Briefing Note: Results of the 2017 School Audits

To: Hon Chris Hipkins, Minister of Education

Date: 2 May 2019

Security Level: In Confidence

Drafter: Emma Dorrian

Key Contact: Natasha Barnett

Messaging seen by Communications team: No

Priority: Low

METIS No: 1178679

DDI: s 9(2)(a)

Purpose of Report

The purpose of this paper is for you to:

Note that the Office of the Auditor-General has published its report on the Results of the 2017 School Audits.

Note that the Ministry of Education has provided a response to the recommendations made by the Office of the Auditor-General.

Approve the proactive release of this briefing.

Agree   Disagree

Summary

- Schools are required to prepare financial statements annually, for the financial year ended 31 December. These financial statements are required to be independently audited by Auditors appointed by the Office of the Auditor-General (OAG). The Ministry of Education (the Ministry) provides $880k to the OAG annually to subsidise the cost of these audits.

- The OAG's report was published on its website on 5 December 2018. The report shows that the majority of almost 2,500 schools met their obligations for producing audited accounts and that, for most schools, there were no significant issues.
The issues that the OAG identified include potential conflicts of interests, the use of crown funds for overseas travel, schools experiencing financial difficulty and schools breaching clauses of the Education Act 1989 or Crown Entities Act 2004.

Katrina Casey
Deputy Secretary
Sector Enablement and Support
2.11.2019

Hon Chris Hipkins
Minister of Education
23.5.19
Background

1. All school Boards of Trustees are required to prepare an annual report\(^1\). The annual report includes the annual financial statements, which are required to be prepared in accordance with generally accepted accounting practice and must be audited. The financial year for schools runs from 1 January to 31 December.

2. The Auditor-General is the appointed auditor of every crown entity. The OAG undertakes the required auditing work on behalf of the Auditor-General and subcontract's the audit work to Chartered Accountancy firms.

3. Schools are required to provide draft annual reports to their appointed auditor by 31 March of each year and the audited annual reports must be provided to the Ministry by 31 May of each year.

4. Following completion of the audit work, the OAG compiles the audit findings from the appointed auditors. These findings are included in a report which is sent to the Secretary for Education. In recent years the report has also been published on the OAG's website.

5. The report highlights matters which the OAG and its auditors consider to be in the public interest, such as the mis-use of public funds. The report also names schools that have been found to have breached laws or regulations during the year, including those schools that have failed to meet the reporting obligations.

Summary of Audit Findings

6. The findings for the 2017 year are in the following broad categories:
   a. Completion of the 2017 school audits:
      For the 2017 year 86% of audits were completed by 31 May. This is an improvement on the 2016 year when a completion rate of 81% was achieved. The report lists schools with outstanding audits for either the 2017 reporting period or for earlier reporting periods. The level of arrears has reduced since the date of the 2016 report.
   b. Matters of public interest:
      The report comments on certain matters which were highlighted in the auditors' reports because they were deemed to be of interest to the public. For 2017 these include potential conflicts of interest of Boards, and the use of crown funds for overseas travel. Similar findings have generated interest from the media and the public in the past. The Ministry is working with the named schools on resolving the issues raised but this only represents a small proportion of the almost 2,500 schools. Significant matters have been detailed in the section below.

---

\(^1\) Education Act 1989, section 87.
c. Schools in financial difficulty:
For the 2017 year 44 schools were showing signs of financial difficulty. This is a reduction in comparison to the 2016 year where 59 schools were showing signs of financial difficulty. Returning a school to financial health can often take several years and this is reflected in the fact that some of the listed schools were also reported in the previous year. The Ministry will continue to provide support to these schools. The Ministry will also continue to work with schools to improve financial literacy, capability and decision making, to reduce instances of financial difficulty.

d. Breaches or laws and regulations:
   - Where a school has breached a legislative requirement this is disclosed in their financial statements and the schools are listed in an appendix to the report. These breaches include:
     - Borrowing more than allowed under section 29 of the Education Act (49 schools).
     - Payments to teachers outside of the Education Payroll system (6 schools).
     - Providing loans to staff (4 schools).
     - Investing money in organisations without the Ministry's approval (4 schools).
     - Banking arrangements that are inconsistent with requirements (2 schools).
     - Conflicts of Interest (2 schools).
   - There was a reduction in the number of legislative breaches reported compared to the 2016 year.

e. Matters for the attention of the Secretary for Education:
   - This section highlights areas where the OAG consider that the Ministry should provide further guidance to schools or where the Ministry should facilitate the provision of information to streamline the audit process. The Ministry has provided a response to the OAG on the recommendations made. A copy of the Ministry’s response has been enclosed in Annex 2.

7. A full copy of the OAG’s report has been enclosed in Annex 1.

Matters of public interest

Al-Madinah School (Auckland)

8. The Auditors were unable to express an opinion on the 2016 and 2017 financial statements of Al-Madinah School due to insufficient audit evidence to support payments. The Auditors were also unable to identify all related party transactions and whether these were at arms-length. The 2015 audit opinion was limited due to insufficient information on related party transactions and drew attention to potential conflicts of interests with the proprietor of the school.
9. A Limited Statutory Manager (LSM) was appointed in May 2016. The LSM was vested with all functions, powers and duties of the board to manage financial operations. On 8 April 2019 the existing intervention was revoked, the board of trustees was dissolved and a Commissioner was appointed, assuming all roles and responsibilities of the board.

10. s 6(c)

Sacred Heart College (Auckland)

11. The Auditor’s opinion drew attention to the close relationships between the school, the proprietor, and the Sacred Heart Development Foundation, and potential conflicts of interest between these entities. The school, Sacred Heart Foundation and the proprietor all have trustees in common. The audit report also highlighted the school should not pay for hospitality to further relationships between the Sacred Heart Foundation and old boys of the school.

12. The Ministry has discussed the concerns raised with the Board Chair and Board Finance representative. The Board has reviewed its financial processes and made changes which it believes will alleviate concerns over potential conflicts of interest. The Board has confirmed hospitality expenditure relating to fundraising for the foundation will not be met by the school.

Te Kura Kaupapa Maori o Nga Uri a Maui (Bay of Plenty, Waiariki)

13. The Kura spent $32,401 on accommodation, food, venue and vehicle hire over six days for a four-day school planning meeting held on the Gold Coast. The school expected the teachers to pay their own airfares. The school only collected $10,013 from the teachers, leaving $1,737 uncollected.

14. The planning meeting in question occurred in 2017 and involved 19 attendees. At the time, the Ministry’s overseas travel guidance was that overseas trips must be approved by the Board, there must be an educational outcome in taking the trip and the trip must be funded by parent contributions or fundraising, not crown funding.

15. The Ministry has subsequently issued new overseas travel guidance which reflects the Boards’ role in making decisions about the use of crown funds. The Kura has been provided with a copy of this guidance. The Kura is in a sound financial position.

Blockhouse Bay Intermediate School (Auckland)

16. The Auditor’s opinion drew attention to expenditure on a student trip to Korea. The school spent $23,000 of school funds to send 21 students and 3 teachers to Korea on a cultural exchange. The students contributed $56,000 for the trip. The Ministry’s guidance at the time was that schools should fundraise specifically for overseas travel for students.

17. This matter is similar to the finding from the 2016 audit. At the time the OAG published its report on the Results of the 2016 school audits in December 2017, this subsequent trip had already occurred.

18. A new Principal was appointed in May 2016. At that time the May 2017 trip had already been planned, approved and paid for. The school has since modified its policies, and any future exchange student programmes will be fully funded by parents.

19. The trip did not place the school at financial risk; the school is in a sound financial position.
Te Whata Tau o Putauaki (Bay of Plenty, Waiairiki)

20. The school spent $47,839 of school funds to send five students, 4 teachers and one caregiver to attend the World Indigenous Peoples Conference on Education in Canada. The total cost of the trip was $100,858 with the students raising funds of $53,219 to cover the other costs.

21. A large contingent of Māori education advocates, scholars and supporters attended the conference including representation from the Ministry of Education.

22. The school fundraised over half of the cost of the trip for their ten travellers. The trip did not place the school at financial risk; the school is in a sound financial position. A copy of the Ministry’s guidance on funding for overseas travel has been provided to the school.

Te Kura Kaupapa Māori o Te Kura Kokiri (Bay of Plenty, Waiairiki)

23. For the audit of the 2013 financial statements, Auditors drew attention to:
   - a lack of documentation and evidence of approval for refunds of payments from a personal account, which the school considered to be school payments;
   - unusually high levels of fuel expenses, food and groceries, and koha payments;
   - repairs and maintenance paid on cars not owned by the school;
   - payments for a trip to Hawaii;
   - tertiary fees paid for staff; and
   - other general expenses not supported by suitable documentation.

24. The Ministry has provided support to help the Kura strengthen its systems and processes. The Kura’s accountant is also helping the Kura address the historical documentation issues. The audits of the 2014, 2015, 2016 and 2017 financial statements remain outstanding. There is an agreement in place between the Kura, its accountant and the auditor to complete all outstanding audits during 2019.

Mana Tamariki (Taranaki, Whanganui, Manawatu)

25. The school decided not to seek recovery of an overpayment to an employee of about $21,000, even though the school was in financial difficulty. The school had a working capital deficit of $173,258 as at 31 December 2016 and needed a letter of support from the Ministry to ensure it was a going concern. The Ministry have agreed to a long term repayment plan for the $202,052 the school owes for over staffing, which has allowed the school to return to a working capital surplus in the 2017 year.

26. This finding related to the audit of the 2016 financial statements. Prior to 2016 the Kura had amassed a large staffing debt. The Ministry has agreed a five year repayment plan with the school. A new Principal has been appointed and both the Board and the Principal have undertaken significant governance training and the Kura is on track to becoming financially sustainable. The Ministry has been providing financial advice and support to the school. The Kura’s 2017 financial statements were completed on time and no letter of going concern was required by the Ministry.

Tahatai Coast School (Bay of Plenty, Waiairiki)

27. The school made a trading loss of $71,438 during the 2017 year, which included the write off of more than $26,000 of uniform inventory. The write-off of excess stocks was necessary because the school bought uniform in bulk over several years without considering low selling items. The school’s decision to change the school uniform from 2020 meant the school had to write off certain uniform items because they could not sell them.
28. The Ministry has discussed the trading loss with Tahatai Coast School to ensure the school is adequately managing its uniform stock and is not purchasing large volumes of slow moving items. The school has a positive operating surplus and the trading loss relates to several one-off events that occurred in the 2017 year and which are not expected to occur again. The school is financially sound and is able to meet its longer term commitments.

**Tauranga Boys College (Bay of Plenty, Waikato)**

29. The Auditor drew attention to an unusual arrangement between the college and a related entity. The school borrowed $100,000 in 2008 from the Tauranga Boys College Titan Sports Council Trust (the Titan Trust) at an interest rate of 20% per annum. The Titan Trust is an independent, non-public entity and charged the school interest at a rate higher than a bank would charge. The school made no repayments of the loan until the school repaid the loan in full on 22 May 2018.

30. The ten-year contract with the Titan Trust included a higher interest rate as there was no repayment requirement for the term of the loan. The contractual arrangement did not place the school at financial risk; the school is in a sound financial position.

**Ministry of Education actions to date**

31. OAG's report highlighted the audit pipeline as the highest priority of their published findings. Consequently, this has been the Ministry's focus, since the release of the report. The following actions have been taken, by the Ministry, to address this finding:

a. We are leading a project team, comprised of representatives from the Ministry, Education Payroll Limited, OAG and Ernst Young. Together we have successfully delivered key payroll reports and associated guidance to schools, in line with agreed deadlines, thus removing a barrier to the successful completion of the 2018 financial statements.

b. Targeted communications have been sent to Financial Service Providers and the School Executive Officers Association, providing key guidance materials and encouraging early preparation and submission of financial statements.

c. Key messages have been supplied to the Ministry's Regional Offices, to facilitate discussions of financial reporting compliance.

d. The Ministry's School Financial Advisors have made direct contact with schools that have been identified as requiring additional support, including those that have previously missed the reporting deadline.

32. The report listed schools that had not yet completed financial reporting for 2017. The Ministry has been contacting these schools and the level of arrears has decreased from 84 to 46 with further submissions expected in the coming months. We will continue to work with the remaining schools to fulfil their outstanding reporting obligations.

33. The Ministry is continuing to work with schools experiencing financial difficulty. The approach involves partnering with schools to perform root cause analysis and to prepare financial recovery plans. Where it is clear that all necessary actions have been taken to remediate the cause but recovery is unlikely to be achieved within a school's allocated funding, the Ministry will consider recapitalisation. To date 13 capital grants have been approved for 2018/2019.
The Ministry has developed a reporting and risk indicator tool. This tool utilises financial and non-financial information to identify those schools that are either in financial difficulty or risk of financial difficulty. This tool will assist the Ministry's School Finance Advisors in prioritising their work.

A programme of work to address the OAG's recommendations to the Ministry has been scoped and is now underway.

Key Risks and Benefits

Failure to sufficiently address the findings of the report could result in:

a. Continued breaches of reporting requirements, with implications for public accountability;

b. Waste and probity issues, including the misuse of public funds;

c. Schools continuing to experience financial difficulty, with insufficient resources for the delivery of teaching and learning; and

d. Increasing instances of legislative breaches.

Next Steps

The Ministry has already commenced the work required to address the recommendations, as outlined in our response to the Office of the Auditor-General.

The Ministry will continue to work with the schools highlighted in the report to address the issues raised.

Proactive Release

It is intended that this briefing is proactively released as per your expectation that information be released as soon as possible. Any information which may need to be withheld will be done so in line with the provisions of the Official Information Act 1982.

Annexes

Annex 1: Results of the 2017 school audits

Annex 2: Response to the Results of the 2017 School Audits