

## The Community Pharmacy Contractual Framework and the retained medicine margin

### NAO Report findings, conclusions and recommendations

#### Scope of the report

This report examines the financial impact of the **Community Pharmacy Contractual Framework** (the Framework) since its inception in April 2005. We carried out this work because the Department of Health asked us to review the arrangements for ensuring that the amount of margin community pharmacies make from the purchase of medicines—the so-called **‘retained margin’**, which forms part of pharmacy remuneration—is in line with the levels agreed in the Framework.

In order to assess the financial impact of the retained margin element of the Framework, the report:

- established the total expenditure on the Framework over the four years 2005-06 to 2008-09, including the outturn on the retained margin;
- established a counterfactual total expenditure, by calculating what total expenditure would have been, had the pre-Framework arrangements for remunerating pharmacies remained in place;
- compared actual and counterfactual expenditure to estimate the overall savings in NHS expenditure on medicines arising from introducing the Framework, and used actual data on outturn and dispensing volume increases over time to calculate the productivity gain over the four years 2005-06 to 2008-09; and
- assessed the extent of the retained margin element of the Framework within this context.
- examined the operation of the systems for monitoring and controlling the retained margin since its introduction.

#### The community pharmacy contractual framework

There were 10,475 community pharmacies in England at 31 March 2009. They are operated by independent contractors, owned by sole traders, small multiples, supermarkets and large chains, and are located on the high street, in communities, shopping centres and rural areas. NHS pharmaceutical services account for about 90 per cent of a typical community pharmacy’s turnover. Community pharmacies provide NHS services under a Contractual Framework which has been in operation since 1 April 2005, agreed between the Department of Health, PSNC and NHS Employers.

The Framework provides for pharmacy contractors to be remunerated for the services they provide in three ways:

1. About half of budgeted remuneration for pharmacies is in the form of fees and allowances that are paid from a **‘global sum’** budget, which over the period covered by this report was administered centrally by the Department of Health. The 2008-09 budget for the global sum was £1,049 million.
2. Pharmacies also receive further fees and allowances from their Primary Care Trusts. The main one is the **‘practice payment’**, which takes the form of a monthly payment for smaller pharmacies, or a fee per item dispensed for pharmacies dispensing more than a threshold level of items per month.

Payments for medicines use reviews and the electronic prescription service are also met by Primary Care Trusts. The 2008-09 budget for PCT payments was £664 million.

3. The third source of community pharmacies' remuneration is the '**retained margin**': the margin arising from the difference between the price at which a pharmacy purchases a medicine and the price at which the pharmacy is reimbursed by the NHS when the medicine is dispensed.

The Department and PSNC agreed at the outset of the Framework that the target level of retained margin would be set at **£500 million annually**. The Department adjusts the level at which pharmacies are reimbursed for commonly dispensed items based on the level of margin achieved in the previous year.

In order to assess the actual total retained margin achieved each year, the Department carries out a survey of invoices, which show actual prices paid for a sample of medicines, from a sample of pharmacies. The Department uses the survey results to determine how to set the prices at which the NHS reimburses pharmacies for the medicines they dispense. These reimbursement prices, which are published monthly in the NHS Drug Tariff, are deliberately set higher than the actual cost of medicines to pharmacies, at least for commonly dispensed generic medicines, so that globally pharmacies can earn the agreed target £500 million margin.

In managing the delivery of the margin by periodically adjusting reimbursement prices, therefore, the Department has to balance the risk of exceeding the target level of margin against the risk of falling short of the agreed level, and failing to meet its commitment to community pharmacies—potentially, in the longer term, affecting the availability of local community pharmacy services across the country and the supply of medicines to patients.

Since April 2008, when the White Paper *Pharmacy in England: Building on Strengths – Delivering the Future* was published, the Department has also had the related objective to provide, through the Contractual Framework, an incentive structure that will further increase the chances of achieving the Government's aims of delivering more NHS services through community pharmacies, over and above the dispensing of medicines, and of fully utilising the skills of pharmacists and their staff in contributing to primary care and public health improvement, especially in the management of long-term conditions.

## Findings and conclusions

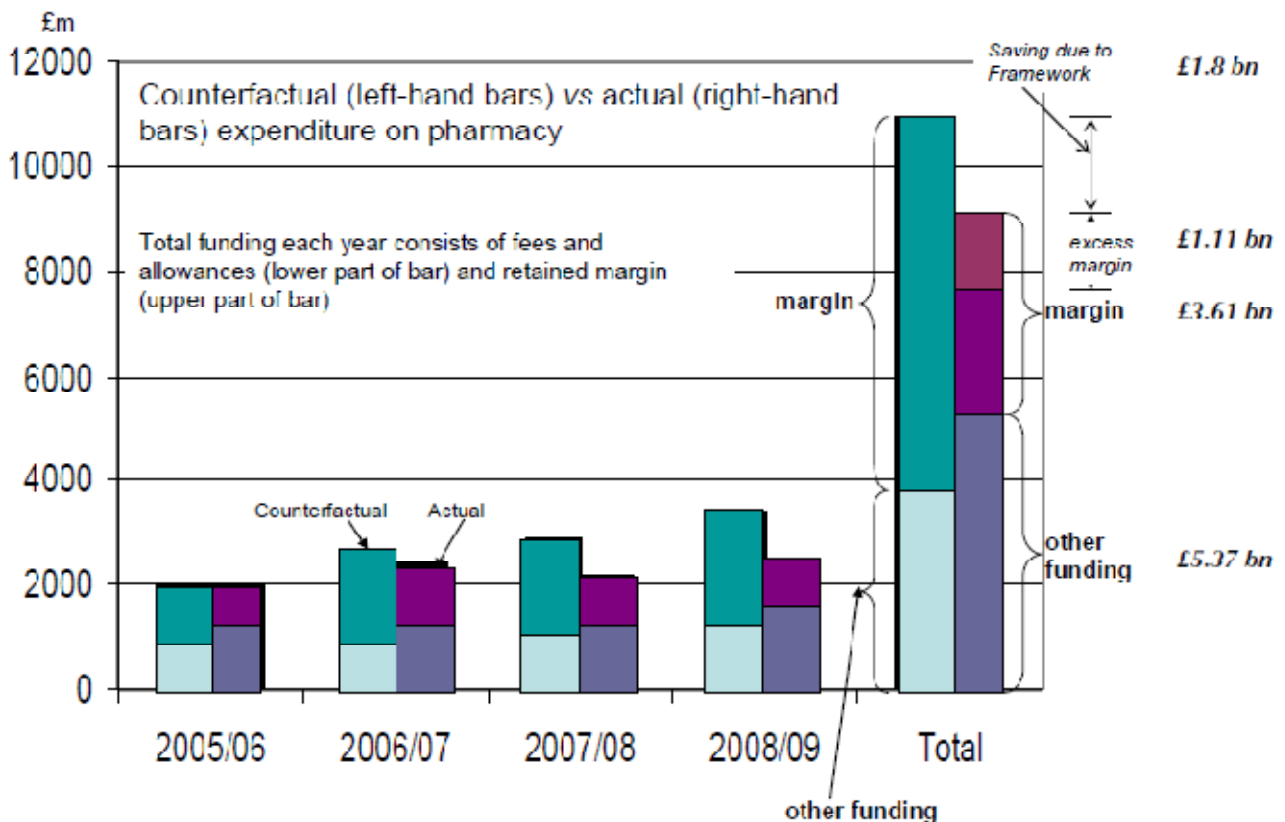
The introduction of the new Contractual Framework in April 2005 has achieved two notable outcomes: There has been a cost saving to the NHS of around £1.8 billion over the period 2005-06 to 2008-09 by comparison with a counterfactual scenario of retaining the pre-Framework remuneration and medicines pricing arrangements. The saving has arisen principally because, under the new Framework, the reimbursement prices paid to pharmacies for a number of commonly dispensed medicines have been reduced.

The productivity of pharmacies, with respect to core dispensing work, has also increased by 8 per cent over the four years 2005-06 to 2008-09. In 2005-06, the total volume of medicines dispensed by pharmacy contractors was 679 million items, and total payments to contractors were £1.975 billion. By 2008-09, the number of items dispensed had increased by 17 per cent, to 795 million, for an increase in total payments of 8 per cent in real terms, to £2.418 billion. In addition, pharmacies are now delivering new services, such as repeat dispensing, health promotion services and support for self care that were not available prior to the Framework.

However the new Contractual Framework also involved the introduction of an agreed annual target of £500 million in respect of the level of medicines margin allowed to be retained by pharmacies. That target was

exceeded by £1.11 billion overall in the four years 2005-06 to 2008-09 (Figure 1). If reimbursement prices had been adjusted contemporaneously to meet the target, then potentially the Department could have increased savings by £1.11 billion - the difference between the £7.87 billion target and the £8.98 billion outturn set out in Figure 2. The total target retained medicines margin was £2.03 billion and the actual retained medicines margin was £3.61 billion: a difference of £1.57 billion. £0.46 billion of this difference was offset by reduced practice payments, leaving a total difference of £1.11 billion.

**Figure 1: Expenditure on the Community Pharmacy Contractual Framework, 2005-06 to 2008-09**



Source: NAO analysis of Department of Health data

**Figure 2: Payments to pharmacy contractors under the Community Pharmacy Contractual Framework, 2005-06 to 2008-09**

Element of remuneration	2005-06		2006-07		2007-08		2008-09		4-year total		
	Target (£m)	Outturn (£m)	Target (£m)	Outturn (£m)	Target (£m)	Outturn (£m)	Target (£m)	Outturn (£m)	Target (£m)	Outturn (£m)	Difference (£m)
Global sum	966	947	991	1,000	1,017	1,020	1,049	1,053	4,023	4,020	-3
PCT payments	300	228	420	247	430	281	664	595	1,814	1,351	-463
Retained margin	500	800	500	1,161	532 <sup>1</sup>	874	500	770 <sup>2</sup>	2,032	3,605	+1,573
<b>Variance on retained margin (£m)</b>		<b>300</b>		<b>661</b>		<b>342</b>		<b>270</b>		<b>1,573</b>	
Total remuneration	1,766	1,975	1,911	2,408	1,979	2,175	2,213	2,418	7,869	8,976	+1,107
<b>Variance on total contract sum (£m)</b>		<b>209</b>		<b>497</b>		<b>196</b>		<b>205</b>		<b>1,107</b>	

Source: NAO analysis of Department of Health data

<sup>1</sup> An extra £32 million retained margin was agreed by Ministers this year, to offset some NHS Business Services Authority underpayments to pharmacies, and stock loss.

<sup>2</sup> Subject to final confirmation