



## Minister of Health

### **Improving the financial performance of Health New Zealand**

22 July 2024

These documents have been proactively released by the Ministry of Health on behalf of the Minister of Health, Hon Dr Shane Reti.

#### **Title of Cabinet paper:**

- Improving the financial performance of Health New Zealand

#### **Title of Cabinet minute:**

- Improving the Financial Performance of Health New Zealand (CAB-24-MIN-0255)

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply have been identified. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

#### **Key to redaction codes:**

- S 9(2)(f)(iv) - to maintain the constitutional conventions that protect the confidentiality of advice tendered by Ministers and officials.
- S 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between or to Ministers and officers and employees of any public service agency.

**Sensitive**

Office of the Minister of Health

Cabinet

**Improving the financial performance of Health New Zealand**

**Proposal**

- 1 This paper provides Cabinet with further information on the current financial performance of Health New Zealand (Health NZ) and associated risks for the 2024/25 year and sets out the proposed actions to address these.

**Relation to Government priorities**

- 2 The financial sustainability and delivery performance of the health system underpins achievement of a wide range of government priorities, including specific targets in health and mental health and addiction.

**Executive summary**

- 3 After having delivered a financial break-even result in its first year after establishment, and expecting to meet its budget up to February this year, Health NZ advised me in March 2024 that it had identified significant and unexpected overspending in the hospital system. This has persisted in the subsequent months.
- 4 The key facts are:
  - 4.1 Health NZ is currently overspending at the rate of approximately \$130 million per month.
  - 4.2 At the current rate, Health NZ would be expected to face a \$1.4 billion operating deficit by end 2024/25.
  - 4.3 Without mitigation, this would lead Health NZ to exhaust its cash reserves to cover the overspending, potentially leading to a cash flow issue.
- 5 There are a number of underlying contributors to the current position, including risks that have been observed and reported by monitors over the life of the entity, such as:
  - 5.1 an overly centralised operating model where national planning and budgeting is uncoupled and disconnected from local management,
  - 5.2 ineffective financial reporting and limited oversight of financial and non-financial performance by Health NZ Board and management,

- 5.3 fragmented administrative data systems, which were unable to identify risk and provide early warning for the impending financial issues until they were already embedded.
- 6 There are a number of underlying contributors to the current position, outlined in paragraph 26 below. In the immediate term, Health NZ has put in place financial and operational controls to stem the overspending in areas such as recruitment. To date, I have not yet seen evidence of these controls having an effect.
- 7 Our Government had already responded to the known risks of Health NZ's governance by taking early action, including putting in place a Crown Observer to the Board in November 2023 and agreeing to appoint a new Board member with financial expertise in February 2024. Since identifying the more recent financial issues, we have moved further to replace the Chair of the Health NZ Board, appointing Dr Lester Levy in June 2024. These three appointments have been instrumental in unveiling the extent of financial issues.
- 8 I have set clear expectations for the new Chair, who is currently developing a detailed turnaround plan for a hard reset of Health NZ, including expectations for savings to deliver a pathway to financial sustainability, and focus on regional accountability and control measures to address the underlying causes of the issues.
- 9 There are further options to strengthen Health NZ governance to respond to this issue. These include filling the three vacancies created by member terms coming to an end; or appointing a Commissioner for 12 months to oversee the recovery.
- 10 Addressing this scale of financial challenge will be very difficult, will take time, and will require support for the necessary trade-offs. I expect frontline services to be protected and health targets to be prioritised, <sup>s 9(2)(g)(i)</sup>
- 11 <sup>s 9(2)(g)(i)</sup>
- 12 Communication to the health sector and the public will be important – and we want to be proactive. I am discussing a plan to lead announcements within the next three weeks, subject to Cabinet's confirmation of governance decisions.
- 13 I will be reporting back to Cabinet regularly on Health NZ performance, including in relation to delivery of government targets and actions to improve financial sustainability.

## **Background**

- 14 The health reforms introduced by the previous Government in July 2022 brought together 20 district health boards (and other entities and functions) into one entity, Health NZ, with the intention of enabling more robust national planning and better coordination of resources to address inequities of access and outcomes. Additional, ongoing funding was provided at the establishment of Health NZ to cover the deficits inherited from the contributing DHBs and to support system change.
- 15 During its first year, Health NZ aimed for a breakeven position and initially achieved a \$130 million surplus result<sup>1</sup>. Heading into 2023/24, its second year of operation, Health NZ identified a self-imposed savings target of \$540 million required to meet its budget. By mid-year the savings programme was in doubt, and alternative actions to realise savings were required to bridge the gap.
- 16 During these first two years, service performance issues continued to be experienced across hospital and specialist services as well primary and community care, with contributing workforce, infrastructure, and technology challenges. It was in this context of deteriorating service performance that this Government re-established health targets to drive improvement.
- 17 A number of challenges with the operating model and governance of Health NZ had been identified from the early days of its establishment, in large part deriving from a lack of transparency from the Board. The Ministry of Health had advised regularly that it did not have assurance that the Board was able to exercise its functions effectively, and did not receive Board materials for monitoring purposes. In late 2023, the Ministry noted that the Board did not have a comprehensive performance framework or reporting process in place to monitor priorities and risks, and the Board may not be cognisant of key strategic and performance issues.
- 18 These concerns were amplified by other commentary. The Ministerial Advisory Committee on health reform implementation noted in its February 2024 report that Health NZ should rapidly progress the development of its internal performance monitoring framework. This was further supported by the Office of the Auditor General's report on Health NZ for the 2022/23 year, received in February 2024, which noted issues requiring major improvements including the management control environment, financial information systems and control, and the quality of performance information.
- 19 When we became Government in 2023, we acknowledged the existing crisis in the health system and the reported issues above. We acted in November 2023 to appoint a Crown Observer to the Board of Health NZ to provide greater oversight of Board activities. This appointment strengthened our understanding of the risks related to the Board's operating model, and financial performance monitoring in particular, and we acted further in

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s 9(2)(f)(iv)

February 2024 to agree to appoint a new Board member with specific financial expertise.

- 20 In March 2024, based on financial results for the month of February 2024, Health NZ first reported a significant and unexpected overspend in their monthly results. This had not been raised through prior reporting, and indeed until that time there had been repeated assurance provided that the organisation was still on target to make savings in the 2023/24 year. This also coincided with the Health NZ Board papers being shared with monitors (the Ministry of Health and Treasury) for the first time.
- 21 Despite taking immediate steps to constrain areas of overspending and apply cost controls, such as on recruitment, Health NZ's financial position has continued to deteriorate. The section below describes the key facts of the current position.

### **Financial performance of Health NZ**

*Health NZ has overspent its budget for 2023/24, which poses major financial risk in 2024/25 and outyears*

- 22 Based on the latest financial reporting up to the month of May 2024, Health NZ is currently overspending its budget at the rate of \$130 million per month and is forecasting a year-end deficit for 2023/24 in the region of \$600 million. This equates to 1.8% of Health NZ's total budget.

- 23 If actions are not taken to address current levels of overspending, and the current rate of overspending continues, this will lead to an estimated \$1.4 billion deficit in 2024/25.

- 24 s 9(2)(f)(iv)

- 25 If the current financial performance were to continue, Health NZ would deplete its cash reserves over the coming twelve months. The Board has instigated moves to manage the cash balances within the organisation as effectively as possible, s 9(2)(g)(i)

*The causes of this situation reflect issues with Health NZ's operating model and culture*

- 26 The causes of current issues for Health NZ are deep and reflect a number of structural and cultural matters that have been raised by monitors over the past 12-18 months (as noted in the background section above). These include:

- 26.1 **An overly centralised operating model** where service planning, budgeting, and corrective actions at the national level, are separated from local management. This has led to weak internal and

management control with consequential impacts on effective cost control. Over-centralising has cut out clinical voices and local expertise that is critical to ensure that on the ground issues are well understood at the centre and appropriate actions taken.

- 26.2 **Ineffective performance reporting.** Health NZ still does not have a workable internal performance framework, and until recently financial and service performance were reported separately. Financial reporting has been developing but is not yet at the level of granularity required to monitor performance effectively.
- 26.3 **Limited governance oversight and transparency.** The Board has lacked financial capability to more actively enquire into the level and depth of information it was receiving, to enable it to better identify issues and take corrective actions in a timely way. Furthermore, until recently, the entity has not shared relevant information with monitoring agencies, which affected their role in monitoring risk and providing assurance.
- 26.4 **Poor state, fragmented IT.** Health NZ inherited a range of disparate data and management systems (such as payroll) from district health boards, many of which rely on legacy platforms that are no longer effectively supported. While the task of modernising this data infrastructure is very significant, there has been relatively limited progress in the past two years.
- 27 The consequence of these factors combined is that the looming financial risk was not sufficiently recognised as such by Health NZ's management or the Board, or visible to the Ministry and central agencies, prior to it becoming a material issue in February 2024 financial reporting.

### **Actions to address financial performance risks**

*Health NZ has a new Chair in place, with further change planned*

- 28 The Government acted quickly to appoint a new Chair, Dr Lester Levy, for Health NZ from 1 June 2024 as the size of the challenges facing Health NZ became clear.
- 29 Urgent action is required to address the current situation and stop it worsening. My expectation to the Board of Health NZ on next steps includes:
- 29.1 A turnaround/recovery plan that improves governance and resets the Health NZ operating model to correct the current issues.
- 29.2 A financial sustainability plan that sets a clear course towards break-even, identifies the necessary savings and productivity-releasing initiatives and trade-offs, and sets the financial parameters for the next three years.

29.3 A revised NZ Health Plan, that will need to build on the above and be situated within the financial parameters and the GPS financial sustainability expectations.

*The new Chair has mapped out a turnaround plan*

30 To this end, Dr Levy has outlined his turnaround plan to deliver a fundamental hard reset to performance at Health NZ, ahead of a full implementation plan being submitted to me shortly. The key elements include:

30.1 Delivery and accountability: s 9(2)(f)(iv)

30.2 Fiscal responsibility: s 9(2)(f)(iv)

30.3 Effective internal control environment: s 9(2)(f)(iv)

30.4 A focus on value through enhancing productivity: s 9(2)(f)(iv)

*There are options for further changes to the governance model*

31 Given the seriousness of Health NZ's financial situation, I am considering options to strengthen the governance of the organisation.

32 A process is already underway to refresh the Board membership, due to the expiry of three members' terms (of seven current members). This process would provide an opportunity for new members that would bring clinical leadership, a community focus, and commercial business expertise to the Board, further strengthening the overall governance of the organisation. However, given the serious financial situation, I believe that there is a strong case to take more robust action.

- 33 The section 62 provisions in the Pae Ora (Healthy Futures) Act 2022 permit me to replace the Board with a commissioner if I am seriously dissatisfied with their performance. I consider this test has been met, given the current situation.
- 34 If this approach were pursued, I would anticipate asking Dr Levy to take on the commissioner role, and work with him to identify appropriate deputy commissioners (as they are appointed by the commissioner under the Pae Ora Act). Appointing Dr Levy would ensure continuity in the governance arrangements and enable an uninterrupted implementation of his turn-around plan.
- 35 Appointing a commissioner is the strongest ministerial intervention available under the Pae Ora Act and sends an unequivocal signal. The advantage is that it gives the commissioner and deputy commissioners speed and mandate to move at pace to turn the performance around.
- 36 The potential downside of deploying this option is that it vests governance oversight into a small group of people, and given the size and complexity of the Health NZ, it will be difficult for a single commissioner (even supported by deputy commissioners) to be sufficiently abreast of all issues and risks. Additionally, using this step now means that should performance not improve, we would have no clear next step to influence a performance turn around.
- 37 Having considered the options in light of the circumstances we face, I propose to move forward with removing the Board and appointing a commissioner.
- 38 I am advised that there is a due process to be followed, including a natural justice process where I would invite the current Board to respond to my concerns in writing before taking a final decision. I intend to proceed rapidly and propose to write to the Board outlining my serious dissatisfaction and invite their feedback, before confirming my final decision.
- 39 This paper seeks Cabinet's agreement to this approach, and agreement in principle to the appointment of a commissioner should my final decision be to remove the Board. I will bring any appointment back to Cabinet for noting through the usual appointments process, and intend to be in a position to do so at the Cabinet Appointments and Honours Committee meeting on 23 July 2024. This would enable a commissioner to be appointed from the end of July, and facilitate the subsequent appointment of deputies by the commissioner. It would also support an early announcement on our intended approach.

**The pathway to financial sustainability will be challenging**

- 40 The scale of the challenge ahead will mean trade-offs are required in terms of the activity that can be delivered in the upcoming year and beyond.



*Budget 24 funding was intended to address cost pressures for 2024/25 but efficiencies and savings were already necessary*

- 41 In Budget 2024, we agreed to implement multi-year funding for the health sector to ensure that there is an increased opportunity for effective forward planning to take place. The cost pressure funding agreed through Budget 2024 for Health NZ was designed to meet Health NZ's cost pressures.
- 42 However, Health NZ had already noted that there was a need for them to generate efficiencies to live within their means over the coming years, to ensure that Health NZ had the scope to focus resources upon the areas of highest priority to us, such as beginning the journey to achieving the health targets.

s 9(2)(g)(i)

*Enhanced monitoring and reporting will be critical*

- 45 I have strengthened Ministerial oversight of Health NZ's financial position through regular meetings held with the Chair and Chief Executive of Health NZ, together with Ministry of Health and Treasury monitors.
- 46 More active monitoring by the Ministry of Health and the Treasury will be essential to ensure as close to real-time tracking of Health NZ's performance as possible. Change to the organisation and governance of Health NZ is necessary, but further disruption has the potential to lead to ongoing deterioration, which effective monitoring must watch for. The Ministry of Health is developing an enhanced monitoring model with the Treasury to ensure that financial and non-financial performance and risks are appropriately monitored over 2024/25, in particular in relation to key actions identified in Health NZ's turnaround plan.
- 47 I plan to update Cabinet regularly on the progress in addressing Health NZ's financial performance and the actions underway to place the entity on a more sustainable footing.

s 9(2)(f)(iv)

**Cost-of-living implications**

50 There are no cost-of-living implications.

**Financial implications**

51 This paper does not have immediate financial implications due to Health NZ's cash reserves. s 9(2)(g)(i)

52 This paper also provides information for Cabinet on the potential risk that, should the rate of expenditure over budget continue, Health NZ is likely to realise an operating deficit position by the end of 2024/25, potentially of around \$1.4 billion. However, current cost control actions instituted by Health NZ in the last few months, and a turnaround plan being developed by the Chair of Health NZ, aim to produce savings for the entity to mitigate this deficit while delivering on core government priorities.

53 Further analysis and planning to confirm the levels of savings and their implications for service delivery are necessary to finalise expectations for 2024/25 and subsequent years. Once both fiscal and service implications are clearer, Cabinet will be appraised of any potential funding implications for outyear budgets.

**Legislative implications**

54 This paper has no legislative implications.

**Impact analysis**

55 A regulatory impact statement is not required for this paper.

## Population implications

- 56 One of the core objectives of setting system performance improvement expectations is to drive improvement in health outcomes in areas that matter to patients. These include service activities and outcomes in which there is current under-performance at a whole-population level, as well as particular challenges and gaps for certain groups with higher needs, including Māori, Pacific and disabled communities.

## Human Rights

- 57 This paper does not have human rights implications.

## Use of external resources

- 58 No external resources have been used in the preparation of this paper.

## Consultation

- 59 The following agencies were consulted on this paper and their feedback incorporated: the Treasury and the Department of the Prime Minister and Cabinet.

## Communications

- 60 I propose to announce further changes to the Health NZ Board, and in so doing communicate the financial pressures faced by the entity and associated challenges for the new board, in the near future.

## Proactive release

- 61 This paper and its associated minutes will be proactively released within 30 days in line with standard practice, subject to redactions as appropriate under the Official Information Act 1982.

## Recommendations

The Minister of Health recommends that the Committee:

- 1 **note** that Health New Zealand first reported a deteriorating financial position in March 2024, based on significant overspending becoming apparent in financial reporting from February 2024
- 2 **note** that financial performance has worsened subsequently, and Health NZ is currently forecasting an operating deficit in the region of \$600 million for the end of the 2023/24 financial year
- 3 **note** that this financial performance carried forward into the 2024/25 year, if unaddressed, would lead to an estimated deficit of \$1.4 billion and would consume the majority of Health NZ's cash reserves

- 4 **note** that there are long standing issues with the governance and operating model of Health NZ that have contributed to this position
- 5 **note** that Cabinet recently agreed to the appointment of a new Chair of Health NZ, following the recent appointment of a new Board member with financial expertise
- 6 **note** that the incoming Chair of Health NZ has developed a turnaround plan to address financial performance and set a path towards financial sustainability
- 7 **note** that this turnaround plan sets an objective for Health NZ s 9(2)(g)(i) and includes actions to strengthen governance and management of the entity
- 8 **note** my view that the threshold of being seriously dissatisfied with the Board of Health NZ has been met, given the circumstances
- 9 **agree** to my proposal to proceed with a process to remove the Board of Health NZ and appoint a commissioner
- 10 **agree in principle** that should my final decision be to appoint a commissioner following feedback from the Board, that this appointment will be for a 12 month term
- 11 **note** that any commissioner appointment would proceed through the usual Cabinet appointments process, as soon as practicable
- 12 **note** that Health NZ intends to prioritise delivery of Government targets and related priorities in 2024/25 s 9(2)(g)(i)
- 13 **note** that it may take more than 12 months for underlying issues to be addressed sufficiently, and it is possible that Health NZ will continue to post a deficit in 2024/25
- 14 **note** s 9(2)(g)(i)
- 15 **invite** the Minister of Health to keep Cabinet regularly updated on progress in implementing the turnaround plan and improvements in Health NZ's financial performance.

Authorised for lodgement.

Hon Dr Shane Reti

Minister of Health



# Cabinet

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

### Improving the Financial Performance of Health New Zealand

**Portfolio**                      **Health**

On 8 July 2024, Cabinet:

- 1        **noted** that Health New Zealand (Health NZ) first reported a deteriorating financial position in March 2024, based on significant overspending becoming apparent in financial reporting from February 2024;
- 2        **noted** that financial performance has worsened subsequently, and that Health NZ is currently forecasting an operating deficit in the region of \$600 million for the end of the 2023/24 financial year;
- 3        **noted** that this financial performance carried forward into the 2024/25 year, if unaddressed, would lead to an estimated deficit of \$1.4 billion and would consume the majority of Health NZ's cash reserves;
- 4        **noted** that there are long-standing issues with the governance and operating model of Health NZ that have contributed to this position;
- 5        **noted** that Cabinet has recently noted the appointment of a new Chair of Health NZ [APH-24-MIN-0064], following the recent appointment of a new Board member with financial expertise [APH-24-MIN-0026];
- 6        **noted** that the incoming Chair of Health NZ has developed a turnaround plan to address financial performance and set a path towards financial sustainability;
- 7        **noted** that this turnaround plan sets an objective for Health NZ s 9(2)(g)(i) and includes actions to strengthen governance and management of the entity;
- 8        **noted** the view of the Minister of Health that the threshold of being seriously dissatisfied with the Board of Health NZ has been met, given the circumstances;
- 9        **agreed** to the Minister of Health's proposal to proceed with a process to remove the Board of Health NZ and appoint a commissioner;
- 10       **agreed in principle**, should the Minister of Health's final decision be to appoint a commissioner following feedback from the Board, that this appointment will be for a 12 month term;

- 11 **noted** that any commissioner appointment would proceed through the usual Cabinet appointments process, as soon as practicable;
- 12 **noted** that Health NZ intends to prioritise the delivery of Government targets and related priorities in 2024/25, s 9(2)(g)(i)
- 13 **noted** that it may take more than 12 months for underlying issues to be addressed sufficiently, and that it is possible Health NZ will continue to post a deficit in 2024/25;
- 14 **noted** that s 9(2)(g)(i)
- 15 **invited** the Minister of Health to keep Cabinet regularly updated on progress in implementing the turnaround plan and improvements in Health NZ's financial performance.

Rachel Hayward  
Secretary of the Cabinet

PROACTIVELY RELEASED