Members of the Board and the CEO have, however, informed us that there is robust debate around key issues to arrive at decisions. Being able to attend and observe full Board and QFARC meetings would enable us to confirm this.
- **Planning for breakeven:** We note that FY16 and beyond were addressed in a Board briefing in June 2015, and we recommend that a financial scenario based on the remodelled 2012 DBC forecasts be developed that demonstrates the trade-offs and consequences of the CDHB returning to breakeven within the forecast period of the current DAP.
- **Assets and Capex:** We suggest there is a lack of clarity on capital drawdown/ funding/ treasury management processes. As noted earlier, we strongly encourage the progression of work between the CDHB and the Ministry to optimise these processes. We note that a centralised function to monitor overall DBC/earthquake works including the CDHB programme of work and Partnership Group projects may be beneficial. This should be accompanied by a clear forecast funding requirement for all capital work.
- **Funding:** PBFF is not the core driver of funding dilemmas. Further analysis is required to identify any need for additional targeted cash support for identifiable earthquake impacts or maintaining output mix.
- **Finance function:** Simpler and clearer KPIs, issues and key drivers of change are needed. There needs to be "one version of the truth" with a clear financial plan required that is regularly updated.
- **Other analysis and external reporting**: Agreement is needed on the basis of reporting/analysis and simplifying multiple reporting/communication lines.

We note that with core business / supply chain the qualitative performance appears reasonable. Procurement is not immediately identifiable as a material driver of negative variances.

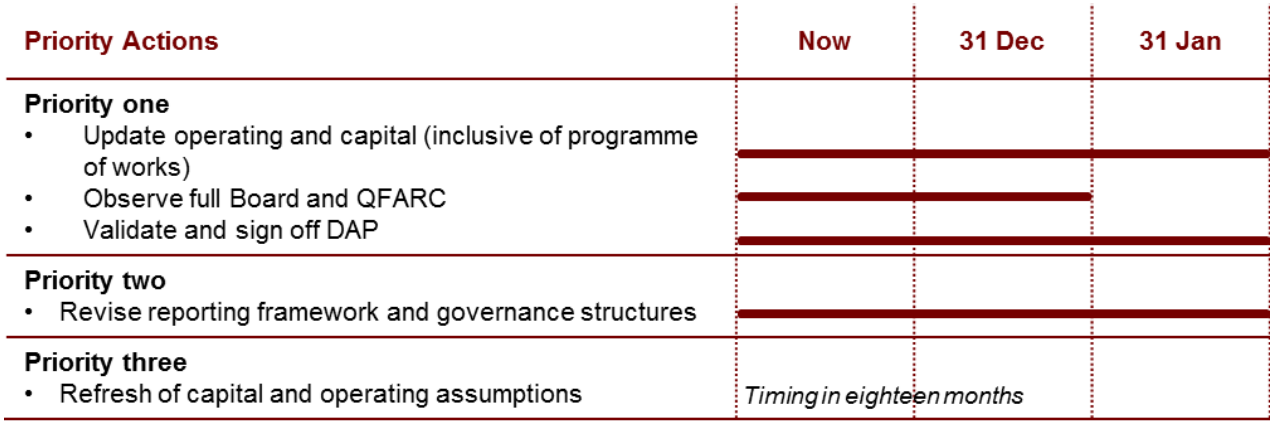
In terms of recommendations, we suggest the above areas be enacted as part of ongoing improvements for governance and decision making processes at CDHB. Specialist expertise may be required to support the Board where appropriate. The Board will also need to be responsible for holding management to account for any agreed deficit track.

Next steps

Figure 2 provides an overview of the next steps (and suggested timeframes) required to determine an agreed deficit track for CDHB and if any cash support is necessary for CDHB.

The activities are grouped by priority, with the desired completion dates shown, updated to reflect the time passed since the draft report was submitted.

Figure 2: Timeline of next steps



Appendix A : Additional financial and personnel analysis

Set out in the tables overleaf is further financial analysis relating to:

- Normalisation analysis carried out by the CDHB to reconcile past performance with earthquake related costs and other drivers.
- A more granular analysis of FTE projections including variations with the 2012 Detailed Business Case.
- Funding scenarios developed by management for the CDHB Board and QFARC members.
- Financial ratio analysis conducted by PWC on the CDHB.

Normalisation Analysis to reconcile financial performance with earthquake driven costs as determined by CDHB

- The normalisation analysis undertaken by CDHB, and refreshed at our request, records a core operations surplus in every year, with an average surplus of $12m.
- The treatment of the redraw of the insurance funds is inconsistent with the prior treatment. The major pay-out in FY13 is recorded as revenue, and then passed to MOH as a repayment of capital, but not through the income statement. However, in FY15 a redraw against these funds of $13.15m is recorded as revenue, which may represent a double record of the revenue amount. For normalisation purposes this should have no impact, but it should be considered and assessed for accounting purposes, including in future forecasts as to how the FY13 surplus is then offset in future years.
- The adjustment to revenue in FY13 and FY14 for CHDB's calculation of PBF underfunding could be interpreted as either an earthquake adjustment or as a variance which is anticipated in the DHB sector, and which is reliant on census forecasts for funding delivery. Without these adjustments, FY13 would be breakeven and the FY14 surplus would reduce to $6m. Overall the average surplus would then reduce to $7m. CDHB has noted its views on some of the drivers of this situation including electives funding.
- No adjustment has been made to interest income in FY13 and FY14, which was higher than usual due to the period of time the insurance proceeds were held.
- No adjustment has been made for the impact on capital charge of the repayments to MOH for subsequent drawback.
- The depreciation impact appears small (we assume it primarily relates to higher depreciation charges for adjusted shorter lives on damaged assets given the "rebuild" has not significantly progressed). A large proportion of the work undertaken to date is repairs on buildings which have not previously been impaired.
- Further analysis of the methodology/assumptions used to calculate the earthquake driven costs is required in order to finalise a normalised position for the historical performance.

$ in millions	FY11 All	FY11 EQ	FY11 Core	FY12 All	FY12 EQ	FY12 Core	FY13 All	FY13 EQ	FY13 Core	FY14 All	FY14 EQ	FY14 Core	FY15 All	FY15 EQ	FY15 Core	Total All	Total EQ	Total Core
Income																		
MoH funding	1,318	-	1,318	1,360	-	1,360	1,383	(15)	1,398	1,422	(9)	1,432	1,465	-	1,465	6,948	(25)	6,973
Deficit funding	16	16	-	10	10	-	35	35	-	23	23	-	-	-	-	84	84	-
EQ drawdown	-	-	-	-	-	-	-	-	-	-	-	-	-	13	(13)	-	13	(13)
Patient related	41	-	41	45	-	45	44	-	44	43	-	43	53	-	53	226	-	226
Other income	25	1	24	50	25	26	320	295	25	32	3	29	38	-	38	466	323	143
Interest	6	-	6	7	-	7	9	-	9	16	-	16	5	-	5	44	-	44
	1,406	**17**	**1,389**	**1,472**	**35**	**1,438**	**1,792**	**314**	**1,478**	**1,536**	**17**	**1,520**	**1,561**	**13**	**1,548**	**7,767**	**395**	**7,372**
Expenditure																		
Employee	564	2	562	584	3	581	600	2	597	637	1	637	661	0	660	3,045	8	3,037
Treatment related	126	0	125	138	0	138	129	-	129	133	1	132	145	-	145	671	2	669
External services	570	20	550	581	24	557	581	24	558	584	20	564	585	21	564	2,902	108	2,794
Depn and Ammort	47	-	47	46	-	46	48	1	47	58	2	56	61	3	58	261	6	255
Interest	5	-	5	5	-	5	6	-	6	5	-	5	6	-	6	26	-	26
Building R&M	-	2	(2)	-	8	(8)	-	9	(9)	-	6	(6)	-	13	(13)	-	37	(37)
Other expenses	80	2	78	103	10	93	128	7	121	98	3	96	109	3	106	518	24	493
Capital charge	15	-	15	15	-	15	13	-	13	19	-	19	13	-	13	75	-	75
	1,406	**26**	**1,380**	**1,472**	**45**	**1,427**	**1,505**	**43**	**1,462**	**1,536**	**32**	**1,504**	**1,579**	**40**	**1,539**	**7,499**	**186**	**7,313**
	(0)	**(9)**	**9**	**(0)**	**(11)**	**11**	**287**	**272**	**15**	**-**	**(15)**	**15**	**(18)**	**(27)**	**9**	**269**	**210**	**59**

FTE Variances – detailed analysis

The reconciliations of FTE numbers are at a very "granular" level whereby the two key levels not accounted for in the DBC can be detailed as outlined in the tables below. This information has been provided by CDHB:

FTE Variances (cumulative)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
FTEs not included in DBC opening balance								
SISSAL / SIAPO	30	30	30	30	30	30	30	30
Canterbury Laundry - baseline staff	90	90	90	90	90	90	90	90
Balance of FY12 base FTE - align to actual in DAP	210	210	210	210	210	210	210	210
CMI Transfer		21	21	21	21	21	21	21
BEL Adjustment		62	62	62	62	62	62	62
Taurangi home -Twigger/Havelock wing		9	9	9	9	9	9	9
Allowance for 5% growth in FY13 as nil in DBC		35	35	35	35	35	35	35
	330	**457**	**457**	**457**	**457**	**457**	**457**	**457**
Estimated net FTEs not accounted for/anticipated in DBC								
CREST - internal provider staff	-	38	38	38	38	38	38	38
Mental Health - Service pressure	-	7	39	67	67	67	67	67
New Graduates - Supernumerary (unabsorbed)	-	2	4	9	14	19	24	29
New Graduates - Additional intake since June 2012 e.g. ARC	-	13	14	49	56	56	56	56
EQ related Project staff	-	3	5	5	5	5	5	5
EQ related - Dual site impact (temporary)	-	30	15	-	-	-	-	-
HBL - FPSC - staffing saving assumption not realised	-	-	26	30	34	34	34	34
Canterbury Laundry - movement since FY12	-	15	24	29	29	29	29	29
Regional Info System Project staff - recorded against CDHB	-	5	7	9	9	9	9	11
PICS - project staff coded to opex (2014/15 to date)	-	-	2	19	22	25	-	-
EMeds - project staff coded to opex (2014/15 to date)	-	-	2	16	18	18	-	-
Other Capital project staff - coded to opex (to date)	-	-	2	2	4	4	4	4
Burwood In HouseRadiology	-	-	-	-	4	13	13	13
One-off Resource Transition to New Burwood & ASB Facilities	-	-	-	-	13	27	59	79
RMO Over-recuitment (One-off)	-	-	62	31	-	-	-	-
ICU - additional 2 beds FY13	-	8	16	16	16	16	16	16
ICU - additional 4 beds FY15	-	-	-	16	36	53	53	53
New services (non demographic related)	-	5	10	10	10	10	10	10
WCDHB services consolidation (non IDF related)	-	10	12	14	14	14	14	14
Contra Reduction in Outsourced/agency Personnel	-	-	-	-	(76)	(72)	(70)	(68)
Rostering system project	-	3	4	4	4	4	4	4
	-	**139**	**282**	**364**	**317**	**369**	**365**	**394**

Forecast scenarios provided to the CDHB Board to achieve breakeven

- These scenarios range from a deficit of $22m under the worst case scenario, to a surplus of $3m under the best case scenario. As noted, the key assumptions and drivers of the improvements are increased levels of PBF and other MOH base funding. Scenario 1 assumes that the CDHB will be able to constrain growth in external providers to less than national price increases, despite the demand driven nature of the expenditure, and in addition, create efficiencies in personnel costs to constrain the impacts of the mandatory MECA increases. The other scenarios reflect actual forecast cost increases.
- We have discussed the absence of such a budget scenario with the Chairperson, CEO and CFO. We note that the CDHB is not prepared to cut services, and that the strategy of the CDHB is to improve efficiency and manage demand for services where possible to reflect the realisation of benefits set out in the original 2012 DBC.

$000	**Scenario 1**	**Scenario 2**	**Scenario 3**	**Scenario 4**	**Draft DAP Budget**
Operating Revenue	1,579,252	1,594,752	1,599,454	1,614,454	1,594,000
Operating Expenditure	(1,532,823)	(1,542,509)	(1,542,509)	(1,542,509)	(1,538,300)
EBITDACC Before Donations	**46,429**	**52,243**	**56,945**	**71,945**	**55,700**
IDACC and Donations	(68,448)	(68,928)	(68,928)	(68,928)	(72,100)
Net Surplus / (Deficit)	**(22,020)**	**(16,686)**	**(11,984)**	**3,016**	**(16,400)**
(Additional) Key Revenue Assumptions	• Base funding as per MOH advice • Other funding as advised	• Additional funding for Mental Health, Electives and Chathams	• Additional net MOH / PBF of c.$5m	• Additional PBF of $15m	• n/a
(Additional) Key Expenditure Assumptions	• Employee costs include "step" increases and rate increase of 2.3% • CPI increase of 1% for costs	• Employee costs of a further 0.5% • Additional external provider costs of $5.5m • PICS opex of $1.3m	• No further cost increases or reductions	• No further cost increases or reductions	• n/a

Financial Ratio Analysis

- In the table below we outline the key financial ratios for the CDHB for the last 7 years and out to FY2025.
- With the exception of FY13 (which is skewed due to the large insurance receipt in that year), EBITDACC remained consistent with, or an improvement on, performance prior to the earthquakes. In FY15 and FY16 this is expected to drop, which aligns with the increased demand for Mental Health services noted by CDHB, and increasing repair work, some of which is not insurance funded. We have comparative DHB performance metrics for FY14 and CDHB's EBITDACC was slightly better than average for both the similar sized and all DHBs.
- The increased depreciation resulting from reduced useful lives of some assets, and going forward, the completion of the new facilities will have an increasingly material impact on net performance. A full review of depreciation policies may provide some mitigation, but overall an increase is likely to be inevitable. However, a key associated risk is additional costs (for both depreciation and operational), which may occur due to timing changes and associated dependencies within the wider programme of works, including the Burwood and ASB builds.
- CDHB has avoided an increase in capital charge as a result of transferring the insurance proceeds to MOH and the repayment of $180m in equity from reserves as a contribution to the ASB/Burwood builds. We note that the timing of when Burwood transfers to the CDHB will have a material effect on capital charge.

	Audited Financial Statements						FinTemplate 10 years High Level for Revised DAP Phased										
High Level Financial Perfomance Rati	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**Draft FY15**	**Plan FY16**	**Plan FY17**	**Plan FY18**	**Plan FY19**	**Plan FY20**	**Plan FY21**	**Plan FY22**	**Plan FY23**	**Plan FY24**	**Plan FY25**
EBITDACC (% of total income)	**4.3%**	**4.2%**	**4.7%**	**4.5%**	**19.8%**	**5.4%**	**4.0%**	**3.9%**	**4.6%**	**5.3%**	**6.0%**	**6.9%**	**7.9%**	**8.9%**	**9.0%**	**9.3%**	**9.7%**
EBITDACC (% of MoH revenue)	4.6%	4.4%	5.0%	4.8%	25.0%	5.7%	4.2%	4.2%	4.9%	5.6%	6.4%	7.3%	8.5%	9.4%	9.6%	9.8%	10.2%
Depn and amort (% of total income)	**3.5%**	**3.2%**	**3.3%**	**3.2%**	**2.7%**	**3.8%**	**3.9%**	**4.0%**	**4.3%**	**4.3%**	**4.4%**	**4.7%**	**4.6%**	**4.6%**	**4.6%**	**4.5%**	**4.4%**
Depn and amort (% of MoH revenue)	3.8%	3.4%	3.5%	3.4%	3.4%	4.0%	4.2%	4.3%	4.5%	4.6%	4.7%	5.0%	4.9%	4.9%	4.8%	4.8%	4.7%
Depn and amort (% of total expenses)	**3.5%**	**3.2%**	**3.3%**	**3.2%**	**3.2%**	**3.8%**	**3.9%**	**4.0%**	**4.2%**	**4.3%**	**4.4%**	**4.6%**	**4.6%**	**4.6%**	**4.6%**	**4.6%**	**4.5%**
Depn and amort (% of expenses before interest, capital charges)	3.6%	3.2%	3.4%	3.2%	3.2%	3.9%	3.9%	4.0%	4.3%	4.3%	4.5%	4.8%	4.8%	4.8%	4.8%	4.7%	4.7%
Capital charge (% of total income)	**1.4%**	**1.3%**	**1.1%**	**1.0%**	**0.7%**	**1.2%**	**0.8%**	**0.5%**	**1.1%**	**1.2%**	**1.3%**	**2.2%**	**2.0%**	**2.0%**	**2.0%**	**1.9%**	**1.8%**
Capital charge expense (% of total MoH revenue)	1.5%	1.4%	1.1%	1.1%	0.9%	1.3%	0.9%	0.5%	1.2%	1.3%	1.4%	2.3%	2.2%	2.1%	2.1%	2.0%	1.9%
Capital charge (% of total expenses)	**1.4%**	**1.3%**	**1.1%**	**1.0%**	**0.9%**	**1.2%**	**0.8%**	**0.5%**	**1.1%**	**1.2%**	**1.3%**	**2.1%**	**2.0%**	**2.0%**	**2.0%**	**1.9%**	**1.9%**
Net Result	**-1.0%**	**-0.7%**	**0.0%**	**0.0%**	**16.0%**	**0.0%**	**-1.2%**	**-1.0%**	**-1.4%**	**-0.9%**	**-0.6%**	**-1.5%**	**-0.2%**	**0.7%**	**1.1%**	**1.5%**	**2.0%**

Appendix B : Restrictions

- This report has been prepared for the Ministry of Health in accordance with our engagement letter. We specifically disclaim any responsibility to any other party seeking to rely upon this report. Its content is not to be copied or released to any other party other than the Ministry of Health without the prior written consent of PwC for each party requesting its release.
- We have not carried out anything in the nature of an audit nor, except where otherwise stated, have we subjected the financial or other information contained in this presentation to checking or verification procedures. Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of the information in this report, except where otherwise stated.
- We have had good access to, and cooperation from, management.
- The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.
- We reserve the right, but will be under no obligation, to review or amend our findings if any additional information, which was in existence on the date of this report was not brought to our attention, or subsequently comes to light.

Glossary

Term	Definition/Meaning
CDHB	Canterbury District Health Board
DBC	Detailed Business Case
CEO	Chief Executive Officer
CFO	Chief Financial Officer
DAP	District Annual Plan
FTE	Full time established positions
HAC	Hospital Advisory Committee
HRBC	Hospital Redevelopment Business Case
IDCC	Interest, depreciation and capital charges
IDF	Inter District Flows
MOH	Ministry of Health
PBF	Population based funding
PBFF	Population based funding formula
Q3	Third quarter of the financial year
Q4	Fourth quarter of the financial year