ANU Financial Health Strategy 2021-2023

Peer Review

Introduction

1. I have been asked to Peer Review the proposed Financial Health Strategy presented to the ANU Finance Committee on 11 September 2020. This was requested by the Executive Management of ANU under a Consultancy Agreement dated 9 September 2020 and an associated Non-Disclosure Agreement dated 8 September 2020.
2. I have been provided with a number of key documents once these Agreements were signed, including the unpublished ANU Annual Report, the Financial Health Strategy paper presented to the Committee, the ANU Budget Model (Top Down), the 5-year Load Plan, the Load Planning Assumptions, 2021 Tuition Fee paper, CGS Reform Impact Modelling plus Fee Load and Revenue Summary..
3. I have had free access to a number of Planning and Finance personnel and they have shared information with me in a completely open fashion. This has been very helpful in the short time since the Consultancy Agreement was signed on 9 September 2020. The analysis behind the Peer Review below is therefore highly dependent on the information sought and provided. It is limited in extent and value by the time period available prior to drafting this report.

Approach

4. Given the time available I have focussed on doing a number of high-level tests and analyses in order to provide my opinion on the strategic direction and proposed actions outlined in the Financial Health Strategy paper presented to the Committee.
5. My work can be categorised into four sections:
   (1) The current situation, the financial standing of ANU prior to the advent of the coronavirus pandemic and the impact of the changes which have had to be made to operations at all Australian Universities this year and likely to persist for a number of years going forward.
   (2) The relevance and value of the Financial Health Strategy itself, the structure of the actions, the methodology, the value created or preserved, the possible impact on the staff and student experience

and the effect on the financial standing of ANU during this interim period and also looking forward.

(3) Sensitivity testing of some of the key variables to demonstrate the robustness of the Financial Health Strategy and some of the risks faced during the years covered.

(4) Conclusions drawn and some recommendations to consider.

Current Situation

6. ANU entered 2020 in a relatively strong financial position. Whilst the Operating Surplus and Operating Margin was relatively low in 2019, at 1.7%, the significant boost of the investment markets assisted with a hefty level of capital gains due to the size and well-balanced funds and investment strategy. This meant that ANU reported a Surplus of a shade over $300m in 2019 and entered 2020 with substantial strength on the Balance Sheet. A very helpful position to have at the start of this year of massive upheaval.
7. Nevertheless, the relatively low Operating Margin will need to be remedied going forward because this combination of market strength to overcome lowish cash generation in operations may not occur in the future.
8. Attachment 1 shows the Consolidated Income Statements for each of the Group of 8 Universities during 2014, 2018 and 2019. Attachment 2 shows the Consolidated Financial Position of the Go8 Universities at the end of each of those years. These show the relatively strong financial position of ANU due mainly to two factors relevant to this analysis. The first is the relatively lower exposure to Fee Paying Student Revenue as a share of Operating Revenue compared with the Sydney and Melbourne based Go8 institutions. The second is the reasonable Leverage of Borrowings on the ANU Balance Sheet, though by no means the lowest gearing. Added to that is a reasonable Cash Flow Margin over recent years.
9. Many in the Australian Higher Education sector face a significant fall in Operating Revenue due to the substantial reduction in Fee Paying student load (measured as Equivalent Full Time Student Load or EFTSL) without being able to make reductions in Operating Expenditure in the same timeframe. This has meant that most of the sector will be suffering Operating Deficits this year and as a result Operating Cash Flows will fall

substantially and in most cases be negative this year and almost certainly next year too.

10. The projections shown in the Finance Committee paper indicate a negative Cash Flow for ANU in 2020 and also in the 2021-23 period. This has the impact of utilising the strong Balance Sheet and the Liquidity Buffer to good effect. The reason for this ongoing “plight” without corrections to the operating model is the pipeline effect of students going through their 2 to 4 years study cycle.
11. If Commencing Load is very low one year, as it is in 2020 and predicted in 2021, that flows through to future years as existing load (EFTSL) falls off when current students complete their studies and not relaced in the same numbers the following year. That is tackled in the Financial Health Strategy by ANU. It is also being tackled in various ways by many others too.
12. So, the ANU platform appears to be well primed for the challenging circumstances but there are some lessons for the future to consider.

The Financial Health Strategy

13. I have considered the value of the Financial Health Strategy and its three parts. I am strongly of the view that the three Workstream element construction was the right move and will provide ANU with a strong framework for the recovery effort. It is however only as good in terms of recovery if the effort is also put into reshaping the operating model.
14. The University has shown itself to be highly adaptable to the challenges thrown its way due to the COVID-19 circumstances. The switch to online teaching and learning, working from home and introducing strong workplace controls for those elements which had to continue to operate on campus was swiftly and competently implemented! Whilst this is not necessarily the right operating model going forward it does demonstrate amply that the likelihood of returning to the “old” model is highly unlikely to have merit in all aspects. Not only will staff wish to have more flexibility in their choice of workplace but so will students wish to choose a more attuned mix of digital and physical learning delivery. Staff and student experience outcomes will be a key driving force for success and will ensure the right mix is better attracted to be working or studying at ANU.
15. Whilst the world of Higher Education will not suddenly become totally digital and off campus due to a number of factors, there is a need to

revise the way that research and innovation, teaching and learning and various professional services will be delivered in the future. It is clear that physical research will still need to be carried out experiments physically but perhaps in a redesigned format with different controls of space exposure. Students will still wish to get together face-to-face as well as through digital means because human beings need human touch to ask questions, to see the body language for idea testing and solution generation and so on.

16. This redesign is implied to some extent in Workstream 3 but understandably not in an explicit fashion. Understandable because this requires quite a lot of planning and discussion, as well as some astute decision making. I am aware that the University is already well down the track on this work but it will evolve over time and will require some crucial investment allocations to ensure resources are properly reset and dedicated to the task. Facilities infrastructure, ways of working and the technology solutions to back these effectively will generate a significant program of projects. Benefit realisation will be essential to achieve the aims because smart planning must be followed by determined and effective execution.
17. The elements of Workstream 1 are all very good and I endorse this completely. The one aspect that I would call into some debate is the way the Liquidity Buffer is determined as $250m, or 3 months' Expenditure, and the speed with which this is to be fully restored under the Financial Health Strategy.
18. There is nothing wrong per se with the setting of the Liquidity Buffer as a deterministic matter. However, it would be useful to test its validity at this level using a Risk Framework analysis. That is, set the right Risk Appetite for "ruin", set up some disaster scenarios including black swan events such as COVID-19. Then, run the scenario analysis to see under what circumstances certain Liquidity Buffer levels would fail the test. Finally, as a result reset the Liquidity Buffer Policy to stand up with reasonably strenuous certainty to be sufficient.
19. This exercise can be repeated every two or three years to fine tune the Policy. It means that there may be some level of liquidity which could be now be freed up to be invested in the large program of projects mentioned above.

20. In addition, the Liquidity Buffer strategy has been seen to work as designed this year. It has more than cushioned the impact of COVID-19 as it would be required. Having done its job of putting a buffer underneath the University it should be allowed to recover to its policy setting over a reasonable but relatively short period. This should not be so short that it crimps the organisation from its well framed recovery efforts, nor too long so that it fails to act as the buffer at the right time in the medium-term. The right answer here is more a matter of appetite and affordability than a cookie cutter recipe.
21. I endorse the work incorporated under Workstream 1 especially the regular monitoring of liquidity and solvency testing.
22. Workstream 2 is well under way. It is an important step to reduce expenditure in the short term in a sensible and balanced manner. The set of measures, but especially the Voluntary Separation offer, have been very well designed for immediate effect. The only issue to watch is the loss of crucial knowledge and skills is not the ultimate outcome. I expect this is being watched carefully by the Executive. I endorse this Workstream.
23. Workstream 3 is the critical element to deliver a healthy ANU going forward. I fully endorse its three key aims of managing an acceptable Operating Surplus which is not dependent on investment markets or the generosity of donors, maintaining adequate Cash Flows in order to create a virtuous cycle of sufficient resources to fund capital investment and strategic projects plus managing both Debt and Liquidity prudently.
24. I have tested the integrity of the Revenue Modelling work. I endorse the use of the three models of Best Guess, Further International Student Decline and being Optimistic. This provides an adequate range of outcomes in a deterministic manner. It is good to see that the changes in tuition funding for Domestic students announced by Minister Tehan have been included, noting that there is still some legislation to be passed by Parliament before its final form is known.
25. Having reviewed the load forecasts provided to me there is some possibility that the international EFTSL numbers included for 2021 may be on the high side. This is because Australian borders may in fact remain closed for longer than currently forecast as a result of many countries still experiencing rising COVID-19 infection rates, especially many of the target recruitment markets for international students like

India. In addition, the current relationship changes between Australia and China may also have some impact on the number of students who come to Australia to study from that country.

26. This may impact the method of delivery perhaps more than the enrolment numbers. That is a possibly acceptable scenario and could be the way forward in the medium term. That has some implications for the pipeline as well as Revenues. It is also a crucial issue for the distribution channel of Recruitment Agents who need to be made comfortable to generate the volume of Commencing Student load that is implied by the model underlying the Revenue forecasts.
27. One other factor to test is the level of Fees set for the next intake of students. Whilst it is important to maintain the key positioning of premium price for a premium offering, especially with the strong showing of ANU in the most recent University Rankings, there is also the need to ensure that the Fee setting methodology is sufficiently flexible and fluid to ensure that it takes account of a fast-moving target. Many other Universities are fine tuning their marketing approaches.
28. The Expenditure modelling is well structured and appears to have a fair amount of integrity. That does not mean it is complete by any means. The Do-Nothing scenario has not much to commend it in the short to medium term. This is because a return to “normal” is unlikely to happen quickly. In fact, what was normal is unlikely to return in my view but that is yet to play out. I am happy that it shows the results of the possibility of this happening but the Savings scenario is more likely operationally.
29. The target of reducing expenditure by $103.5m is an interesting choice. It appears targeted to absorb the Depreciation and Amortisation and Restructuring costs impact. This ensures that the Cash Flow generated returns the Liquidity Buffer to the desired level more quickly. I made some comments on the pace earlier, but the aim is valid. The critical issue now is to ensure the Expenditure reduction is well targeted to deliver the required new operating model going forward in anticipating whatever “normal” emerges in the medium term.
30. I have tested the assumptions and the projection methodology and am satisfied that the details, obviously estimates by nature, provide the right picture for the outlook. It is not so accurate that the models can provide a basis for the Financial Health Strategy in detail as yet, but it does provide the level of confidence required for the University that

Workstream 3 will allow a more well-structured plan and projection set to emerge in the next couple of months.

31. The one issue yet to be developed with greater integrity is the need for a well-structured Capital Investment Plan for the next three years. This is crucial so that the various desired strategic projects, infrastructure and research equipment etc are well funded and within the capacity of the University. This needs some careful management and will involve some interactive planning between the Operating Plan and the Capital Plan until a well-balanced set of outcomes finds the desired equilibrium.

Sensitivity Testing

32. Just as important as the Financial Health Strategy and its ability to deliver the desired outcome is the need to test its ability to withstand some unexpected or unplanned changes to the assumption set. The 3-Stage model has validity. The Revenue and Expenditure models have my overall endorsement with the factors suggested above to consider to improve its outcomes and information quality. There is nothing inherently wrong with the Financial Health Strategy as demonstrated in the previous section, and it can be actioned in its current form, however, the University should build continued sensitivity analysis into its quarterly forecast processes.
33. However, some sensitivity testing of key assumptions is required to ensure that the Finance Committee, through the Executive, is aware of the points to watch to ensure there is flexibility for change at the right moments going forward. The word “pivot” has become the norm for action these days and will need to be regularly utilised in the future too.
34. A further downturn in international student EFTSL, especially mode of delivery and pricing as well as numbers of students, will be crucially important. This scenario plan needs to be more fully developed as an alternative, as should the positive outcome of quicker uptake of enrolment by international students albeit likely on a digital delivery basis. These sensitivities are needed for greater understanding of the boundaries within which acceptable outcomes can emerge and the various targets can be maintained or recalibrated as ANU goes forward with confidence.
35. I have carried out some sensitivity testing in the time available. There is a need to build the Revenue models driven by EFTSL as a number of alternative scenarios both upside and downside. It is also important to

consider the likelihood of each scenario in order to consider the final impact on the Financial Health Strategy. It is also important to build some further scenarios for Expenditure as well with some reasonable scenario testing behind it. Given the Do Nothing and Saving scenarios developed for Expenditure already in the paper there is probably less emphasis required on that score.

36. The Financial Health Strategy paper already incorporates an estimate of the impact, including Transition support, as a result of the likely Jobs Ready package passing through Parliament. Given the economic downturn will take some further time to work through there is a high likelihood of domestic demand to increase. This is likely to drive a higher rather than lower level of direct applications to the sector and the higher ranked Universities, such as ANU, are likely to attract more than their fair share. Therefore, a further 300 EFTSL is a strong possibility and it is dependent on ANU being prepared to accept this additional load in 2021 for Commencement which should flow through into the next couple of years too. This could bring a further $5m additional Revenue in 2021 and possibly flow through at $7m and $9m in the following two years. The likelihood of a reduction in domestic EFTSL being lower than the current Revenue forecasts is quite low, unless there is some further impediment introduced to the acceptance process at ANU different to the rest of the sector. This additional Revenue will help but will not be a decisive change for the Financial Health Strategy.
37. The International Fee-Paying Revenue sensitivity testing is less certain whether there is going to be more upside or more downside in the next couple of years. There are factors in terms of load but there is also factors in terms of fee levels. There are also factors in terms of financial support, either in discounting of fees for certain students such as those who cannot arrive on campus next year and maybe the year after, or in financial support with bursaries or covering some element of travel or living expenses as is the case in 2020.
38. The projection for 2020 appears to be more positive now than just a few weeks ago. That is great to see but the Commencing load is still way down on past years and there will be a flow through of that to next year and the year after that. I have projected Commencing load 10% below this year for 2021. I have also projected a 5% lower Commencing load in 2022. Given fee levels of around $45,000 per EFTSL that means a lower

Revenue in 2021 of around $7m and in 2022 of around $10m. Of course, there is an equivalent upside of the same order if the University is better in succeeding to attract more students from the international market. This in itself is not a breaker factor for the Financial Health Strategy.

39. If we now turn to the other load factor of international students needing to do more part time work to support themselves financially and thereby reducing their enrolment load by say 10% of the total. This represents a more serious impact, and it is likely to only be a negative one with little opportunity, other than some minor increases, of a natural increase in load by existing students. Given the $225m Revenue projection in 2021 this could mean say around a $20m downturn in Revenue. For three years that could be a more significant factor.
40. The last issue to consider for international students are the level of fees earned per EFTSL. The average in 2020 was around $47,000 and projected at around $45,000 in 2021 and beyond. If the projected fees have to be reduced by say 5% which may mean an average per EFTSL of just under $43,000. That means a reduction in Revenue of around $10m each year for the next three years. Is there an equal opportunity for fee increases? That depends on the likely variance between the $A and the $US or the Renminbi? So, for the sake of being fair there is a possible variance of say + or - $10m per annum.
41. Could these factors be multiplicative? Possibly! So, there could be impacts as high as $40m per annum? That is less likely both positive as well as negative. However, that means a Cash Flow swing factor of around $120m over the forecast period. This does require some further consideration and some scenario testing in the next couple of months.
42. Another area to consider is Domestic Fee-Paying student load. This is more likely to have more upside rather than downside as more Australians wish to upgrade their knowledge and skills. There is probably a swing in this area of both upside and downside of $5m per annum. This is also worthwhile pursuing further and ANU should provide more attractive options than some other less highly regarded Universities.
43. In terms of Expenditure change it is possible that the level of project investment will rise, as predicted earlier in this paper. This may increase Expenditure next year by perhaps some $10 to $20m but with a lower Expenditure base in the years following. One area to tackle for better short-term Expenditure benefits is to reduce international acquisition

expenses. The current method of recruitment involves a number of high up-front cost Recruitment Agents. This could be tackled in different ways to reduce the cost of acquisition which may provide some Cash Flow to utilise for more active marketing with higher throughput as a result.

44. These various sensitivity tests need further work and the building of various scenarios and to measure impacts with greater rigour and accuracy.
45. Whilst the above paragraphs need some attention I have no hesitation in recommending that the Financial Health Strategy and the models within it be endorsed as an excellent framework and as a foundation for future planning and decision making.

Conclusion

46. Thank you for the opportunity to Peer Review the paper presented to the ANU Finance Committee to seek endorsement of the Financial Health Strategy.
47. As outlined above, I endorse and recommend the paper, its aims and outcomes and have no hesitation to say that my Peer Review has not uncovered anything to reject it. The Strategy has integrity, is well structured and should deliver a much better outcome for the University over the period to 2023.
48. There are a number of recommended actions in this paper which I commend be considered and if thought appropriate to be followed up. The sensitivity testing of various elements is also recommended with a scenario testing methodology.
49. I am happy to discuss any aspect of the Finance Committee paper and this Peer Review but most certainly wish ANU well in taking this well developed and considered Financial Health Strategy forward.

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