

Better Business Cases

Schools Payroll Detailed Business Case

| | |
|----------------------|----------------|
| Prepared by: | XXXX |
| Prepared for: | XXXX |
| Date: | 3 October 2016 |
| Version: | 1.00 |
| Status: | FINAL |

Purpose

This Detailed Business Case seeks an increase in the service price for the schools payroll

This increase in price will be used to support the investment required to deliver the schools payroll services required by the Ministry of Education at an acceptable level of risk, while complying with relevant legislation, collective employment agreements, and Ministry policy.

It is a response to directions by Cabinet and shareholding Ministers

This Detailed Business Case is a response to the requirement for EPL to provide to shareholding Ministers details of its strategic direction, including the moving of the schools payroll to a steady state and achieving efficiencies and long-term sustainability.

In February 2016, EPL reported back through an Indicative Business Case (IBC) which provided three options covering minimal lifecycle, payroll efficiency and systems risk management. Considerable work has been undertaken since then to develop the preferred option presented in this Detailed Business Case (DBC). This has included reviewing all investment choices in detail and undertaking a structured value assessment involving a wide range of stakeholders.

It is based on the Ministry's specified requirements for schools payroll

This business case is premised on EPL meeting the Ministry of Education's specified requirements for a payroll service. We have translated these requirements into a programme of technical and operational investments which will ensure that the payroll service is fit for purpose for the longer term.

The resolution of Holidays Act compliance issues is excluded from this business case – these issues will be resolved in a subsequent process with the Ministry of Education



Because of the significant work remaining to understand the Holidays Act issues and the consequent continuing high level of uncertainty, this business case does not include costs for core Holidays Act remediation. There are however some projects included in this business case that address aspects of the Holidays Act. These projects are included in the business case as they address broader compliance and operational issues. They will be reviewed on an ongoing basis to ensure that their deliverables comply with the Holidays Act.

The investment proposed in this business case will be required to ensure there is an adequate technology and compliance platform in place to support the Holidays Act remediation. We therefore believe that the investment sought in this business case must proceed as a matter of urgency.

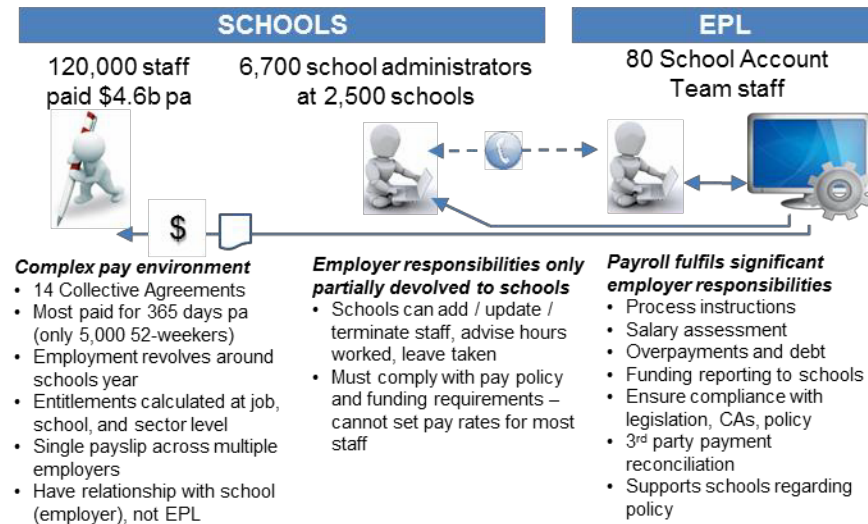
The funding required for Holidays Act remediation will be addressed with the Ministry in a subsequent process.

1 Schools payroll environment

The Novopay go-live problems are fresh in the public's mind ...

- Novopay went live in August 2012 with disastrous results
- This led to Ministerial enquiry and \$41m of stabilisation costs
- To reduce Crown risk and deliver an effective service, EPL was formed in 2015
- Novopay issues are still in the mind of the Education Sector and the public

This is not a standard payroll ...



The history, uniqueness and scale of the education payroll challenges effective, efficient, and sustainable delivery

4 Options considered

| DBC options analysed | Ensure sustainability | Achieve compliance incl. HA | Improve operating model |
|---------------------------------|-----------------------|-----------------------------|-------------------------|
| 1 Status quo | | | |
| 1+ Minimum viable | ✓ | | |
| 2 Risk & compliance | ✓ | ✓ | |
| 3 Digital assist / fully online | ✓ | ✓ | ✓ |

| IBC options previously discarded | Rationale for discarding |
|--|--|
| 4 New online, staged transition to new payroll | <ul style="list-style-type: none">• High cost• High implementation risk• Can be kept as medium term transition option |
| 5 New online, new payroll | <ul style="list-style-type: none">• High cost• High procurement risk• Very high implementation risk• Delays remediation – including Holidays Act – by 4-5 years |
| 6 All new outsourced payroll service | |

Changing the payroll system is high cost and high risk, and delays remediation by 4-5 years – including Holidays Act

Discovery work on payroll system and supplier concluded that current platform can be used at acceptable risk for ten plus years

2 Current situation

Significant improvements since 2014 ...

- Dramatic improvements to the service – people capability, technology, processes
- Increased school satisfaction with the service

However, infrastructure not sustainable

- Core payroll system on very old release and using outdated technical components
- Online system used by schools (Novopay Online) impossible to maintain and enhance, and will not have technical support from December 2019
- Core payroll is 60% customised / 40% standard

Service not compliant with legislation and collective agreements

- Not compliant with legislation – e.g. Holidays Act
- Significant functional defects– e.g. leave, tax, allowances, deductions
- Error-prone manual workarounds still required

Inefficient and error-prone operating model

- 13,000 manual forms/fortnight drive inefficient service with high error and rework
- School satisfaction still significantly lower than good practice
- Schools still spend too much time on payroll

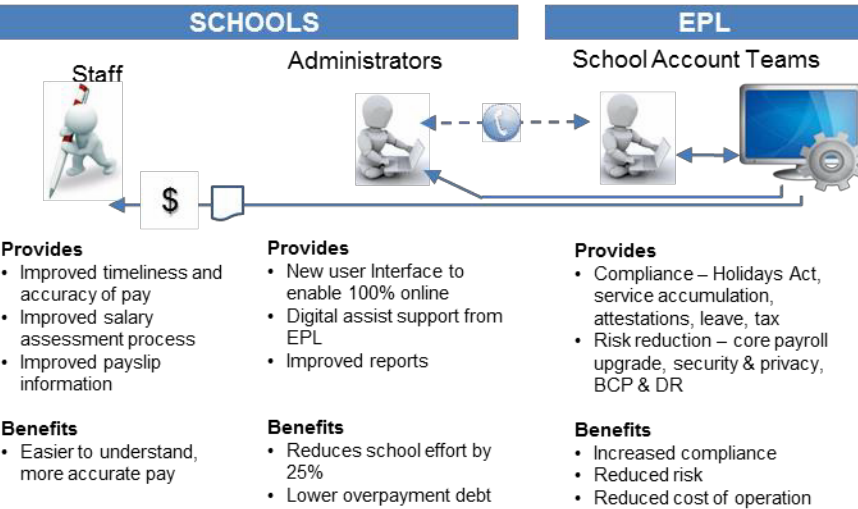
High risk of another service failure from 2020

- Some reduction in risk because of investment planned for 2016/17
- However, without further investment risk will rise to “high” in 2020
- Failure will become almost certain

Payroll problems distract staff from teaching and learning

Investment is required to prevent another “Novopay” event

5 Preferred option (Option 3)



Preferred option:

- Compliant with legislation (excluding Holidays Act – separate process), CAs, and Ministry payroll and workforce policy
- Sustainable systems and infrastructure – ten plus years
- Aligned with Education Sector digital strategy
- Supports administration “hubs” at CoLs
- New user-friendly online system designed with schools in mind
- Piloted, incremental, well-supported sector change
- Future-proofed architecture able to adapt to sector and industry
- Programme off-ramps from July 2019
- Risk managed programme
- Supports future ownership options for EPL

3 Sustainability through simplification

To get to a reliable, compliant, sustainable and cost effective payroll service – we MUST ...

Simplify the payroll service delivery approach

- Implement school centred service delivery
- Provide a completely on-line service
- Build skills and knowledge across the sector in payroll management
- Reduce errors and waste across all of pay processing
- Make the system compliant with legislation
- Keep all the ICT systems current

Adapt to policy and operational developments in the Education Sector

- Support the implementation of the Sector Digital Strategy
- Quickly adapt to new approaches to school administration (e.g. CoLs)
- Improve the management of staff who move between schools
- Support right teacher / right place / right time

Support simplification of Employment Agreements

- Create effective governance across all interested parties
- Create a common architecture for employment contract provisions
- Manage against a long term plan for simplification

This will deliver the Ministry's service requirements, build the resilience and flexibility needed for long term sustainability, and move towards a more standard payroll

6 Economics

Preferred option costs \$271 million over ten years

- Projected funding for EPL based on 2016/17 costs for ten years is \$246 million (excluding dividend and cost of capital)
- Preferred option requires extra funding of \$64 million over ten years (capex + opex + depreciation)
- Fully online / digital assist enables EPL to reduce from 185 staff to 100 staff
- Because of savings achieved, only net additional funding of \$24 million needed for ten year period (capex + opex + depreciation) – this include risk based contingency at 85% level

Preferred option reduces school payroll effort by 25%

- Fully online / digital assist will reduce effort at schools by estimated 25%
- Reduces school effort by 99,000 hours – equivalent to 12,000 days pa

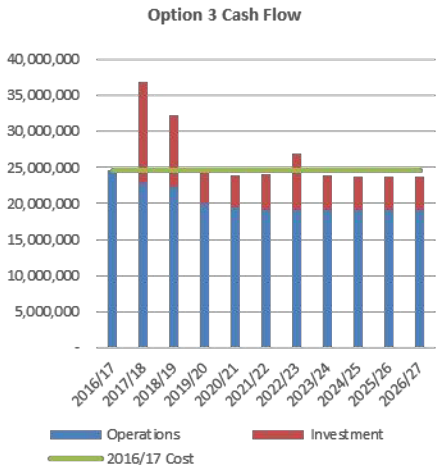
There are two funding alternatives ...

One: Fixed fee, EPL borrows to invest

- EPL borrows to invest and uses this to fund a fixed annual fee
- Cost of approximately \$27.5 million pa (up from \$24.6 million in 2016/17)

Two: Ministry completely funds cash flow

- The Ministry can fund the additional annual cash flow in the year it falls
- This will mean an increase in funding for 2017/18 and 2018/19, and reductions in outyears



Executive Summary

Schools payroll environment

EPL provides the schools payroll under contract to the Ministry of Education

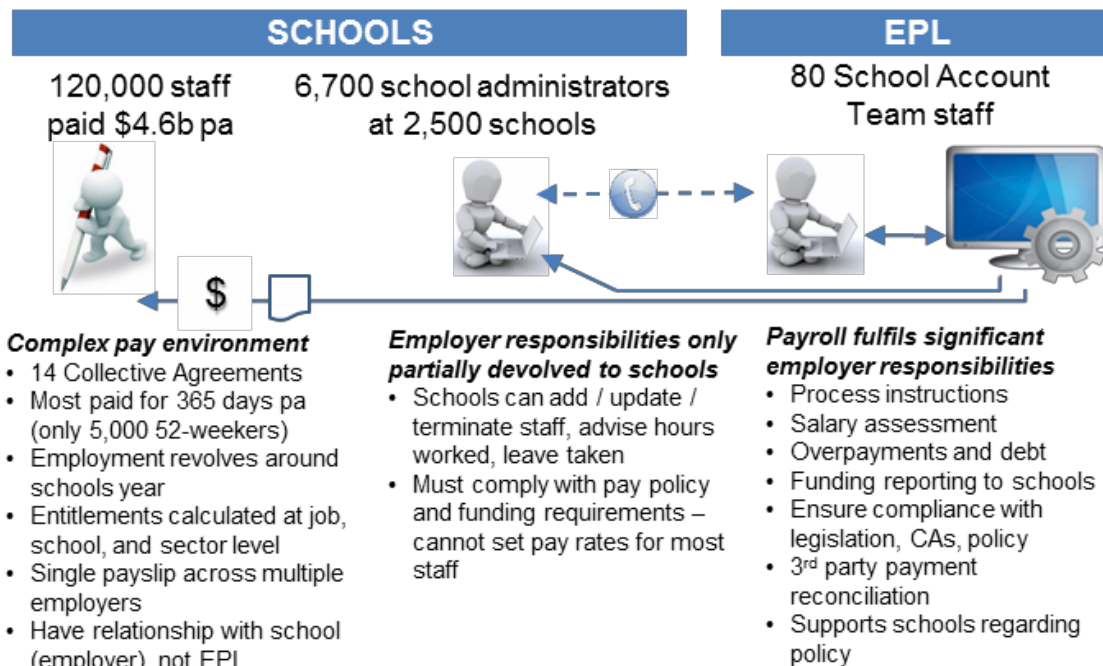
The Ministry of Education is responsible for the provision of payroll services to the schools sector. Under its strategy for provision it currently undertakes this by purchasing services from EPL. This payroll pays approximately 90,000 teaching and non-teaching staff at 2,500 state and state integrated schools each fortnight. It pays \$4.6 billion per annum.

The Novopay go live problems are still fresh in the public's mind ...

Novopay went live in August 2012. Well-publicised problems led to significant non-payment, under-payment and over-payment of school staff. A Ministerial Inquiry was initiated and \$41 million was spent on stabilisation of the payroll. The creation of EPL and the transfer of the payroll from Talent2 in October 2014 formed a key part of the risk mitigation strategy. The Novopay go live problems remain fresh in the mind of the public and schools. For the sector, it has been a significant distraction from its core focus of teaching and learning.

This is not a standard payroll

The schools payroll is not a standard payroll. Employer responsibilities are only partially devolved to schools. EPL is therefore required to provide additional services over and above a normal payroll. These include compliance monitoring and enforcement, salary assessment, overpayment debt recovery, school payroll support and sector communications, payroll data and reporting, and management of banking staffing and staffing funding for schools. This results in a high level of customisation to the underlying payroll system (approximately 60%).



The history, uniqueness and scale of the schools payroll challenges effective, efficient, and sustainable delivery.

Current situation

EPL has made significant improvements since 2014

EPL has addressed immediate technical infrastructure risk around its people, data centre, hardware, operating platforms. Measured pay accuracy is well within the benchmark level of 99.5%, but there are limitations with the measuring process. School satisfaction with the service has increased and EPL is transforming the operating model to increase service to schools and reduce errors and effort.

However, the core payroll infrastructure not sustainable ...

The core payroll system is on very old release and is using outdated technical components that are close to end of support or already out of support. The online system used by schools (Novopay Online) is impossible to maintain and enhance, and will not have technical support from December 2019. This inability to continue using NOL and enhance it means that EPL is limited as to the performance efficiencies it can achieve, the Ministry is limited in the simplification that can actually be implemented, EPL will not be able to support the Education System Digital Strategy, and schools cannot receive a more user-friendly online service. NOL will cause a payroll failure sometime after December 2019.

... the payroll service is not compliant with legislation and collective agreements ...

The payroll service is not compliant with the Holidays Act. There are still other outstanding leave issues, namely long service leave, leave booking, and annual leave for 52-week staff. There are outstanding software defects in tax, allowances, and deductions. Error-prone manual workarounds still required for EPL to manage around the current issues.

... EPL has an inefficient and error-prone operating model ...

As all transactions cannot be processed online by NOL, the EPL operating model relies on 13,000 manual forms being processed every fortnight. This drives an inefficient service with high error and rework levels. Approximately 60% of all current instruction processing effort is failure demand – i.e. the effort required where instructions are not processed right first time, resulting in rework (e.g. rekeying) and then retrospective resolution (e.g. debt). Organisational and process changes will improve this situation but not resolve it.

While school satisfaction with the service has increased, it is still significantly lower than good practice targets. Schools still spend too much time on managing their payroll.

... there is a high risk of another service failure from 2020

The schools payroll still carries an unacceptably high level of operating risk. While this risk will continue to fall over 2016/17, without investment this risk will start rising again from 2017/18, reaching “high” in early 2020 as the technology platforms age. This will lead to almost certain failure, affecting significant numbers of those paid through the service.

EPL does not wish to repeat the early history of Novopay. This would have high financial and reputational costs for all.

Sustainability through simplification

The schools payroll can be improved through simplification

We share with the Ministry the view that there are further opportunities for improving efficiency of the payroll service through simplification of collective agreements. Simplification however will not be a rapid process. Therefore, we have taken a conservative approach regarding these opportunities in this business case and have not included the benefits of these being implemented. The anticipated changes will be managed through change control.

To get to a reliable, compliant, sustainable and cost effective payroll service, we must:

1. Simplify the payroll service delivery approach

This will mean implementing a school centred service delivery, providing a completely on-line service, building skills and knowledge across the sector in payroll management, reducing errors and waste across all of pay processing, making the system compliant with legislation, and keeping all ICT systems current.

2. Continually adapt to policy and operational developments in the Education Sector

This will mean supporting the implementation of the Ministry of Education's Education System Digital Strategy, rapidly adapting to new approaches to school administration (e.g. Communities of Learning, Communities of Online Learning), improving the management of staff who move between schools, and supporting the Ministry's workforce goals of having the right teacher in the right place at the right time.

3. Support simplification of Employment Agreements

This will mean creating effective governance across all interested parties, creating a common architecture for employment contract provisions, and managing against a long term plan for simplification.

This business case supports the required ongoing simplification.

Options considered

The Ascender Pay supplier and product risk can be managed at "low/medium" residual risk – all options considered therefore involve retaining the Ascender Pay software

We have assessed the technical state of the current pay platform and the ability of the supplier to support it. We have concluded that the Ascender Pay supplier and product risk can be managed at "low/medium" residual risk over the projected life of the service. The options considered all involve retaining the Ascender Pay core software platform (formerly called Alesco).

Table 1 Options considered in DBC

| DBC options analysed | Ensure sustainability | Achieve compliance incl. HA | Improve operating model |
|---------------------------------|-----------------------|-----------------------------|-------------------------|
| 1 Status quo | | | |
| 1+ Minimum viable | ✓ | | |
| 2 Risk & compliance | ✓ | ✓ | |
| 3 Digital assist / fully online | ✓ | ✓ | ✓ |

Our preferred option involves a fully online model for schools, that saves effort at schools and brings efficiencies for EPL

Option 1 – Status Quo – does not address the risk level and will result in payroll failure and major additional costs.

Option 1+ – Minimal viable – addresses core technology infrastructure risk, but does not address compliance issues, and does not improve the service operating model, while requiring significant additional investment.

Option 2 – Risk and compliance – mitigates the technology infrastructure risk and the compliance risk, but does not improve the service operating model, while requiring the highest additional investment.

Option 3 – Digital assist / fully online – mitigates the technology infrastructure risk and the compliance risk, as well as improving the service operating model, gaining major financial benefits for EPL. [PREFERRED]

Transition to a new payroll system and/or service is costly and risky – these options have been rejected

We consider transition to a new payroll system a high risk undertaking. We have therefore not considered staged transition to a new payroll system or service (Indicative Business Case Options 4, 5, 6) as part of this business case. We have however ensured that the preferred option supports a later staged transition to a new payroll system (if and when this may be required).

Table 2 Discarded options from Indicative Business Case

| IBC options previously discarded | Rationale for discarding |
|--|---|
| 4 New online, staged transition to new payroll | <ul style="list-style-type: none"> • High cost • High implementation risk • Can be kept as medium term transition option |
| 5 New online, new payroll | <ul style="list-style-type: none"> • High cost • High procurement risk • Very high implementation risk • Delays remediation – including Holidays Act – by 4-5 years |
| 6 All new outsourced payroll service | |

Preferred option

The preferred option (option 3) is a series of operational and technology investments to achieve compliance, deliver a new on-line, digital assisted service that meets the needs of users, and upgrade technology to reduce risks to a low level and extend the life until 2030.

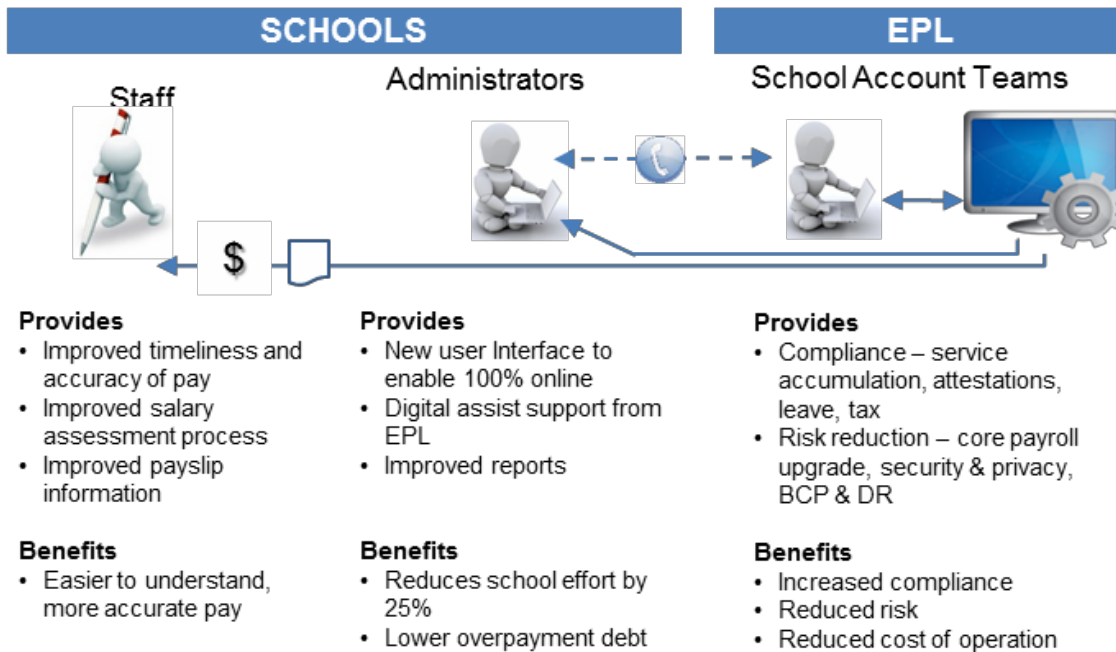


Figure 1 Preferred option

The key features of this preferred option are summarised below.

Compliant with legislation, CAs, and Ministry payroll and workforce policy

The preferred option ensures that the payroll is compliant with the specified Ministry requirements including pay related legislation (excluding Holidays Act), the collective agreements, and the Ministry payroll and workforce policy. This will also include resolving current issues with leave, service entitlement calculations, and deductions.

Holidays Act compliance issues were present in the schools payroll prior to Talent2 or EPL taking over operation. [REDACTED]

[REDACTED] It is not just a payroll systems and service issue. Holidays Act remediation is therefore likely to be very complex.

Because of the significant work remaining to understand the Holidays Act issues and the consequent continuing high level of uncertainty, this business case does not include costs for core Holidays Act remediation. However, the investment proposed in this business case will be required to ensure there is an adequate technology and compliance platform in place to support the Holidays Act remediation. The funding required for Holidays Act remediation will be addressed with the Ministry in a subsequent process.

Sustainable systems and infrastructure – ten plus years

The preferred option supports sustainable systems and infrastructure for a ten year plus timeframe. This is well beyond the original contract period with Talent2 that was to finish in August 2022.

The preferred option moves the operational risk of the payroll to “low” from its current “medium / high” level.

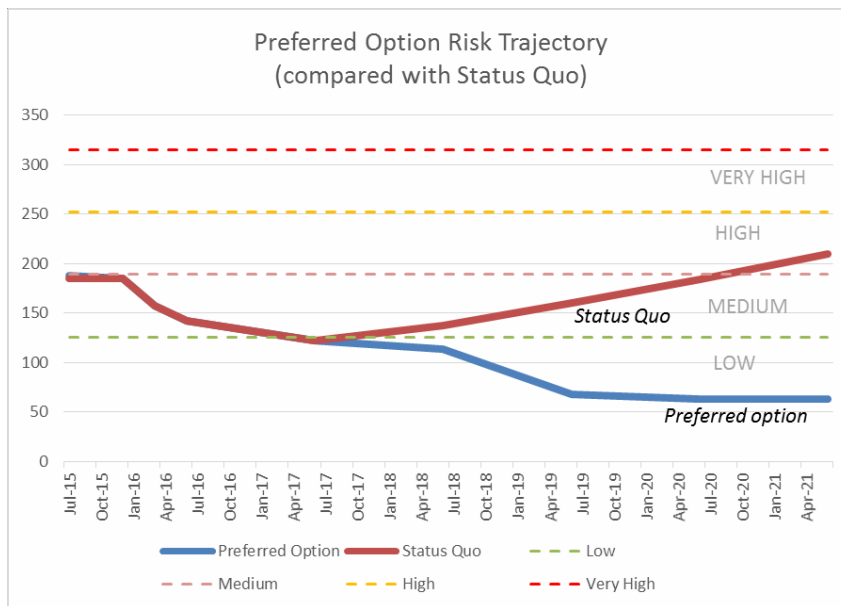


Figure 2 Risk trajectory for preferred option

Aligned with Education System Digital strategy

The preferred option is aligned with the Ministry’s Education System Digital Strategy. EPL will continue to ensure that as the work proceeds it will remain aligned with the Education System Digital Strategy. For example, EPL is working with the Education Council regarding use of common platforms for online use by schools as well as a common workforce register. This work will be used to inform choices around implementation of the new online payroll service for schools incorporated in the preferred option.

Supports administration “hubs” at Communities of Learning

While the Communities of Learning (CoLs) are currently focused on teaching and learning, there are opportunities for CoLs to support administration hubs for the schools engaged. EPL already supports a number of schools administrators who are responsible for pay across multiple schools. This support will continue and will be grown to support administration hubs at the CoLs as they appear.

New user-friendly online system designed with schools in mind

This new online service will enable schools to reduce their effort in operating the payroll. Currently schools spend an average of 6 hours per fortnightly pay period managing their payroll. We estimate that this can be reduced by 25% under the preferred option as schools directly enter their information rather than using manual forms. (This is the equivalent of a saving of 12,000 person-days per annum across the sector.)

Piloted, incremental, well-supported sector change

The achievement of the benefits in the preferred option depend upon achieving full online usage of the service by school administrators. The current online service (based around NOL) was not well implemented – the sector and school administrators were not included in its design. NOL is itself difficult to use and the rollout occurred in a “big bang” implementation with insufficient training and support. In contrast, the development and rollout of the new online service will centre on the change management required for the sector to use the new service.

Table 3 Differences between new online service implementation and Novopay implementation

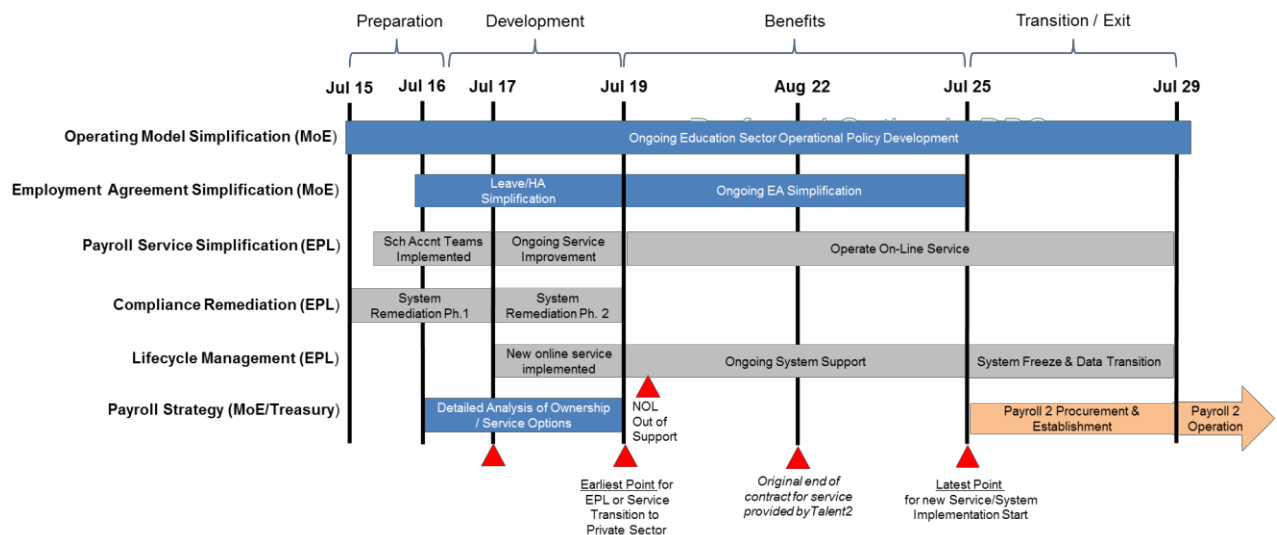
| Novopay Transition | New Online Transition Approach |
|---|--|
| No prior universal digital service | All current users have Novopay Online login and the overwhelming majority have used it |
| Limited knowledge of schools and sector | In depth understanding of schools and sector supported by design research undertaken prior to procurement |
| Limited involvement of users | Co design/develop with users – user group, usability testing |
| Limited digital project capability | Use of best practice digital methodologies include agile development, user centred design and product management |
| Limited knowledge of user requirements | Full range of workflows analysed to inform procurement |
| Schools with limited payroll capability | Increased payroll capability due to users in larger schools with business backgrounds and schools having better understanding of employer role |
| Limited payroll support | Expert support provided by school account teams |

Future-proofed architecture able to adapt to sector and industry

The preferred option provides an open interface package that supports the implementation of a new user interface and enhanced analytics capability. This will enable the customised parts of the system to be progressively separated from the core payroll.

Flexible scheduling with programme off-ramps from July 2019

Dependencies between work packages are minimal – this provides for great flexibility as to when work is scheduled, enabling speeding up and slowing down of the programme to manage risk. This effectively provides for 24 individual off ramps, one for each work package.

**Figure 3 Preferred option timeline**

The whole remediation programme will enable an off ramp from July 2019 for an EPL or service transition to the private sector. The requirement to replace NOL by December 2019 and the need for remediation of infrastructure and compliance issues limits the opportunity for programme off ramps before then.

Supports future ownership options for EPL

Although not specifically requested to examine this area, EPL has been mindful of the need to ensure that the strategy does not preclude any ownership options for EPL. Therefore, the investment must create value for the Crown by capturing the value of any investments early and improving the proposition for any return of the service to the private sector.

Economics

We propose managing all EPL's costs for investment through the service fee paid by the Ministry

As EPL is a supplier to the Ministry all EPL costs for its operation are required to be covered by a service fee as part of an arms-length Service Agreement. We believe that this is the most appropriate mechanism for dealing with increased investment as it provides the appropriate incentives for ongoing improvement of the service and cost efficiencies.

A fixed annual service can be set, with EPL borrowing to invest

Taking into account the investment required to meet the Ministry's service requirements, we estimate that the indicative annual service fee would be \$27.5 million for the ten-year period. The current fee has been set at \$24.600 million for 2016/17.

To support the investment required, EPL would be required to extend its working capital over a three period peaking at \$13.2 million in 2018/19. The proposed service fee includes interest on the loan required to support the investment but not any return on capital already employed, or any dividend to shareholders.

Alternatively, the Ministry can fund the annual cash flow

Under this option the Ministry pays a service fee that is matched to the actual cash flow required for operating the service and funding the required investment. This means that the service fee is higher in 2017/18 and 2018/19 and then reduces in 2019/20 onwards as savings are achieved. This will require the Ministry to fund EPL through its service fee for \$271 million over the period of the ten-year contract (excluding any dividend or cost of capital).

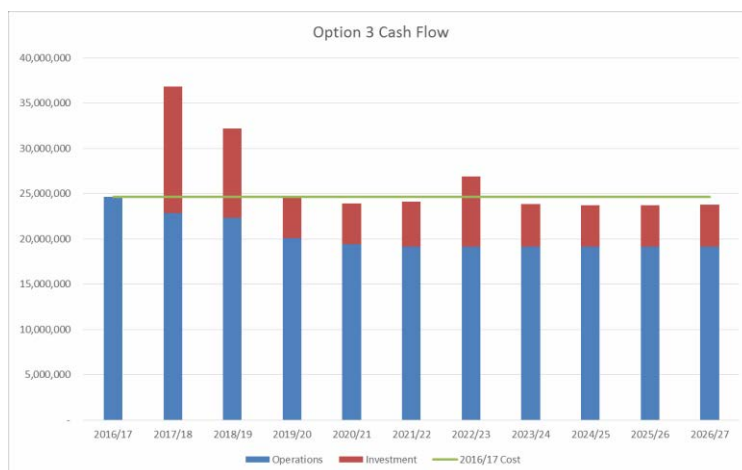


Figure 4 Projected cash flow for preferred option

We have used the Quantitative Risk Assessment to inform the level of funding required, and have sought funding to the 85% percentile

The QRA provided an assessment of the overall funding required. It concluded that for the 85% percentile when taking into account all the key risks (costs and benefits), an additional

\$7.3 million should be allocated to address the costs and benefits risks. Because of the level of risk that needs to be borne by EPL, we have included this risk factor in our proposed costs. The additional costs have been pro-rated across the years for the business case to take account of the risk for both costs and benefits.