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## Schools: Results of the 2012 audits





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# Schools: Results of the 2012 audits

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## Auditor-General's overview

The quality of education that our children and young people receive affects us all in some way, either directly or indirectly.

My Office has an ongoing interest in the education sector, and we continue to focus on public entities operating in the sector. This focus includes annual audit work and other work that builds on the information we gather from our annual audits.

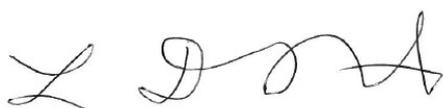
Schools are a significant part of the education sector and are diverse. The size and nature of schools can vary significantly from community to community. Each school is a separate Crown entity and is required to prepare annual financial statements, which we audit.

Boards of trustees, who are mainly parents from the local community, govern schools. Each board is accountable to its local community, thereby providing a strong link between the school and community.

Each year, I report to Parliament on the work of my Office. In recent years, we have reported the results of that work in sector reports that focused on particular groups of public entities.

In the last two years, I have reported separately on the education sector. This year, I have decided to prepare a report that focuses on schools. This recognises the importance of schools to all communities throughout the country.

I intend to continue reporting on schools periodically.



Lyn Provost  
Controller and Auditor-General

15 May 2014



# Part 1

## Introduction

- 1.1 New Zealand has about 2500 state schools. This number includes state primary and secondary schools, state-integrated schools, and kura kaupapa Māori (kura, or Māori language immersion schools). Total public expenditure on schools is about \$6.6 billion a year.
- 1.2 Schools vary significantly in size. The smallest spend less than \$200,000 a year, while the largest are more than 100 times larger and spend more than \$20 million a year. Schools are Crown entities, which are governed by boards of trustees (boards). There are about 18,500 trustees throughout the country.
- 1.3 There are about 330 state-integrated schools. These schools used to be private schools, but are now part of the state education system. They provide education within the framework of a particular or general religious or philosophical belief.
- 1.4 Boards govern and principals manage state-integrated schools in the same way that other state schools are governed. The boards are responsible for the governance and operation of their schools, which, like all other state schools, are publicly accountable. The Auditor-General is the auditor of all state-integrated schools.
- 1.5 There are about 70 kura, which are also state schools set up under the Education Act 1989. The principal language of instruction in kura is te reo Māori (the Māori language). Kura tend to be small and are often located in rural parts of the country.
- 1.6 Kura are also governed by boards and managed by principals. Each kura has its own governance and board constitution. These are intended to ensure that communities are fully involved in governing and operating the kura. Kura are subject to the same accountability requirements that govern all other state schools, and the Auditor-General is the auditor of all kura.

### Structure of this report

- 1.7 In Part 2, we report on the results of our 2012 school audits and other school audits completed before the end of February 2014, including the nature of our audit reports, the timeliness of the audits, and other matters arising from the audits.
- 1.8 The introduction in August 2012 of a new centralised payroll system, Novopay, significantly affected the 2012 school audits. With a few exceptions, Novopay is used to pay staff in all state schools. In Part 3, we summarise the effect that Novopay had on our 2012 school audits.

- 1.9 In Part 4, we outline the financial health of schools as a whole. We have used information published by the Ministry of Education (the Ministry) and other information held on the Ministry database as a result of schools providing the Ministry with their audited financial statements.
- 1.10 In Parts 5, 6, and 7, we provide updates on the matters that we reported on in recent years about state-integrated schools, kura, and payments to principals above their normal salary.
- 1.11 In Part 8, we comment on the upcoming changes to schools' financial reporting, which come into effect in 2015.

## Part 2

# Results of the 2012 school audits

- 2.1 Up to 28 February 2014, we completed nearly 2450 audits of schools' financial statements for the year ended 31 December 2012, including school subsidiaries. This Part summarises the results of those audits and others from previous years that we completed in the year.
- 2.2 The Education Act requires boards to prepare annual financial statements and have them audited. The annual cost of all school audits is about \$10.5 million, which is an average of about \$4,200 for each school. The cost to individual schools varies between \$2,000 and \$15,000. The audits take about 105,000 hours of audit time, which is the equivalent of 50 full-time people, and vary between 20 and 130 hours for each school.
- 2.3 Our school audits are more limited than our audits of larger public entities. They are limited to an audit of the financial statements, some aspects of compliance with legislation, and matters of probity and financial prudence. They do not include auditing service performance information because schools are not required to prepare a statement of service performance.
- 2.4 The results of each school audit are contained in an audit report, which is a public document attached to the school's annual financial statements, and a management letter addressed to each board.
- 2.5 Most schools receive standard audit reports that include our opinion that the financial statements can be relied on for accountability purposes and that the audit has not found anything that our auditors consider important enough to draw to the public's attention.
- 2.6 Each year, our auditors provide management letters to school boards that include recommendations for improvements in financial management practices and other matters. These matters are generally considered to be less important than those included in our audit reports.

### Timeliness and statutory deadlines

- 2.7 Each year, schools prepare their financial statements for the year ended 31 December. Schools are expected to send their draft financial statements to the auditor by 31 March in the following year and their audited financial statements to the Ministry by 31 May.
- 2.8 Of the 2480 audits of schools and subsidiaries that we expected to complete during the reporting period, draft financial statements for 2195 (89%, slightly less than the 93% in the previous year) were available for audit by the statutory date of 31 March 2013. However, many of these financial statements did not include

payroll figures because of difficulties obtaining reliable payroll information. There were 285 (11%) that were not available by the deadline.

- 2.9 By the statutory deadline of 31 May 2013, 772 audits (31%) had been completed, leaving 1708 that were not completed by this date. In contrast, 95% of audits for 2011 were completed by 31 May 2012. The substantial difference in timeliness was because of the problems with Novopay. Usually, we expect less than 1% of school audits to remain outstanding more than a year after the balance date. The number at the end of 2013 was almost 2%, meaning the backlog had largely been cleared by then.
- 2.10 The audit reports for three schools had not been issued at the time of writing this report and had been outstanding more than two years after the balance date (they were for 2010 and 2011). The schools, and the reasons why the audit reports have not yet been issued, were:
- Hukarere College – we noted our doubts about the financial viability of the school in our report on our 2009 audit and we found more matters of concern during our subsequent audit work.
  - Te Aute College – continuing problems with governance and administration have added to the doubts we had about the financial viability of the school that we noted in our report on our 2009 audit.
  - Te Kura Kaupapa Māori o te Kura Kōkiri – this kura has ongoing financial management and other matters of concern, such as those noted in our report on our 2009 audit.
- 2.11 Problems with Novopay resulted in the number of incomplete school audits being higher than normal. This is largely because of resourcing pressures experienced by our auditors as a result of delays caused by Novopay. Figure 1 lists the schools for which we had not completed audits for 2012 by 28 February 2014.

**Figure 1**  
**School audits for 2012 not completed by 28 February 2014**

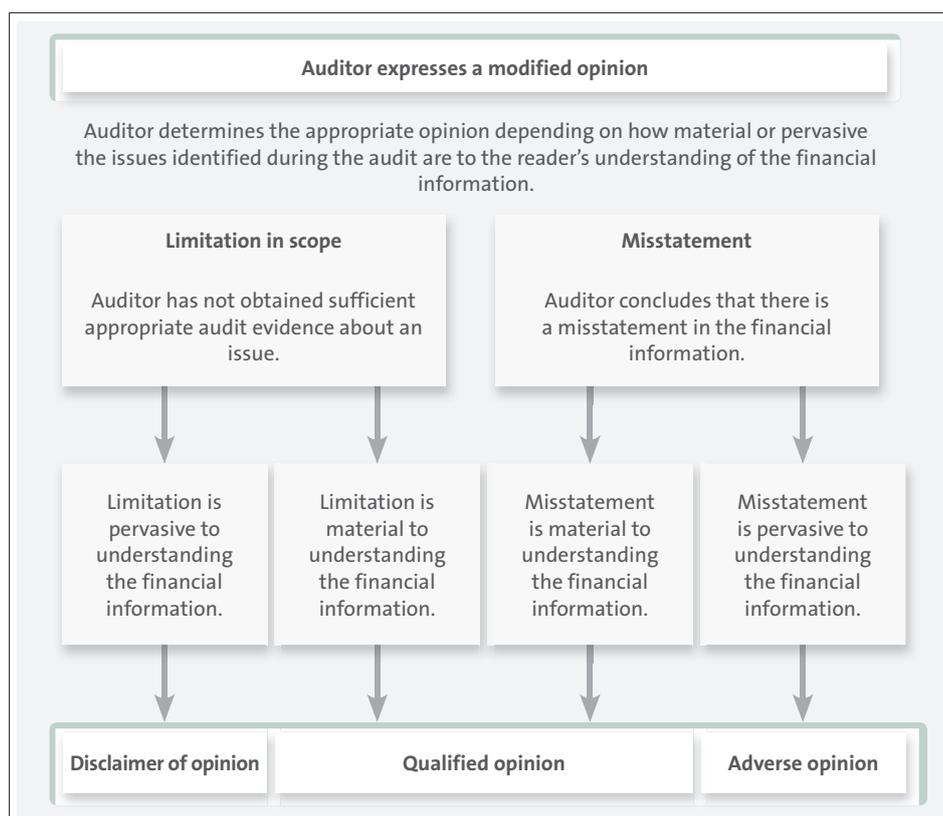
Aquinas College	Rotorua Boys' High School
Avondale Intermediate School	Rotorua Lakes High School
Cambridge High School Educational Trust	Star Of The Sea School (Howick)
Feilding High School	Te Aute College
Forest View High School	Te Kura Kaupapa Māori O Otara
Hamilton's Fraser High School	Te Kura Kaupapa Māori O Otepou
Hato Paora College	Te Kura Kaupapa Māori o te Kura Kōkiri
Hukarere College	Te Kura Kaupapa Māori O Waipiro
Jacobs River School	Te Wharekura o Mauao
Kia Aroha College	Timaru Boys' High School
Koromiko School	Tokoroa High School Trust
Murupara School	Trident High School
Murupara Area School	Waimahaka School
Rangitahi College	Waimangaroa School
Riverslea School	Westbridge Residential School

- 2.12 We will complete these audits as soon as possible. Any significant matters arising from the audits will be included in our next report on the results of school audits.

## Our opinions and comments on schools' financial statements

- 2.13 In most instances, we have issued standard audit reports on the financial statements of schools. However, we have issued non-standard audit reports on the financial statements of some schools. These non-standard audit reports contain a modified audit opinion and/or an "emphasis of matter" or "other matter" paragraph. We modify our opinion by expressing a qualified or adverse opinion, or by disclaiming an opinion (see Figure 2).

**Figure 2**  
**What happens when an auditor expresses a modified opinion**



- 2.14 In certain circumstances, we include additional comments in our audit reports that emphasise a matter referred to in a school's financial statements, or note a matter not referred to in a school's financial statements to draw a reader's attention to the matter because it is relevant to their understanding of the financial information. Such comments are not modifications of our opinion and are referred to as "emphasis of matter" or "other matter" paragraphs. They are used to draw attention to, for example, important information in the financial statements, a breach of legislation, or a matter of probity.

## Modified audit opinions

- 2.15 Of the audits completed for 2012, 16 school audit reports (22 in the previous year) contained a modified audit opinion, one had a disclaimer of opinion, and 15 had qualified opinions. We issued a further four modified opinions in relation to 2010 and 2011 audits that had been in arrears.

### Reasons for the modified opinions

- 2.16 For these schools, the auditor was not able to obtain assurance about the school's payroll figures because of Novopay problems:

- Kawerau College;
- Kawerau Putauaki School;
- St Joseph's School (New Plymouth);
- Te Kura O Te Whakarewarewa; and
- Waihi Beach School – we issued a disclaimer of opinion because the Board would not sign the statement of responsibility.

- 2.17 For these schools, the auditor was not able to obtain assurance about all the school's income and/or expenditure:

- Hamilton's Fraser High School (2010 and 2011 audits) – insufficient evidence to confirm the financial information for a division of the School;
- Hatea-A-Rangi School (2010 and 2011 audits) – limited controls over income and expenditure;
- Haumoana School – limited controls over locally raised income;
- Korokoro School – limited controls over locally raised income;
- Red Beach School – the comparative figures for 2011 were qualified because of limited controls over locally raised income;
- Taumarunui High School and Community Trust – limited controls over locally raised income;
- Te Kura Kaupapa Māori O Otepoti – limited controls over expenditure; and
- Waiau School – limited controls over locally raised income.

- 2.18 For these schools, the auditor was not able to obtain reliable evidence to support the cyclical maintenance provision, which is an estimate of the board's liability to maintain the Ministry's buildings:

- Wellington High School; and
- Wellington East Girls' College.

- 2.19 For these schools, the Board of Trustees did not prepare consolidated financial statements, including the transactions and balances of its subsidiary, as required by accounting standards:
- Wanganui City College; and
  - William Colenso College.
- 2.20 In this school, the Board of Trustees failed to comply with the Education Act, because it did not provide budgeted figures for the financial year in the Statement of Financial Position:
- Ridgway School.

### Emphasis-of-matter paragraphs on probity and similar matters

- 2.21 Some audit reports refer to matters that are not related to the presentation of the financial statements but are considered to be important to public accountability.
- 2.22 With public accountability in mind, Ministry Circular 2009/08 commented on sensitive expenditure:
- The Ministry expects that no Crown funds will be used to fund overseas trips (or expensive domestic travel) for students and only in very rare circumstances for senior staff. Schools are entitled to fundraise specifically for overseas travel ...*
- 2.23 During the reporting period, four audit reports referred to matters concerned with probity, prudence, or waste. These were:
- Ferguson Intermediate School (Ōtara) – The school spent about \$52,000 on sending teachers to Samoa and Tonga, conferences in Melbourne and Prague, and koha for funerals. We considered that aspects of this expenditure were indicative of waste and a lack of financial prudence by the board. We made a similar comment in the school's 2009 and 2011 audit reports.
  - Te Kura Kaupapa Māori O Whakawatea – The kura spent \$5,120 on Christmas gifts and vouchers for its staff and board members bought from a business owned by the principal. In our view, spending of this nature illustrates waste and a lack of probity on the part of the board. We have suggested to the Ministry that it consider whether schools would benefit from guidance on gifts.
  - Te Kura Toitu O Te Whaiti-nui-a-toi – the kura contributed funding of \$38,000 for a two-week trip to Hawaii for 13 children and six adults. We considered expenditure of this nature to indicate waste and a lack of financial prudence by the board.

- Viscount School – The school spent \$43,000 on overseas travel for nine staff for professional development in San Diego. We consider that aspects of this expenditure indicate waste and a lack of financial prudence by the board.

### Schools experiencing financial difficulties

- 2.24 The financial statements of schools show that most schools are financially sound. For example, the latest information available indicates that most schools have a working capital surplus, which is what we would expect because the Ministry tends to fund schools in advance. However, about 120 schools have a working capital deficit, which could affect the school's ability to pay its bills.<sup>1</sup> For a few, the deficit is large enough to be of concern. Deficits arise for different reasons, such as spending more on staff or assets than can be afforded.
- 2.25 Where a school has a large working capital deficit for its size, the auditor seeks confirmation from the Ministry that it will continue to support the school financially. Normally, the Ministry provides that confirmation. However, it is important that in appropriate circumstances we draw the public's attention to schools that are experiencing financial difficulties.
- 2.26 In the reporting period, we drew attention to 19 schools (significantly less than the 45 the previous year) experiencing financial difficulties (see Figure 3).

**Figure 3**

#### Schools whose audit reports draw attention to financial difficulties

Burnside Primary School	Ngaruawahia High School
Fairfield College	Northland College
Hamilton Junior High School	Opaki School
Hato Petera College	Taihape Area School
Kadimah School	Taumarunui High School
Kaitaia Abundant Life School	Te Kura Kaupapa Māori O Nga Maungarongo
Kaitao Intermediate School	Te Kura Kaupapa Māori O Ngati Rangi
Kamo Intermediate School	Te Kura Kaupapa O Te Puaha O Waikato
Kelston Intermediate School	Te Kura o Ratana
Motumaoho School	

- 2.27 Because of public interest in the financial health of schools, we have carried out a high-level analysis of the financial information for all schools for 2009-2012. We include the results in Part 4.

<sup>1</sup> In December 2013, the Ministry's database indicated that 120 schools had a working capital deficit on 31 December 2012. In December 2013, 92% of the results of schools audits for 2012 had been entered into the database.

## Compliance with legislation

- 2.28 As part of the annual audits of schools, we ask auditors to consider whether schools have complied with particular legislative requirements related to accountability. Most schools comply with the requirements.
- 2.29 During the 2012 audits, auditors identified a number of breaches of the Education Act. These breaches were either disclosed by the schools in their financial statements, or reported by our auditors in their audit reports or management letters to the affected schools.
- 25 schools (33 in the previous year) borrowed more than they were legally permitted to (section 67 of the Education Act);
  - 14 schools (16 in the previous year) gave loans to staff (section 73);
  - nine schools (six in the previous year) invested money in organisations that had not been approved (section 73);
  - five schools (10 in the previous year) had conflicts of interest (section 103A and/or clause 8(8) of Schedule 6); and
  - 17 schools (20 in the previous year) breached for other reasons.
- 2.30 We have not given details of all the schools that breached legislation in 2012. However, some of the more important breaches were:
- Kaitao Intermediate School, which is experiencing financial difficulty, borrowed \$19,900 more than it was permitted to without the approval of the Ministry.
  - Kamo Intermediate School, which is experiencing financial difficulty, borrowed \$47,000 more than it was permitted to without the approval of the Ministry.
  - Northland College, which is experiencing financial difficulty, borrowed \$156,000 more than it was permitted to without the approval of the Ministry. It also acquired \$450,000 in company shares without approval. The College is seeking retrospective approval from the Ministry.
  - Our auditors noted that a board member breached section 103A of the Education Act by providing services to the board in excess of \$25,000 without the approval of the Ministry. The school made payments of \$140,000 for building works to a company where one of its board members is a director and shareholder.

## Other matters that arose in the 2012 audits

- 2.31 Each year, school auditors raise some other matters that we usually refer to the Ministry for resolution.

### Use of land and buildings

- 2.32 Schools use land and buildings that the Ministry (or a proprietor, in the case of state-integrated schools) provides. Schools include the estimated cost of their use of land and buildings in their financial statements. This is to show the full cost of running the school.
- 2.33 The Ministry provides schools with the estimated costs of their use of land and buildings, which is like a notional rent charge. Some of the figures that the Ministry provided for the 2012 financial statements were significantly different from those provided for the previous year. This was mainly because of changes in the underlying information and updated assumptions used in valuing the Ministry's land and buildings.
- 2.34 The estimated costs have not yet been adjusted to account for the work required to repair leaky buildings or for earthquake strengthening as these costs have not been assessed.

### Hostels

- 2.35 About 40 schools have hostels for boarding students. In most instances, the schools are not legal owners of the hostels. However, the Ministry considers that the schools are entitled to the benefits of ownership of the hostels and has removed the assets from its own balance sheet. Most of the schools had included the hostels on their own balance sheets.

### Transport grants

- 2.36 About 75 schools receive specific grants from the Ministry for the transport of their pupils. A few schools were found to be in breach of the Ministry's conditions of grant – for example, they were allowing a third-party entity, such as a trust, to retain the surplus generated from the transport operation.
- 2.37 This matter has been drawn to the attention of our school auditors for them to consider during the 2013 audits.

### **Truancy services**

- 2.38 At the end of 2012, the district truancy services were transferred from about 80 schools to the National Attendance Service. One of the schools enquired about whether it could retain the surplus it had generated from the provision of the service. The Ministry decided that the surplus funds of \$128,000 should be returned. The Ministry has not yet decided whether the other schools can retain any surplus that they might have generated.

## Part 3

# Novopay's effect on school audits

### Background

- 3.1 New Zealand's 2500 or so state schools have about 750,000 students. The major cost of schools is the employment of teachers and other staff. Schools spend about 63% of their total costs on staff. Also, most schools' income is directly related to staff. About 53% of their income is by way of a grant from the Ministry for teachers' salaries. With some limited exceptions, schools use the Ministry's outsourced payroll service for the payment of all their staff.
- 3.2 The Ministry pays about \$170 million to about 90,000 people each fortnight through its outsourced payroll service. In August 2012, the Ministry introduced Novopay. In its report on the schools sector for 2012, the Ministry noted that:
- Problems with the Novopay system were evident from the first pay round, with approximately 5,000 staff underpaid, approximately 700 staff overpaid, and 15 people not paid at all.<sup>2</sup>*
- 3.3 In this Part, we summarise the problems with Novopay, their effect on the 2012 school audits, and what the Ministry is doing to resolve those problems.

### The problems with Novopay

- 3.4 Novopay was introduced in August 2012. Substantial public and media criticism followed, particularly before the Ministry was satisfied that it had stabilised the operation of Novopay in mid-2013. In summary, the criticisms covered:
- the number of employees that were not paid, underpaid, or overpaid;
  - the financial and other effects on staff;
  - the financial and other effects on schools;
  - the other types of errors that Novopay was generating;
  - the inaccuracy of the reports that Novopay produced;
  - the lack of support for schools despite their enhanced role in data entry and ensuring data quality;
  - the additional work that schools had to carry out to administer their payroll; and
  - the extra costs needed to make Novopay work to an acceptable standard.

2 Ministry of Education (2012), *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, Wellington, page 20, available at the Ministry of Education's Education Counts website, [www.educationcounts.govt.nz](http://www.educationcounts.govt.nz).

- 3.5 There have been several reviews of the problems that arose when introducing Novopay. The main reviews have been a Technical Review by Deloitte in March 2013 and a Ministerial Inquiry in June 2013, which gave an account of the reasons for the problems. The main findings from these reviews were that:
- Weaknesses in project governance and leadership allowed Novopay to go live with significant risks.
  - Novopay was not adequately developed or tested in some important respects.
  - The payroll service centre was not fully ready to go live.
  - Schools were not ready and the Ministry did not adequately train and support school staff.
  - Novopay cost much more than had been forecast.
- 3.6 Considerable publicity about the extent of errors followed Novopay's introduction. These errors include under- and overpayments, and schools being incorrectly charged with other schools' employees.
- 3.7 We asked the Ministry for information about the extent of the errors, so that we could consider them in relation to the overall payroll and put them into perspective. The Ministry does not have this information available at a school level. However, the Ministry has given us some analysis of overpayments.
- 3.8 The amount of established debt relative to total payroll indicates the extent of overpayments. For the last few months of 2012, after the transition to Novopay, debt was 0.56% of payroll, compared to an average of 0.07% under the previous system, Datacom. The percentage has since dropped to 0.15% for 2013.
- 3.9 The average value of debt outstanding to schools under Datacom fluctuated between \$230 and \$714 a school. In December 2013, this debt was \$4,308. This did not directly affect schools' operational funding because most overpayments relate to teachers' salaries, which the Ministry pays. Most (2029) schools had total overpayments from operations grants of less than 1% of their operations grant funding.

### Schools' financial reporting

- 3.10 The Education Act specifies that schools should prepare audited financial statements. These are to show the school's financial performance and financial position – income and expenditure during the year and assets and liabilities at the end of the year. Schools should submit draft statements to the auditor by 31 March in the following year. The Ministry should receive the audited statements by 31 May.

- 3.11 The Auditor-General is responsible for carrying out the annual audits of schools' financial statements. The Auditor-General discharges this responsibility by appointing auditors from about 35 audit firms to carry out the about 2500 audits on her behalf. Normally, more than 90% of school audits are completed by the statutory deadline of 31 May at a total cost of about \$10.5 million and with no modified audit opinions because of payroll-related matters.
- 3.12 Our audits are designed to provide assurance that a school's financial statements fairly reflect the school's financial performance and financial position. We carry out our audits to provide reasonable assurance about whether the statements are free from material misstatements. We do not look at every transaction, and we do not guarantee that the statements are completely accurate.
- 3.13 Material misstatements are differences or omissions of amounts and disclosures that, in our judgement, are likely to influence a reader's overall understanding of the statements. If we find material misstatements that are not corrected, we refer to them in our audit opinion.
- 3.14 The results of each school audit are contained in an audit report, which is a public document attached to the financial statements of each school, and a management letter, which is addressed to each board. Auditors who are not satisfied with the figures in the financial statements are expected to issue a modified audit opinion.
- 3.15 To ensure that our school audits are as efficient as possible, we have a centralised audit approach to schools' payrolls. It would be substantially more expensive for our audit teams to carry out their 2500 school audits solely using the information available at each school. Every year, the Auditor-General's appointed auditor of the Ministry audits the central payroll system and provides assurance that the annual payroll reports that the system produces may be relied on for the purposes of preparing schools' financial statements.
- 3.16 In previous years, the Ministry has provided schools with their annual payroll reports by mid-January. This has allowed most schools to submit their draft financial statements to the school auditor by the 31 March deadline. The assurance report from our appointed auditor of the Ministry on the work carried out on the central payroll system is normally available by the end of February. This has allowed school auditors to complete most of their audits by the 31 May deadline.

### The 2012 financial reporting process of schools

- 3.17 Because payroll has such a significant effect on the expenditure of schools and related grant income, the Novopay problems have had a significant effect on our 2012 audits of schools.
- 3.18 At the time of our audits, the Ministry was focused on stabilising the Novopay system to pay school employees accurately and consistently. Understandably, preparing historical payroll information for financial reporting purposes had a lower priority. This affected our audit work.
- 3.19 We started our 2012 central assurance work late and found that:
- We could not rely on the controls operated centrally to the same extent that we could in previous years. For example, data input in the Novopay service centre was not reviewed independently.
  - New errors were being generated each pay period, adding to the significant number of transactions to be processed, including corrections of previous errors.
  - Compared with the previous system, Novopay relies far more on schools checking for and detecting errors. However, schools have limited opportunity to check their payroll.
  - We could not confirm the Novopay data on banking staffing, which measures the extent to which schools have used their annual staffing entitlements for teachers, or on staff leave balances.
  - The Ministry had problems accessing some of the data. This affected the ability of the Ministry to answer questions about the data in a timely way.
  - The security of data needed to be improved.
- 3.20 The annual payroll reports were not made available to schools until mid-March 2013 they would usually be expected in early-to-mid February. The data was difficult for schools to reconcile and contained errors. Therefore, many schools submitted their draft financial statements to their auditor with incorrect or no payroll figures.
- 3.21 We had to carefully consider the balance between having audits completed on time, minimising additional audit fees, and not issuing modified audit opinions unnecessarily. Because of the late availability of the end-of-year payroll reports, we concluded that it would not be possible to achieve the normal 90% completion rate by the statutory deadline. We concluded that it was in the public interest to delay completing our audits to avoid issuing modified audit opinions

unnecessarily – it would be better for us do more work to be able to provide positive assurance on the financial statements.

- 3.22 We considered the option of not extending the audit work carried out centrally and at each school, but this would have resulted in many modified audit opinions. Public confidence in Novopay was already low. We did not wish to reinforce that low public confidence unnecessarily.
- 3.23 Schools had little confidence in the accuracy of the payroll information, and many schools spent considerable time on payroll matters. This made it more likely that there would be less focus on financial reporting processes.
- 3.24 Because we had concluded that the controls within Novopay could not be relied on, we had to carry out more extensive and detailed checks of payroll transactions than in previous years. This work could not begin until the middle of March 2013, when the annual payroll reports became available. To confirm the accuracy of the annual payroll reports, we compared a sample of these reports with the base payroll data. We extended our usual anomaly identification process.
- 3.25 The central assurance work was carried out in phases, with school audits being released for completion in batches between late April and late June 2013. We worked closely with the Ministry and received satisfactory explanations for many of the apparent anomalies that we identified. However, the final batch of schools to be released contained anomalies that were not possible to resolve centrally. For these, the Ministry had to tell the schools and we had to tell auditors that schools had to satisfactorily resolve these anomalies.
- 3.26 Despite the additional work we carried out centrally, many school audit teams had to do more audit work to assess the significance of errors that had not been corrected and to consider whether our central assurance work had missed any errors.
- 3.27 The total cost of this additional audit work was about \$1.56 million: \$0.66 million on the more extensive central assurance work and about \$0.90 million on additional audit fees for school auditors. The Ministry met these additional audit fees. The annual audit fees that all schools pay totalled about \$10.5 million.
- 3.28 Only 772 (31%) of audits were completed by the statutory deadline of 31 May 2013. Our appointed auditors have other work from June onwards, much of it outside the public sector, and, therefore, had to fit in the remaining 1708 school audits with their other work. At the time of finalising this report, about 30 (1%) of the 2012 audits had yet to be completed.

- 3.29 By the time this report was being finalised, only five audit opinions had been modified because of Novopay.

### **Banking staffing and accrued leave**

- 3.30 Schools are allocated an annual staffing entitlement, expressed in full-time teacher equivalent units, which is reduced as teaching days are used. The banking staffing facility allows teaching resources to be used flexibly. Any unused full-time teacher equivalent units are effectively “banked” and may be used later in the year for staffing above a school’s entitlement.
- 3.31 Under- or overuse of a school’s entitlement normally results in either an asset (a net underuse is reimbursed in cash) or liability (a net overuse will be deducted from the school’s operations grant for the following year) being recorded in the school’s financial statements.
- 3.32 The “balancing period” for banking staffing normally extends to 31 March of the following year, when the school may reduce their under- or overuse and the resulting asset or liability. However, because of problems with Novopay, the Ministry decided to modify the banking staffing facility and extended the balancing period from one year to two years, with the option that schools could settle their banking staffing balances if they wished.
- 3.33 This meant that for most schools, no asset or liability for banking staffing was recorded in their financial statements at 31 December 2012 because the balancing period had not ended. The position has since returned to normal for the 31 December 2013 financial statements of schools. However, for many schools the recorded asset or liability at 31 December 2013 will reflect a two-year “wash-up” rather than the normal one year.
- 3.34 The use of the banking staffing facility has evolved to enhance the way banking staffing works for schools, but the underlying system has not changed. Schools receive a staffing entitlement to employ regular teachers. The Ministry funds schools separately through operations grants for short-term relief teachers. However, since 2002, schools have been allowed to use any banking staffing under-use for short-term relief teachers.
- 3.35 When introducing Novopay, the Ministry discovered that the rate it used to calculate banking staffing usage for short-term relief teachers encouraged schools to use short-term relief teachers instead of regular teachers. This indirectly created additional entitlement and led to the Ministry providing considerable additional funding to schools for teachers between 2004 and 2011. The Ministry estimated this additional funding to be about \$420 million over this period.

- 3.36 The Ministry has now adjusted the rate at which short-term relief teachers are charged to banking staffing to remove the incentive and equalise the cost to the Ministry of funding short-term relief teachers through banking staffing or operational funding. However, incentives remain (to a lesser extent) within the banking staffing facility in relation to the use of long-term relief teachers. We understand that the Ministry is closely monitoring how schools use these teachers.
- 3.37 The Ministry has focused more on ensuring that Novopay's banking staffing report is reliable, particularly in relation to the effect of overpayments on banking staffing balances.
- 3.38 The Ministry has told us that it intends to carry out a comprehensive review of the banking staffing facility in 2014. Because of the complexity of banking staffing, we fully support the Ministry's proposal to carry out such a comprehensive review.
- 3.39 Historically, the Ministry had not had reliable enough records of annual leave for non-teaching staff in schools to be in a position to require schools to record a liability for annual leave in their financial statements. However, some schools have maintained their leave records, which have been considered reliable enough to support the recording of a liability in the school's financial statements. Such liabilities can be recorded only if it is possible to make a reliable estimate of the amount owing.
- 3.40 We have taken a pragmatic view of this matter on the understanding that the introduction of a new payroll system would result in reliable leave records, which would support including annual leave liabilities in the financial statements of schools.
- 3.41 Unfortunately, despite the introduction of Novopay, there remain challenges in the Ministry being able to provide all schools with reliable information about outstanding leave balances to support recording an annual leave liability.
- 3.42 We will continue to liaise with the Ministry about this matter and advise our auditors when this information becomes reliable enough for the routine inclusion of an annual leave liability in schools' financial statements. We hope that most schools will be able to recognise this annual leave liability in their 2013 financial statements.

## How the Ministry of Education addressed problems with Novopay

- 3.43 As the Ministerial Inquiry report noted, when the problems with Novopay became apparent in September 2012, their nature and scale overwhelmed the Ministry and its outsourced provider of payroll services. It took until early 2013 for the Ministry to begin to take major steps to stabilise Novopay and its supporting processes, including setting up a specialised Novopay business unit in March 2013.
- 3.44 During the last year, the Ministry has devoted substantial time and effort to resolving the problems. Although the Ministry considers that it has stabilised the routine payroll operation, much work remains to ensure that Novopay can provide a reliable payroll service in the long term. As part of the fortnightly pay cycle, the Ministry relies on many manual procedures that use a lot of resources and are inconsistent with the objective of moving to the Novopay system.
- 3.45 The Ministry considers that it achieved a steady state with Novopay in mid-2013. However, the Ministry acknowledges that, more than 18 months after Novopay went live, much remains to be done to ensure that a robust and sustainable outsourced payroll service is in place with minimal manual procedures. Recent problems with the 2014 “start of year” payroll processes underscore this.
- 3.46 Since mid-2013, the Ministry has begun remedial work, such as in:
- data quality;
  - controls at the Novopay pay centre; and
  - security and privacy.
- 3.47 Also, the Ministry continues work to resolve problems with:
- overpayments;
  - leave; and
  - tax.
- 3.48 The Ministry has told us about further remediation plans for Novopay. The Ministry considers that putting these plans into effect should progressively improve the performance of the Ministry's outsourced payroll service and the confidence that users have in the service.
- 3.49 However, in the short term, we expect considerable resources to continue to be applied to Novopay problems, so regular pay runs can be successful, with few manual procedures, system errors, and data quality problems.

- 3.50 Schools now play a larger role in the payroll process. It is important that all schools fully appreciate this enhanced role and are able to respond appropriately. The Ministry needs to consider providing further guidance to schools about the main controls that each school should have to increase assurance that Novopay is working effectively and consistently.

### **Avoiding delays in schools' 2013 financial reporting**

- 3.51 To improve the financial reporting process, the Ministry has:
- made annual payroll reports available to schools earlier than last year, and each school has been sent a supporting schedule of adjustments that have to be made to the figures in the annual payroll reports to prepare their financial statements; and
  - better supported schools in the financial reporting process with guidance on financial reporting and standard payroll processes.
- 3.52 However, the need to ensure that resources have been available to help resolve operational problems associated with fortnightly pay runs has limited the Ministry's actions. Because of ongoing operational problems and problems with collating payroll information for each school, the Ministry has not been able to provide the necessary payroll information to schools in the time frame set. The Ministry has provided information about six weeks later than planned, which is likely to delay the completion of the 2013 school audits.
- 3.53 Although the Ministry has provided schools with further guidance about the 2013 financial reporting process, the process is complex because of payroll errors, which schools need to account for when preparing their financial statements.
- 3.54 Because of delays in the Ministry providing payroll information to schools, we have only recently completed our central assurance work on 2013 payroll information. We have been able to provide assurance to our auditors about:
- the annual payroll reports used in the financial statements of schools;
  - withdrawals from the Ministry's and schools' bank accounts as reflected in the payroll reports;
  - the allocation of costs between salaries grants and operations grants;
  - banking staffing information; and
  - accrued leave.

## Novopay's effect on our audit of the Ministry of Education

- 3.55 Novopay also affected our 2012/13 audit of the Ministry, because the cost of the Education Services payroll is included in the Ministry's non-departmental schedules in the Ministry's financial statements.
- 3.56 In its statement of service performance, the Ministry reported on the accuracy of payments made throughout the year to 30 June 2013, the first 11 months of Novopay's operation. The lowest fortnightly reported performance was 86%, with an average of 96.7% against a target of 100%.
- 3.57 In our 2012/13 audit report, we drew attention to the disclosures in the Ministry's financial statements about matters that arose during 2012/13 relating to the Ministry's provision of education services payroll.
- 3.58 Also, delays in the completion of school audits because of problems with Novopay affected the Ministry's sub-consolidation of school results for preparing the Government's financial statements. The major effect was that the Ministry had to make more use of 2011 audited financial information from schools instead of 2012 information.
- 3.59 We have reported to the Ministry about our assessment of the management control environment for Novopay. As noted in paragraph 3.5, the Ministry has also received the Ministerial Inquiry report, a technical review of the problems arising from the use of Novopay, and some other specifically targeted reports from other sources.
- 3.60 We have recommended some improvements and the Ministry is continuing to work on putting changes into effect to make Novopay more reliable.

## Part 4

# Financial health of schools

- 4.1 The financial health of schools is a matter of significant public interest. In this report, we provide an overview of the financial health of schools as a whole. We do not comment on the financial health of individual schools.
- 4.2 Boards are responsible under section 75 of the Education Act for managing, organising, and administering state schools. This has been the case since the education reforms of the late 1980s and early 1990s.
- 4.3 The Government largely funds schools through operational grants, teachers' salaries grants, and other grants. Also, schools typically raise funds ("locally raised funds") within their local communities. Some schools generate revenue from other sources, such as through operating hostels or enrolling international students.
- 4.4 Boards have significant discretion in how to spend their operational grant funding, whereas the Ministry pays teachers' salaries on behalf of schools. Funding for teachers' salaries is based on staffing entitlements that the Ministry works out using school roll data.
- 4.5 The Crown owns most land and buildings that state schools use. The proprietors own the land and buildings of state-integrated schools. Most land and buildings that state schools use are not recorded as assets in schools' financial statements.
- 4.6 The Ministry provides funding for major capital works in state schools. The proprietors pay for major capital works in state-integrated schools. Some schools own buildings that they have wholly or largely funded, with the Ministry's approval.
- 4.7 Schools are expected to maintain the buildings that they use through regular and cyclical maintenance programmes. Cyclical maintenance, such as periodic painting of school buildings, has a pattern of recurrence spanning several years. Funding to cover this maintenance is included in the operational grants that each school receives.
- 4.8 The decision on whether a school should continue to exist is driven mainly by educational, not financial, factors. If the Ministry considers that a school is needed in a particular location, it is likely to continue to support the school financially and, if necessary, by statutory management. If the Ministry considers that a school is no longer needed in a particular location, the financial health of the school is unlikely to be a deciding factor.

## Financial profile of schools

- 4.9 Section 87B of the Education Act requires the Minister of Education to prepare and present a report on the performance of schools to the House of Representatives every year. In preparing this Part, we drew from the Minister's 2012 report – *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*.<sup>3</sup> We have also used more recent information from the audited financial statements that the Ministry collects each year from all schools. When the relevant 2012 information is not yet in the Ministry's database, we have used 2011 data instead.
- 4.10 In the graphs in this Part, we have used information from audited financial statements of schools covering the period from 2009 to 2012.<sup>4</sup>
- 4.11 The Government provided slightly more than 88% of schools' revenue in each of the years 2009 to 2012 (see Figures 4 and 5). Locally raised funds are the next most significant source of schools' revenue (about 7% of total revenue).

**Figure 4**  
**Sources of school revenue, 2009-2012**

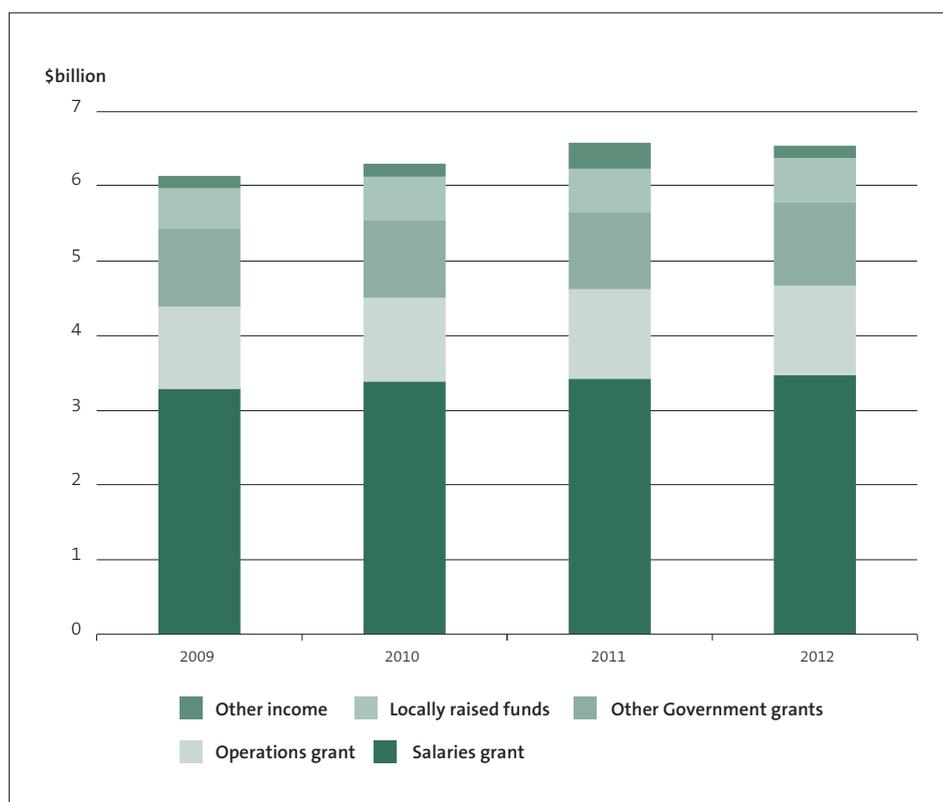
Revenue	2009	2010	2011	2012 (est)
	\$000	\$000	\$000	\$000
Government grants	5,446,245	5,562,574	5,840,535	5,898,163
Locally raised funds	474,809	473,484	477,480	487,535
International students	99,210	105,125	110,770	108,133
Investments	36,450	39,168	39,596	38,668
Hostels	30,140	30,261	32,540	33,441
Other revenue	70,981	104,838	112,852	108,690
<b>Total revenue</b>	<b>6,157,835</b>	<b>6,315,450</b>	<b>6,613,773</b>	<b>6,674,630</b>
Proportion of government funding	88.4%	88.1%	88.3%	88.4%

Notes: Based on *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, page 25, Table 1 School revenue, 2009-2012. Figures are GST exclusive, rounded, and include grants from the Government and proprietors for the use of land and buildings. Figures for 2012 are estimates based on 1942 (80% of schools at the time the report was prepared (September 2013) and estimates based on previous accounts data for the remaining schools.

<sup>3</sup> This report is available on the Ministry of Education's Education Counts website at [www.educationcounts.govt.nz](http://www.educationcounts.govt.nz).

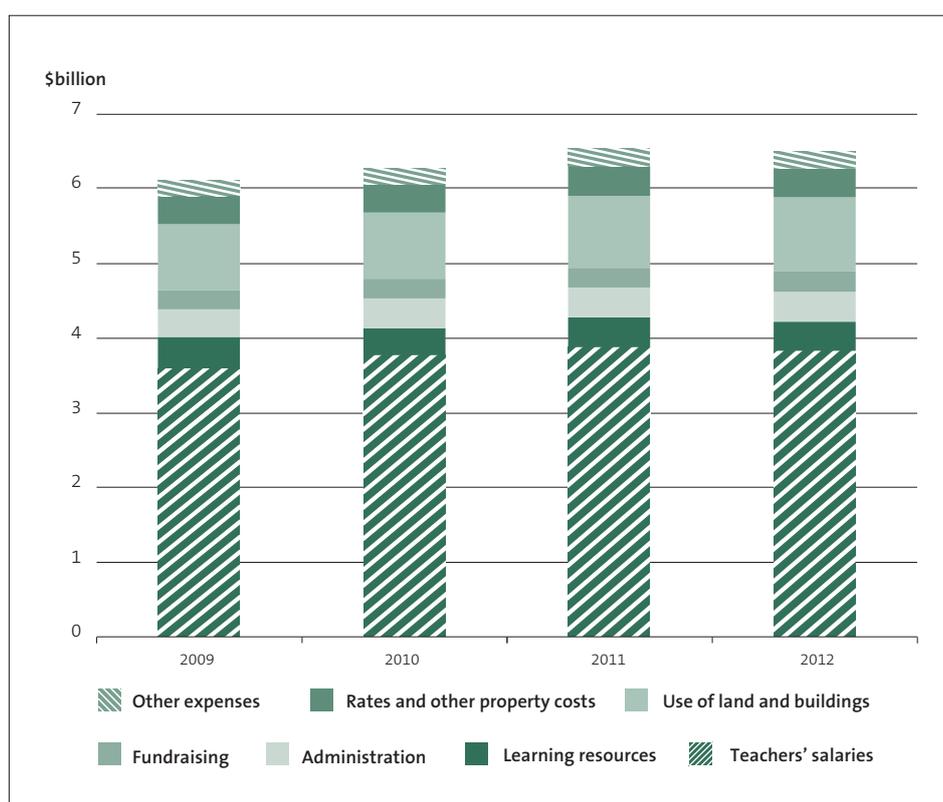
<sup>4</sup> This information comes from the Ministry of Education's database of schools' financial statements as at December 2013. By December 2013, about 92% of the results of schools audits for 2012 had been entered into the database. For the remaining schools, the 2011 financial statement data was used as a proxy for 2012.

**Figure 5**  
Schools' total revenue by source, 2009-2012



- 4.12 Our analysis confirms the significance to schools of Crown funding, which contributed to an increase of 8.4% in schools' annual revenue between 2009 and 2012.
- 4.13 Schools' most significant expenses are salaries (of teaching and non-teaching staff), and the notional rent that the Ministry charges for the use of Crown-owned land and buildings (see Figure 6).

**Figure 6**  
Schools' total expenditure by type, 2009-2012



- 4.14 Between 2009 and 2012, schools' annual expenses increased by 8.3%, slightly less than the increase in revenue during the same period.
- 4.15 One of the main measures of a school's financial health is its financial performance during the year. The operating position is important because it helps us to understand whether a school is operating within its means. This is shown by the operating surplus or deficit (whether it spends more than its revenue). In any year, many schools spend slightly less than their revenue and others spend slightly more. This is inevitable and not a concern.
- 4.16 Schools achieved a combined operating surplus of 0.5% of total revenue in 2012, slightly less than the 0.6% in 2011.<sup>5</sup> Figure 7 shows that about half of the country's schools reported an operating surplus in the years 2010-2012.

<sup>5</sup> *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, page 27.

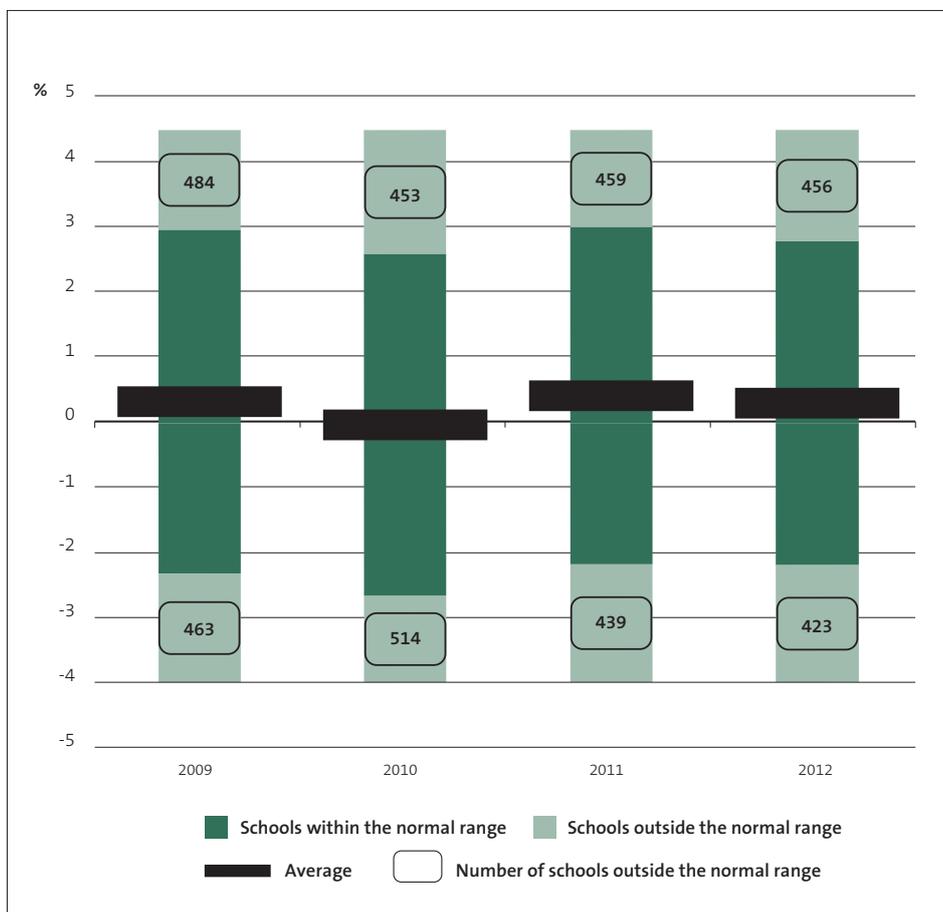
**Figure 7**  
Percentage of schools with an operating surplus, 2010-2012

	All schools (%)	Primary schools (%)	Secondary schools (%)	Other schools (%)
2010	49.2	48.2	52.9	56.5
2011	56.3	55.3	59.6	71.1
2012	55.2	54.4	57.2	72.5

Based on *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, page 27, Table 3 Percentage of schools with an operating surplus 2010-2012.

4.17 Schools that recorded an operating surplus and schools that recorded an operating deficit are relatively evenly distributed, as shown in Figure 8.

**Figure 8**  
Schools' net surpluses and deficits as percentage of total revenue, 2009-2012



- 4.18 In Figure 8, “the normal range” is one standard deviation either side of the average. The schools outside that range with positive values had a surplus to total revenue percentage that was more than one standard deviation better than the average. The schools outside that range with negative values had recorded deficits that put their deficit to total revenue more than one standard deviation below the average.
- 4.19 Another measure of the financial health of a school is its financial position at the end of the year. Within that overall financial position is the working capital surplus/deficit – whether current assets exceed current liabilities and, therefore, whether short-term debts can be paid as they fall due. Schools tend to receive funding, such as for maintenance of buildings, in advance, so a working capital surplus is expected to be the norm.
- 4.20 Figure 9 shows that more than 90% of all schools had a working capital surplus at the end of 2012.

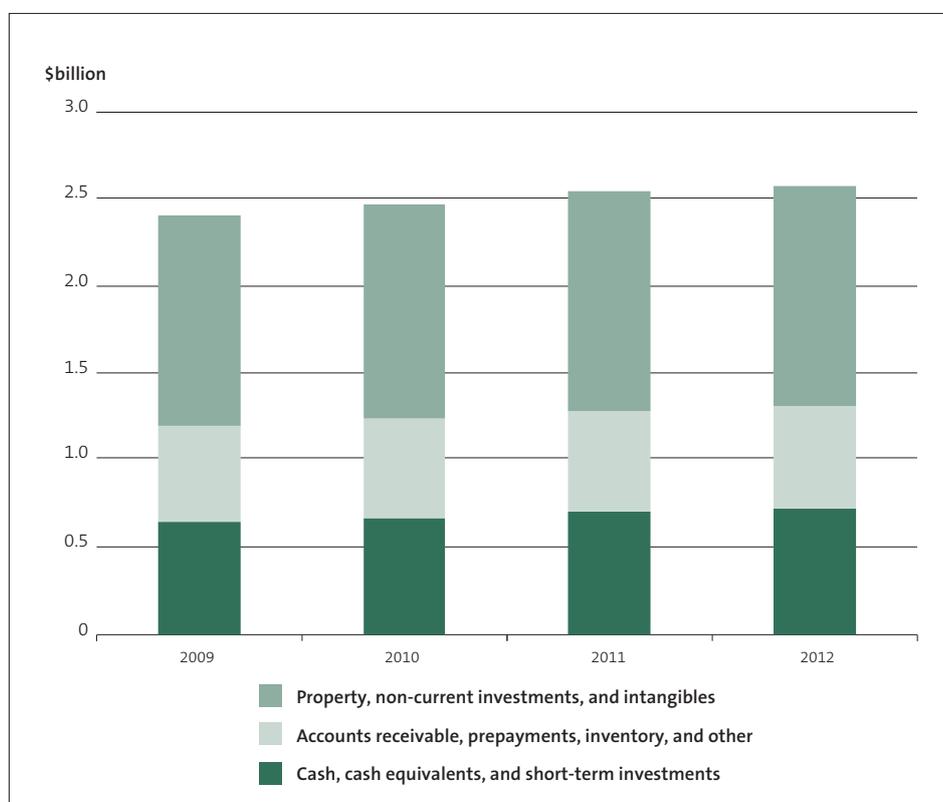
**Figure 9**  
**Percentage of schools in different working capital ratio bands, 2012**

Working capital ratio	All schools (%)	Primary schools (%)	Secondary schools (%)	Other schools (%)
Under 1.0	6.2	4.9	12.8	0
1.0 to 2.0	41.6	38.7	56.7	17.5
2.0 to 3.0	26.8	28.7	17.3	37.5
More than 3.0	25.4	27.7	13.2	45.0

Note: Based on *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, page 27 Table 4 Percentage of schools in different working capital ratio bands, 2012. A working capital ratio of more than 1.0 is a working capital surplus, meaning current assets exceed current liabilities.

4.21 Figure 10 shows that the value of schools' total assets grew steadily between 2009 and 2012.

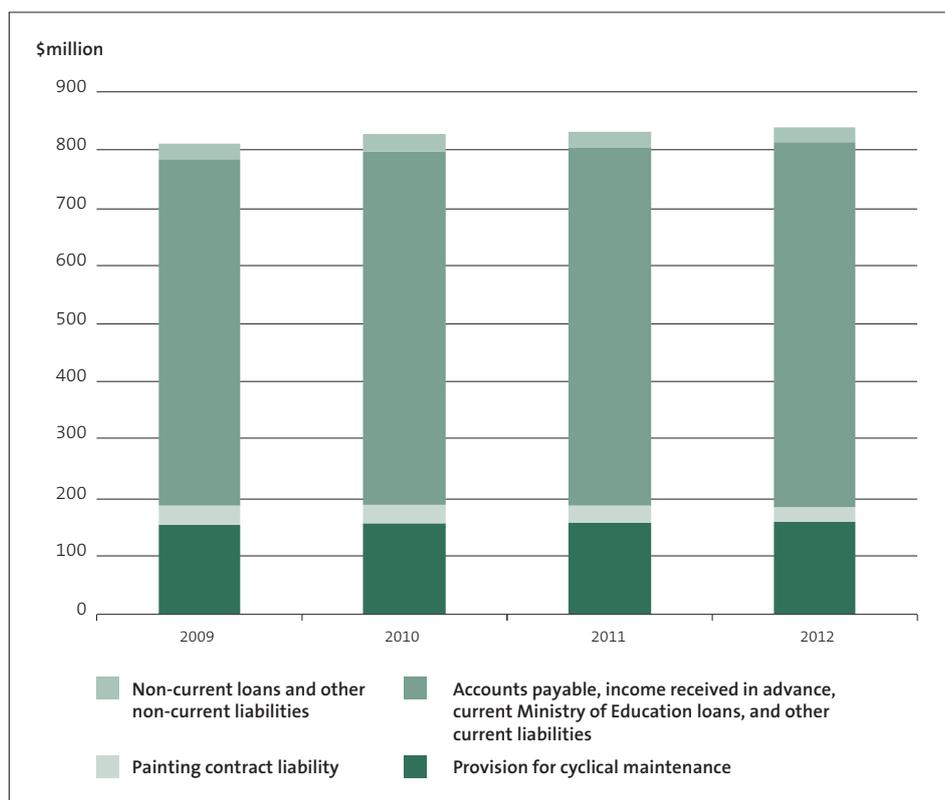
**Figure 10**  
Total value of schools' assets, 2009-2012



Note: Excludes school land and buildings owned by the Crown.

4.22 Schools' assets are about three times larger than their liabilities. Net assets, the difference between total assets and total liabilities, is also an indicator of financial health. Schools' total liabilities have not increased as quickly as total assets (see Figure 11), meaning that schools' net assets (or public equity) increased between 2009 and 2012.

**Figure 11**  
Schools' liabilities, 2009-2012



4.23 Figure 12 shows the increasing value of net assets of schools between 2010 and 2012.

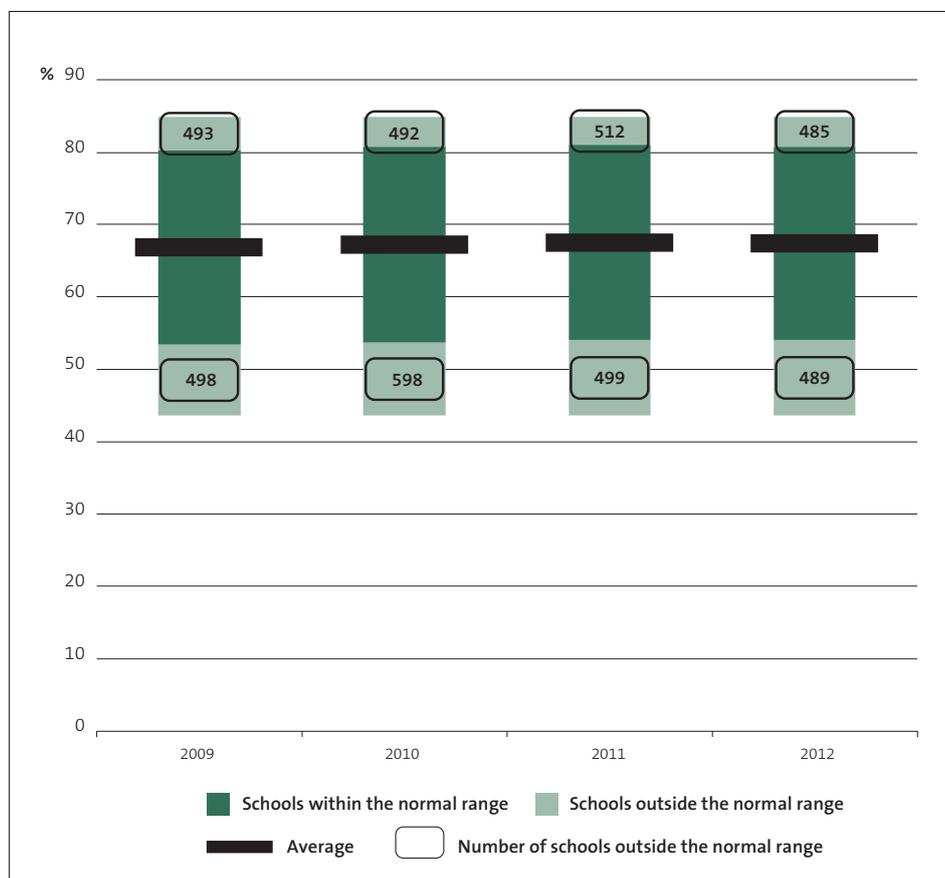
**Figure 12**  
Growth in schools' net assets, 2010-2012

	All schools \$000	Primary schools \$000	Secondary schools \$000	Other schools \$000
2010	1,653,381	894,709	705,854	52,818
2011	1,723,981	920,329	747,627	56,025
2012	1,761,579	939,814	763,789	57,976

Note: Based on *New Zealand Schools Ngā Kura o Aotearoa: A report on the compulsory schools sector in New Zealand – 2012*, page 28. Table 5 Public equity trends (\$) 2010-2012

4.24 The ratio of net assets to total assets in schools has been slightly less than 0.7 in each of the years 2009 to 2012 (see Figure 13), indicating a strong balance sheet for schools as a whole.

**Figure 13**  
**Schools’ net assets as a percentage of total assets, 2009-2012**



4.25 In Figure 13, “the normal range” is one standard deviation either side of the average. The schools outside that range and above the average have a particularly strong financial position. The schools outside that range and below the average have a relatively weaker financial position.

## Concluding comments about the financial health of schools

- 4.26 Using financial information that the Ministry has collected, we can draw some conclusions about the financial health of schools as a whole.
- 4.27 We have reviewed information on revenue and expenditure, the operating surplus/deficit, working capital, assets, liabilities and net assets/public equity.
- 4.28 The financial health of schools as a whole appears to be relatively sound, with:
- a high proportion of revenue from crown funding;
  - a high average working capital ratio – about 50% of schools have more than \$2 of current assets for every dollar of current liabilities; and
  - high average net assets (public equity) of nearly 70% of total assets.
- 4.29 However, the financial profile of schools, as shown in the figures in this Part, indicates that some schools are not in such a sound financial position as schools as a whole.

## Part 5

# State-integrated schools

- 5.1 The 330 or so state-integrated schools comprise 13% of all state schools. About 88,000 pupils attend state-integrated schools, former private schools that are now part of the state education system. State-integrated schools provide education within the framework of a religious or philosophical belief.
- 5.2 Elected boards govern state-integrated schools, which are Crown entities, in the same way that boards govern other state schools. The boards are responsible for the governance and operation of their schools, and are publicly accountable.
- 5.3 However, state-integrated schools differ from other state schools in having proprietors that are private entities. Proprietors appoint representatives to boards, provide and maintain the school land and buildings, and are responsible for maintaining the religious or philosophical character of the schools.
- 5.4 The Government funds boards and proprietors, which can also raise money directly from private sources. The Private Schools Conditional Integration Act 1975 sets out which matters boards and proprietors are each responsible for and allows proprietors to set compulsory charges for attending the school (“attendance dues”).
- 5.5 The Ministry is responsible for most of the public funding for state-integrated schools and administers the Private Schools Conditional Integration Act. The Government funds boards for the teaching and operating costs of state-integrated schools and for minor maintenance, in the same way that it funds all other state schools. Boards of state-integrated schools receive more than \$500 million a year for these purposes.
- 5.6 State-integrated school boards have to work in partnership with proprietors. Different funding streams and split responsibilities between the board and the proprietor make this complex. Therefore, it is not always easy to draw clear lines between publicly and privately funded activities. Because of the different bodies involved, each with different reporting obligations, it can also be difficult to provide clear information and accountability to parents.
- 5.7 Because the Auditor-General is the auditor of all public entities, we audit each board’s financial statements, which detail Crown funding and any donations to, or funds raised by, the school. We do not audit the financial statements of private proprietors.
- 5.8 In *Education sector: Results of the 2011 audits*, (our December 2012 report) we reported on state-integrated schools and the results of a survey we had carried out. This Part provides an update of progress in addressing matters that we raised in 2012.

## Relationships between boards and proprietors

- 5.9 In most instances, the relationship between boards and proprietors is handled with proper regard to public accountability, recognising the need to maintain a separation between public and private money.
- 5.10 However, in some instances, the financial relationship between the board and the proprietor is blurred. About 2000 trustees sit on state-integrated school boards. Many trustees are in that position for only a few years and therefore may not know enough about how their boards are expected to operate.
- 5.11 The Ministry has taken several steps to improve the relationship between boards and proprietors. For example, boards no longer provide funding for proprietors' buildings without the Ministry's approval, guidance has been issued on the fees that may be charged to parents, and guidance has been issued on managing conflicts of interest.
- 5.12 However, some matters have yet to be resolved. Most of these matters affect only a minority of boards. However, one of these matters could have more widespread relevance. In 2007, the Ministry commissioned an audit of how proprietors use the property funding it provides. Subsequently, guidelines were issued to proprietors on the accounting and audit of the funds. However, the guidelines did not require proprietors to have an audit of the property funding that they receive. To date, the Ministry has not sought information to account for the use of that funding.
- 5.13 The Ministry has said that its Education Infrastructure Services assurance activities for 2014/15 will include a review of integrated schools' use of (policy 1 and 2) property funding. The review will use internal and external resources and is expected to be carried out in the first half of 2015.

## Parental donations

- 5.14 In our February 2010 report, *Central government: Results of the 2008/09 audits*, we noted that the accountability arrangements for parental donations were of public interest because of concerns about the size of the donations being sought, confusion about whether the contribution is voluntary or compulsory, or a lack of clarity about whether the donation is for the board or the proprietor.
- 5.15 Our December 2012 report summarised some information that we had collected on the accountability arrangements for parental donations and outlined weaknesses in the contemporary arrangements.

- 5.16 Various bodies can ask parents of pupils at state-integrated schools for money:
- The board may seek funds of a similar nature to that requested from the parents of pupils at other state schools (donations and some limited fees).
  - The proprietor may require parents to pay compulsory attendance dues.<sup>6</sup> The Ministry approves these dues, which can be used to provide land and buildings.
  - The proprietor may seek voluntary contributions, which may be used for any purpose.<sup>7</sup>
  - Other bodies, such as trusts that may be connected to the board or proprietor, may ask parents for donations, which may be used for any purpose.
  - If a school has a boarding hostel, parents will be charged fees by the body running the hostel (which may be the board, the proprietor, or some other body).
- 5.17 Parental fees and donations can appear in different sets of financial statements. The financial statements of the board, the proprietor's attendance dues account, and the proprietor's voluntary financial contributions account have to be audited. The financial statements of another entity (such as a trust) do not have to be audited.
- 5.18 The Auditor-General appoints the auditors of boards, whereas proprietors appoint auditors to audit the attendance dues and financial contributions accounts. The Auditor-General is responsible for auditing the board's financial statements, including any entities that the school controls, but is not responsible for the other audits.
- 5.19 When a proprietor or another body raises funds from parents, it is a transaction between two private parties, even though the school office often provides administrative support.
- 5.20 In our view, the number of different parties involved and the associated accountability arrangements make it difficult for parents to satisfy themselves about the use to which their fees and donations have been put because:
- the charges and donations can appear in three (or four) different sets of financial statements;
  - different auditors can be appointed to audit those financial statements;
  - financial statements of some of the entities involved might not be audited or be publicly available; and
  - it can be difficult for a parent to access all the financial statements to get an overall picture.

6 Section 36 of the Private Schools Conditional Integration Act.

7 Section 37 of the Private Schools Conditional Integration Act.

- 5.21 Some of this complexity is inevitable, given the legislated model for state-integrated schools. However, from an accountability perspective, it creates risks. For example, in this type of structure, it might not be possible to detect whether the same expenditure was being charged against more than one source of income.
- 5.22 In June 2013, the Ministry issued updated guidance (*Circular 2013/06 – Payments by parents of students in state and state-integrated schools*). The substance of the advice contained in the updated guidance has not changed from the previous guidance, because the relevant law has not changed. However, updating the guidance served as a useful reminder of the obligations of boards in relation to parental donations.
- 5.23 In our view, updating the guidance represents an important initiative by the Ministry to address a matter that has been of public concern for some years. We intend to ask our auditors to report any non-compliance with the updated guidance.

## Part 6

### Kura Kaupapa Māori

- 6.1 In December 2011, we reported on the findings of our review of financial management in kura kaupapa Māori, where most, or all, of the teaching is carried out in te reo Māori.<sup>8</sup> In this report, we refer to those schools as kura.
- 6.2 Most of the 72 kura had good policies and processes to manage their finances, comply with legislation, and appropriately manage sensitive expenditure and conflicts of interest. However, the policies and practices in about 20% of kura did not reflect the good practice set out in the guidance that the Ministry provides to schools.
- 6.3 The Ministry told us that it was revising the model financial management policies that it makes available to schools. The revised policies, which the Ministry had planned to publish in December 2011, were intended to include more detailed guidance about sensitive expenditure and delegations. In our December 2011 report, we recommended that the Ministry monitor how effectively kura and other small schools follow and comply with its guidance and, if necessary, provide more targeted guidance.
- 6.4 The Education and Science Committee's report on its May 2012 hearing into our December 2011 report noted that the Ministry had confirmed that it would provide revised guidelines on sensitive expenditure and make it clear that loans to staff are unlawful. The Committee expressed an interest in viewing the revised guidance. It also noted that we would monitor the matter and, if necessary, ask the Ministry to issue targeted advice to the kura in question.
- 6.5 In *Education Sector: Results of the 2011 audits* (our December 2012 report), we stated that, because of the delay in publishing the model financial management policies, the Ministry was carrying out another round of consultation to ensure that the proposed model policies remained fit for purpose.
- 6.6 We understand that the Ministry plans to issue model financial management policies, including guidelines on sensitive expenditure and delegations, in 2014.
- 6.7 We also stated in our December 2012 report that the Ministry had been exploring appropriate vehicles for producing more targeted guidance for kura. The Ministry has yet to issue more targeted guidance.
- 6.8 The Ministry has said that boards of kura, along with other state schools, will receive more funding for professional development and support for their governance functions, including financial governance. The New Zealand School Trustees Association will be expected to work closely with Te Rūnanga Nui o Ngā Kura Kaupapa Māori o Aotearoa and Ngā Kura ā Iwi (which both provide additional specific support to kura). The Ministry has completed contract negotiations with

these two organisations to provide support and training to kura boards. Work is under way with the contracted entities, with a view to the Ministry putting guidelines in place later in 2014.

- 6.9 We had intended to ask the auditors of kura to carry out a follow-up exercise as part of their 2013 audits to assess whether there had been any improvement in practice. However, we deferred that exercise because the Ministry has not yet issued its guidance.
- 6.10 It is important that kura have an opportunity to consider and act on the revised guidance before our auditors do any further review.

## Part 7

# Payments above a principal's normal salary

- 7.1 In December 2010, we reported on the results of our review of additional payments to secondary school principals, which was carried out as part of our 2009 school audits. The auditors reviewed about 400 schools. They found that for about 80 schools, either additional payments had been paid without the Ministry's approval or it was not clear whether some payments needed the Ministry's approval – for example, because the guidance was not precise enough.
- 7.2 In most instances, the additional payments were not large. However, the underlying principles are important. First, payments are lawful only if the Ministry approves them. Secondly, there is always heightened sensitivity about payments that have the potential to create private benefits, even if they are genuine business expenses. Thirdly, in some circumstances, reimbursing a private expense can be unlawful and can lead to prosecution.
- 7.3 After we published our December 2010 report, the Ministry gave comprehensive guidance to schools to clarify when its approval is required. The Ministry also published a circular on the need for boards to consider recovering unlawful payments. This should ensure that boards are aware of the general expectation that they consider recovering the money when they make unlawful payments.
- 7.4 More recently, the Ministry has issued further guidance (*Circular 2013/27 – Principal Concurrence*). Changes have been made to the process to increase flexibility and create a more streamlined approach. As a result, boards may approve “sensitive payments” within clear boundaries. However, these must be mainly related to work and give only a small, if any, private benefit. For example, the Ministry will not agree to a vehicle being provided for non-work use, allowances for transport to and from work, insurance, subsidised housing rental, non-work-related Air New Zealand Koru Club membership, or personal grooming expenses.
- 7.5 Although the Ministry has provided further guidance to schools about additional payments to secondary school principals, that guidance does not yet address all of the matters that we raised in our December 2010 report.
- 7.6 We understand that the Ministry is considering the matters that we raised about payments by proprietors of state-integrated schools. Those matters included the possibility that some of the payments were unlawful, equality of pay for all state schools, and properly managing conflicts of interest.

- 7.7 The Ministry has also told us that it would consider requiring boards of state-integrated schools to disclose financial transactions with proprietors in their financial statements. This would help maintain the transparency of any payments that principals receive directly from proprietors.
- 7.8 It is more than three years since we told the Ministry the findings of our review of the additional payments to secondary school principals. We are concerned that the Ministry has not yet managed to address all the matters we raised in our December 2010 report.
- 7.9 The Ministry has said that it will hold discussions in 2014 with the Association of Proprietors of Integrated Schools on the desirability of including a disclosure note in boards' annual financial statements to resolve this matter. A disclosure note could cover all payments from proprietors to boards, and would take effect from the year ending 31 December 2014.

## Part 8

# Changes to schools' financial reporting

8.1 In *Education sector: Results of the 2011 audits*, we commented on strategic changes to New Zealand's financial reporting framework, and proposed changes to New Zealand's financial reporting standards and their effect on the education sector.

8.2 In this Part, we highlight the new financial reporting standards applicable to schools that will apply to financial statements for the year ending 31 December 2015. The current financial reporting standards will continue to apply to the financial statements of schools for 2013 and 2014.

### New financial reporting standards for schools

8.3 In keeping with its "multi-standards approach", the External Reporting Board (the XRB) has issued new financial reporting standards for public benefit entities in the public sector.<sup>9</sup> Public benefit entities will report under one of four categories, depending on the nature and size of the entity. The categories are:

- full reporting (tier 1);
- reduced disclosure reporting (tier 2);
- simple format accrual reporting (tier 3); and
- simple format cash reporting (tier 4).

8.4 Size will dictate the minimum category of reporting that schools will be required to comply with. Schools are allocated to tiers as follows:

- tier 1 – operating expenditure of more than \$30 million;
- tier 2 – operating expenditure between \$2 million and \$30 million;
- tier 3 – operating expenditure of less than \$2 million; and
- tier 4 – only if permitted by legislation.

8.5 Apart from Te Aho o Te Kura Pounamu, The Correspondence School, no schools have operating expenditure of more than \$30 million and no legislation allows schools to apply simple format cash reporting. Therefore, schools will report in keeping with either reduced disclosure reporting (tier 2) or simple format accrual reporting (tier 3). About 1100 schools are likely to be tier 2 and about 1400 are likely to be tier 3.

8.6 Reduced disclosure reporting uses the same standards as full reporting, but will require significantly fewer disclosures in the notes to schools' financial statements than full reporting. Importantly, the number of required disclosures is expected to be less than what schools must comply with currently.

<sup>9</sup> The XRB has responsibility for preparing and issuing financial reporting standards under the Financial Reporting Act 1993 and the Financial Reporting Act 2013.

- 8.7 However, under reduced disclosure reporting, schools will be required to include a statement of cash flows as part of their financial statements. Although a statement of cash flows is not currently a requirement for most schools, we consider that its inclusion will help readers to better understand schools' financial statements. We also expect that fewer disclosures being needed will partly offset the extra effort needed to meet this requirement.
- 8.8 Other than these changes, the new tier 2 standards are generally in line with the current standards for schools.
- 8.9 Simple format accrual reporting for tier 3 public benefit entities is expected to be more straightforward than reduced disclosure reporting for tier 2 public benefit entities. Where reduced disclosure reporting is based on a full set of standards, only one standard of about 50 pages needs to be followed for simple format accrual reporting.
- 8.10 As the name suggests, simple format accrual reporting requires qualifying entities to follow the accrual basis of accounting, as used for tier 1 and tier 2 reporting. However, simple format accrual reporting incorporates some simplifications to the way transactions are accounted for, when compared to tier 1 and tier 2 reporting. Such simplifications include accounting for all leases as operating leases, such as information technology equipment leases.
- 8.11 Simple format accrual reporting requires entities to provide a minimum amount of information in their financial statements, and to add to that minimum amount, as necessary, to make it easier for readers to understand the financial statements.
- 8.12 Like reduced disclosure reporting, schools using simple format accrual reporting will be required to include a statement of cash flows as part of their financial statements. As noted in paragraph 8.7, we consider that a statement of cash flows will help readers to better understand schools' financial statements. Therefore, we support the new requirement for all schools.
- 8.13 We are aware that most schools report in a similar way, and that, in general, the Ministry is satisfied that schools report consistently. The new financial reporting standards offer an opportunity for change, and for schools with less than \$2 million of operating expenditure to report more simply than those schools whose operating expenditure is more than \$2 million. In general, we support public entities reporting in keeping with the standards relevant to their tier of reporting.

- 8.14 We understand that the Ministry is considering whether to allow schools with operating expenditure of less than \$2 million to use simple format accrual reporting (tier 3), or whether to require all schools to use reduced disclosure reporting (tier 2), to maintain consistency of schools' reporting. In line with this, the Ministry is considering making its "Kiwi Park" model financial statements mandatory for all schools from 2015.
- 8.15 We will work with the Ministry about matters affecting schools' transition to the new financial reporting standards that are to be used in preparing their financial statements for 2015.



# Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- New Zealand Customs Service: Managing Trade Assurance capability risks
- Draft annual plan 2014/15
- Central government: Results of the 2012/13 audits (Volume 2)
- Additional work on Solid Energy New Zealand Limited
- Inquiry into property investments by Delta Utility Services Limited at Luggate and Jacks Point
- The Auditor-General's Auditing Standards 2014
- The Treasury: Learning from managing the Crown Retail Deposit Guarantee Scheme
- Department of Internal Affairs and grants administration
- Maintaining a future focus in governing Crown-owned companies
- Delivering scheduled services to patients
- Continuing to improve how you report on your TEI's service performance
- Central government: Results of the 2012/13 audits (Volume 1)
- Department of Corrections: Managing offenders to reduce reoffending
- Public entities in the social sector: Our audit work
- Immigration New Zealand: Supporting new migrants to settle and work
- Summary: Inquiry into the Mangawhai community wastewater scheme
- Inquiry into the Mangawhai community wastewater scheme
- Regional services planning in the health sector
- Effectiveness and efficiency of arrangements to repair pipes and roads in Christchurch

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