nzist new zealand institute of skills and technology

Cash Reserves and Ring-Fencing Policy

Effective date	1 April 2020	**Policy owner**	Chief Executive
Version	1	**Policy Section**	Governance
Approved by	NZIST Council	**Policy review frequency**	Annually
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Purpose

As part of the Reform of Vocational Education, Cabinet directed that cash amounts accumulated by existing ITPs at the time of the establishment of the NZIST, should be ring-fenced in the new NZIST, for use within the regions in which they had been accumulated. The Cabinet decision is as follows.

*"10. **agree** to the following requirements on the Institute:*

10.1 to set a policy whereby existing reserves from previous institutes of technology and polytechnics (above a set limit) would be consolidated through the central balance sheet of the Institute, but would only be able to be drawn upon for projects and capital expenditure in the relevant region that have been approved by the Institute head office (within specific operating parameters)."[1]

The text from the Summary of Change Decisions elaborates:

"***Appendix: Cash Reserves for regional operations of the Institute***

The Government's objective is that existing reserves are in the future spent on the regions in which they had been accumulated by the relevant legacy ITPs.

Any cash reserves that are retained would still be consolidated through the central balance sheet of the Institute. However, these would only be able to be drawn upon for projects and capital expenditure in the relevant region that have been approved by the Institute national office (within specific operating parameters).

The use of ring-fenced amounts will be restricted to particular uses, which may include major capital expenditure projects, routine/minor capital expenditure, operating investments (e.g. funding the establishment of a new capability) or operating losses of the regional operation.

While Cabinet approved the broad principles in paragraph 2 about how the money will be spent, the Establishment Board and Unit will be tasked with determining both the specific principles of expenditure, and how this will practically work. This will include consideration of how exactly reserves are defined and the value of these calculated, and the types of project the Institute would consider for the draw-down of reserves.

…

[1] Cab minute: CAB-19-MIN-0354 dated 22 July 2019

Further Details

While it will be finalised by the Establishment Unit, the definition of "reserves" for these purposes needs to consider the:

a. specific balance sheet items included; and

b. time period over which or at which they are measured (e.g. year end, average over a year) for the purposes of determining a starting ring-fenced amount.

The latter is important given that the Institute is likely to come into existence during the financial year, rather than at year end, and that ITPs have cyclical cash flows over the year (the low point tends to be in December and January, but an April establishment date would be at the time of peak cash).

If the Institute was to have been established at year-end, the calculation would have been relatively simple. Conceptually, the ring-fenced amounts need to represent the underlying cash or equivalents, which have accumulated over time, and which are in excess of normal working capital and liquidity requirements.

For instance:

Included in reserves	*Cash* *Term deposits* *Liquid investments (e.g. equities and debt instruments)*
Less	*Debt (if any)* *Fees paid in advance* *An allowance for routine working capital*

Using the premise above, a potential theoretical calculation at the year-end balance date could be:

$60M in cash
$2M in term deposits and liquid investments

Less

$8M debt
$7M two month's routine working capital
$4M fees paid in advance

= potential $43M in reserves

However, the determination of the ring-fenced amounts is much more complicated for a mid-year establishment. The starting point should always be an audited set of accounts (either the prior year-end of the date of dis-establishment). If the starting point is the latest year end (31 December 2019), then adjustments will need to be made for capital expenditure and realisations in the meantime and operating performance in the interim. If the starting point is the disestablishment accounts, then a similar approach will be needed, to reflect the fact that the mid-year cash position (subject to capital expenditure) is likely to be significantly higher than the year-end.

Given the difference in each ITP, it is unlikely that a purely formulaic approach would be appropriate. Therefore, a common methodology will be used, recognising that each ITP will have specific circumstances that might affect precisely how the methodology is applied.

Arguments can be made for different levels of allowance for routine working capital. The TEC's long-standing Financial Management Framework uses a Liquid Funds measure. This defines "low risk" as having roughly one month's operating cash flow, and gives maximum points to having approximately two months' cash flow in liquid reserves. Since ring-fenced amounts can only be used to support material investments in a region, the risks are relatively one-way in favour of the region (local deficits would be the responsibility of the whole Institute), we intend to align with the most conservative end of the Liquid Funds measure (i.e. approximately two months' operating expenditure is removed from reserves in order to calculate ring-fenced amounts)."[2]

[2] https://conversation.education.govt.nz/conversations/reform-of-vocational-education/resources/

This policy sets out, in relation to ring-fenced reserves:

- High-level principles governing the arrangement;
- The definition of the specific balance sheet items included in the ring-fence;
- The methodology by which ring-fenced amounts are initially determined;
- The definition of “region” for the purposes of the ring-fencing policy;
- The uses to which ring-fenced amounts may be put;
- Control and decision-making powers in relation to the use of the ring-fenced amounts;
- How the ring-fenced amounts are held, managed and disclosed;
- Treatment of ring-fenced amounts in any security arrangements supporting centrally arranged borrowing;
- The time period over which the reserves would persist.

Principles and Expectations

High Level Principles

The following high-level principles will be applied to the ring-fencing:

- The Cash Reserves Ring-fencing Policy applies to cash, cash-equivalents and liquid investments, measured on a net basis. It does not apply to other “assets” or “reserves”.
- The Policy is applied to cash reserves (as defined) brought into the Institute, at the time of its establishment, from the predecessor ITP i.e. cash reserves as at 31 March 2020.
- Ring-fenced amounts are to be used solely in the principle region(s) in which they were accumulated by their predecessor ITP, which is the core region in which the predecessor region was located and operated, and with which it was associated.
- Uses to which the ring-fenced amounts may be put should be subject to the minimum of restrictions, in line with the way in which they would have been available for use in their predecessor ITP (i.e. it is treated as a general cash reserve), subject to the “spent in region” test and the general requirement that subsidiary Companies operate within a budget approved by the Institute and the framework for Reserved Matters established by the Company’s constitution.
- Release of ring-fenced amounts is at the discretion of the NZIST Council and management, with any approval rights being within the relevant delegation.
- Existing restricted cash funds (e.g. bequests specifying a particular use of funds) are excluded from this policy, and are left unchanged.
- The ring-fencing should not be an opportunity to centralise losses/liabilities, and localise surpluses/assets.
- While a methodology for determining the initial reserve is prescribed, the Institute reserves the right to change the methodology in the face of circumstances not covered by the methodology.

Definition of items for inclusion in the ring-fence amounts

The ring-fencing policy is restricted to cash, cash-equivalents and other financial instruments and investments, measured on a net basis. It therefore does not apply to, inter alia:

- Tangible assets such as property, plant and equipment.
- Intangible assets such as intellectual property or software.
- Accounting reserves.

Determining the initial ring-fenced amount

The starting ring-fenced amount shall be calculated in accordance with the following methodology.

	Item	Notes
Starting point	Cash, cash equivalents, derivatives (net) and other financial instruments and investments	Per audited accounts as at 31 March 2020
Minus	Debt	Per audited accounts as at March 2020, includes overdrafts, term debt, mortgages etc. Includes both Crown debt and commercial debt
Minus	Restricted funds	Bequests with specific purposes etc. as disclosed in the predecessor ITP's Annual Report and Accounts
Equals	Net Cash	
Minus	Student fees in advance	As at 1 April 2020, most student fees for 2020 will have been received, but the teaching for which payment was made would be only partially delivered. An amount representing that undelivered portion will need to excluded from the ring-fenced reserve.
Minus	Refunds due to students and not yet paid	
Minus	Crown claw-back amounts not yet paid	If amounts are to be clawed back, but haven't yet been paid, they do not represent part of a "long-term reserve".
Plus/Minus	Any other wash-ups on SAC and other Crown funding	
Minus	Allowance for working capital	2 months' operating expenditure, calculated as the average from 2019, and the 2020 budget
Minus	Capital expenditure commitments	
Minus	Ad hoc commitments not included above (and to be decided on a case by case basis)	This is a catch all and could include items such as unpaid restructuring costs, legal settlements etc
Equals	**Initial ring-fenced cash reserve**	

There may be specific circumstances not contemplated above, which will need to be dealt with on a case by case basis, in accordance with the high-level principles and intent of the table above.

Estimates and wash-up of initial ring-fenced cash reserve

On or about 1 April 2020, each subsidiary with cash reserves that might be sufficient to lead to ring-fencing will calculate an estimated ring-fenced amount, in accordance with the methodology above, that shall become subject to this policy. Cash may be drawn from this initial amount in accordance with this policy.

Once the disestablishment audit has been completed, the NZIST will perform a wash-up calculation, to calculate the correct amount that should have been set aside on or about 1 April 2020. If the estimated amount was too high, the Ring-fenced Cash Reserve will be reduced to the correct amount; if the estimated amount was too low, the balance will be added to the Ring-fenced Cash Reserve from the subsidiary's non-ring-fenced cash balances.

Treatment of the Ring-Fenced Cash Reserves Over Time

Ring-fenced Cash Reserves are established as a one-off reserve, as a result of the creation of the NZIST, and is in relation to the cash and equivalents brought into the NZIST group from the predecessor ITPs, on the day of the NZIST's establishment.

No amounts (e.g., cash operating surpluses, proceeds of asset sales) are to be added to the ring-fence over time, other than in accordance with the wash-up process set out above.

Amounts cannot be "borrowed" from the ring-fence (i.e. drawn from the ring-fenced amounts and then repaid); once drawn from the ring-fence, they are permanently drawn.

Any income derived from the ring-fenced amounts is not retained within the ring-fence.

The ring-fencing mechanism shall continue in effect until the ring-fenced amounts are reduced to zero.

Uses of Ring-fenced Cash Reserves

The ring-fenced amounts should function as closely as possible to the way in which a cash reserve would have been used in a predecessor ITP. Ring-fenced amounts could therefore be allocated to:

- Routine capital expenditure e.g. ICT hardware and software, buildings, equipment (teaching and other), programme and materials development.
- Major capital projects (of whatever nature).
- Building maintenance.
- Investment in building or maintaining capability.
- Any local component of a wider NZIST investment project (for instance, a major systems replacement that provides a capability needed by the regional operation).
- Operating losses.
- Change and restructuring costs.
- Settling of one-off/exceptional costs.

Definition of "Region"

The Cabinet Minute refers to ring-fenced amounts only being spent in the "relevant region". For these purposes, the relevant region will be the home or core regions in which the predecessor ITP operated. This would, for example, mean Southland for SIT; Christchurch, Timaru and the whole of Canterbury for Ara; the whole of the Bay of Plenty, and Rotorua and Taupo for Toi Ohomai; Hawkes Bay and Eastland for EIT; Whanganui, Manawatu and the Wairarapa for UCOL.

In the case of the Open Polytechnic of New Zealand, "region" is not a relevant concept for a nation-wide provider of on-line learning. For these purposes therefore, "region" will be deemed to be nationwide and for the purposes of developing distance learning capability or delivering distance learning.

Practical Management of Ring-fenced Cash Reserves

Ring-fenced amounts, once identified, will be held in separate bank accounts, or as separately identifiable deposits or liquid investments.

The NZIST may determine at any time whether these amounts are to be held by the relevant subsidiary, or managed by the NZIST's central treasury function on behalf of the subsidiary company.

The NZIST and/or any of its subsidiaries with a Ring-fenced Cash Reserve should be able to identify and report on a day-to-day basis on any drawings from the reserve and the amounts still held as a Ring-fenced Cash Reserve.

Ring-fenced Cash Reserves will continue to be subject to existing security arrangements which already cover the relevant amounts.

Authority to access Ring-fenced Cash Reserves

Approval to use Ring-fenced amounts is a matter reserved to the NZIST parent entity, and will be provided in accordance with this policy, taking into account the individual circumstances of the subsidiary company (financial or otherwise), the Institute's strategy, the Institute's capital and asset management plan, and regional priorities as reflected in these.

Any such approvals will be given in accordance with the parent-entity's delegations framework, as applicable to the nature of the expenditure for which amounts are to be released from the ring-fence (e.g., the Institute's CE will be able to give approvals for use of ring-fenced amounts for capital expenditure, up to the CE's delegation for capital expenditure; amounts above this threshold will require authorisation by the Council).