

**Cambridge High School's
management of conflicts of
interest in relation to
Cambridge International
College (NZ) Limited**

October 2005

This is the report of an inquiry we carried out under sections 16 and 18 of the Public Audit Act 2001.

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Foreword

Managing conflicts of interest in the public sector involves more than consideration of the law. The ethics of the situation must also be considered.

The findings of my inquiry into how Cambridge High School managed conflicts of interest in relation to Cambridge International College (NZ) Limited highlight the need for schools to carefully consider the ethical dimensions of conflicts of interest.

Two particular aspects of this inquiry stand out:

- € The lack of understanding by the School's Board of Trustees and the Principal of the nature and proper management of conflicts of interest in the public sector.
- € The unwillingness of the Principal of Cambridge High School at the time to provide an account to her employer and to us of her private interests where these were relevant to her employer. The Principal was at the centre of a set of relationships that resulted, or had the potential to result, in personal gain. Her inadequate disclosures of her interests meant that the gain or potential gain was not clear. All public officials must be accountable for their actions and private interests that may affect their public duties.

There are about 2500 state schools. Although it is unlikely they will ever have to manage a conflict of interest of the complexity found in this inquiry, all school Boards of Trustees must be prepared to understand the nature of conflicts of interest, and be able to act as and when appropriate.

Those school Boards of Trustees that do need to manage a conflict of interest must do so properly, to uphold the high standards and reputation of the public sector.

While each state school Board of Trustees is a Crown entity in its own right, and has legal obligations, the Ministry of Education also performs an important role in relation to schools. The Ministry's Statement of Intent says it seeks to support good governance and management, develop clear expectations of quality, and provide core infrastructure in the schools sector.

I therefore urge the Ministry to take steps to ensure that schools are fully aware of both the nature of conflicts of interest in the public sector and how they should manage them.



K B Brady
Controller and Auditor-General

13 October 2005

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Part 1 – Background

Why we conducted an inquiry

- 1.1 In September 2004, we decided to conduct an inquiry into how the Board of Trustees (the Board) of Cambridge High School (the School) managed any conflicts of interest in relation to its arrangements with a private company, Cambridge International College (NZ) Limited (the College).
- 1.2 The decision was made after the Minister of Education asked the Auditor-General to inquire into these matters, and after preliminary enquiries to find out the nature of the issues involved. The full terms of reference for our inquiry are in Appendix 1.
- 1.3 Primarily, our inquiry looked at the circumstances in relation to establishing a partnership between the School and the College to educate overseas students, and whether any member, office-holder, or employee of the School had any conflicts of interest through their relationships with the College.

Conflicts of interest

- 1.4 In the public sector, a conflict of interest exists where a person's duties or responsibilities to a public entity could be affected by some other separate (usually private) interest or duty that he or she may have. Impartiality and transparency in administration are essential to maintaining the integrity of the public sector.
- 1.5 Managing conflict of interest issues in the public sector involves more than consideration of the law. The ethics of the situation must also be considered.
- 1.6 Assessing whether a conflict of interest exists in the public sector involves considering not only the possibility of financial loss to the public entity concerned. The potential for public funds, resources, or time to be used by someone to advance their own private interests is also a consideration. Assuring the public that those entrusted with the proper management of public sector resources do not have any interests that are incompatible with that role is another important aspect.
- 1.7 This highlights the need for decisions on conflicts of interest to be made on the basis of what an informed objective bystander would think of the situation.
- 1.8 In these respects, the rules and expectations for handling conflicts of interest may differ between the public and private sectors.

- 1.9 The existence of a conflict of interest does not necessarily mean that the person concerned has done anything wrong. What it does is create an issue that needs to be managed carefully by the public entity.
- 1.10 In the public sector, simply declaring a conflict of interest may not be enough. Once a conflict of interest has been identified or disclosed, the entity may need to take steps to remove both the perception and the actuality of any potential for taxpayers' funds to be used for private gain.

The statutory position in schools

- 1.11 There are about 2500 state schools, each governed by its own Board of Trustees, made up of members of the local community. Each Board of Trustees is a Crown entity in its own right and has legal obligations, which include being subject to the Education Act 1989 (the Act).
- 1.12 Each state school principal is also subject to the Act – as the Board of Trustees' chief executive in relation to the school's control and management, and in managing day-to-day administration of the school.
- 1.13 Section 103A of the Act disqualifies a person from being a member of a Board of Trustees (a trustee) in some circumstances where they have a conflict of interest. That section did not apply in relation to this inquiry.
- 1.14 Clause 8(8) of Schedule 6 of the Act requires a trustee who has a financial interest in any matter to be excluded from any meeting of the Board while it discusses, considers, considers anything relating to, or decides, the matter. This requirement has been strengthened recently to include non-financial interests.

Relevant guidance

- 1.15 The Ministry of Education (the Ministry) has issued some guidance on conflicts of interest in its handbook *Financial Information for Schools*. It defines a conflict as –

A conflict of interest arises where a prospective or existing trustee has an interest which conflicts (or might conflict, or might be perceived to conflict) with the interests of the board itself. The key question to ask when considering whether an interest might create a conflict is:

does the interest create an incentive for the trustee to act in a way which may not be in the best interests of the body?

If the answer is "yes", a conflict of interest exists. The existence of the incentive is sufficient to create a conflict. Whether the appointee would actually act on the incentive is irrelevant.

A conflict of interest may be more perceived than actual. Perception is a very important factor; the processes must be fair and ethical, and must be very clearly seen to be so.

- 1.16 The guidance for schools does not address how to manage conflicts of interest. However, the Ministry has issued more detailed guidance for tertiary education institutions (TEIs),¹ which gives hypothetical examples of conflicts of interest, such as –

Example 1: An appointee to the Council of a TEI holds shares in a private training enterprise that is in direct competition with the TEI.

- 1.17 In our view, such a situation is equally relevant in the school sector. In that context, it could be a school trustee who holds shares in a private training enterprise that is in direct competition with the school to attract students. A poor performance on the part of the school may translate into greater profits for the competing company and its investors (including the trustee). The trustee therefore has an incentive to put their own financial interest ahead of the interests of the school.
- 1.18 The Ministry's guidance for TEIs also describes how, having established the existence of a conflict of interest, the [school] should consider whether the conflict of interest is manageable, and possible mechanisms for avoiding or managing the associated risk.
- 1.19 The State Services Commission revised its Code of Conduct for the Public Service in September 2001.² The Code applies officially in the core public service, but, in our view, is also relevant to employees in the wider public sector as an expression of the general standards expected. It requires public servants to avoid situations that might compromise their integrity or otherwise lead to conflicts of interest.
- 1.20 We have referred to the guidance issued by the State Services Commission and by the Ministry (for tertiary education institutions), not because they applied to the Board, but because they both set out standards that represent good practice in the public sector for the management of conflicts of interest.
- 1.21 More guidance on managing conflicts of interest in the public sector has been made available since our inquiry into this matter began. For example, our report *Christchurch Polytechnic Institute of Technology's management of conflicts of interest regarding the Computing Offered On-line (COOL) programme*³ (the CPIT report) was published in November 2004.
- 1.22 The CPIT report contains a comprehensive statement of what we consider to be public sector expectations around conflicts of interest. It contains a detailed discussion of the concept, provides references to further relevant reading, and can be applied generally.

¹ Tertiary Advisory Monitoring Unit, *Conflicts of Interest in Relation to Tertiary Education Institution Councils*, available at: <http://www.minedu.govt.nz/index.cfm?layout=document&documentid=7182&CFID=2646106&CFTOKEN=85758537>.

² The Code of Conduct was also updated in July 2002 and February 2005.

³ Report of the Controller and Auditor-General, November 2004, ISBN 0-478-18123-X. The report is available on our website at www.oag.govt.nz.

Overview of the organisations, individuals, and events referred to in this report

- 1.23 Our inquiry looked at the relationships between a number of organisations and individuals, and a series of events from September 2001 to mid-2004. The following paragraphs provide an overview of events and introduce those involved.
- 1.24 The School is based in the town of Cambridge in the Waikato region. It is a co-educational state secondary school, with a roll of more than 1000 students. It has been active in enrolling overseas students since 1989, with the help of a recruitment agent.
- 1.25 The School's Principal from January 1992 to September 2004 was Mrs Alison Annan. Mrs Annan left the employ of the School in September 2004. As Principal, Mrs Annan was not only a member of the Board but also the Board's chief adviser about management of the School.
- 1.26 Her husband, Mr Ron Annan, was employed by the School as Director, International Student Programme, until he resigned with effect from 11 August 2005.
- 1.27 In September 2001, the Board was asked to consider entering a partnership with a proposed private training college to provide pre-university education to students from China. The proposal was for the School to provide the proposed college with a comprehensive educational service, at cost, and to receive an annual payment of \$100,000 for use of its name and expertise.
- 1.28 Subsequently, the College was incorporated in November 2001. Mrs Annan was the Foundation Principal of the College.
- 1.29 The owners of the College are the School's recruitment agent for overseas students, and another person. The College is a fully functional private training establishment which now has no contact with the School. Nothing in this report is intended as a criticism of the College.
- 1.30 The situation became more complex in mid-2002 when the original proposal was changed. Instead of the School providing an educational service to the College, the new proposal meant the College would now receive its educational service from a private company, Cambridge Class Limited.
- 1.31 Cambridge Class Limited was incorporated on 9 September 2002, with Mrs and Mr Annan and 2 other people as the shareholders and directors. The Annans continue to be shareholders and directors of the company.
- 1.32 Under the new proposal, it was intended that the College would make use of the School's facilities after hours. However, later in 2002, it was decided that the College did not need to make use of the School's facilities, and that the College could manage on its own.

- 1.33 Mrs and Mr Annan were paid \$15,000 each by Cambridge Class Limited in relation to their role as directors of the company during 2003.
- 1.34 The Minister of Education decided to dissolve the Board in September 2004 after a report from the Education Review Office into the Board's governance of the School. The Minister directed the Secretary of Education to appoint a Commissioner to replace the Board. A Commissioner was appointed and was still in place when we published this report.

How we carried out our inquiry

- 1.35 During the course of our inquiry, we reviewed documents, and interviewed:
- € the Chairperson of the Board at the time these events occurred;
 - € Mrs Annan;
 - € Mr Annan;
 - € the recruitment agent and part-owner of the College; and
 - € the current Principal of the College.
- 1.36 We were unable to gain access to all the information that we required, because the documentation of the School's decision-making process was not of the standard we would normally expect. The School has acknowledged that it did not keep a file on its relationship with the College. Mrs Annan told us that she had provided us with all relevant documentation in her possession. Despite the lack of documentation, we were able to form conclusions, and have made 2 recommendations in Part 3.

Part 2 – Chronology of events

- 2.1 In this Part, we describe the events from September 2001 – when the College was first proposed – to the middle of 2004. We have included comment where necessary to explain the relevance of the events. We also discuss information provided to the School’s appointed auditor⁴ that was relevant to our inquiry.
- 2.2 The description of events is not complete because:
- € The documentation of the decision-making process was not of the standard we would have expected, and it is possible that not all relevant documents were available to us; for example, in relation to the establishment of Cambridge Class Limited.
 - € Mrs Annan, who was the Principal of both the School and the College at the time of the events, refused to provide explanations to us for some matters relevant to the inquiry.
- 2.3 The sequence of events falls into 4 distinct periods. We discuss these as follows:
- € original proposal (from September 2001 to June 2002);
 - € change in the proposal (from June to August 2002);
 - € revised proposal (from August to December 2002), including comment on the overseas marketing trip in September 2002; and
 - € the arrangement that was put in place from December 2002 onwards.

Original proposal (September 2001 to June 2002)

- 2.4 The School has been active in enrolling overseas students for a number of years. It has used a recruitment agent to help enrol students from China.
- 2.5 In the middle of 2001, the recruitment agent approached the School to explore ways of improving the academic success of the Chinese students that he had introduced, so that they were more likely to gain university entrance qualifications. His initial proposal was for the School to establish a special class for Chinese students, in which they would be expected to study harder and longer.
- 2.6 After discussions with Mrs Annan, as the School’s Principal, and her husband Mr Annan, as the School’s Director, International Student Programme, the recruitment agent proposed a joint venture to establish a separate school in its own right, rather than a special class for Chinese students in the School.

⁴ Under the Public Audit Act 2001, the Auditor-General is the auditor of state schools. He can appoint private sector audit firms (appointed auditors) to act on his behalf.

- 2.7 In September 2001, a number of members of the Board and the Annans met the recruitment agent to discuss the proposal for a joint venture. The proposal was that the recruitment agent would establish a private school and hostel for Chinese students in Cambridge. The School would provide staffing and teaching for 100 students initially, increasing to 300 or more. There would be financial incentives for the School, which would continue to enrol a number of Chinese students. Later that month, the Board agreed to the proposal in principle.
- 2.8 Mrs Annan then briefed the Minister of Education about the proposal in writing, saying that the School would provide teaching and other services for a projected roll of 300 students within 2 years. The School would cover all its costs and make a healthy profit. The Minister replied in October 2001, outlining matters for the School to consider and advising caution before entering into any arrangement.
- 2.9 On 16 October 2001, Mrs Annan advised the School's Resources Committee that another meeting had been held with the recruitment agent and that he had obtained funding for the College project. He was now seeking information on what income the School would expect from the venture.
- 2.10 Mrs Annan summarised for the Resources Committee the types of additional costs the School would need to recover for the services it would provide, including 1.5 teachers for the first intake, administration costs, and payment for senior staff involved in managing the project. The monetary return for the School for the use of its name and expertise was suggested to be about \$100,000 a year.
- 2.11 The senior staff who were to be paid for managing the project would have included the Annans. This is the first indication of a financial interest, and therefore of a conflict of interest, on the part of Mrs Annan and other senior staff. In relation to Mrs Annan's position as a trustee, clause 8(8) of Schedule 6 of the Act specifies that a trustee who has a financial interest in a matter must be excluded from any meeting of the Board while it discusses, considers, or decides the matter.
- 2.12 To comply with the requirements of the Act, Mrs Annan, in her capacity as a trustee, should have declared her financial interest in the proposal and been excluded from the meeting once she had given all the information that the Board required. Mrs Annan told us that the Board knew of her interest. However, she did not declare her interest, as she was legally required to do, and she was not excluded from the meeting.
- 2.13 After the meeting, Mrs Annan wrote to the recruitment agent confirming the services and facilities that the School could provide, and agreeing that the School's name could be used for promotional purposes.
- 2.14 The letter noted the need for a contract on the financial arrangements between the Board and the College. These were to cover the costs of staffing,

administration, resources, and management, and a payment to the School for the use of its name and expertise.

- 2.15 The letter also noted that the recruitment agent had been given a rough verbal estimate. Mrs Annan told us that she could not recall the amount of the estimate that she gave to the recruitment agent.
- 2.16 The letter said that the School would not want its auditors involved with the College. Mrs Annan maintained this was the view of the Board, but we did not see a Board minute confirming this position.
- 2.17 The recruitment agent told us that he recalled that it was agreed only in principle that he would make a payment for use of the School's name and expertise. The only amount he recalled being discussed was \$25,000 for the School's help with the College's accreditation. He had no recollection of any discussions involving payment of \$100,000 a year to the School.
- 2.18 On 13 November 2001, the College was incorporated, with the recruitment agent as the sole director, and part-owner with another person. (We refer to the recruitment agent as "the agent-owner" in the rest of this report.)
- 2.19 None of the people directly connected with the School, including the Annans, had an ownership interest in the College.
- 2.20 In February 2002, the School's solicitor provided written advice to the Board about the proposal. The advice said that the benefit to the College of the arrangement with the School (including use of its name and expertise) would be credibility, a strong brand, and access to expertise. The advice recommended that the best form of arrangement would be a contract for services. The solicitor advised caution, and that the Board should obtain the consent of the Ministry.
- 2.21 In March 2002, Mrs Annan wrote to the Minister of Education's office to seek advice on how to obtain approval for the proposal. An annual payment to the School of \$100,000 was mentioned, in addition to recovery of costs. The School's Resources Committee noted at a meeting on 14 March 2002 that Mrs Annan was working on a proposal to go to the Ministry.
- 2.22 Also in March 2002, Mrs Annan provided the School's solicitor with further information on the proposal. The School would enter into a contract for services, to supply teaching and curriculum and qualifications knowledge. There was to be an additional contract for use of the School's name and expertise, estimated at \$100,000 a year, payable in advance. The services for the additional contract were to be supplied on behalf of the Board by the Principal and the Director, International Student Programme – the Annans.
- 2.23 Mrs Annan told us that she could not recall how it was envisaged that the \$100,000 a year would be spent, and said that how much she and Mr Annan would be paid was never discussed and was a matter for the Board.

- 2.24 In April 2002, the Annans visited Japan, China, and Hong Kong for marketing purposes on behalf of the School. Mrs Annan reported to the Board about meetings held in China with the agent-owner, to ensure that Chinese schools would be “feeding” students to the College. The agent-owner would require the Annans to visit China again. The Board noted that Mrs Annan was satisfied that the College was “a very solid project” for the School.
- 2.25 Also in April 2002, Mrs Annan gave the Minister of Education’s office a further written briefing on the proposal. She mentioned her recent trip to China, the contract for services between the School and the College, and the proposal being a long-term source of revenue for the School.
- 2.26 On 20 June 2002, Mrs Annan wrote to the School’s solicitor saying the Board would have a draft proposal to him from the agent-owner’s solicitor shortly.
- 2.27 At this point, neither of the Annans had received any remuneration from the College. Mrs Annan was Foundation Principal of the College and was due to receive \$5,000 for her work in obtaining a private school licence for the College (see paragraph 2.36).

Change in the proposal (June to August 2002)

- 2.28 At some point between 20 June and 15 August 2002, the proposal changed.
- 2.29 The original proposal was for the School to provide a full educational service to the College, in return for an annual payment of \$100,000 in addition to costs.
- 2.30 The revised proposal was for the College’s educational services to be provided by a new company – Cambridge Class Limited – that would be owned partly by the Annans, with the School providing a limited range of services.
- 2.31 As an indication of the scale of the change, we have estimated that, under the original proposal, the School would have received income of about \$340,000 a year – based on 60 students. Under the revised proposal, the School would have received income of only about \$12,000 a year – based on 60 students at \$200 each.
- 2.32 We have not been provided with any documentation to explain the change in the proposal or the establishment of Cambridge Class Limited.
- 2.33 The recollections of the main people involved were:
- € The agent-owner told us that the idea for the change came from Mrs Annan. He did not have a preference whether the College received its educational services from the School or from a separate company owned partly by the Annans.
 - € The College’s then Deputy Principal told us that Mrs Annan enquired about his interest in pursuing a business venture providing educational

services to the College. Subsequently she asked for his help with the registration of the College as a private school. He told us that he never had any documentation about Cambridge Class Limited before the new company was incorporated on 9 September 2002.

- € The Board's Chairperson told us that the Board came to the view that there was a legal impediment to it being involved in both the School and the College. Also, it was not keen on providing the full educational service to the College, given other issues at the School that needed to be resolved. The Chairperson did not recollect any documents outlining the Board's concerns and decisions. The first time the Chairperson heard about Cambridge Class Limited was on a declaration of interests form signed by Mrs Annan in February 2003. The Chairperson also told us that the Board did not know that the College was using the School's name for promotional purposes. The Chairperson expressed the view to us that the Board was not sufficiently well informed about the College and Cambridge Class Limited.
- € Mr Annan told us that he had no involvement in the decision to change the proposal. He could not remember when the concept of Cambridge Class Limited was first suggested, but it was clear to us that it was not his idea. He did not know if there was any documentation on the creation of Cambridge Class Limited. We formed the view that Mr Annan was not instrumental in changing the nature of the proposal or the creation of Cambridge Class Limited.
- € Mrs Annan told us that the decision not to proceed with the original proposal was made in discussion with a number of Board members, and was as a result of legal and practical difficulties. She could not recall when the discussions took place and said there was no documentation on the decision. Mrs Annan told us that she believed the Board was aware of the School's name being used by the College for promotional purposes.
- € In relation to Cambridge Class Limited, Mrs Annan did not recall when the concept was first suggested. She also told us that, if she did have any documentation explaining the creation of Cambridge Class Limited, she would regard it as being private and not relevant to an inquiry about whether she had a conflict of interest. She confirmed that the Board was not involved in the creation of Cambridge Class Limited.

2.34 We have not been able to draw any conclusions on the reason for the change, as we have not been provided with any documentation on the matter.

Registration of the College

2.35 Also during this period, in late July 2002, the School received \$25,000 inclusive of GST (\$22,222 net) from the College to fund work associated with applying for registration of the College as a private school under the Act.

2.36 Of this amount, the School paid an employee of the School \$8,000 and Mrs Annan \$5,000 for their work in obtaining a private school licence for the College. Legal costs were about \$5,000. The School retained the balance of about \$4,200.

Revised proposal (August 2002 to December 2002)

2.37 On 15 August 2002, the School's Resources Committee considered a written report from Mrs Annan for funding for the Annans to accompany the agent-owner on a proposed overseas marketing visit. Mrs Annan was not present at the meeting.

2.38 The report said a long-term partnership was planned between the College and the School for mutual benefit. The annual income from the arrangement for the College's students to access the School's facilities after school hours would "realistically" be \$25,000 to \$30,000. The report made no mention of the annual payment of \$100,000 for use of the School's name and expertise.

2.39 Mrs Annan told us that she did not mention in the report that the College was to receive its educational services from Cambridge Class Limited, as she believed that it had nothing to do with the School.

2.40 The income of \$25,000 to \$30,000 a year quoted in the report equates to 125 to 150 students at \$200 a student. In our view, this was an unrealistic number of students to expect the College to attract in its first years.

2.41 In August 2002, the College submitted its application to the Ministry for registration as a private school. The application described Mrs Annan as the Foundation Principal, and was signed by Mrs Annan and others as "a true statement of the current status and planned intentions of Cambridge International College".

2.42 One section of the application listed 19 names as the College's "Prospective Pupils", which included 5 from the School.

2.43 The application made frequent reference to a partnership agreement and contract for services with the School in relation to items such as teaching physics, the library, computer suite, science laboratories, professional development support, and training of staff. At the time of the application, or subsequently, there was no partnership agreement or contract for services between the College and the School. In August, the School's solicitor wrote to the Board, noting that the Board was to provide its instructions for the solicitor once the College's solicitor had formulated an agreement.

2.44 In September 2002, the Ministry approved the College's application for provisional registration as a private school under Section 35A of the Act, with effect from 1 December 2002.

- 2.45 An e-mail of 27 August 2002 from Mrs Annan to a marketing company in China said that the College course “will guarantee university entrance requirements are met in the curriculum in one year”. The e-mail also said: “In a conventional school such as Cambridge High, achieving university entrance in one year is unrealistic.”
- 2.46 On 9 September 2002, Cambridge Class Limited was incorporated with the Annans and 2 other people as the shareholders and directors. We have not been provided with any documentation before this date that mentions Cambridge Class Limited.
- 2.47 On 16 September, Mrs Annan wrote to the Ministry advising that “my Board has sanctioned my additional, but limited, employment by the College”. She also confirmed that the Board was in the process of establishing an agreement with the College for access to the library, and the science and computer laboratories, after school hours at a cost of \$200 a student a year. We note that this agreement was never established.
- 2.48 On 18 September, the draft heads of agreement between Cambridge Class Limited and the College provided for a fixed amount for each student for 60 students and, if the number of students was below 60 in the first year only, then for both parties to renegotiate in good faith to make the combined enterprise viable for that year.
- 2.49 One of the conditions of the draft agreement was for the College to contract with the School to provide Cambridge Class Limited with access to some School facilities at an annual fee of \$200 a student.
- 2.50 The Board Chairperson told us she could not recall any discussions on the amount of the fee (\$200 a year) to be charged to the College for the limited range of services.
- 2.51 On 17 October 2002, Mrs Annan advised the School’s Resources Committee that the College had received approval to be established as a private school. As an interim measure, the School would approve student admissions and act as an agent for tuition funds. In November, the School began offering places for College students.
- 2.52 The School’s Resources Committee minutes also noted that –
- Formal contracts, based on a per student fee, are nearly ready for signing and one of the conditions is that there would be access to school facilities after hours.*
- 2.53 We had formed the view that the draft contracts referred to as being nearly ready for signing were those between the College and Cambridge Class Limited. This is because no-one that we spoke to, with the exception of Mrs Annan, recalled a contract between the School and the College ever having been drafted. However, Mrs Annan was adamant that the contracts she had been referring to were those between the College and the School. She told us that she did not recall seeing

such a draft contract specifically. The agent-owner did not recall any contract between the College and the School being drafted at any stage.

- 2.54 On 27 November 2002, Mrs Annan reported to the School's Personnel Committee that she would be entering into a formal contract with the College, which would be secondary employment for her.
- 2.55 The report said that her aim was to ensure that there was an advantage to the School. She expressed the view that there would not be a conflict of interest, as the connection was likely to be of benefit to the School, in the short and long term.
- 2.56 The minutes of the Committee meeting note that Mrs Annan gave an assurance that, if any conflict of interest did arise, it would be addressed immediately.
- 2.57 Mrs Annan's comment about the connection likely to be of benefit to the School demonstrates a lack of understanding of the nature of a conflict of interest. The possible existence of a benefit to the School did not remove the conflict of interest that existed between Mrs Annan's role as the senior officer of the School and her financial interest in the College as the part-owner of the supplier of the College's educational services.

Overseas marketing visit (in September 2002)

- 2.58 The report of 15 August 2002 to the School's Resources Committee mentioned that the agent-owner had asked if the Annans could visit China to assist him with marketing. The agent-owner was to pay for accommodation and meals at a cost of \$2,760. The School was to meet the estimated cost of the flights of \$10,200, which was more than the School's remaining marketing budget of \$7,300.
- 2.59 The Resources Committee agreed to pay the shortfall of \$2,900. The justification for the School paying for the flights was that Mrs Annan was confident that the partnership with the College would be a lucrative long-term prospect for the School, and that some marketing would also be carried out for the School. It was also noted that not all of the \$25,000 received from the agent-owner for work on the private school licence had been spent. The agent-owner confirmed that his understanding was that the Annans would also be promoting the School.
- 2.60 The Annans' trip to China was from 19 to 29 September 2002, with a 3-day stopover in Singapore on the return journey. The actual cost of the flights was \$9,864 and was paid by the School. The agent-owner paid for the accommodation and other expenses in China. The School met other expenditure of \$550. Mr Annan has confirmed that he paid for the accommodation on the Singapore stopover.
- 2.61 An e-mail of 19 August from Mr Annan to a marketing firm in China said –

The seminar and promotion (in September 2002) is mainly the College because the School roll for next year is full however we can speak to prospective students, but primarily we are promoting the College.

- 2.62 We understand that 2 students may have been enrolled for the School as a result of the visit.
- 2.63 At our interview with Mrs Annan, she said that the amount of marketing carried out for the School and the College on the trip was proportionate to the costs incurred by the 2 parties. This would imply about 20% for the College and 80% for the School.
- 2.64 Mr Annan's record of the trip indicates that there was some marketing for the School, but much of the visit appears to have been related to the College, in particular, establishing a school for years 11 and 12 in China to prepare the students for coming to the College for year 13.
- 2.65 The record of the trip also notes that –
- If they can persuade year 12 students to go to the College, then we can replace with new students.*
- 2.66 We asked Mr Annan about this comment as we considered that it might have referred to the School's year 12 students being persuaded to go to the College, and then the School replacing them with new students. We did not receive a satisfactory explanation on the matter.

Arrangement that was put in place (from December 2002 onwards)

- 2.67 On 6 December 2002, a heads of agreement between the College and Cambridge Class Limited was signed. The Cambridge Class Limited signatories included the Annans.
- 2.68 The provision relating to the use of the School's facilities had been deleted from the agreement. The agent-owner told us that he and Mrs Annan agreed to delete the clause because they had concluded that the College would not need the facilities of the School, and that it was not necessary to incur the additional cost.
- 2.69 Mrs Annan told us that the School's Resources Committee made the decision to delete the reference to the School's facilities, but she could not recall the date of the meeting. We have not seen any minute confirming a decision by the School's Resources Committee. Moreover, 6 months later, the School informed the Ministry and the School's auditor that the proposal was still being considered.
- 2.70 We have not formed a view as to whose recollection is more likely to be correct.

- 2.71 Mrs Annan provided us with a copy of a letter dated 14 January 2003 to the Chairperson of the School, declaring her intention to undertake 2 private business ventures. One was Cambridge Class Limited, which was said to be involved with the supply of professional educational and curriculum materials and services.
- 2.72 The letter said that the venture would not interfere with Mrs Annan's duties at the School. It did not mention that Cambridge Class Limited was providing educational services to the College. This notification was 4 months after Cambridge Class Limited was established. The School's copy of this letter could not be located.
- 2.73 The New Zealand Qualifications Authority (NZQA) analysis report of 12 February 2003 on the accreditation of the College noted that –
- ...it has a Contract for Services with the School and this is a significant component in the work of the College. The contract includes access to the School's library, science and computer laboratories, and gymnasium after normal school hours. College students may also join regular classes at the School.*
- 2.74 The NZQA relied on Mrs Annan's certification, and, on 20 February 2003, formally accredited the College.
- 2.75 On 20 February 2003, Mrs Annan submitted a conflict of interest declaration form to the Chairperson of the Board. It referred to her being a shareholder of Cambridge Class Limited, with a business of "writing and selling curriculum materials for teaching Chinese students pre-university". It also referred to her position as Foundation (Honorary) Principal of the College and "providing advice and consultancy in establishing the College".
- 2.76 In our view, this declaration was not adequate, as it did not specify that Cambridge Class Limited was providing educational services, including selling its curriculum materials, to the College. There is no record that the Board considered the declaration by Mrs Annan, and, therefore, it did not take the opportunity to discuss whether action was necessary to remove or mitigate the conflict of interest.
- 2.77 On 24 February 2003, the College was officially opened. Two Chinese pupils who were with the School in year 12 enrolled at the College for year 13. The School retained 7 Chinese students who moved from year 12 in 2002 to year 13 in 2003.
- 2.78 On 8 March 2003, Mrs Annan and others signed the contract for the provision of educational services between the College and Cambridge Class Limited.
- 2.79 The marketing brochure issued by the College in about March 2003 referred to –
- ...other subjects [that] can be studied by arrangement with our partner Cambridge High School [and] ...our guarantee is that a student who is*

hard working and keen to learn will succeed in gaining university entrance in one year at our college.

- 2.80 The contact e-mail address in the brochure was Mr Annan's at Cambridge High School.
- 2.81 As a result of enquiries by the School's auditor, in May 2003, the Chairperson of the Board wrote to the Ministry saying that the proposal to contract with the College was still being worked on.
- 2.82 In addition, the Board applied to the Ministry for approval of the \$5,000 for additional remuneration paid to Mrs Annan in 2002 for her work on the College's application for a private school licence. On 31 July 2003, the Ministry approved the payment in retrospect.
- 2.83 On 14 and 15 June 2003, while on an overseas marketing trip, Mrs Annan engaged in e-mail correspondence with the College about its marketing activities, and the difficulty in achieving the minimum figure of 60 students for the 2004 school year. One of the e-mails said: "A successful one year programme, endorsed by Cambridge High School, would be very popular indeed."
- 2.84 In July 2003, Mrs Annan reported to the Board on the overseas student programme. The report mentioned her interest in the College and said that, while at some stage in the future she and Mr Annan expected to receive remuneration from the College, to date no money had been paid from the College to either of them. The report did not mention Cambridge Class Limited, its relationship with the College, or that she and Mr Annan expected to receive income from Cambridge Class Limited because of its contract with the College.
- 2.85 On 17 November 2003, Mr Annan wrote to the Chairperson of the Board declaring his intention of undertaking a private business venture called Cambridge Class Limited, which was said to be involved with the supply of professional educational and curriculum materials and services.
- 2.86 The letter said that the venture would not interfere with Mr Annan's duties with the School.
- 2.87 In our view, this declaration was not adequate because it did not mention that Cambridge Class Limited was providing educational services to the College. This notification was more than a year after Cambridge Class Limited was established. Mr Annan told us that he could not recall why he declared his interest at that time or why it took him more than a year to make the declaration.
- 2.88 In February 2004, 6 Chinese students who had been with the School in year 12 enrolled at the College for year 13. The School retained 2 Chinese students who moved to year 13 in 2004. We were not able to determine the reasons for the transfer of the 6 students. However, we note that the transfer of these students is evidence of competition between the School and the College.

- 2.89 The agent-owner confirmed to us that there was financial pressure to achieve the minimum of 60 students mentioned in the contract between the College and Cambridge Class Limited.
- 2.90 On 15 April 2004, Mrs Annan submitted a conflict of interest declaration to the Chairperson of the Board. It referred to Cambridge Class Limited as “ESOL⁵ and curriculum material” and the College as “international education”.
- 2.91 In our view, this declaration was not adequate because it did not mention that Cambridge Class Limited provided educational services to the College.
- 2.92 On 25 May 2004, the accountants of Cambridge Class Limited produced a paper on Directors’ Remuneration, which showed \$15,000 payable to each of the Annans. It is understood that this was paid by means of a single cheque for \$30,000 to Mr Annan. Mrs Annan declined to answer our questions about these payments because, in her view, it was a private company matter. Mr Annan said that the payments were in respect of general directors’ services.
- 2.93 On 21 June 2004, Mrs Annan reported to the Board that, for a variety of reasons, the partnership with the College had never proceeded beyond the proposal stage. She said that she had never been paid for the position of Principal of the College, and that neither she nor Mr Annan was on the College payroll. The report mentioned Cambridge Class Limited, but made no reference to its contract with the College.
- 2.94 On 26 July 2004, the College’s website still made reference to the facilities of the School being available to College students.

Information provided to Cambridge High School’s auditor

- 2.95 From May 2003 onwards, the School’s appointed auditor sought information on the College and Cambridge Class Limited in the context of the audit of the School’s 2002 financial statements. The initial responses given by the Board to the auditor included:
- € The Principal had not been involved in decisions where a possible conflict of interest existed.
 - € Heads of agreement negotiations between the College and the School were still in progress. (This was 6 months after it had been decided that the School’s facilities would no longer be required.)
 - € The College employed Mrs Annan as Principal.
 - € Mrs Annan was still working on the proposal to go to the Ministry.

⁵ English for Speakers of Other Languages.

- 2.96 In August 2003, as a result of continuing enquiries from its auditor, the Board told the auditor that the proposed relationship with the College was not going to proceed and that Cambridge Class Limited had nothing to do with the School.
- 2.97 The Board was asked about a potential breach of Schedule 6 of the Act, which requires a trustee who has a financial interest in a matter to be excluded from any meeting of the Board while it discusses the matter.
- 2.98 The Board accepted that there had been a breach of the Act, in that Mrs Annan had been present while the Board discussed the College, in which she had a financial interest (see paragraphs 2.11-2.12). The Board said that the breach had occurred through genuine oversight, and agreed to disclose it in its financial statements for 2002.
- 2.99 Also in August 2003, the Board confirmed that it was not aware of, nor had it agreed to, any contract for services between the School and the College. As far as the Board was concerned, the College proposal was still on the table. The Board also said that it was unaware of the existence of Cambridge Class Limited, and believed that the company had nothing to do with the School's affairs.
- 2.100 By September 2003, the College had formally decided that it would not enter into a contract with the School either for its services or in co-operation as a partnership. Both the Annans signed the College minute recording this decision.
- 2.101 On 24 March 2004, the appointed auditor's report to the Board on the School's 2002 audit was completed. In relation to the College, the report recommended that the Board take steps to ensure that third parties obtained consent before claiming any form of relationship. This was because the College had referred to a relationship with the School in gaining accreditation, although the Board had not considered the nature of the relationship other than in principle.
- 2.102 In relation to Cambridge Class Limited, the appointed auditor's report gave all the information to the Board that had been obtained about the company in the interests of transparency and openness.

Part 3 – Our conclusions and recommendations

3.1 In this Part, we:

- € discuss the changing nature of the proposal for a contract between the School and the College;
- € conclude that there were conflicts of interest;
- € discuss whether the conflicts of interest were managed properly;
- € assess whether the School suffered any financial loss as a result of any conflict of interest; and
- € make 2 recommendations.

The changing nature of the proposal

3.2 We were hampered throughout our inquiry by limited and, at times, contradictory documentation. We were given explanations which, at times, did not tally with what was in the documents.

3.3 We were also unable to draw any conclusions on why the proposal changed in mid-2002 (see paragraphs 2.28-2.34) because no documents were provided to us.

3.4 It is possible that the Board decided not to pursue the original proposal and Mrs Annan decided to take advantage of the business opportunity herself. If that were the case, we would have expected there to have been some documentation recording the Board's decision, such as:

- € A report to, and minute of, the Board. We could not find anything in the Board and Committee papers that we reviewed to explain the change in the proposal.
- € A letter to the agent-owner saying that the Board had decided not to provide a comprehensive range of services to the College, and advising that the School's name should no longer be used by the College, but agreeing that the Board would still help with the application for a private school licence.
- € A letter to the Ministry and Minister of Education saying that the Board had decided not to proceed with the proposal.

- 3.5 We would also have expected to see a report to the Board from the Annans requesting permission to pursue the business opportunity in a private capacity.
- 3.6 Alternatively, the change in the proposal may have occurred because Mrs Annan decided that the business opportunity would be better handled using a private company rather than the School to provide the services to the College. We would still have expected to see written information to the Board advising of the change.
- 3.7 There was nothing provided to us in writing about the establishment of Cambridge Class Limited before the date that the company was incorporated.

Were there any conflicts of interest?

Principal of Cambridge High School (Mrs Alison Annan)

- 3.8 In our view, Mrs Annan had a conflict of interest from September 2001 between her duties as Principal of the School and her involvement in the affairs of the College. Initially this was because she had a financial interest in the affairs of the College, intending to gain personally from assisting with its establishment and operation.
- 3.9 Mrs Annan's report to the School's Resources Committee in October 2001 referred to payment for the senior staff involved in managing the project. This was the first indication of a conflict of interest on her part.
- 3.10 In 2003, the School's auditor raised the question of a possible breach of legislation in relation to this conflict of interest. Mrs Annan was not excluded from meetings of the Board when it considered matters relating to the College. In August 2003, the Board and Mrs Annan accepted that there had been a breach of legislation. In March 2004, the breach of legislation was reported in the School's financial statements for 2002. (The audit of the financial statements was delayed because of consideration of, among other things, the relationship between the School and the College and Cambridge Class Limited by the appointed auditor and the Office of the Auditor-General.)
- 3.11 From September 2002, Mrs Annan's conflict of interest continued because she had an ownership interest in Cambridge Class Limited, which provided educational services to the College. The College, in turn, was in competition with the School for the enrolment of Chinese students seeking pre-university education.
- 3.12 Both Mrs and Mr Annan told us that the College was not in competition with the School because the 2 organisations were recruiting from distinctly different groups of students. Mrs Annan told us that the College was intended to provide a means for older students (sometimes aged 20 or more) who had completed

secondary education in China but wanted to complete New Zealand qualifications at university.

- 3.13 The College provided only a one-year course, that was based on the study of purpose-designed workbooks. They asserted that this was different from the School, which did not provide a one-year course, educated its students by teacher contact rather than workbooks, and provided contact with students from other countries. Mr Annan told us that the only role of Cambridge Class Limited was to provide workbooks.
- 3.14 In our view, these distinctions are not sufficient to conclude that the School and the College were not in competition. Both offered pre-university education to Chinese students. The education offered by the 2 institutions was different in some respects, but the client group was sufficiently similar to conclude that there was an incentive for the Annans to seek students for the College, which would result in personal financial gain, possibly at the expense of student numbers at the School.
- 3.15 Some students had transferred from the School to the College, which is further evidence of competition between the 2 bodies. The number of students at the College affects the profitability of Cambridge Class Limited, because the contract between those 2 organisations provides for a set sum to be paid for each student, which therefore affects the financial gain of the Annans.
- 3.16 As late as June 2003, 6 months after it was decided that the School would not receive any financial benefit from an association with the College, Mrs Annan expressed the view to the College that: “A successful one year programme [by the College], endorsed by Cambridge High School, would be very popular indeed [with students].”
- 3.17 This remark illustrates, in our opinion, Mrs Annan’s inability to distinguish between her private interests and those of the School. She appears to have been of the view that she was able to give the School’s endorsement to a competing supplier of educational services, a supplier from which she stood to make a personal gain.
- 3.18 In our view, even if she did not believe or realise that she had a conflict of interest, Mrs Annan should have known her responsibility under the Act to exclude herself from meetings where she had a financial interest. She also should have known that it was prudent to seek professional advice about her involvement in the 3 organisations. She could not necessarily have been expected to have the knowledge to manage the conflict of interest situation appropriately by herself.
- 3.19 Mrs Annan told us that she believed she acted in good faith at all times, and that the interests of the School she served as Principal were always uppermost in her mind. Although she was involved with both the School and the College, she never thought her roles were in conflict as she was never responsible for day-to-day management of the College, nor for policy development there.

3.20 Mrs Annan's conflict of interest ceased in September 2004 when she left the employment of the School.

Director, International Student Programme of Cambridge High School (Mr Ron Annan)

3.21 In our view, Mr Annan also had a conflict of interest from September 2001. He told us that he had not declared an interest in the College because, in his view, he did not have an interest in that body.

3.22 On the basis of the information we reviewed, we have concluded that he did have a financial interest in the College. Information provided to the School's solicitor in March 2002 said that there was to be an additional contract with the College for various services, valued at \$100,000 a year, which were to be supplied in part by Mr Annan as an employee of the School.

3.23 In addition, Mr Annan signed a document on behalf of the College (see paragraph 2.100) as "Executive Officer". Also, his wife had a financial interest in the College, which, under normal practice in respect of conflicts of interest, he would be deemed to share.

3.24 From September 2002, Mr Annan's conflict of interest continued because he had a financial interest in Cambridge Class Limited, which provided educational services to the College, which in turn was in competition with the School.

3.25 Mr Annan's conflict of interest ceased on his resignation from the School on 11 August 2005.

Were the conflicts of interest managed properly?

3.26 We considered:

- € whether the School had policies and procedures for managing conflicts of interest; and
- € how the Board managed the Annans' conflicts of interest.

Did the Cambridge High School Board have policies and procedures to manage conflicts of interest?

3.27 The Board did not have any written policies or procedures for identifying or managing conflicts of interest. However, we were told that there was an informal expectation that any conflicts would be disclosed.

3.28 Mrs Annan submitted her own conflict of interest declaration form to the Board Chairperson on at least 2 occasions. We found no evidence that these forms were assessed by the Board to see if the conflicts of interest were manageable.

- 3.29 Mrs Annan told us that it was the Board's responsibility to manage conflicts of interest. She did not know whether the Board's policies and procedures for managing conflicts of interest had been written down. We note that Mrs Annan, in her capacity as Principal, was a member of the Board, and its chief adviser.
- 3.30 Mrs Annan also told us that she did not see the communication of the Board's informal policy on conflicts of interest to the School's staff as being her responsibility, as the Board had not delegated this to her.
- 3.31 We do not share this view. It is reasonable to expect that a school principal would communicate information to staff about the school board's attitude to conflicts of interest as part of their role in day-to-day managing of the school (see paragraph 1.12).

How did the Cambridge High School Board manage the conflicts of interest?

- 3.32 In our view, the Board did not identify or manage the Annans' conflicts of interest properly. However, we consider there are mitigating factors.
- 3.33 Schools' Boards of Trustees comprise representatives of the community who may have little or no experience in, or understanding of, the management of public bodies; in particular the concept of public accountability and the need to ensure that conflicts of interest are managed properly.
- 3.34 Most of the country's 2500 state schools are unlikely to ever have to address conflicts of interest as complex as those we have investigated in this inquiry. Therefore, as the issue may not have been given attention by school boards generally, when a conflict of interest does arise, the board involved may not be fully able to manage it properly.
- 3.35 To a large extent, school boards are reliant on their principals, as their chief advisers, to inform them of the proper processes to ensure compliance with legislation and proper accountability. In this case, the Board's chief adviser, who was the source of the conflict of interest, did not provide the Board with full information about the conflict of interest, or guidance that it should seek its own advice on how the conflict should be managed.
- 3.36 In the view of Mrs Annan, both she and the Board did everything that could reasonably have been expected of them in the absence of Ministry guidelines. Mrs Annan also is of the view that the Ministry was aware of her involvement with the College. However, we have no information that Mrs Annan informed the Ministry that she had an interest in Cambridge Class Limited.

Management of Mrs Annan's conflict of interest

- 3.37 In our view, Mrs Annan's conflict of interest was not managed properly.
- 3.38 The conflict of interest was declared to the Board some time after it came into existence. The first time Mrs Annan's interest in the College was declared formally was in November 2002, more than a year after the interest first became apparent in September 2001.
- 3.39 The first time her interest in Cambridge Class Limited was declared formally was in January 2003, at least 5 months after the company was first contemplated in August 2002. There was no evidence that the Board considered this declaration. From our enquiries, it appears that, in general, the School had not heard of Cambridge Class Limited until its auditor raised the issue in the middle of 2003.
- 3.40 When Mrs Annan declared her interests, the information she provided was incomplete. At no stage was the Board informed that Cambridge Class Limited was providing educational services to the College. Mrs Annan explained to us that this was because Cambridge Class Limited is a private company and therefore, in her opinion, of no interest to the Board. In our view, this shows a lack of understanding on the part of Mrs Annan of the nature and management of conflicts of interest in the public sector. In many cases, it is the potential for personal gain through private interests that causes a conflict of interest.
- 3.41 In November 2002, when the School's Personnel Committee considered Mrs Annan's declaration of interest in the College, it relied on her assurance that there was not a conflict of interest and that, if one did arise, she would address it immediately. At no stage did the Board attempt to identify or manage the conflict of interest in the manner exemplified by the good practice set out in the Ministry's guidance to tertiary education institutions. Again, in our view, this shows a lack of understanding of the nature and management of conflicts of interest on the part of the Board. As we have mentioned, the Board's chief adviser did not provide it with guidance that it would need to seek external help.
- 3.42 Mrs Annan told us that she had conversations with other Board members about the relationship between the College and Cambridge Class Limited, and that she received no indication that the Board or those members did not consider her disclosures to be adequate. We have not seen any documentary evidence of Mrs Annan making such disclosures.
- 3.43 The then Board Chairperson told us that she had no clear recollection that the Board was informed of the nature of the contract between the College and Cambridge Class Limited, or that the Annans expected to receive remuneration from Cambridge Class Limited.
- 3.44 In our view, the late and incomplete declarations of interest by Mrs Annan were caused partly by a lack of understanding on her part about the nature of a

conflict of interest and the appropriate conduct for a public official with a conflict of interest, and partly as a result of her wish to keep private that which she thought of as her own private business.

- 3.45 This lack of understanding was shown by:
- € Mrs Annan’s attendance at Board meetings when the College was considered, thereby breaching legislation;
 - € her refusal to provide information about the private company in which she had a financial interest to the Board, to the School’s auditor in 2003, and in the context of this inquiry; and
 - € the view she expressed in June 2003, 6 months after the proposal was changed and it was clear that the School would not receive any financial benefit from an association with the College, that “A successful one year programme [by the College], endorsed by Cambridge High School, would be very popular indeed [with students].”
- 3.46 We consider that this lack of understanding of the nature and management of conflicts of interest on the part of an experienced principal of a large school is of concern, and indicates that the guidance for schools needs to be strengthened. We have made a recommendation for the Ministry accordingly.
- 3.47 We have considered whether Mrs Annan’s conflict of interest was manageable, and concluded that it would not have been appropriate for her to have a financial interest in the College or Cambridge Class Limited while she was Principal of the School.
- 3.48 The only way that the situation could have been managed while she was employed as Principal of the School would have been for her to divest herself of involvement with the private companies, thus removing the source of the conflict of interest.
- 3.49 In our view, it is not possible for the most senior employee of a public body to manage a contractual relationship between the public body and a private company in which they have a financial interest.
- 3.50 When there was no longer any possibility of the School having a contract with the College, it was still not appropriate for Mrs Annan to have a financial interest in a company that was providing similar services to the same client group as the School. The most senior employee of a public body should be solely concerned with the interests of their public employer, without any possibility of personal gain from a private business providing a similar service to the same client group.

Management of Mr Annan's conflict of interest

- 3.51 In our view, Mr Annan's conflict of interest was not managed properly.
- 3.52 His interest in the College was not declared at all. We are of the view that Mr Annan's mistaken belief that he did not have an interest in the College is primarily because of his lack of understanding of the nature of conflicts of interest. This was apparent at our interview with him.
- 3.53 Mr Annan's interest in Cambridge Class Limited was declared to the Chairperson of the Board in November 2003, more than a year after the company was first contemplated in August 2002. The information about the nature of the interest was incomplete. The interest was not reported to the Board as a whole.
- 3.54 While Mr Annan's conflict of interest was not managed properly, there were mitigating factors. At no stage was Mr Annan given adequate guidance on the management of conflicts of interest. Also, the School's Principal was fully aware of Mr Annan's interests through their marital relationship, and therefore he was entitled to assume that his employer was managing any conflict that may have existed.
- 3.55 Although Mr Annan resigned from the School in August 2005, we considered whether his continuing conflict of interest could be managed, particularly given that an integral part of his responsibilities was to market the School to current and prospective students. We provide our findings as an example for similar situations.
- 3.56 If Mr Annan's position as an employee had been, for example, a maths teacher or groundsman, the implications of the situation might have been different and more manageable. However, the nature of his position involved recruiting and retaining students from overseas, so it directly involved him in matters that might touch on his interests in Cambridge Class Limited.
- 3.57 We concluded that it might be difficult for the Commissioner of the School to find an appropriate mechanism to manage the conflict of interest other than for Mr Annan and Mrs Annan to dispose of their interests in Cambridge Class Limited. This is because, under normal practice in respect of conflicts of interest, Mr Annan would be deemed to share his wife's ownership interest in Cambridge Class Limited.
- 3.58 This is not because we considered that Mr Annan would have exploited his official position for personal gain. However, it could be perceived that he had an interest in encouraging the School's current and prospective students to enrol with the College, which would increase the income of Cambridge Class Limited, in which he had a financial interest.

Did Cambridge High School suffer any financial loss as a result of any conflict of interest?

- 3.59 Under our terms of reference, we considered whether the School has suffered any financial loss as a result of any conflict of interest.

Use of Cambridge High School's name

- 3.60 The College used the School's name for promotional purposes. The Board had been informed that it would receive an annual payment of \$100,000 for the use of its name and expertise. The College's promotional and other material made frequent reference to its relationship with the School, even after it had been decided that the School would not receive any benefit from the arrangement.
- 3.61 Although a financial contribution of \$100,000 a year had been envisaged, in part for use of the Board's name, the School did not receive any financial contribution for the use of its name by the College.
- 3.62 We have not sought to place a value on what an appropriate contribution would have been. However, we note that there may be a policy issue about the extent to which a non-commercial public entity may appropriately trade on its name.
- 3.63 The School's auditor addressed the use of the School's name by the College in the auditor's report of 24 March 2004 on the School's financial statements for 2002. That report noted that the College had referred to its relationship with the School as part of its case for gaining accreditation for its courses from the NZQA. But, at the time accreditation was sought, the Board had not considered the nature of the relationship other than in principle. The auditor recommended that the Board take steps to ensure that third parties, such as the College, obtained its consent before claiming any form of relationship with the School.

Competing for students

- 3.64 We consider that there is a potential loss of income to the School from the competition with the College for Chinese students seeking pre-university education; in particular, that students who might otherwise have enrolled or continued with the School may enrol with the College.
- 3.65 In our view, there was no actual loss of income in 2003 or 2004, because there was sufficient demand from Chinese students for the School to achieve the maximum number of overseas students it wished to accommodate. We have not considered the position in 2005, as the School received substantial media coverage in the middle of 2004 which may have affected the enrolment of overseas students.
- 3.66 However, there is some evidence that the Annans may have considered the School to be a source of students for the College:

- € The College’s application for registration as a private training establishment in August 2002 included the names of 5 prospective students who were enrolled with the School at that time.
- € Two of the School’s students transferred to the College in 2003, and 6 transferred in 2004. It is quite possible that these transfers may have been because the students decided that the College would better meet their needs than continuing with the School. However, this is evidence of the competition between the School and the College.
- € Mr Annan’s record of a marketing trip to China (see paragraphs 2.60-2.66) in September 2002 notes that: “If they can persuade year 12 students to go to the College, then we can replace with new students.”

3.67 The competition between the 2 institutions could have resulted, and could still result, in a loss of income for the School, if the demand from Chinese students for pre-university education were to decline and the School were to be unable to achieve its target for overseas students from other countries.

Paying for the overseas marketing trip

3.68 In September 2002, the Annans accompanied the agent-owner on a trip to China to help with marketing the College. At Mrs Annan’s recommendation, the School’s Resources Committee agreed to pay for the flights at a cost of \$9,864. The agent-owner paid for the accommodation and meals at a cost of about \$2,760. The justification recorded at the time for the School paying for the flights was that the visit would benefit the long-term relationship with the College and that some marketing would be carried out for the School.

3.69 Mrs Annan told us that the marketing effort, which she and Mr Annan applied to the business of the College and that of the School, was proportionate to the costs that each body met. That view would suggest that about 80% of the marketing effort was devoted to the School and about 20% to the College.

3.70 In our view, the Board should not have met the full cost of the flights because:

- € At that stage, after the proposal was changed and it was clear that the School would not provide full educational services, there would have been little financial benefit to the School from the establishment of the College.
- € Mr Annan informed a marketing firm in China just before the visit that: “The seminar and promotion is mainly the College because the School roll for next year is full however we can speak to prospective students, but primarily we are promoting the College.” (See paragraph 2.61.)
- € A record of the trip indicates that there was some marketing for the School, but nothing like as much as 80%.

3.71 However, we do not think it is appropriate to pursue recovery of the money from the Annans at this stage because the Resources Committee approved the

expenditure, albeit, in our view, based on an incomplete understanding of the Board's future relationship with the College.

Other costs

- 3.72 The School incurred other costs to help with the establishment of the College. For example, as an interim measure it approved student admissions and acted as an agent for student fees while the College established its own administrative procedures.
- 3.73 Again, we consider that recovery would be inappropriate, as the costs would be difficult to quantify with certainty and were not subject to agreement in advance.

Recommendations

Recommendation 1

We recommend that the Ministry of Education provide guidance to schools on the management of conflicts of interest, based on its guidance issued to tertiary education institutions, and taking into account any more recent guidance on the subject.

Recommendation 2

We recommend that the Cambridge High School Commissioner adopt policies and procedures for the identification, declaration, and management of conflicts of interest, based on the Ministry of Education's guidance for tertiary education institutions.

Appendix 1 – Inquiry terms of reference

Inquiry into Cambridge High School's management of conflicts of interest concerning Cambridge International College

Terms of reference

The Auditor-General has decided to conduct an audit and inquiry into the management by the Board of Trustees of Cambridge High School (CHS) of any potential or actual conflicts of interest as they relate to its arrangements with a private company, Cambridge International College (CIC). The audit and inquiry will be conducted under sections 16(1) and 18 of the Public Audit Act 2001.

The Auditor-General has made this decision after receiving and considering a request by the Minister of Education to inquire into these matters, and after extensive preliminary inquiries to ascertain the nature of the issues involved.

The focus of the audit and inquiry will be on communications which took place between CHS and CIC about a partnership for the education of overseas students, and whether any member, office-holder or employee of CHS had either potential or actual conflicts of interest by virtue of their relationships with CIC. The audit and inquiry will:

1. Examine and inquire into what communications took place between CHS and CIC in respect of the education of overseas students, the nature of the relationship (if any) that eventuated, what resources of CHS were involved, and any related issues of accountability.
2. Examine, in the context of the communications, the relationship, and the use of resources referred to in paragraph 1:
 - € whether any potential or actual conflicts of interest have at any time existed on the part of any member, office-holder or employee of CHS;
 - € whether CHS and/or any member, office-holder or employee acted properly in respect of any such conflict; and
 - € whether CHS has suffered any financial loss as a result of any such conflict.
3. Examine CHS's policies and procedures for identifying and managing conflicts of interest, including, but not limited to, any conflicts in respect of CIC; and identify whether any improvements should be made to those policies and procedures with the objective of addressing any concerns identified as a consequence of the findings in 1 and 2 above.
4. Examine and inquire into any other issues that the Auditor-General considers relate to or arise from the above matters.

The Auditor-General will report to CHS and such other persons as he considers appropriate under section 21 of the Public Audit Act on the above terms of reference and such other matters arising from the audit and inquiry as he considers it desirable to report on.

The Auditor-General may also report the findings of the audit and inquiry to the House of Representatives under section 20 of the Act.

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Appendix 2 – Sources of guidance on conflicts of interest

Publications by other organisations that contain useful discussions or guidance about some types of conflicts of interest include:

- € State Services Commission, *New Zealand Public Service Code of Conduct* (July 2002);
- € State Services Commission, *Walking the Line: Managing Conflicts of Interest*, resource kit (June 2003);
- € State Services Commission, *Report for State Services Commissioner on Civil Aviation Authority Policies Procedures and Practices relating to Conflicts of Interest and Conduct of Special Purpose Inspections and Investigations* (December 2003);
- € State Services Commission, *Board Appointment and Induction Guidelines* (August 1999);
- € Securities Commission, *Corporate Governance in New Zealand Principles and Guidelines: A Handbook for Directors, Executives, and Advisers* (March 2004);
- € Crown Company Monitoring Advisory Unit, *Crown Company Directors' Fees and Reimbursement Guidelines* (February 2004);
- € Cabinet Office, *Cabinet Manual*, paragraphs 2.46-2.77 (2001);
- € Institute of Chartered Accountants of New Zealand, *Auditing Standard 510: Related Parties* (1998);
- € Tertiary Advisory Monitoring Unit, *Conflicts of Interest in Relation to Tertiary Education Institution Councils* (updated November 2004);
- € New South Wales Ombudsman, *Public Sector Agencies Fact Sheet No. 3: Conflict of Interests* (July 2003);
- € New South Wales Ombudsman, *Pre-requisites to Avoid or Manage Conflict of Interests* (January 2004).

Publications by the Auditor-General that discuss various aspects of conflicts of interest include:

- € *Christchurch Polytechnic Institute of Technology's management of conflicts of interest regarding the Computing Offered On-line (COOL) programme* (November 2004).
- € *Conflicts of Interest: A Guide to the Local Authorities (Members' Interests) Act 1968 and Non-pecuniary Conflicts of Interest* (August 2004);
- € *Procurement: A Statement of Good Practice* (June 2001);

- € *Inquiry into Public Funding of Organisations Associated with Donna Awatere Huata MP* (November 2003);
- € *Local Government: Results of the 2002-03 Audits*, sections 2.7 and 2.8 (June 2004);
- € *Local Government: Results of the 2001-02 Audits*, section 2.4 (September 2003);
- € *Local Authority Governance of Subsidiary Entities* (March 2001);
- € *Report on the Disposal of 17 Kelly Street by The Institute of Environmental Science and Research Limited* (June 2003);
- € *Inquiry into Expenses Incurred by Dr Ross Armstrong as Chairperson of Three Public Entities* (December 2003);
- € *The Auditor-General's Auditing Standards: AG-3 – The Auditor's Approach to Issues of Performance, Waste and Probity* (May 2002).

All of these publications are available from the websites of the relevant organisations.