About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

About the Technical Information Service

CIMA supports its members and students with its Technical Information Service (TIS) for their work and CPD needs.

Our information and accounting specialists work closely together to identify or create authoritative resources to help members resolve their work related information needs. Additionally, our accounting specialists can help CIMA members and students with the interpretation of guidance on financial reporting, financial management and performance management, as defined in the CIMA Official Terminology 2005 edition.

CIMA members and students should sign into My CIMA to access these services and resources.

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**Definition**

‘Payment by results’ (PbR) is the name of the current funding flows mechanism employed in the UK NHS. It is defined by the Department of Health in the following statement of intent:

‘The aim of payment by results is to provide a transparent, rules based system for paying trusts. It will reward efficiency, support patient choice and diversity, and encourage activity for sustainable waiting time reductions.

Payment will be linked to activity and adjusted for case mix. Importantly, this system will ensure a fair and consistent basis for hospital funding rather than being reliant, principally, on historic budgets and the negotiating skills of individual managers.’

**Context**

PbR is a sector specific funding flows mechanism, although similar systems exist in some other developed health economies. For this reason students are unlikely to study this specific topic.

However, the topic has associations with the current CIMA syllabus. CIMA students will learn and may be examined on this topic in paper P1, Management Accounting Performance Evaluation, chapter 8, Developments in Management Accounting and paper P2, Management Accounting Decision Management, Chapter 10, Activity-based approaches.

**Overview**

PbR is part of the NHS reforms initiated by the NHS Plan (2000) which set out a four pronged approach to reform. This approach has been described as a ‘supply side’ and a ‘demand side’ reform programme.

A 2003 consultation (Payment by results: preparing for 2005) on the technical aspects of payment by results, identified four principle policy directions that PbR was intended to underpin.

**Devolution:** the belief that important decisions should be taken as close to the patient as possible, within a national framework of standards and accountability.

**Choice:** the belief that patients should be able to take key decisions about the care they receive from the NHS.
Plurality: the belief in a 'mixed' economy of public and private sector healthcare provision. Over the last several years there has been a growth in independent sector hospital provision in England. PbR makes the price of each procedure transparent to all.

Investment: NHS investment is made on the basis that the NHS must spend the money wisely and efficiently. The national tariff is the 'new' basis of NHS funding and provides a series of benchmarks against which relative costs can be measured.

Background and history
Information setting out the recent history behind the development of the PbR framework is found on the Department of Health website. [www.dh.gov.uk](http://www.dh.gov.uk) [Accessed 12 March 2008]

The NHS plan, together with Delivering the NHS plan, sets out a major programme of NHS investment, expansion and reform over a ten year period. Consequently, the PbR initiative is being implemented incrementally, in terms of both scope and financial impact.

In terms of scope, PbR began in a small way in 2003-04 and was extended in 2004-05. For the majority of NHS Trusts, PbR included only elective care in 2005-06. The following year, PbR was extended to include non-elective, accident and emergency, outpatient and emergency admissions for all Trusts.

2007-08 marked a year of consolidation with no significant changes to the tariff. The financial impact of PbR was also introduced gradually with a four year transition path, which comes to a close in 2008-09.

The relevant consultation processes governing these changes are outlined below.

Consultations and policy developments post 2000
In July 2000, the NHS plan introduced the government’s intention to link the allocation of hospital funds to the activity undertaken by hospitals. [www.dh.gov.uk](http://www.dh.gov.uk) [Accessed 12 March 2008]

In order to optimise extra resources, the government proposed major changes to the way money flows around the NHS. The plan also included differentiation between incentives for routine surgery and those for emergency admissions.

Hospitals would be paid for the elective activity they undertake, a system of payment by results.

In August 2003, the government issued the consultation paper *Payment by results: preparing for 2005*. This identified the key decisions needed for implementing the next stage of PbR. It outlined how PbR will apply to NHS foundation trusts from April 2004 and to all NHS trusts from April 2005. Feedback was sought on the proposed approaches. [http://digbig.com/4wxqy](http://digbig.com/4wxqy) [Accessed 19 May 2008]

**Key elements of payment by results**

1. **The national tariff**

   The national tariff is the inflation adjusted national average cost of procedure. It comprises three components:

   - a definition (the healthcare resource group or HRG, backed up by detailed clinical definition)
   - a currency (the time spent in hospital, from admission to discharge)
   - a financial sum (based on the NHS defined ‘average’ cost).

2. **Healthcare resource groups (HRGs)**

   HRGs are a standard method of analysing clinical procedures and hospital activity, based upon diagnosis and any interventions. [http://digbig.com/4wxra](http://digbig.com/4wxra) [Accessed 19 May 2008]

3. **The market forces factor (MFF)**

   The MFF is an adjustment to the tariff that reflects the different costs of healthcare provision in different parts of the country.

   It was developed to adjust the unavoidable variations in input costs, for example, staff costs, regional weighting, land, buildings and equipment in health care delivery.
4. **NHS reference costs**

NHS reference costs are an analysis of each HRG’s spending at the end of the financial year. They are a standardised presentation of the costs of NHS services, prepared and published annually. [http://digbig.com/4wxrb](http://digbig.com/4wxrb) [Accessed 19 May 2008]

The underlying intention of reference costs publication is to allow cost comparisons between services through the use of a consistent approach to costing.

Differences between reference costs and the tariff arise from:

- the effects of time related inflation, data collection and other adjustments
- a variation in the scope of each.

**Application**

**How payment by results works**

1. **Tariff for hospital in-patient procedure**

   For each HRG, the Department of Health publishes tariffs (prices) for urgent and non-urgent ‘spells’ (a ‘spell’ refers to time spent in hospital from admission to discharge).

   The tariff is based upon the inflation-adjusted national average NHS cost of the procedure in question.

   The prices are derived from Department of Health ‘reference costs’, which use the cost information provided by all NHS providers as part of their annual reference costs submission. They reflect the actual (rather than budgeted) cost of procedures, and should ensure full recovery of all relevant support functions and overhead costs.

2. **Regional adjustment**

   This is an adjustment to the price, to reflect the fact that the cost of running a hospital varies from one part of the country to another. This is known as the MFF.

3. **Income calculation**

   The price multiplied by the MFF represents the amount of income an NHS Trust can expect to receive for each procedure it undertakes.
A worked example

The ‘cost to commissioner’ and ‘income to provider’ of a bilateral hip replacement at Glebeland NHS Trust may be calculated with reference to steps one, two and three below:

1. Prices of hospital procedure:

<table>
<thead>
<tr>
<th>HRG code</th>
<th>HRG name</th>
<th>Elective spell tariff (£)</th>
<th>Non-elective spell tariff (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>H 01</td>
<td>Bilateral primary hip replacement</td>
<td>6,362</td>
<td>6,362</td>
</tr>
<tr>
<td>H 03</td>
<td>Bilateral primary knee replacement</td>
<td>7,211</td>
<td>7,211</td>
</tr>
<tr>
<td>H 04</td>
<td>Primary knee replacement</td>
<td>5,376</td>
<td>5,412</td>
</tr>
<tr>
<td>H 07</td>
<td>Primary or revision shoulder, elbow or ankle replacement</td>
<td>4,326</td>
<td>4,834</td>
</tr>
</tbody>
</table>

2. Regional adjustment: (to reflect regional cost variations)

<table>
<thead>
<tr>
<th>Location</th>
<th>Market forces factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Boroughs Partnership NHS Trust</td>
<td>1.086207</td>
</tr>
<tr>
<td>Ambridge NHS Trust</td>
<td>1.119265</td>
</tr>
<tr>
<td>Glebeland NHS Trust</td>
<td>1.061669</td>
</tr>
<tr>
<td>Brookfield NHS Trust</td>
<td>1.062248</td>
</tr>
<tr>
<td>Penny Hassett NHS Trust</td>
<td>1.057801</td>
</tr>
</tbody>
</table>

3. Income calculation for a bilateral primary hip replacement

The amount Glebeland NHS Trust can expect to receive for the procedure undertaken =

\[
\text{National tariff} \times \text{market forces factor} = £6,754
\]

\[
£6,362 \times 1.061669 = £6,754
\]

The same procedure performed by Penny Hassett NHS Trust earns:

\[
\text{National tariff} \times \text{market forces factor} = £6,730
\]

\[
£6,362 \times 1.057801 = £6,730
\]
Under PbR, a basic premise is the application of the national tariff and therefore the ‘cost to commissioner’ is the same regardless of the provider used. The actual income received by the provider may be different due to the top-up provided in the form of the MFF, which is paid to providers by the Department of Health.

**Related tools and techniques**

The primary objective of PbR is the delivery of optimal efficiency in health service provision by NHS organisations.

A range of topic gateways providing guidance and information relevant to management accounting is available to CIMA members. Those topic gateways, which may be of particular interest and value for those operating under a PbR regime, include:

- activity based costing and management (ABC/ABM)
- planning and forecasting.

Other helpful tools and approaches include:

- target costing
- value analysis
- value engineering
- just-in-time (JIT)
- total quality management (TQM)
- materials requirements planning (MRP)
- kaizen
- lean manufacturing
- cause-effect analysis (‘fishbone’ diagrams).

The topic gateways are available from [www.cimaglobal.com/mycima](http://www.cimaglobal.com/mycima) [Accessed 12 March 2008]
Further information

Articles


Ellwood, S. Full-cost pricing rules within the National Health Service internal market: accounting choices and the achievement of productive efficiency. Management Accounting Research, 1996, Volume 7, pp 25-51


Lockamy, A. and Smith, W. Target costing for supply chain management: criteria and selection. Industrial Management and Data Systems, 2000, Volume 100, Numbers 5-6, pp 210-218


**Books**


**CIMA research**


**Other research**


(1999). *Target costing for effective cost management: product cost planning at Toyota Australia*. IFAC Financial and Management Accounting Committee

**Websites**


Specific pages of interest include Payment by Results.
Chartered Institute of Management Accountants (CIMA)

www.cimaglobal.com
[Accessed 12 March 2008]

Connecting for Health
Supports the NHS to deliver better, safer care to patients, via new computer systems and services, that link GPs and community services to hospitals.

http://digbig.com/4wxrd
[Accessed 19 May 2008]

[Accessed 12 March 2008]

Specific pages of interest are:

Payment by Results http://digbig.com/4wxre
[Accessed 19 May 2008]

BMA - Caring for the NHS http://digbig.com/4wxrf
[Accessed 19 May 2008]

Health Matters
Health Matters is an independent non-profit UK magazine covering the NHS, public health and health politics. www.healthmatters.org.uk
[Accessed 12 March 2008]

Healthcare Resource Groups: Casemix
The Casemix Service develops clinical grouping methodologies and software products that enable the NHS to record clinical activity.

http://digbig.com/4wxrh
[Accessed 19 May 2008]

Healthcareworkforce.nhs.uk
Provides one stop access to NHS healthcare workforce planning information, knowledge, intelligence and practical tools.

www.healthcareworkforce.nhs.uk
[Accessed 12 March 2008]

The King’s Fund
The King’s Fund is an independent charitable foundation working for better health, especially in London. www.kingsfund.org.uk/index.html
[Accessed 12 March 2008]
NHS Costing Manual
Sets out the principles and practice of costing to be applied in the NHS.
http://digbig.com/4wxrj
[Accessed 19 May 2008]

NHS Networks
Promotes and connects the many networks which exist throughout the NHS, and encourages the formation of new ones.
www.networks.nhs.uk/1.php
[Accessed 12 March 2008]

Office of Health Economics
Provides independent research, advisory and consultancy services on policy implications and economic issues within the pharmaceutical, health care and biotechnology sectors.
www.ohe.org/page/index.cfm
[Accessed 12 March 2008]