



## Education Report: Managing the fiscal implications of RoVE – A3 for discussion on 10 February

<b>To:</b>	Hon Chris Hipkins, Minister of Education		
<b>Date:</b>	4 February 2020	<b>Priority:</b>	High
<b>Security Level:</b>	Budget Sensitive	<b>METIS No:</b>	1218369
<b>Drafter:</b>	Scott Connew		9(2)(a)
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<b>Messaging seen by Communications team:</b>	No	<b>Round Robin:</b>	No

### Purpose of Report

This report updates you on the development of the draft Cabinet paper on managing the fiscal implications of the Reform of Vocational Education (RoVE). This report also seeks further direction on potential interim Unified Funding System (UFS) investments.

### Recommended Actions

The Ministry of Education and Tertiary Education Commission (TEC) recommend that you:

- note** that the A3 attached as Annex One provides an overview of the scale of funding estimated as needed by components of RoVE and the funding that is available for investment, for discussion with you on Monday 10 February 2020
- note** that a near-final version of New Zealand Institute of Skills and Technology (IST) Establishment Board's implementation business case is now expected to be received on Friday 7 February

### Scale of estimated costs and available funding

- note** that the scale of funding sought across RoVE (around 9(2)(i) million) significantly exceeds the funding available for investment (around 9(2)(i) million), and excludes:
  - a borrowing facility the IST will need to manage working capital across its network of subsidiaries
  - provision for 'going concern' funding support for the most at-risk IST subsidiaries beyond 2021
  - the full cost of the transformation programmes the IST will need to implement to achieve Government's objectives and expectations
  - 9(2)(f)(iv)

- 4) **note** that officials intend to test the scale of funding that both the IST and WDCs may actually need in their initial years of operation, given there will be lead-in times to build capabilities and develop detailed operating models
- 5) **discuss** the following key issues with officials in your agency meeting on Monday 10 February:
- a) your expectations of the 'up-front' investment in the IST to manage its network of subsidiaries and plan and design transformation activities
  - b) sequencing future investments in the IST via consideration and approval of project-specific business cases
  - c) the scale of funding you wish to transfer from the Industry Training Fund (ITF) to a baseline for WDCs, as this decision reduces the amount of ITF funding that could then 'flow through' to the Unified Funding System when it is implemented

9(2)(f)(iv), 9(2)(j)

AGREE / DISAGREE

9(2)(f)(iv), 9(2)(j)

OR

AGREE / DISAGREE

9(2)(f)(iv), 9(2)(j)

AGREE / DISAGREE

9(2)(f)(iv), 9(2)(j)

#### *Next Steps*

- 11) **note** that, following discussion of the above with you on 10 February, we intend to provide you with an updated draft Cabinet paper on 13 February, with a view to it being

shared with the Minister of Finance prior to being updated as needed for formal Ministerial consultation in late February

- 12) **note** that we propose lodging the Cabinet paper with Cabinet office on 5 or 12 March for decisions by the Social Wellbeing Committee on 11 or 18 March, which would enable you to announce the funding decisions on or around 1 April
- 13) **agree** that this Education Report is proactively released once Cabinet has taken decisions on the fiscal implications of RoVE Cabinet paper.

Agree / Disagree



**Tim Fowler**

Chief Executive

Tertiary Education Commission

04 / 02 /2020



**Andy Jackson**

Acting Deputy Secretary

Ministry of Education

04 / 02 /2020



**Hon Chris Hipkins**

Minister of Education

12/2/20

## Background

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- 1 As part of Cabinet's decisions to implement the Reform of Vocational Education (RoVE), you were invited to report back to Cabinet by December 2019 with a more detailed strategy to manage the fiscal implications of RoVE [CAB-19-MIN-0344 refers].
- 2 In September 2019, you and the Minister of Finance agreed that the fiscal implications of RoVE would be managed with the contingency set aside for RoVE at Budget 2019 and funding likely to be unspent in Vote Tertiary Education.
- 3 In November 2019, you agreed to defer the fiscal management of RoVE Cabinet paper to February 2020 to enable it to be informed by robust updated estimates of costs across components of RoVE, particularly the New Zealand Institute of Skills and Technology (IST) Establishment Board's 'implementation business case' [METIS 1208763 refers].
- 4 We provided you with the first draft of the fiscal management of RoVE Cabinet paper on 11 December [METIS 1215684 refers], which you provided some initial feedback on in your final agency meeting of 2019 on 16 December. You also met with the Chair of the IST Establishment Board on 18 December, where funding of the IST was discussed.

## We propose lodging the fiscal management of RoVE Cabinet paper in March

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- 5 Although work to progress the implementation of RoVE continued at pace across December and January, it became clear in mid-January that updated estimates and supporting detail would not be sufficiently refined in time to submit a proposed final version of the Cabinet paper to you near the start of February. This was primarily due to the significant scale of work involved to produce and refine the IST's 'implementation business case', and to prioritise the available funding across components of RoVE.
- 6 We met with staff from your office on 22 January and agreed to work toward lodging a paper on 5 March for consideration by Cabinet's Social Wellbeing Committee (SWC) on Wednesday 11 March. Your office noted that the actual timeline for the paper would be at your discretion. To achieve this timeframe, we undertook to provide:
  - this report and attached A3 to inform a discussion with you on Monday 10 February
  - an updated draft of the Cabinet paper on 12 February, unless agreed otherwise.
- 7 We suggest you share the next version of the Cabinet paper with the Minister of Finance. Following any necessary amendments, we suggest that you consult your Cabinet colleagues on a proposed final draft of the paper in the last week of February. Subject to that process, you could lodge the paper for SWC's meeting on 11 March. We have informed the Department of the Prime Minister and Cabinet of this potential timeline.
- 8 We note that SWC will also be meeting on 18 March, but not on 25 March. SWC decisions on either 11 or 18 March and subsequent Cabinet confirmation would enable you to announce the decisions on or around 1 April.

### *Scope of IST 'implementation business case'*

- 9 A near-final version of the IST Establishment Board's 'implementation business case' (IBC) is now expected on 7 February. A provisional draft was provided to the IST Establishment Board and Ministry and TEC officials on Monday 27 January. At its meeting on 28 January, the IST Board requested that further work be untaken and tasked a sub-group of Board members to guide its completion.
- 10 We emphasise that the provisional version we have been provided has not been approved by the IST Board, though note that the scale of funding proposed as needed to the Board was around \$9(2) million.

- 11 On Friday 31 January and Monday 3 February, we were provided with updated estimates that increased the amount of funding that might be requested to around **£9(2)** million, with the following high-level breakdown:
- Core head office capability and enabling projects – **£9(2)** million across 2020, 2021 and 2022
  - Initial planning and design of transformation programmes – **£** million across 2020 and 2021, with signalling of larger implementation costs from 2022
  - Subsidiary ‘going concern’ support – **£** million across 2020 and 2021 (with signalling of additional funding needed for 2022 to 2024).
- 12 In addition to the above, and as signalled to you by the Chair of the IST Establishment Board in December, the IST would also need access to as an over-draft type facility to manage cash flow across its network of subsidiaries. This has been estimated as requiring a facility of around **£9(2)** million across 2020, 2021 and 2022, although officials are seeking further information to verify whether a facility of this scale would be necessary.
- 13 Officials consider there to be a risk that the level of detail in the 7 February version may fall short of the standard needed to support the scale of funding outlined above. We note that Cabinet’s July 2019 decisions require the IBC product to be submitted to Cabinet as part of the fiscal management Cabinet paper. Senior officials have met with the IST Establishment Board Chair to discuss and clarify the content of the business case product and the level of detail it contains.
- 14 While we are confident that high-quality work is being undertaken across the IST Establishment Board’s work streams, the level of detail that may be in the final IBC product nonetheless raises questions about the level of funding that could be agreed by Cabinet without further information first being submitted to Ministers.
- 15 In particular, we suggest that in-principle agreement of funding beyond 2021/22 be considered, with approval of that funding being conditional on greater clarity of the consolidated IST’s operating and delivery models, including how head office and other costs might be able to be supported via consolidation of functions across its network.

### *Proposed approach to IST investments*

- 16 We therefore propose that initial investments support the IST to progress its establishment and transformation planning at pace, with funding for large-scale transformation programmes being subject to the development and consideration of specific business cases, and the availability of additional funding.
- 17 We agree that funding needs to be available to ensure that the IST Establishment Board, the inaugural IST Council and Directors of subsidiaries are assured of certain subsidiaries ability to meet the requirements of the Companies Act 1993. However, this ‘going support’ funding does not necessarily need to be provided up-front to the IST itself – the key is that it would be available. If it were provided up-front to the IST, it may need to be ring-fenced to ensure it was used only for that purpose.
- 18 As such, we consider that the IST Board’s ‘implementation business case’ and the Crown’s ‘up-front’ investment in the IST focus on:
- resourcing the IST to:
    - establish and build the capabilities and systems needed to manage its network of subsidiaries; and
    - develop detailed operating and education delivery models for a fundamentally new type of tertiary education institution;

- supporting the scoping and development of business cases for transformation programmes
  - retaining funding in contingency to manage emergent risks and liabilities, including the 'going concern' support some subsidiaries will require
  - signalling the likely need for significant future investments.
- 19 We consider this approach would be in line with to how similar large-scale Crown investments are managed, with additional funding provided once agreed milestones are completed. It would also provide Ministers with greater oversight of the alignment of the IST's transformation programmes with the Government's RoVE objectives, and greater clarity of costs and benefits.
- 20 On 10 February, we would like to discuss your expectations of how a balance of up-front investment in the IST and subsequent investments might be achieved.

*Potential division of operating and capital expenditure*

- 21 We are aware you wish to have a clear understanding of the potential division of operating and capital expenditure investments across RoVE, and particularly in the IST. This detail is still being worked through. We are not aware of a potential source of capital funding, other than converting some of the operating funding that is available into capital funding (which would reduce the amount of operating funding available).
- 22 In general, capital funding is provided to deliver tangible assets owned by the Crown. In exceptional circumstances, capital funding is provided to entities owned or controlled by the Government to ensure their operational viability – in return for the delivery of specific outputs. Capital funding can also be provided in the form of a loan – also usually in return for the delivery of specified outputs.
- 23 In line with the above, we consider that more detail is needed about the assets and/or outputs that would result from potential Crown capital investment in the IST.

Estimated costs in excess of  $\text{£}9(2)$  million have been identified ...

- 24 As at the end of January, noting that significant detail is still be worked through, estimated costs in excess of  $\text{£}9(2)$  million have been identified across components of RoVE. This number reduces to nearer  $\text{£}9(2)$  million once funding already appropriated for 2020/21 is deducted. An overview of these costs is in the A3 attached as Annex One, but can be summarised as:
- Institute of Skills and Technology –  $\text{£}9(2)$  million (over 3 calendar years)
  - Workforce Development Councils  $\text{£}9(2)$  million (over 4 years)
  - $\text{£}9(2)(j)$ ,  $\text{£}9(2)(f)(iv)$
  - Centres of Vocational Excellence –  $\text{£}9(2)$  million (over 4 years)
  - RoVE Programme –  $\text{£}9(2)$  million (over 3 years).
- 25 It is important to note that the above estimates exclude:
- a borrowing facility the IST will need to manage working capital across its network of subsidiaries
  - provision for 'going concern' funding support for the most at-risk IST subsidiaries beyond 2021
  - the full cost of the transformation programmes the IST will need to implement to achieve Government's objectives

- s 9(2)(f)(iv)
  - the likely need to retain some funding in the RoVE contingency to manage risks and unforeseen costs
  - Regional Skills Leadership Groups – for which funding is being sought through Budget 2020.
- 26 It is also important to note that that s 9(2) million estimated cost for WDCs identified above and in the attached A3 is a 'low-end' estimate of the potential scale of the necessary scale of Government investment in WDCs. This amount includes building to an ongoing baseline of s million per annum for WDCs from 2022/23.
- 27 The 'high-end' estimate for WDCs comprises higher establishment funding and building to an ongoing baseline of s million per annum from 2022/23. s 9(2)(j), s 9(2)(f)(iv)

... Funding of s 9(2)(i) million is available, and could be s 9(2)(j) million

- 28 As advised in our 11 December briefing, s 9(2)(j) million has been identified as available for investment across RoVE, which could be increased by re-purposing some funding currently provided to Industry Training Organisations (ITOs). We noted this would involve trade-offs and risks as it would:
- increase the gap between industry training funding rates and Student Achievement Component (SAC) subsidy rates prior to the implementation of the UFS; and
  - reduce the amount of industry training funding that would then flow through to the Unified Funding System (UFS).
- 29 We therefore propose re-purposing s million per annum of the Industry Training Fund (ITF) to fund Workforce Development Councils (WDCs) from the start of 2022, when the transition from ITOs to WDCs is expected to be completed.
- 30 This would make s million available in 2021/22, and s million available for 2022/23 and out-years. When combined with small underspends on some components of RoVE in 2019/20, this would increase the funding available for investment via the Cabinet paper from s 9(2) million to s 9(2)(j) million.
- 31 We are seeking your view on whether you are comfortable with re-purposing this amount of ITF funding to a baseline for WDCs.

*Careful prioritisation is required – with a focus on 2021 and 2022*

- 32 As the funding sought across RoVE exceeds the funding available, prioritisation of investments is necessary. As in a Budget process, this inevitably means that committing funding to one component of RoVE carries trade-offs and opportunity costs for other components. It also means that achieving your objectives for the IST and/or WDCs will require additional funding to be sought in future Budget processes.
- 33 We consider the IST and WDCs to be the highest priorities for investment. At this stage, no funding has been appropriated for the RoVE programme beyond 2020/2. The successful implementation of the reform programme will require significant expertise well into 2022 that is unable to be met within current agency baselines.
- 34 We consider the proposed initial UFS to be important for signalling how the funding system may change in the future. CoVEs will have an important in building and driving collaboration across the system and with entities such as WDCs. However, the size of these proposed investments could be scaled back.

35 However, the primary prioritisation challenge at this point is the funding sought across the initial years of operation of the IST and WDCs, particularly in 2020/21. We consider it likely that both the IST and WDCs will take longer than might be expected to build their capability and systems to effectively invest the scale of funding sought for 2020/21, and intend to work with the IST Establishment Unit (and Board members) and WDC team to develop a better understanding of the scale of funding that might actually be needed in their initial years of operation.

s 9(2)(f)(iv)

36 s 9(2)(f)(iv)

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• s 9(2)(f)(iv), s 9(2)(j)

OR

s 9(2)(f)(iv), s 9(2)(j)

40 s 9(2)(f)(iv)

s 9(2)(f)(iv)

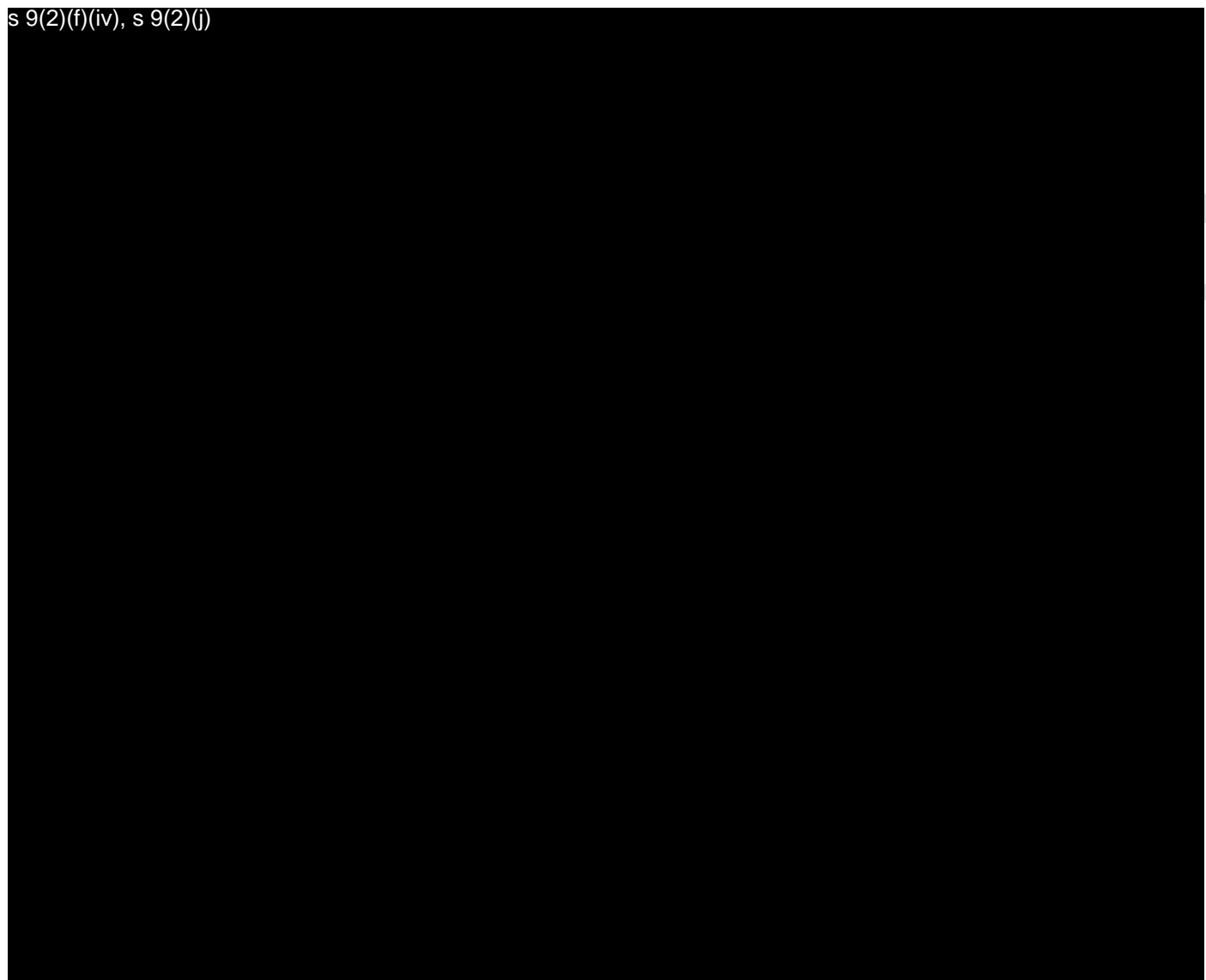
41 s 9(2)(f)(iv)

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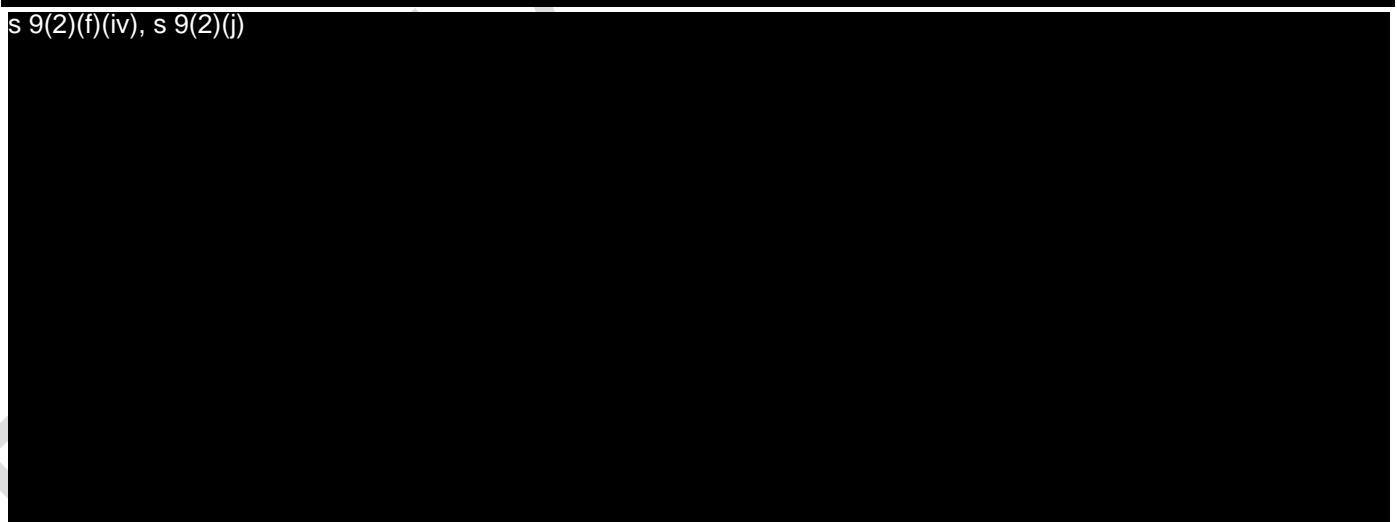
s 9(2)(f)(iv)



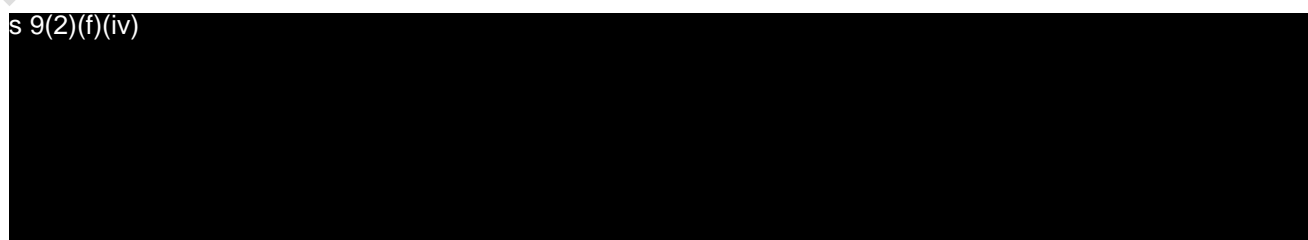
s 9(2)(f)(iv), s 9(2)(j)



s 9(2)(f)(iv), s 9(2)(j)



s 9(2)(f)(iv)



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s 9(2)(f)(iv)

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## Next Steps

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51 Following a discussion with you on Monday 10 February about this report and attached A3, we intend to provide you with an updated draft of the 'fiscal implications of RoVE' Cabinet paper on 13 February, though note this is a challenging timeframe.

## Proactive release

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s 9(2)(f)(iv)

Some information, including the attached draft paper, may be withheld in line with the provisions of the Official Information Act 1982.

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<sup>5</sup> For example, TEC would need to work through some calculation and verification challenges, because the data that TEOs, TEC and NZQA hold, does not always align, and there are time lags between the award of a qualifications and when it is reported. There are also some gaps. For example, achievement data for qualifications that haven't been funded by TEC and those don't sit within the school system.