Tertiary Education Commission
Te Amorangi Mātauranga Matua

Aide-Memoire: Te Pūkenga Programme Business Case

To:	Hon Chris Hipkins, Minister of Education
From:	Tim Fowler, Chief Executive, Tertiary Education Commission
Date:	29 November 2022
Reference:	AM-22-00769

Purpose

1. This aide-memoire provides you with advice on Te Pūkenga's Programme Business Case (PBC) which was submitted to you on 31 October 2022, and potential investment options you may wish to consider as part of inputting into the Budget 2023 process. It also utilises information from a session held by Te Pūkenga with officials, and other material provided by Te Pūkenga following the submission of the PBC.

2. We have consulted with the Ministry of Education (MoE) and the Treasury on this aide-memoire and incorporated their feedback. We recommend you forward this aide-memoire to the Minister of Finance for his information.

3. We recommend that you proactively release this aide-memoire following Budget 2023 announcements with financial and costing information withheld given it may impact on any future procurement processes undertaken by Te Pūkenga.

Background

Over $160 million in Crown funding has already been committed to Te Pūkenga…

4. In 2020, the Government agreed to provide up to $121 million in Crown funding to support the establishment of Te Pūkenga, build capability, and commence the integration and transformation of the current network, including supporting greater delivery of on-job learning [CAB-20-MIN-0140 and CAB-20-MIN-0336 refer]. This funding was also provided on the expectation that Te Pūkenga would generate savings and efficiencies across its network, such that it was self-funded from the beginning of 2023.

5. As part of Budget 2022, the Government committed an additional $40 million in Crown capital funding to Te Pūkenga to allow it to address high priority building issues across its network of ITP subsidiaries [CAB-22-MIN-0129 – Initiative ID 14123 refers].

…and further Crown investment has always been signalled…

6. The initial $121 million investment from the Crown was largely to fund Te Pūkenga's establishment, plan its transformation, and to commence integration of the current network. We have previously advised that further Crown investment would be needed to fund its transformation [CBC-20-MIN-0067 refers]. In particular, the NZIST Establishment Board signalled potential future transformation costs of 9(2)(i) [redacted]

…but the PBC has been delayed multiple times…

7. Te Pūkenga had originally planned to submit a PBC to you in December 2021, so it could begin its implementation over the course of 2022. However, it was unable to meet this timeline given a lack of progress in key areas ultimately limiting the quality of analysis that could be undertaken. In December 2021, Te Pūkenga informed you that it was deferring the submission of the PBC until mid-2022. This was to allow it time to undertake organisational design and further develop its operating model, which would provide a greater understanding of the costs of implementing its transformation programme and whether it was affordable.

8. On 30 June 2022, Te Pūkenga submitted a PBC to you seeking a 9(2)(f)(iv) investment from the Crown to support its transformation programme. We provided advice to you in June 2022 (AM-22-00293 refers). However, shortly after submission of the PBC, Chief Executive Stephen Town went on personal leave and Peter Winder became Acting Chief Executive.

9. In the weeks following Mr Winder's appointment, Te Pūkenga undertook a much needed reset of its transformation programme. As a result, Te Pūkenga delayed the planned consultation of its new organisation design as it sought to develop a more simplified model, address financial sustainability concerns, and reduce transition risks. Te Pūkenga also decided to revise the June 2022 PBC so it could strengthen the Management Case, make amendments to the transformation programme and the timetable for integration, and modify its financial forecasts. These changes have resulted in a substantially better financial pathway to sustainability, and a reduction to the amount of funding it is now seeking from the Crown.

…with Te Pūkenga now seeking an investment decision through Budget 2023

10. Te Pūkenga submitted its revised PBC to you on 31 October 2022 seeking 9(2)(f)(iv) in operational funding, which will be considered as part of Budget 2023. Te Pūkenga consider that there is considerably more thought and robustness behind this investment proposal and its ability to deliver on the work programme compared to the PBC submitted in June 2022.

11. To support Budget 2023 decisions, the PBC has recently been considered by Treasury's Investment Panel given it is a significant proposal. The Treasury has stated that all initiatives being considered by the panel sit outside your Budget cost pressure envelope. The Investment Panel will be providing advice on the initiative to the Minister of Finance in the near future.

Independent Quality Assurance

An IQA has been undertaken on the PBC…

12. Te Pūkenga engaged IQANZ to undertake an Independent Quality Assurance (IQA) review of the PBC, as required by its Crown funding agreement. IQANZ had also undertaken an assessment of Te Pūkenga's draft PBC in December 2021 and the June 2022 version sent to you. The purpose of the IQA is to assess the business case against the Treasury's Better Business Case guidance and provide Ministers with assurance that there is enough context and information in the business case to make informed decisions. IQANZ's report was submitted to you alongside the PBC on 31 October 2022.

13. IQANZ had reviewed a draft of the PBC in early October 2022 and made 13 recommendations for improvement. Nine were addressed in the final version while four of the recommendations would require more substantial changes which were not possible in the time available. IQANZ noted that subsequent project business cases could address these recommendations, but "*none of the four present a material risk to the PBC's ability to be a well-reasoned and robust presentation of the options available to Te Pūkenga to address the need*".

14. In summary, IQANZ assessed the Strategic, Financial and Commercial Cases as '*appropriate and fit for purpose*' while the Economic and Management Case were assessed as '*mostly appropriate and fit for purpose*' with minor improvement opportunities identified. The four

outstanding recommendations relate to the Management Case and are focussed on work plan and programme structures and how team resources will be organised to manage both business-as-usual and transformation activities. Te Pūkenga has stated it will address these recommendations in subsequent business cases it submits to Ministers.

Te Pūkenga Programme Business Case

The strategic case for change remains robust…

15. The Strategic Case for Te Pūkenga's transformation programme remains largely unchanged from the version submitted in June 2022. It provides a clear rationale for the required changes, and the outcomes Te Pūkenga is trying to achieve. There are seven investment objectives Te Pūkenga is seeking to achieve through its work programme:

    1. Gives effect to Te Tiriti o Waitangi in all that Te Pūkenga does.
    2. Provides exceptional learning experiences and equitable outcomes for Māori.
    3. Is learner-centred, recognising the diverse and unique needs of all learners and staff, empowering diversity, belonging, safety and wellbeing.
    4. Creates barrier-free access to, and mobility within, the network, delivering regional flexibility and nationally consistent outcomes.
    5. Partners with employers to deliver relevant work-integrated education and training that meets skills needs.
    6. Becomes a connected, relevant, and future focused provider driven by innovation, collaboration, and teaching excellence.
    7. Focuses on efficient and cost-effective delivery across the network as well maintaining financial viability.

…with IT systems integration and the unification of academic programmes seen as the two key projects to deliver on the investment objectives…

16. Te Pūkenga is implementing a large work programme to transform vocational education and training. This includes a number of 'capability uplift' projects focused on improving Tiriti partnerships, enhancing learner services, better supporting employers, and implementing improved teaching models that better integrate work-based, campus, and online delivery. However, Te Pūkenga has identified two key areas it considers are critical in enabling it to meet its investment objectives – integration of IT systems and unification of academic programmes. Alongside the implementation of its new organisation structure, these two projects are the focus of the PBC.

17. Integrated systems will provide Te Pūkenga with greater oversight of the entire organisation, including all learners, which will enable it to:

    - identify and respond to unmet needs of learners, Māori, employers, and communities.
    - help ensure sustainability through operating efficiencies and reduced duplication.
    - identify and realise cost savings of scale.
    - enable learners to access and navigate their learning system seamlessly.
    - easily track traditionally underserved learners' participation, engagement, and success.
    - utilise data and analytics to understand and improve system performance.

18. The consolidation of existing Institute of Technology and Polytechnics (ITPs) and Transitional Industry Training Organisation (TITO) functions into Te Pūkenga has also highlighted the multiplicity of academic programmes and qualifications which are costly and do not provide flexibility for learners. Unification of academic programmes will allow Te Pūkenga to:

    - be more responsive to the needs of learners, employers, industries, regions, and communities.
    - provide greater flexibility to its learners, giving them the ability to switch modes and delivery locations to suit their circumstances.

- increase study options in certain areas and provide greater access to those currently underserved.
- increase revenue as there will be more study options in regions and across multiple modes.
- reduce programme maintenance costs and allow the organisation to right size.
- enhance and maintain a relevant offering.

…with this programme of work being costed at [redacted] …

19. Te Pūkenga's wider transformation programme (i.e. including the capability uplift projects) will need to be implemented successfully to deliver the full benefits Te Pūkenga is seeking to achieve. The capability uplift projects will be self-funded. However, Te Pūkenga has identified IT system integration, transformation programme management, organisation change, and academic programme unification as needing targeted investment due to the key role they will play in enabling the wider transformation.

20. Te Pūkenga's preferred option outlined in the PBC will cost [redacted] over the 2023 to 2027 period comprising:

    - [redacted] for IT systems integration.
    - [redacted] for transformation programme management.
    - [redacted] to support academic programme unification.
    - [redacted] in people change costs.

…with [redacted] being sought from the Crown as a grant…

21. Te Pūkenga is seeking a [redacted] investment from the Crown to contribute to these costs, to be paid as a Crown operating grant (rather than a capital injection). It has also assumed it will draw down $15.6 million of the $16 million in key systems funding that is already appropriated, set aside as part of 2020 funding decisions. This funding can be released subject to Joint Ministers' approval of a single stage business case, which Te Pūkenga intend to submit in the next week. The remaining [redacted] will be funded through Te Pūkenga cash reserves, operating profits, and asset divestments.

22. Specifically, Te Pūkenga is seeking [redacted] in Crown funding to fund IT systems integration and [redacted] to run its transformation programme. People change costs will be funded by Te Pūkenga, while academic programme unification will be part-funded by the strategic component of the unified funding system.

…which will deliver an NPV of [redacted] primarily due to increased enrolments

23. Te Pūkenga has undertaken a net present value (NPV) analysis which shows the implementation of its transformation programme and capability uplift results in a positive NPV to Te Pūkenga of [redacted] and an NPV to society of [redacted] over the next 30 years.

Table 1: NPV analysis

	30-year NPV
NPV of net Te Pūkenga benefits	[redacted]
NPV of net societal benefits	[redacted]
Societal NPV of Te Pūkenga transformation	[redacted]

24. Over one-half (57 percent) of the financial benefits to Te Pūkenga are driven by its forecast increase in EFTS (through both a higher number of students and increased student retention), with 33 percent of the financial benefits driven by a reduction in FTE numbers (totalling [redacted] FTEs over the 2023 to 2027 period). The remainder of the benefits are realised through IT systems savings, programme design and development savings, reduced Council and board fees, and reduced auditor fees. These benefits are, however, offset by the costs of

implementing the transformation programme and the ongoing costs of running its new operating model.

25. Te Pūkenga's net societal benefits are based on increased enrolments leading to individuals having increased earnings due to higher education levels as well as the subsequent increase in tax revenue. This translates to a benefit-cost ratio of [redacted] for society as a result of the Te Pūkenga transformation.

26. A key driver of the positive NPV results is continued, strong enrolment growth. A failure to achieve the optimistic enrolment forecasts would result in the NPV for the investment being much lower, or potentially negative, particularly for Te Pūkenga. However, while increased enrolment numbers are desirable, we do not necessarily consider it to be the primary benefit of Te Pūkenga's transformation. It must also have a stronger focus on employers and industry, and ensure it provides learners with the necessary skills they require to succeed in the workplace. While not measured in Te Pūkenga's NPV analysis, more relevant vocational education that delivers the skills employers need should result in productivity increases that generate social and economic benefits.

Overview of the IT systems integration

Te Pūkenga plan on delivering [redacted] of IT spend over the next four years…

27. Te Pūkenga has identified a need to invest [redacted] in IT systems integration over the 2023 to 2026 period to ensure the projects are delivered successfully as soon as possible. This is considerably lower than the [redacted] that was identified in the June 2022 version of the PBC. Te Pūkenga consider the investment in IT is absolutely critical to enable the level of transformation needed over the next four years and to achieve the wider outcomes of RoVE.

…and have undertaken a detailed process to identify the projects required…

28. Te Pūkenga has identified a range of capabilities and tools it needs to deliver its transformation objectives. Each IT project can be linked back to key business drivers and point to an area of capability that will benefit and, in turn, realise quantifiable outcomes. Te Pūkenga has prioritised projects that will enable a controlled environment and improve learner experience.

29. Te Pūkenga has also considered investment options in terms of leveraging from existing systems (brownfield) versus new investments (greenfield). The investment strategy is dominated by greenfield solutions due to the scale of change required in an environment where many different instances of the same system exist across 25 organisations, and integration is complex. An advantage of implementing new systems is that it allows Te Pūkenga to scale quickly to centralise management of key functions, and realise savings associated with this. It also reduces risk around existing network operations, as existing network systems can be transitioned incrementally.

…which has resulted in 35 key technology systems being identified…

30. Te Pūkenga has identified 35 technology systems across six workstreams to support its future operating model. Utilising a detailed costing framework, Te Pūkenga has identified the resource and licensing costs for each project as well as the investment type, migration, consolidation, and integration needs. Te Pūkenga note that it has taken a conservative approach to pricing and has assumed an overall project contingency of 25 percent (in addition to inflationary adjustments). Given Te Pūkenga still have to undertake detailed planning and sequencing, we are comfortable that this level of contingency is appropriate. We would expect it to be refined over the next year as further planning is completed.

31. We have summarised the 35 projects and their associated costs under the six workstreams on the following page. It should be noted that the cost estimates are before inflation adjustments and do not include contingency.

Overview of Te Pūkenga IT systems integration projects, 2023 to 2026

[redacted]

…which Te Pūkenga considers will result in improved efficiency and effectiveness…

32. Te Pūkenga considers that it will reduce overall staffing numbers by [redacted] FTEs through the implementation of its new organisation design as it removes duplicate roles between organisations. However, the majority of staff reductions – a further [redacted] FTEs – will occur as IT system integration is delivered over 2023 to 2026. These savings come from the back office areas of the business (e.g. HR, finance, property, digital, marketing and communications). There will also be savings through running fewer IT systems as well as increased effectiveness through improved decision making and a better user experience for learners and employers. We would note however, that in the short-term, these savings will be offset by a large increase in the number of specialist FTEs needed to deliver the IT systems integration.

…but it is an ambitious programme of work with no clear phasing…

33. Te Pūkenga is forecasting to undertake [redacted] of IT expenditure in 2023 as it brings capability on board and commences the programme, before spending between $[redacted] and $[redacted] per annum over the 2024 to 2026 period. This is a significant amount of spend over a short period of time, particularly in year one as the programme is being set up and with a new executive leadership team only just being put in place.

34. The key rationale behind the aggressive approach is that the faster Te Pūkenga can implement the IT systems integration, the faster it can realise savings through reduced FTE headcount and improve overall management of the network. In particular, Te Pūkenga note that its finance and digital function will remain inefficient and ineffective while it is running 25 separate systems. Te Pūkenga is also conscious that staff, learners, and stakeholders have been going through change and uncertainty for a long period of time and are eager to see tangible results.

…and we have concerns about Te Pūkenga's ability to deliver the programme

35. We support the overall strategic need for IT systems integration and consider the identified projects are comprehensive – with the exception that Te Pūkenga also needs to ensure it

focuses on increasing maturity in cyber security. However, our main concern is around Te Pūkenga's, and the market's, ability to deliver the complex programme of work over the four year period. This is a considerable amount of spend for an organisation that does not have experience delivering, large, complex IT programmes. By compressing the timeframes for delivery in an attempt to realise benefits earlier, it significantly increases the risk profile of the programme.

36. Furthermore, it is trying to implement IT systems integration at the same time it is delivering a range of other projects and changing the way it operates. There will need to be strong alignment between decisions being made around its future operating model and the design and implementation of IT systems. Given decisions are still being made around the future operating model, overall governance and management of the work programme is integral.

37. As further planning is undertaken, Te Pūkenga will need to carefully analyse its timeframes for delivery against the risk profile. While a delay in the delivery of all 35 key systems will defer the realisation of some benefits, we do not consider this to be a major issue if they are implemented well and largely within budget. A bigger concern is that to implement 35 different key systems over a four year period will require Te Pūkenga to initiate a range of projects in parallel, which brings a risk of non-delivery and having to do significant rework. This will have impacts on cost and the overall realisation of benefits. Te Pūkenga will need to be clear how it will manage these delivery risks in future business cases, including how it will prioritise capability towards the most important projects.

Affordability of Te Pūkenga's transformation programme

Te Pūkenga forecast an operating surplus in 2024…

38. Since June 2022, Te Pūkenga has implemented a range of cost saving measures and financial controls in an attempt to improve its performance over 2022 and 2023 and set a more solid base from which to deliver its transformation programme. Considerable effort has also been put into reviewing and remodelling its financial forecasts as part of revising the overall PBC. Nevertheless, the modelling and assumptions used have a large degree of uncertainty around them. Te Pūkenga is also yet to develop a financial strategy that these forecasts can be assessed against.

39. Te Pūkenga has forecast its underlying operating performance (i.e. excluding transformation funding and costs) to improve in 2023 due to increased funding through the unified funding system, and a recovery in international enrolments. Te Pūkenga is forecasting to reduce its operating deficit to [redacted] in 2023 before reporting its first surplus [redacted] since inception in 2024. Continued growth in domestic and international enrolments is expected to occur resulting in the operating surplus continuing to improve so that by 2026 onwards, Te Pūkenga is reporting an operating surplus of [redacted] of revenue. Earnings before interest, taxes, depreciation, and amortisation (EBITDA) is expected to consistently improve over the entire forecast period.

[redacted]

[redacted]

…based on increased domestic and international enrolments…

40. Te Pūkenga has forecast that domestic provider-based EFTS will increase by an average of [redacted] per annum over the eight years to 2031 while industry trainees will increase by an average of [redacted] per annum. Ideally, the PBC would have shown a greater movement towards work-based learning over the next eight years. However, it is acknowledged that how Te Pūkenga integrates work-based, campus-based, and online delivery is ultimately still being designed and there remains considerable uncertainty around both provider-based and work-based enrolments in future.

41. Te Pūkenga considers domestic enrolment growth will be driven by population growth and its proposed interventions/learner support initiatives which will result in both new enrolments and increased retention rates. From 2026 onwards, Te Pūkenga expect its interventions to drive an additional [redacted] of enrolment growth per annum. As a result of these initiatives, enrolment growth is forecast to be stronger for priority learners ([redacted] per annum) compared to non-priority learners ([redacted] per annum).

42. To increase enrolments by [redacted] per annum through interventions would be a significant achievement. Early work on learner success initiatives by Te Pūkenga is encouraging with Te Pūkenga working closely with the TEC's Ōritetanga Learner Success team. The key challenge for Te Pūkenga is the successful operationalisation and implementation of these initiatives.

[redacted]

[redacted]

Note: the large increase in domestic EFTS in 2023 is due to TITOs moving into Te Pūkenga over the course of 2022.

43. International EFTS are forecast to increase by an average of [redacted] per annum through to 2026 (from [redacted] so that overall international EFTS will be approximately 80 percent of pre-COVID levels by 2026. International EFTS are then expected to grow by [redacted] percent per annum from 2027 onwards. For context, Te Pūkenga had 10,870 full-fee international EFTS at the end of 2019, prior to COVID-19.

…while savings from the transformation will begin to be realised from 2023…

44. While overall expenditure is expected to increase over the forecast period in line with increasing enrolments, Te Pūkenga will begin to realise cost savings through transformation from 2023. Te Pūkenga forecast to achieve [redacted] in cost savings in 2023, mainly through the implementation of its new organisation design, which gradually increases to [redacted] in 2026 as the IT systems integration projects realise efficiencies. By 2031, [redacted] in cumulative transformation savings are forecast.

…and Te Pūkenga will fund the transformation through multiple funding streams…

45. Te Pūkenga's financial forecasts have assumed the [redacted] Crown operating grant is paid in full as well as the $15.6 million of funding for key systems, which is already appropriated. The remaining $[redacted] is to be funded by Te Pūkenga through:

- *Cash reserves* – forecast to be [redacted] at the end of 2022.

- *Operating surpluses* – forecast to be a cumulative $9(2)(f)(iv) [redacted] over the 2024 to 2026 period with a 9(2)(f)(iv) [redacted] surplus forecast in 2026.
- *Asset divestments* – forecast to generate 9(2)(f)(iv) [redacted] in cash through asset divestments over the 2023 to 2026 period (and a further 9(2)(f)(iv) [redacted] over the 2027 to 2031 period).

…which will support Te Pūkenga's overall cash position…

46. As Te Pūkenga implements its transformation programme, its net cash position (cash minus debt) is expected to fall to 9(2)(f)(iv) [redacted] over 2024 and 2025. This is well above Te Pūkenga's self-imposed cash floor of $50 million, noting Te Pūkenga also has a 9(2)(f)(iv) [redacted] borrowing consent which can be used to access liquidity (the borrowing consent limit is currently being rolled over for 2023 but will need to be revisited after Crown funding decisions are made). Over this period, debt is expected to remain steady at around 9(2)(f)(iv) [redacted], most of which represents Crown loans provided to 9(2)(f)(iv) [redacted]. From 2026, cash then increases as operating performance improves. By 2031, Te Pūkenga forecast to have 9(2)(f)(iv) [redacted] in net cash.

9(2)(f)(iv) [redacted]

47. Based on its base case scenario and forecast cash position, we consider that Te Pūkenga could afford to fund the large majority of its transformation programme itself and rely less on Crown funding. However, we consider that the assumptions behind the financial projections are optimistic, and it is likely that a much softer level of financial performance is achieved, resulting in a lower level of cash reserves.

…we remain concerned that financial performance is reliant on increased enrolments…

48. Our main concern regarding the financial projections is that they are heavily reliant on a sustained increase in enrolments over the next eight years. We consider there are significant downside risks to both Te Pūkenga's domestic and international enrolment forecasts which we explore through a number of scenarios below.

49. The domestic labour market is expected to remain tight over coming years, which has traditionally put downward pressure on provider-based enrolments. There has also been a consistent decline in domestic provider-based enrolments over the past 20 years with the exception of increases around negative economic events (e.g. the global financial crisis and COVID-19). Industry training numbers remain strong, but they are currently being supported by the Apprenticeship Boost policy which is due to cease at the end of 2023. The cessation of the Targeted Training and Apprenticeship Fund at the end of 2022 will also likely put downward pressure on both domestic provider-based and industry training numbers.

50. While Te Pūkenga has assumed its international EFTS will return to only 9(2)(f)(iv), 9(2) [redacted] of pre-COVID-19 levels by 2026, given it is estimated that 9(2)(f)(iv), 9(2)(i) [redacted] Te Pūkenga's international provision is impacted by changes to post-study work rights, we consider this forecast may also be optimistic.

…with scenarios of lower enrolments having a significant impact on financial performance…

51. As part of the financial analysis of the PBC, Te Pūkenga has worked with the TEC to model a range of downside scenarios. 9(2)(f)(iv) [redacted]

- 9(2)(f)(iv) [redacted]

52. 9(2)(f)(iv) [redacted]

[redacted]

9(2)(f)(iv) [redacted] 9(2)(f)(iv) [redacted]

9(2)(f)(iv) 9(2)(f)(iv) [redacted]

54. 9(2)(f)(iv) [redacted]

…but if multiple downside scenarios occur, affordability will be at risk…

55. 9(2)(f)(iv) [redacted]

[redacted] The most appropriate mitigations would depend on a variety of factors, but would need to include:

- Reducing capital expenditure.
- Reducing staffing levels and undertaking further restructuring.
- Constraining operating expenditure.
- Cancelling or deferring transformation projects.
- Making further asset divestments.

57. These mitigations would reduce the financial impact, but if combination downside scenarios occurred all at once, 9(2)(f)(iv) [redacted] there is a possibility that further Crown support would be required. However, under such a scenario we would expect close monitoring of Te Pūkenga's performance to identify issues early and for engagement to occur to assist Te Pūkenga to minimise the overall impact and/or for Ministers to make informed decisions. 9(2)(f)(iv) [redacted]

9(2)(f)(iv), 9(2)(i) [redacted]

Ministerial decisions and options around the potential Crown investment

Without further Crown funding, Te Pūkenga will not achieve the RoVE outcomes being sought…

58. It was always expected that Te Pūkenga would require further Crown funding to support the integration and transformation of its network and fund key parts of its transformation. If no Crown funding is provided, it would undermine Te Pūkenga's ability to achieve the outcomes being sought through RoVE and impede on its long-term financial sustainability.

59. Under such a scenario, we consider Te Pūkenga would largely continue to operate as a disconnected network and would only be able to undertake integration and transformation activities as, and when, they were affordable. Te Pūkenga would need to reassess its priorities meaning some benefits would likely never be achieved, and others would not be achieved for a long period of time. 9(2)(f)(iv) [redacted]

…and while we consider the PBC could have been more robust…

60. There are elements of the PBC and Te Pūkenga's wider progress that could have provided greater confidence to Ministers that Te Pūkenga's transformation programme would be delivered successfully. The majority of these issues, including a lack of progress over 2021 and the first half of 2022, are well traversed in our recent monitoring reports (AM-22-00695 refers to our most recent report). In particular, there remains a lack of clarity on how Te Pūkenga will integrate work-based, provider-based, and online delivery and the design and implementation of its new organisation structure has only just begun. Furthermore, its current financial situation remains poor and overall planning needs to improve.

61. While there have been much needed signs of improvement over the past four months under the Acting Chief Executive's leadership, Te Pūkenga still has a significant and complex transformation programme to implement under tight timeframes. There remains considerable risk and uncertainty around whether Te Pūkenga has access to the capacity and capability it needs to deliver on its work programme, whether the overall programme is affordable (particularly dependent on Crown funding), and that the appropriate programme management and governance structures are in place to ensure the successful delivery of the programme of work.

...we recommend you support the PBC

62. Although we note there is considerable risk and uncertainty around the delivery of Te Pūkenga's proposed work programme, we support the overall strategic case outlined in the PBC. Despite the risks, we consider that delivery of the proposed transformation and IT systems integration is integral to achieve the outcomes being sought through the establishment of Te Pūkenga and RoVE. We therefore recommend that you support the PBC. If you agree, Ministers will also need to make decisions on:

- the amount and form of Crown funding to be provided to Te Pūkenga.
- the profile of the funding and the conditions for release of funding.
- accountability and monitoring arrangements.

Amount of Crown funding

A careful balance is required between the amount of funding and managing risk…

63. Trying to establish the appropriate amount of Crown funding is difficult, especially given there is so much uncertainty around Te Pūkenga's future financial position and the significant transformation it is undertaking. On one hand, we want it to succeed, but we do not want to provide too much Crown support if it can afford to fund more of the programme itself. By Te Pūkenga funding a larger portion of the transformation costs, it naturally incentivises it to ensure the programme is delivered efficiently and cost effectively. On the other hand, we do not want to put too much pressure on Te Pūkenga's financial position given there are considerable risks associated with any programme of this scale.

64. Reducing the level of Crown support lowers the available cash reserves that Te Pūkenga will have access to (as it contributes more to the cost of delivery). This in effect lowers the level of financial shock that Te Pūkenga would be able to withstand, in the event of cost escalations or a prolonged decline in its financial performance. If funding is set too low, it increases the likelihood that Te Pūkenga does not successfully deliver the programme and/or further Crown funding is required, particularly if Te Pūkenga does not meet its expected level of financial performance. Lower funding levels also run the risk that the Council decides to only implement part of the planned transformation programme due to affordability concerns.

65. Under Te Pūkenga's financial base case, it has access to significant cash reserves. This means that, on face value, the Crown should provide a much lower contribution. 9(2)(f)(iv) [redacted] We also consider Te Pūkenga's assumption of a minimum cash floor of $50 million (noting it also has a $125 million borrowing consent in place which could be used to access further liquidity) may need to be reconsidered once funding decisions are made, financial forecasts are revised, and borrowing requirements are better known. We have therefore considered what an appropriate level of Crown support may be in the context of these downside scenarios.

…but we recommend a portion of Crown support is through a concessionary loan…

66. We consider that a portion of any Crown support should be in the form of a no-interest 10-year Crown concessionary loan. This will provide a strong incentive to Te Pūkenga to manage its financial position and the overall cost of the programme as closely as possible. While the concessionary nature of the loan would still have an operating cost to the Crown, the overall cost to the Crown would be lower than an operating grant, assuming full repayment is made. A Crown loan would also balance the risk of the Crown 'over contributing' in the event that Te Pūkenga does achieve its forecasts and has sufficient cash to fund the programme itself.

67. We consider an appropriate reference point for establishing the portion of the Crown's contribution that could be a loan is the proposed level of asset sales Te Pūkenga plan to undertake over the 2023 to 2031 period (i.e. a 9(2)(f)(iv) [redacted] Crown loan). Te Pūkenga consider there is upside to the modelled level of asset divestments, so we consider this assumption is reasonable. It would also encourage Te Pūkenga to look closely at its property portfolio and make further asset sales, if appropriate, to assist in repaying the loan. Under the base case and individual downside scenarios, we consider the Crown loan could be repaid. If multiple downside scenarios occur at once, Te Pūkenga would have difficulty repaying the Crown loan.

…with a decision to be made around the size of the operating grant provided…

68. If Ministers agree with the approach of providing a $ 9(2)(f)(iv) [redacted] Crown loan as part of the Crown's overall support package, decisions then need to be made around the level of operating grant (if any) that is provided to Te Pūkenga. Three options are presented below for consideration.

Option 1: Full amount provided – [redacted] as a Crown operating grant

69. Under this option, Te Pūkenga's request is fully funded (albeit through a combination of operating grant and Crown loan) including $[redacted] of funding for transformation programme management. Providing the full amount of funding would support Te Pūkenga's financial position and result in the strongest chance of the programme being delivered successfully and benefits being realised as soon as possible. However, it is a large amount of funding and would take the total Crown investment in Te Pūkenga since 2020 to [redacted]

Option 2: Transformation programme management funding not provided – [redacted] as a Crown operating grant

70. When Cabinet made decisions to provide funding to Te Pūkenga in 2020, it was on the basis that its head office operations would be self-funded by 2023. While management of the transformation programme could be considered a 'one-off', in essence, Te Pūkenga will be managing its transformation for at least the next five years. We have always been clear to Te Pūkenga that the Government is unlikely to provide additional funding for Te Pūkenga to run its operations and that any funding request should be focussed on the implementation of key aspects of the transformation programme.

71. Reducing the investment by [redacted] which is the estimated cost of running its transformation programme over the next four years, would have an impact on Te Pūkenga's cash position but we consider it should be manageable. At this lower amount, Te Pūkenga will be required to consider other funding options to fund the programme management costs (i.e. cash reserves, deferring capital expenditure, further asset sales) or it may have to delay some parts of the transformation programme. This option would take the total Crown investment in Te Pūkenga since 2020 to [redacted].

Option 3: No transformation programme management funding and IT systems integration not fully funded – [redacted] as a Crown operating grant

72. Under this option, Ministers could decide to not fully fund the IT systems integration and provide, for example, only [redacted] as a Crown operating grant. The key outcome of a lower funding amount is that the transformation programme is likely to take longer to be implemented. Te Pūkenga is of the view that all IT systems integration is needed, and reduced funding would just increase the amount of time it takes to deliver the integration and delay benefits realisation. A lower amount would also put greater pressure on Te Pūkenga's financial position and impact its ability to manage risks that arise (noting risks are inevitable in such a transformation programme). This option would take the total Crown investment in Te Pūkenga since 2020 to [redacted]

…and we recommend a $[redacted] operating grant is provided (option 2)

73. We consider a $[redacted] Crown loan and a $[redacted] Crown operating grant (option 2) to be the preferred option. This option funds only the IT systems integration and best balances the benefits and risks to Te Pūkenga with the Crown's level of overall investment. Under the base case financial scenario, the programme is clearly affordable at this level of Crown investment. Under the individual downside scenarios, we consider the programme still remains manageable, but it will require strong mitigations to be implemented and potentially require Te Pūkenga to take on commercial debt. It will also require the Council to make tough decisions.

The profile of funding and conditions for the release of funding

Further business cases will be required to access any Crown funding…

74. We recommend that the release of Crown funding be subject to further business cases being completed consistent with the Treasury's Better Business Case framework. This would help manage some of the key planning and delivery risks, especially around IT systems integration,

as well as ensuring prudent commitment to project costs. Each business case would need to provide greater certainty on the costs, provide a value for money assessment, and give assurance that the project will be managed and governed appropriately to ensure its successful delivery.

75. Further work is needed to establish what business cases would be required and how it would be linked to funding. Te Pūkenga plan on developing project business cases for all 35 IT projects. However, we consider it inefficient and burdensome for each business case to be approved by Ministers and for funding to be released project by project. We are currently investigating how key projects can be grouped into three or four areas and a business case is submitted to Joint Ministers for approval for each grouping.

…and an option exists for some funding to be recoverable based on enrolment growth

76. An option exists for Ministers to implement a condition that a portion of the Crown operating grant (e.g. 9(2)(f)(iv) [redacted]) is returned if overall enrolment growth targets are reached by a certain date (e.g. 2028), based on Te Pūkenga's base case scenario. Under the base case scenario, the programme is clearly affordable and such a condition would further protect the Crown from 'overpaying'. This is a potential option you may wish to discuss with officials. 9(2)(f)(iv) [redacted]

Accountability and monitoring arrangements

We would establish a funding agreement to set out the terms and conditions of the funding…

77. As with previous Crown investments in Te Pūkenga, as well as other tertiary education institutions, we consider a funding agreement should be established between the Crown and Te Pūkenga which sets out the accountability and monitoring arrangements. Crown funding agreements with Te Pūkenga are already in place that cover the Crown's initial $121 million investment and the $40 million capital investment for high priority building issues through Budget 2022. These were signed by both you and the Minister of Finance.

78. We recommend that the funding agreement cover:

- the timing, amounts, terms and conditions for the payment and use of Crown funding.
- the business cases that must be developed in accordance with Treasury's Better Business Case guidance.
- the requirement to participate in Gateway reviews and undertake independent quality assurance assessments on business cases to ensure that the programme of work is being well-managed and governed as strongly as possible.
- the monitoring and reporting requirements which will involve, at a minimum, the continuation of comprehensive quarterly reporting to the TEC.
- the receipt of all Council papers as well as those from relevant Council sub-committees.
- any additional governance or oversight mechanisms that Ministers may wish to include.

…and you may wish to consider additional oversight mechanisms

79. A condition of the Crown's investment into the University of Canterbury (UC) and Lincoln University, to assist them rebuild and recover from the 2010 and 2011 earthquakes, was the establishment of a Governance Oversight Group (GOG). The GOG was independently chaired and included representatives from the University Council, the Chair and Chief Executive from the TEC, and in UC's case, a Deputy Secretary from the Ministry of Education.

80. Its purpose was to oversee and monitor progress of the transformation programme against agreed targets and milestones and to ensure the governance mechanisms were working effectively. It was also used to help identify and resolve issues that arose. We would like to

discuss with you whether a similar arrangement may also be beneficial for Te Pūkenga. The group could potentially be complemented with independent members who have IT expertise.

Key risks

81. Te Pūkenga has outlined its key risks and mitigations in the PBC (pages 56 to 59). From our point of view, there are many risks that exist, but these can be linked back to three key risks that need to be considered as part of Crown investment decisions. They are outlined below alongside potential mitigations.

Key risk	Comment	Potential mitigations
Financial sustainability and affordability	Te Pūkenga's current financial position is poor, and it is implementing a costly transformation programme. Future financial sustainability is based on increased enrolments. If increased enrolments do not eventuate, affordability will be tested.	• Te Pūkenga has a range of mitigations it can implement – cancelling/deferring capital expenditure, reducing staffing levels, delaying its transformation programme, cost management, further asset divestment. • Crown investment will support overall affordability. • IT systems integration will drive efficiencies and improve information and overall decision-making. • Intensive Crown monitoring and oversight will ensure issues are identified early. • Requirement for further business cases will provide greater clarity on overall affordability.
Achievability of the programme	Te Pūkenga is implementing a large and complex transformation programme with a range of interdependent projects in a short period of time. There is a risk of delays, cost overruns, and a lack of integration between projects.	• Programme management structures have recently been improved (but further work is needed). • A transformation sub-committee of Council has been established, complemented by independent expertise, with responsibility for overseeing the transformation. • A robust assurance programme will be required as part of the Crown investment, including independent quality assurance reviews and Gateway reviews. • There is an opportunity to address skills gaps on Council with five Ministerial appointments to be made before 31 March 2023. • Requirement for further business cases will help ensure appropriate management and governance structures have been put in place. • Potential for a Crown GOG. • Potential to require regular independent reviews of governance/management arrangements and underlying progress.
Capability and capacity to deliver	Te Pūkenga requires a range of IT expertise, as well as programme management and change management capability to successfully implement its transformation programme. Te Pūkenga has noted much of this expertise will need to be sourced externally. At the same time, a new executive team is being put in place.	• A transformation sub-committee of Council has been established, complemented by independent expertise, with responsibility for overseeing the transformation including capability. • A robust assurance programme will be required as part of the Crown investment, including independent quality assurance reviews and Gateway reviews. • Requirement for further business cases will ensure Te Pūkenga has a plan to address capability and capacity issues. • Potential for a Crown GOG and/or other mechanisms which ensure appropriate oversight and expert support.

Next steps

82. We would like to discuss the PBC and the contents of this aide-memoire with you at your earliest convenience. Based on your feedback, the Ministry of Education and the TEC can incorporate these views into ongoing discussions with the Treasury throughout the Budget process. We can also undertake further analysis and seek additional information from Te Pūkenga as required.

83. Te Pūkenga's proposed investment was recently considered by Treasury's Investment Panel. The Investment Panel will provide a report to the Minister of Finance and Treasury, which will inform their assessment of Te Pūkenga's Budget bid. Treasury has advised that any operating costs of the investment would not impact on your Budget 2023 education portfolio envelope.

84. We recommend you share this aide-memoire with the Minister of Finance. We can support any discussions you may wish to have with the Minister of Finance if necessary.

Tim Fowler

Chief Executive

Tertiary Education Commission

29 November 2022

Hon Chris Hipkins

Minister of Education

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