Tertiary Education Commission
Te Amorangi Mātauranga Matua

Aide-Memoire: Update on Te Pūkenga

To:	Hon Chris Hipkins, Minister of Education
From:	Gillian Dudgeon, Deputy Chief Executive – Delivery, Tertiary Education Commission
Date:	9 June 2022
Reference:	AM-22-00247

Purpose

1. This aide-memoire provides you with additional information on Te Pūkenga following several comments you made on our March 2022 quarterly monitoring report (AM-22-00207 refers). To assist in responding to your comments, we sought feedback directly from Te Pūkenga. Te Pūkenga's full response is attached.

2. We recommend that you proactively release this aide-memoire with information withheld that is commercially sensitive and to maintain the effective conduct of public affairs through free and frank expression of opinions.

Financial performance

Financial sustainability and the minimum viable product

3. *You noted a concern that the minimum viable product (MVP) agreed between the TEC and Te Pūkenga did not have enough emphasis on immediate financial sustainability issues.*

4. The MVP currently includes a requirement that a financial strategy be put in place by 1 January 2023 that drives the future sustainability of the network. Outside of the MVP, we engage closely with Te Pūkenga on its current and future financial performance. This includes receiving detailed monthly financial information, Council papers, and Audit and Risk Sub-Committee papers. Over 2022, our engagements have focussed on improving financial reporting and seeking clarity on what actions are being taken to address Te Pūkenga's significant forecast deficit. We consider there are further improvements to be made, and this will continue to be a focus until such time as our concerns have been resolved.

Actions being taken by Te Pūkenga to reduce costs

5. *You requested an urgent update on what Te Pūkenga is doing to trim costs now in response to lower enrolments.*

6. Based on data for the year to April 2022, Te Pūkenga is forecasting a $90.8 million deficit for the wider group in 2022. This is an improvement on the March 2022 forecast of a $110.0 million deficit. The improvement has been driven by better forecast performance from Work-Based Learning Limited (WBL), primarily due to strong demand. s9(2)(i), s9(2)(b)(ii) [redacted]

7. As noted in our latest quarterly report, Te Pūkenga provided a directive to subsidiaries earlier in the year to employ cost mitigation strategies and prudent cost control measures in response to the large forecast deficit. This included all staff recruitment requiring subsidiary chief executive approval. Over the past month, Te Pūkenga notes it has taken the following additional steps:

   - All subsidiaries providing monthly high-level forecasts to Te Pūkenga.
   - Subsidiaries providing detailed re-forecasts in early August 2022 and November 2022 with the process to include an open book policy where Te Pūkenga finance will work closely with subsidiaries to understand the detailed assumptions made in the forecasts.
   - Te Pūkenga undertaking a further review to better understand what procurement savings are available from within the network, to add to the procurement savings already achieved.
   - Establishment of a centralised view of the group's capital expenditure and implementation of a prioritisation strategy. Although this will have minimal impact on the group profitability, it should assist in maintaining cash balances.
   - Further hiring restrictions across the group with key roles needing replacement to be approved by both the subsidiary chief executive and Te Pūkenga's DCE Operations until the new group CFO commences in July 2022.

8. We consider the above actions will provide some positive impact, but they are unlikely to significantly reduce the deficit. Given the deficit being faced, there urgently needs to be greater accuracy in forecasting performance across the subsidiaries, although this will not directly impact the overall deficit. Nevertheless, Te Pūkenga needs to have an accurate picture of organisational performance so that it can make informed decisions. To date, we have yet to see any improvement in this area.

9. We consider that having a centralised view of capital expenditure and seeking efficiencies in procurement costs is sensible, but any savings identified are likely to be minor and will take time to implement. Ideally, these two actions should already have been implemented and continually explored given Te Pūkenga has now been in operation for over two years.

10. Hiring restrictions are likely to have the biggest impact on reducing the deficit. This will particularly be the case if staff turnover is high, and vacancies are not filled. However, from our point of view, this is not only about responding to the decline in enrolments in 2022. It is also about reviewing and right sizing the cost base of the organisation, to meet both the current and medium-term predicted level of enrolments. Over the past five years, there has been a 16 percent decline in enrolments across the ITP subsidiaries while FTEs have only fallen by 9 percent.

11. Over 2022, it is important that Te Pūkenga closely monitors the impact hiring restrictions and cost control measures are having across its network. If limited benefit is being achieved, further measures will need to be deployed. It is important that Te Pūkenga's Council and management provide clear direction to the subsidiaries and make decisions to preserve the financial resources of the group. As part of this work, we would expect Council to formally adopt its reforecast position and set quantifiable targets for the savings it is seeking to achieve. Progress against these targets should then be incorporated into Te Pūkenga's regular monitoring.

Early wins regarding network efficiencies

12. *You noted you would like to see a plan for some early wins regarding network efficiencies as soon as possible.*

13. Te Pūkenga notes that it is already benefiting from consolidation through insurance savings (around $1 million per annum), reduced interest costs as part of the implementation of the

treasury function (around $0.8 million to $1 million per annum), and personnel cost reductions (around $0.4 million to $0.5 million per annum). However, for an institution that has over $1.2 billion in revenue, these savings are not material.

14. Te Pūkenga has signalled that it expects further efficiencies to be made through its new organisation design 9(2)(i) [redacted]

Financial reporting improvements

15. *You requested assurance that the regularity and quality of financial reporting has been resolved.*

16. To date, we have seen no improvement in the overall quality of financial reporting from Te Pūkenga. In particular, the quality of forecasts provided and the frequency with which they are undertaken remains varied across subsidiaries. Over the past month, Te Pūkenga has presented three different forecasts with regards to its full-year result. In late April 2022, Te Pūkenga forecast a $110.0 million deficit for 2022, which was amended to 9(2)(b)(ii) [redacted] in mid-May before increasing again to 9(2)(b)(ii) [redacted] in late May. 9(2)(g)(i) [redacted] It is integral that Te Pūkenga continue to work with its subsidiaries to improve the quality of their forecasts and better understand what is driving the changes.

17. As per our latest quarterly report, we consider financial reporting and the associated commentary provided by Te Pūkenga management needs improvement and is an issue we have regularly raised over the past year. 9(2)(g)(i) [redacted] Over the past month we have had several engagements with Te Pūkenga to outline our concerns and where we see improvements can be made.

18. Following these engagements, Te Pūkenga has committed to improving reporting and providing additional commentary although we have yet to see any results from this work. We have also set up regular meetings with Te Pūkenga to discuss the financial results as monthly data becomes available. Every quarter, we will have a more formal engagement with senior management to discuss the financial results and the actions management are taking.

19. While we expect some improvements to be made through these engagements, we consider it will take some time before there is a significant improvement in financial reporting. Fundamentally, Te Pūkenga need to improve the quality and accuracy of the financial information it collects (which will be aided by the proposed IT systems integration projects) as well as increase capability so that it can appropriately analyse data and implement mitigation strategies. Following the dissolution of subsidiaries on 31 December 2022, Te Pūkenga should be able to generate more control over improving the quality of financial information and the actions it is taking across the network.

20. Te Pūkenga has recently appointed a new Chief Financial Officer (CFO), who will urgently need to drive improvements. The TEC has extended an offer of invitation to Te Pūkenga to support the CFO's induction process. Ensuring that the new CFO gains a detailed understanding of the Tertiary Education sector and the expectations on Te Pūkenga is critical given they do not have any education sector experience.

Improving financial performance through the new organisational design and transformation

21. *You noted that the PBC needs to identify the synergies and efficiencies possible with the networked approach and how these will be realised. The case for additional investment needs*

to be based on supporting transformation, not an unsustainable status quo. You also sought reassurance that the new organisational design and associated transformation will deliver improved financial performance.

22. In our engagements with Te Pūkenga, we have been clear that the PBC needs to outline what changes Te Pūkenga plan to make to move the organisation towards a financially sustainable position. We have also been clear that any additional Crown funding will not be to cover deficits or the running of Te Pūkenga's head office, but to support its transformation.

23. As signalled in paragraph 14, the draft PBC provided to the TEC shows that creating a single Te Pūkenga organisation on 1 January 2023 9(2)(i) [redacted]

24. Te Pūkenga has also identified several other examples of efficiency gains that will be achieved through transformation, including:

- reduced council and board fees due to the reduced number of boards needed (estimated savings of $31.4 million).
- auditors' remunerations costs decreasing significantly given each ITP and TITO is currently audited separately (estimated savings of $20.5 million).
- the Academic Programme Unification project, which will provide downstream financial benefits as a smaller number of academic courses and programmes results in less course upkeep and development costs in the long run (estimated savings of $44.7 million although the TEC would note that this project has significant up-front costs 9(2)(b)(ii) [redacted]
- further work on its property footprint review to ensure Te Pūkenga has the right spaces that are well utilised in future. This is expected to lead to the rationalisation of underutilised assets across the network to raise funds. 9(2)(b)(ii) [redacted]

25. The largest financial benefit assumed in the PBC however, is that Te Pūkenga's new operating model will result in increased enrolments in future – both through attracting new students and by improving retention. This is expected to lead to increased revenues through greater Government funding, tuition fees, and other fees.

26. From the draft material we have reviewed, the PBC does begin to demonstrate a pathway for Te Pūkenga to return to a surplus position. However, this is strongly reliant on growth in both domestic and international enrolments. A failure to achieve this growth will result in increased financial difficulties.

Early mover subsidiaries

27. *You noted your concern that simply dissolving subsidiary boards without a clearly defined new org structure will not achieve much.*

28. This is a concern we previously raised in our December 2021 quarter monitoring report (AM-22-00060 refers). The recent transition of Toi Ohomai and Wintec are essentially just a 'lift and shift' with the only real change being that they are no longer governed by a board and that they now have a common chief executive.

29. Te Pūkenga considers the benefits of dissolving Toi Ohomai and Wintec earlier than 31 December 2022 include:

- it immediately reduces competition in the regions that Toi Ohomai and Wintec serves.
- Toi Ohomai and Wintec are fulfilling the role of tuakana in leading the transition for other subsidiary ITPs, including having two respected and experienced sector leaders now within Te Pūkenga to support the change leadership process.
- testing the dissolution process of the two subsidiary boards and readiness to receive by Te Pūkenga.
- bringing kaimahi into Te Pūkenga therefore simplifying the transition for the operating model.

30. While we consider there are some benefits of implementing a staged integration and that it will provide a learning opportunity to help de-risk the approach of all subsidiaries ceasing at the same time at the end of 2022, most of these learning opportunities will be around the technical process of dissolving a subsidiary. There will be no lessons learnt around the transfer of staff to new roles and into a new organisation given there are no changes to staffing arrangements. 9(2)(g)(i) [redacted] From our point of view, it will also test Te Pūkenga's ability to drive reporting and performance improvements, given they now have management control of Toi Ohomai's and Wintec's operations.

31. We understand Te Pūkenga, and other ITP subsidiary boards, are considering further early transitions.

Ring-fenced reserves

32. *You requested additional information regarding ring-fenced reserves, following our commentary that there has been very little reduction in ring-fenced reserves despite a mechanism having been put in place for these funds to be utilised.*

33. There has been limited focus from Te Pūkenga on ensuring subsidiaries utilise ring-fenced reserves. As at the end of 2021, ring-fenced reserves totalled $74.8 million, a reduction of $4.7 million since Te Pūkenga was established. The decline was entirely due to NorthTec utilising its reserves. All other ITP subsidiaries had the same balance of ring-fenced reserves as they had on 1 April 2020 when Te Pūkenga was established (see *Table 1* below).

Table 1: Te Pūkenga use of ring-fenced reserves

Subsidiary	Te Pūkenga opening balance	31 Dec 2021 balance
Ara	$29,672,120	$29,672,120
EIT	$14,672,833	$14,672,833
NMIT	$11,702,000	$11,702,000
NorthTec	$4,691,187	-
SIT	$15,174,787	$15,174,787
Open Polytechnic	$3,167,925	$3,167,925
Toi Ohomai	$439,797	$439,797
Total	**$79,520,649**	**$74,829,462**

34. Te Pūkenga budgeted for ring-fenced reserves to 9(2)(b)(ii) [redacted]

35. Given overall capital expenditure is well behind budget, we have doubts whether the $13.0 million budgeted decline will be achieved. Te Pūkenga has also noted that it will focus ring-fenced funds towards high priority building projects. However, we would note that the business case provided to Ministers in late 2021 showed that 9(2)(b)(ii) [redacted]

36. Te Pūkenga needs to focus on ensuring the remaining ring-fenced reserves are utilised if operational and capital projects are undertaken that meet the requirements of its ring-fencing policy.

Next steps

37. Te Pūkenga plan on submitting its PBC to you over the next month. This will allow you to engage on several of the issues you have recently raised with regards to Te Pūkenga's financial performance and its new organisation design. We intend to provide you with some preliminary views on the PBC in the coming weeks.

38. In the meantime, we will continue to work closely with Te Pūkenga on its performance and raise issues as they arise. Our next quarterly monitoring report will be provided to you in August 2022.

Gillian Dudgeon

Deputy Chief Executive

Tertiary Education Commission

9 June 2022

Hon Chris Hipkins

Minister of Education

13 / 06 / 2022

Responses to Minister of Education’s queries – June 2022

Audited Group Results – cleared 31 May 2022

- Te Pūkenga forecasted a deficit in 2021 of $8.6m (including WBL) and achieved a surplus.
- The budgeted deficit was ($51,153m) - Te Pūkenga 2021 Group Result has now been signed off showing a Group Net Surplus of $7.623m.
- Te Pūkenga had $207.371m of cash and cash equivalents at 31 December 2021 that will support the transformation and ensure the benefits are delivered.

Te Pūkenga cost control measures in response to lower enrolments

- Te Pūkenga Council has provided subsidiaries with a directive to employ cost mitigation strategies, including staff recruitment requiring subsidiary CE approval and prudent cost control measures.
- Following the re-forecast work conducted in April/May 2022, additional steps now include the following:
    - All subsidiaries providing monthly high level forecasts to Te Pūkenga
    - Subsidiaries providing detailed re-forecasts in early August 2022 (based on June 2022 actuals) and November 2022 (based on September 2022 actuals) – with the process to include an open book policy where Te Pūkenga Finance will work closely with subsidiaries to understand the detailed assumptions made in the forecasts
    - Te Pūkenga undertaking a further review to better understand what procurement savings are available from within the network, to add to the procurement savings already achieved
    - Establishment of a centralised view of the Group’s capital expenditure and implementation of a prioritisation strategy. Although this will have minimal impact on the Group profitability, it should assist in maintaining cash balances
    - Further hiring restrictions across the group with key roles needing replacement to be approved by both the subsidiary CE and Te Pūkenga DCE Operations until new Group CFO commences.

Early wins through network efficiencies

- Te Pūkenga is already benefiting from consolidation through insurance savings (~$1m p.a.), treasury management (~$0.8m-$1m p.a.), and personnel cost reductions (~$0.4m-$0.5m p.a.).
- The high-level organisation design has been developed and the Operating Model team are currently undertaking detailed design. This will be used to inform the staff consultation process scheduled for July 2022. 9(2)(i) [redacted]
- As outlined in our Programme Business Case (PBC), and below, further efficiencies will be realised from 1 January 2023 as subsidiaries transition into Te Pūkenga.

Wants reassurance that the regularity and quality of financial reporting has been resolved

- Actions have been put in place to address concerns around financial reporting including:
    - Further commentary provided in the financial reporting to better represent the financial situation and mitigating strategies to address risks.
    - Monthly high-level forecasts from subsidiaries as a health check of likely financial outturn for the year.
    - Monthly briefings with TEC on the financials to compliment information provided to Te Pūkenga Council and inform its monitoring.
    - Detailed quarterly re-forecasts to further understand the assumptions used by network subsidiaries with adequate conversation and challenge around drivers of expected financial outturn.

- Appointment of permanent CFO (starting in the role July 2022) who will provide thought leadership and expertise to provide a financially sustainable unified network. The CFO will receive support from TEC and an external tertiary education financial sector experts.

The PBC needs to identify the synergies and efficiencies possible with the networked approach and how these will be realised. The case for additional investment needs to be based on supporting transformation, not an unsustainable status quo.

- The PBC has been developed using the Treasury's Better Business Case™ (BBC). The PBC has developed investment objectives aligned with the Minister of Education's expectations and explored options to achieve these.
- The case has identified additional investment needs to support the transformation and ensure the benefits are delivered.
- One benefit relates to increased ākonga numbers into the future - a higher number of students, and some students staying in study longer, means increased Government funding, tuition fees, and other fees
- 9(2)(i) [redacted]
- Other examples of efficiency areas that will be achieved through transformation are reduced council and board fees due to the reduced number of boards needed, auditors' remunerations costs decreasing significantly as currently each ITP / TITO is audited separately, and the Academic Programme Unification project will provide downstream financial benefits as a smaller number of academic courses and programmes results in less course upkeep and development costs in the long run

Concerned that simply dissolving subsidiary boards without a clearly defined new org structure will not achieve much

- The high-level organisation design has been developed and the Operating Model team are currently undertaking detailed design. This will be used to inform the staff consultation process scheduled for July 2022.
- The benefits of Toi Ohomai and Wintec dissolving earlier than the dissolution date of 31 December 2022 are:
  - Immediately reduces competition in the regions that Toi Ohomai and Wintec serves
  - Toi Ohomai and Wintec are fulfilling the role of tuakana in leading the transition for other subsidiary ITPs, including having two respected and experienced sector leaders now within Te Pūkenga to support the change leadership process
  - Testing the dissolution process of the two subsidiary boards and readiness to receive by Te Pūkenga
  - Bringing kaimahi into Te Pūkenga therefore simplifying the transition for the Operating Model.

Wants reassurance that the new organisational design and associated transformation will deliver improved financial performance

- As highlighted in the PBC, the transformation will create efficiencies 9(2)(i) [redacted]
- From 1 January 2023, Te Pūkenga will gain further control of subsidiary operations, which will enable more effective management of resources and create further opportunities for efficiency realisation into the future.
- As outlined in the PBC, there is also scope to undertake a future property footprint review to ensure Te Pūkenga has the right spaces that are well utilised in the future. The intention is to continue the rationalisation of underutilised assets across the network to raise funds.

Plan for ring-fenced reserves

- As at 31 April 2022 ring-fence funds were [redacted]
- [redacted]
- We will focus ring-fenced funds use towards High Priority Building projects; this will be explored as part of our prioritisation scheduled for the coming months. Furthermore, as part of budgeting for 2023 activities utilising ring-fence funds will be elevated as part of a revised capital expenditure prioritisation framework.
- These activities are expected to significantly reduce the ring-fenced reserve balances over the next 18 months.