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Inquiry into
management
fees paid by
South Auckland
Middle School
and Middle
School West
Auckland in 2018



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Auditor-General's overview

E ngā mana, e ngā reo, e ngā karangarangatanga maha o te motu, tēnā koutou.

This report outlines my views about \$450,000 in management fees the Combined Establishment Board of South Auckland Middle School and Middle School West Auckland paid to Villa Education Trust in 2018.

South Auckland Middle School and Middle School West Auckland are designated character schools that previously (as separate legal entities) operated as charter schools. After the Government decided to discontinue the charter schools' policy in 2017, both schools were disestablished as charter schools and established as designated character schools, which are part of the state school system.

The Minister of Education appointed the Combined Establishment Board for South Auckland Middle School and Middle School West Auckland (the Establishment Board) to govern the new state schools. The trustees of the Establishment Board were also the trustees of Villa Education Trust, which was the sponsor for the charter schools. This meant that the trustees were effectively wearing two hats.

The Establishment Board and Villa Education Trust received money from the Ministry of Education (the Ministry) for different purposes. Villa Education Trust was funded \$291,000 to terminate the charter schools, while the Establishment Board was funded \$1.74 million to prepare the new designated character schools for opening as state schools. The Establishment Board paid Villa Education Trust \$450,000 in management fees for the administration and management services required for the schools to open as designated character schools.

I was initially interested in the \$450,000 management fees because my Appointed Auditor was unable to obtain sufficient, appropriate audit evidence to determine how much of the payment was valid expenditure. The auditor also noted the shared membership of the Establishment Board and Villa Education Trust and that the amounts charged were significantly higher than normally seen in other schools under similar circumstances.

My Office carried out further inquiries, including interviewing trustees of the Establishment Board involved in the decision to engage Villa Education Trust. We found that the Establishment Board had valid reasons to engage Villa Education Trust but that they did not follow good procurement practices. In summary:

- There was no formal agreement between the Establishment Board and Villa Education Trust, and no scope of work before the \$450,000 was invoiced and approved for payment.
- We did not see any evidence showing how the Establishment Board determined the nature of the services to be performed (that is what it was

paying for), assessed the appropriateness of the fees, or actively managed the services that were delivered.

- There is no documentary record of who approved the expenditure as being valid or authorised the invoices for payment and whether they had the appropriate authority to do so.

As public organisations, designated character schools need to be able to show how and when they have spent public money. This enables the public to have confidence that the services paid for with that money have been delivered and that they were delivered for an appropriate amount. That confidence is missing in this case because the Establishment Board has been unable to demonstrate the validity and appropriateness of its payment of \$450,000 to Villa Education Trust.

We also found the members of the Establishment Board failed to recognise that a conflict of interest arose when they effectively decided to pay money to themselves, and this meant they took no steps to manage the conflict. The shared membership of the Establishment Board and Villa Education Trust was a potential conflict of interest that crystallised into an actual conflict of interest when the Establishment Board considered engaging Villa Education Trust. In a situation like this, we expect a public organisation to recognise the conflict and put a process in place to manage it.

Where a decision is made that results in payments being made to the decision-makers (even if they are acting in a different legal capacity), there is an obvious risk that it could be seen as a personal benefit. If this risk is not carefully managed, it could call into question the integrity of the decision and the purpose for paying the money in that way. As a result, the Establishment Board cannot assure the public that the decision to engage Villa Education Trust and the amount of the management fees were not influenced by the personal interests of trustees of the Establishment Board.

I encourage all public organisations to familiarise themselves with our good practice guide *Managing conflicts of interest: a guide for the public sector*. This provides guidance on identifying and managing conflicts of interest, so the public can have confidence that people making decisions and spending public money are doing so in the public interest.

The Establishment Board told us it did not think there was a conflict of interest because the Minister of Education knew that the trustees of the Establishment Board were also trustees of Villa Education Trust when he appointed them. The Establishment Board also said the Ministry knew the Establishment Board had engaged Villa Education Trust to provide the establishment services and did not raise concerns. Although we suggest the Ministry might consider additional steps to support schools to use establishment funding appropriately, we do not accept that

the Minister or the Ministry's involvement here absolved the Establishment Board of its responsibility to identify and appropriately manage conflicts of interest.

There is no evidence that the Minister or the Ministry were involved in the Establishment Board's decision to engage Villa Education Trust or that they were aware of (let alone approved) the full arrangement between the Establishment Board and Villa Education Trust. The Establishment Board was responsible for managing conflicts of interest, not the Minister or the Ministry.

Further comment

Throughout our work and from the time of the school's annual audit for the year ended 31 December 2018, there appears to have been a lack of appreciation by the Establishment Board of the position it was in when it became a state school, or of the expectation when spending public money to properly account for that money. As it is now governor of two state schools, the Establishment Board is – like any public organisation – accountable to the public and Parliament for how it has spent the public money entrusted to it.

The Establishment Board has not been able to provide us with sufficient assurance about the circumstances in which the fee was determined and paid, and about what exactly has been provided in exchange. I expect more from a public organisation spending public money. It is the responsibility of those governors and managers making decisions to be able and prepared to account for what has happened. The circumstances of this payment create a perception of a lack of integrity. Acting with integrity and being seen to act with integrity are fundamental to maintaining the public's trust and confidence in public organisations and in the public sector as a whole.

Information about how the fees were determined, agreed, paid, and managed, and what was received for the payment, should be available to our auditor when asked for in the first instance. That information is part of orthodox procurement and contract management and should be properly documented. If that information was prepared and made available, it might not have been necessary for us to carry out all the work involved in this case to find out the circumstances of a payment like this.

Nāku noa, nā



John Ryan
Controller and Auditor-General

18 November 2021

1

Introduction

Background

- 1.1 Charter schools (also known as partnership schools/kura hourua) were an alternative to state schools under part 12A of the Education Act 1989. “Sponsors” such as iwi, not-for-profit organisations, businesses, or existing education providers operated charter schools.
- 1.2 Charter schools received public funding as well as private donations but had similar freedoms to private schools (such as setting the curriculum, the length of the school year, and teachers’ pay).
- 1.3 As a result of a policy change in November 2017, the Government:
 - repealed the charter school provisions in the Education Act 1989 (from 24 October 2018), meaning that no new charter schools could be established; and
 - began a process of disestablishing current charter schools through negotiations with the sponsors of those schools.
- 1.4 Sponsors of charter schools that were to be disestablished could apply to open new designated character schools, which could operate under the same name as the charter schools. Designated character schools are described on the Ministry of Education (the Ministry’s) website as “state schools that teach the New Zealand Curriculum ... but have developed their own set of aims, purposes and objectives to reflect their own particular values”.¹
- 1.5 South Auckland Middle School and Middle School West Auckland were two charter schools affected by the policy change. Villa Education Trust was the sponsor for these two schools.
- 1.6 The Minister of Education established South Auckland Middle School and Middle School West Auckland as new state schools, after applications by Villa Education Trust. The Minister of Education also appointed a Combined Establishment Board of Trustees for South Auckland Middle School and Middle School West Auckland (the Establishment Board)² to establish the new schools. The Establishment Board had the same trustees as Villa Education Trust.
- 1.7 In early September 2018, the Establishment Board held its first meeting and agreed to contract Villa Education Trust to perform all aspects of the administration and management services required for the schools to open

1 See parents.education.govt.nz for descriptions of different types of primary, intermediate, and secondary schools.

2 Members of the Establishment Board were appointed on 28 August 2018. In June 2020, the Minister of Education approved an alternative constitution for the Combined Board of Trustees of South Auckland Middle School and Middle School West Auckland (New Zealand Gazette (2020), *Alternative Constitution for the Combined Board of Trustees of South Auckland Middle School (876) and Middle School West Auckland (877)*). The membership of the Board has changed, but it remains a Combined Board. We use the term “current Combined Board” to refer to the current Combined Board of Trustees of South Auckland Middle School and Middle School West Auckland.

as designated character schools (in this report we refer to these as the “establishment services”). We discuss the work required to set up the schools later in this report.

1.8 Shortly after that meeting, the Establishment Board paid Villa Education Trust \$450,000 for the establishment services.³

1.9 Appendix 1 shows the flow of funding between those involved.

Why we were interested in this matter

1.10 Under section 14 of the Public Audit Act 2001, the Auditor-General is the auditor of all public entities. This includes school boards (including the boards of designated character schools), which are classified as Crown Entities under the Crown Entities Act 2004.⁴

1.11 Our work helps maintain the public’s trust and confidence in the public sector by providing independent assurance that public entities are operating, and accounting for their performance, in keeping with Parliament’s intentions.

1.12 South Auckland Middle School and Middle School West Auckland were established as designated character schools in August 2018, but they were not fully operational until 2019. The first financial period that the Establishment Board was in existence for was 29 August to 31 December 2018.

1.13 During the audit of the financial statements for that period, our Appointed Auditor could not obtain sufficient, appropriate audit evidence for the management fees paid to Villa Education Trust. Because of this, they were unable to determine how much of the management fees were valid expenditure.

1.14 Accordingly, in August 2020, our Appointed Auditor issued a qualified audit opinion for the financial statements for the period ended 31 December 2018.⁵ Our Appointed Auditor also noted the shared membership of the Establishment Board and Villa Education Trust.

1.15 We sought further information from the current Combined Board of Trustees for South Auckland Middle School and Middle School West Auckland after the audit had been completed and the audit opinion issued. However, the information the current Combined Board provided did not satisfactorily answer our questions.

3 We refer to a payment of \$450,000 because our report focuses on matters arising in the 2018 audit year and management fees of \$450,000 were invoiced for that year. In fact, in the accounts for 2018, the Establishment Board recorded that it paid Villa Education Trust \$467,391 in management fees in 2018. However, we understand that \$17,391 of that amount was pre-paid for services delivered in 2019.

4 Section 7(1)(d) of the Crown Entities Act 2004.

5 The 2018 audit report was delayed partly because of the process that needed to be followed before the auditor could issue a qualified audit opinion for the 2018 management fees.

- 1.16 We also referred the matter to the Ministry, as the agency that had provided the establishment funding to the Establishment Board. We specifically asked the Ministry to:
- carry out further inquiries relating to the expenditure, to ascertain its validity and appropriateness;
 - assess how the Establishment Board had managed any conflicts of interest;
 - consider whether it should seek to recover any public money that had not been spent appropriately; and
 - report back to the Auditor-General on the outcome of its review.
- 1.17 The Secretary for Education wrote back to the Auditor-General in February 2021. The Ministry told us that there was:
- ... no reason to question whether the [Establishment Board] and [Villa Education Trust] have acted in good faith and on a basis they deemed appropriate.*
- 1.18 However, the Ministry concluded that:
- ... there are insufficient records relating to the management fee paid by [the Establishment Board] to [Villa Education Trust]. [The Ministry has] not been provided records which clearly and accurately document the decision-making process of [the Establishment Board] with respect to agreeing the management fees or how they mitigated conflicts of interest.*
- 1.19 The Ministry told us that it would continue to offer advice and guidance to the current Combined Board around the internal control challenges that the audit work highlighted but it was not able to do anything more about this matter.
- 1.20 Because of the limited information the schools provided to our auditor and the Ministry, we were not satisfied that public money had been spent appropriately. We were also concerned about the amount of public money involved.
- 1.21 Accordingly, we decided to carry out an inquiry under section 18 of the Public Audit Act 2001.

Scope of our work

- 1.22 Our work focused on how the Establishment Board:
- identified what establishment services Villa Education Trust would carry out;
 - determined the fees that it paid to Villa Education Trust;
 - monitored the delivery of services and gained assurance that it was receiving value for money; and
 - managed potential conflicts of interest arising from the shared membership of the Establishment Board and Villa Education Trust.

- 1.23 In carrying out our work, we:
- wrote to the chair of the Establishment Board and the chair of the current Combined Board;
 - considered documentation the current Combined Board provided in response to our questions;
 - interviewed the Establishment Board members involved in the decision-making and processes for engaging Villa Education Trust, some of whom remain on the current Combined Board; and
 - talked with staff at the Ministry and others involved in the process of establishing the designated character state schools.

Structure of this report

- 1.24 In Part 2, we describe what happened when the charter schools closed and the designated character schools opened. This includes considering the roles and responsibilities for the various activities that had to be completed at each point in the process, as well as the funding streams that the Ministry provided.
- 1.25 In Part 3, we set out the principles of good procurement practice that we expect public organisations to follow and consider how well they were applied in this instance.
- 1.26 In Part 4, we focus on the potential conflicts of interest arising from the common membership of the Establishment Board and Villa Education Trust and consider whether those conflicts were managed appropriately.
- 1.27 In Part 5, we briefly discuss the role of the Ministry in this case and make some suggestions for the Ministry to consider when providing establishment funding in the future.

2

Closing the charter schools and preparing to open the new state schools

- 2.1 In this Part, we describe:
- the processes for disestablishing South Auckland Middle School and Middle School West Auckland as charter schools;
 - the termination funding that the Ministry provided for the disestablishment of the charter schools;
 - the processes to prepare the designated character state schools for opening; and
 - the funding that the Ministry provided for the purpose of establishing the designated character state schools.
- 2.2 Appendix 2 sets out a timeline of key events. Although chronologically the new designated character state schools were established before the charter schools were formally disestablished, for clarity we discuss the termination process and payments first.

Disestablishment of the charter schools

- 2.3 A formal process was followed for the disestablishment of South Auckland Middle School and Middle School West Auckland as charter schools.
- 2.4 In November 2018, termination agreements were drawn up between the Ministry and Villa Education Trust (as the sponsor of the charter schools that were to be disestablished). According to those agreements, the termination date for the charter schools was 7 December 2018.
- 2.5 The termination agreements set out in detail the activities that had to be completed as part of the closure process, and allocated responsibility for these. Examples of the termination activities included:
- arranging to sublease relevant assets (such as photocopiers) to the new schools;
 - selling other assets to the new schools;
 - transferring staff and student records to the Establishment Board's or the Ministry's systems (as directed); and
 - updating all relevant internal documents/policies as needed.
- 2.6 Villa Education Trust, as the sponsor of the charter schools, was responsible for carrying out most of the tasks. However, Villa Education Trust and the Ministry needed to work together on some activities, such as transferring the lease of property from Villa Education Trust to the Ministry.
- 2.7 The termination agreements also set out the dates the specified activities had to happen by. In most instances, the activities were expected to have been completed by 25 January 2019, although there were some exceptions where it was not practical for that date to be met.

Termination payments from the Ministry of Education

- 2.8 The termination agreements confirmed details of the payments that the Ministry would make to Villa Education Trust (as sponsor of the charter schools being disestablished). These payments were intended to cover the costs of the activities that needed to be done for the schools to be closed.
- 2.9 The termination agreements record that the termination payments would be \$119,372 for Middle School West Auckland and \$81,292 for South Auckland Middle School. The agreements also record a \$20,000 contribution to be paid to each school (to go towards meeting the costs associated with agreeing the arrangements set out in the Termination Agreement) and forgiveness of a \$50,249 debt Middle School West Auckland owed to the Ministry.⁶
- 2.10 The termination agreements required Villa Education Trust (as sponsor) to manage conflicts of interest in relation to both the termination of the charter schools and the establishment of the new designated character state schools. Villa Education Trust was required to:
- a) *actively identify and effectively manage all actual, potential or perceived conflicts of interest that may exist or arise in relation to anything connected with the termination of the Existing Agreement and/or the establishment of, or preparation for the opening and operating of, the [new designated character schools]; and*
 - b) *upon request by the Ministry, demonstrate that all material conflicts of interest have been (or will be promptly) identified and effectively managed to ensure independence, fairness, and impartiality, especially when a Related Person is involved with that process.*⁷

Establishment of the designated character state schools

The approval and appointment process

- 2.11 A formal process was also followed for the establishment of the new designated character state schools. This process started in May 2018, when Villa Education Trust submitted applications for both schools.
- 2.12 The applications were detailed and contained information about all aspects of the schools' operations. This included (but was not limited to):
- provision of property;

⁶ The Ministry also paid the Establishment Board \$298,452 to reimburse to Villa Education Trust. This represented 75% of manager and staff salaries until 31 December 2018.

⁷ Related person was defined as a "company, entity or other organisation (including a trust) or person with a close association with the Sponsor or a person who controls or makes decisions for the Sponsor (whether that association is through ownership, control or other influence)".

- governance and management of the schools;
- physical and emotional safety plans and procedures; and
- financial management plans and budgets.

2.13 In the applications, Villa Education Trust requested that existing Villa Education Trust members be appointed to the Board of the new state schools.

2.14 The Minister of Education initially deferred his decision on the applications and asked the Ministry to appoint an independent evaluator to obtain further information about whether the schools' curriculum met the requirements for a designated character state school. After considering the report from the independent curriculum evaluator, the Minister of Education approved the establishment of both schools as designated character state schools on 28 August 2018.

2.15 On the same day, the Minister appointed the existing trustees of Villa Education Trust as trustees of the Establishment Board, as had been requested in the applications. The Minister noted the importance of keeping the two roles separate in his letters appointing the trustees:

I am aware that you are currently a member of Villa Education Trust that provides governance to the two charter schools, South Auckland Middle School and Middle School West Auckland. It is important that the roles, functions, and responsibilities of [Villa Education Trust] and the [Establishment Board] remain separate. The governance facilitator will be able to support you with this.

2.16 We understand the Ministry appointed the governance facilitator referred to in the appointment letters on 10 September 2018, as a link between the Ministry and the Establishment Board. The governance facilitator's role was described to us as being to:

... assist [the Establishment Board] with understanding duties, becoming operational as a state school, refining the vision for the schools if required, developing policies and procedures and adapting things, and supporting the [Establishment Board] with personnel and employment and preparing the schools for opening.

Establishment funding and payments to Villa Education Trust

2.17 Collectively, the schools received establishment funding of \$1.74 million. This was paid in multiple instalments in September 2018.

2.18 We understand that, although the funding amounts were split to reflect different types of spending (for example, furniture and equipment, and learning and

development), this split was nominal only and the new schools could use the funds on establishment activities as needed.

- 2.19 The Establishment Board held its first meeting on 6 September 2018. The minutes of that meeting include a record of the motions that were passed. The first of these motions sets out that:

Middle School West Auckland and South Auckland Middle School [Establishment Board of Trustees] will contract administration and management of the schools to Villa Education Trust to undertake all aspects of this. This includes opening of bank accounts and obtaining IRD numbers and set up the new account management file. The fee for this service is to be determined when a scope of work is established.

- 2.20 On 10 September 2018, the Establishment Board received the first tranche of establishment funding for the two new state schools from the Ministry. This was \$420,503 for Middle School West Auckland and \$363,791 for South Auckland Middle School.

- 2.21 The next day, on 11 September 2018, the Establishment Board received two invoices from Villa Education Trust, one for \$250,000 for Middle School West Auckland and one for \$200,000 for South Auckland Middle School. Both invoices contained the description “management fee” for 2018 “set up” and were paid in full (\$450,000) on the same day.

3

Good procurement practices were not followed

- 3.1 In this Part, we discuss how well the Establishment Board managed the procurement process when it decided to engage Villa Education Trust to deliver the establishment services and how much to pay for those services.
- 3.2 In particular, we consider whether the Establishment Board:
- had valid reasons for engaging Villa Education Trust to deliver the establishment services; and
 - met the principles of good procurement practice that we expect to see from a public organisation.
- 3.3 We consider conflicts of interest in Part 4.

There were valid reasons to engage Villa Education Trust to provide the establishment services

- 3.4 The Establishment Board told us that it engaged Villa Education Trust to deliver the establishment services because no other party had the background knowledge and understanding needed to set up the new schools effectively. The Establishment Board also told us that a significant amount of work was needed before the schools could open for Term 1 in 2019. We agree that it was reasonable for the Establishment Board to determine that Villa Education Trust was the appropriate provider of the establishment services.

Previous experience

- 3.5 The Establishment Board told us that no-one else could have provided comparable services to assist it in setting up the new designated character state schools. This was because Villa Education Trust had been the sponsor of the previous charter schools and so had an in-depth knowledge and understanding of the schools, as well as the staff, students, families, and communities.
- 3.6 In addition, the integrated and project-based curriculum that Villa Education Trust had developed and owned was a significant factor in South Auckland Middle School and Middle School West Auckland's applications for establishment as designated character state schools.

Amount of work involved

- 3.7 The Establishment Board also told us that a lot of work was needed in a short time for the schools to be ready to open for Term 1 of 2019. For South Auckland Middle School and Middle School West Auckland, there was a condensed time frame and all the Establishment Board members we spoke to commented on the amount of work involved.

- 3.8 When operating as charter schools, South Auckland Middle School and Middle School West Auckland were not part of the state school system and as a result enjoyed more autonomy than state schools. They could set their own curriculum, and they had more freedom over the employment and remuneration of teachers. The operating framework for state schools is more fixed, which meant that before they could open as designated character state schools, South Auckland Middle School and Middle School West Auckland needed to make significant changes to their administrative arrangements and curriculum.
- 3.9 In addition, many charter schools, including South Auckland Middle School and Middle School West Auckland, employed chief executives who were responsible for the day-to-day running of the schools. This meant that the principals could focus on the educational aspects of the school. The new designated character schools would not have a chief executive to carry out the tasks that needed to be done before the schools opened.
- 3.10 Section 125 of the Education and Training Act 2020 confirms that a Board is the governing body of its school/kura. The Ministry of Education also produces a Financial Information for Schools Handbook, which provides guidance for school principals and Boards of Trustees across a range of financial management matters, including strategic planning, budget setting, conflicts of interest, and internal controls.⁸
- 3.11 The Financial Information for Schools Handbook sets out the roles and responsibilities of school boards, which include:
- being responsible for setting the strategic direction of the school;
 - allocating resources to achieve goals;
 - making and documenting significant financial decisions about the school; and
 - declaring and managing potential conflicts of interest in decision-making.
- 3.12 However, being a member of a school board is not typically a full-time position of employment, and it is reasonable for school boards to procure additional capacity and expertise, where appropriate.
- 3.13 We spoke to the governance facilitator engaged to support the Establishment Board during this time. He confirmed that a lot of work was needed and considered that no-one else other than Villa Education Trust could have done the necessary work. He recalled frequent meetings with Ministry staff at the time, and his view was that it was a new and challenging environment for all involved.

⁸ All references to the Financial Information for Schools Handbook in this report are to the March 2018 version, which is the version that applied to the circumstances here. However, similar guidance appears in the 2021 version of the Financial Information for Schools Handbook, which is available on the Ministry's website: [education.govt.nz](https://www.education.govt.nz).

The Establishment Board's procurement practices

Context to the procurement

- 3.14 When South Auckland Middle School and Middle School West Auckland were approved as designated character schools on 28 August 2018, they became part of the state school system. This also meant that the Establishment Board was a public organisation because school boards are Crown Entities as defined in the Crown Entities Act 2004.
- 3.15 As set out in the Financial Information for Schools Handbook, money received by school boards, whatever the source, automatically becomes public funds and boards are accountable for all expenditure. All public organisations are expected to make spending decisions transparently. This means that they should be open about the spending, and willing and able to explain spending decisions. The Financial Information for Schools Handbook advises school trustees that they make "significant financial decisions" and should "carefully document those decisions and their decision-making processes".
- 3.16 The Establishment Board also needed to apply good procurement practices. For example, this should include (but is not limited to):
- a clear determination of the agreed scope of work and expected cost before work begins and payment is made;
 - establishing appropriate delegations and approval processes; and
 - a clear understanding of how delivery of services will be monitored and who by.

Determining the scope of work and fees that would be paid

- 3.17 There are a range of factors that organisations might consider when making spending decisions. These include whether they can get the same level of service from a different provider for less cost and the potential risks of engaging particular providers.
- 3.18 An organisation that can show what factors it considered when making spending decisions is better placed to demonstrate how it assessed the value of services provided by a particular provider.
- 3.19 Organisations will usually have written records (such as minutes of meetings, workshops, or tender evaluation sessions where the decisions were made) that show the decision-making process they followed when selecting a supplier and agreeing the final price. The conclusion of the decision-making process and the final selection of a particular supplier is usually evidenced by a signed contract or other agreement that is finalised before the work begins.

- 3.20 We were especially interested in the decision-making process here because the fees appeared high compared to those paid by other schools in the state school system in similar circumstances. We did not see any evidence that showed how the Establishment Board determined the nature of the services to be performed or assessed the appropriateness of the fees that were charged.
- 3.21 There was no formal agreement between the Establishment Board and Villa Education Trust before the \$450,000 was invoiced and approved for payment.⁹ There was no scope of work, nor did we see any evidence that the expected costs of the establishment services were discussed or agreed. This is despite a resolution requiring those things being passed and recorded in the minutes of the 6 September 2018 meeting.
- 3.22 It is also not clear how the management fees were determined. Before our interviews with members of the Establishment Board, we were provided with some high-level workings (which were undated) that included details of:
- who worked on the establishment activities;
 - high-level descriptions of the establishment activities;
 - approximate number of hours worked (4090 hours); and
 - an hourly rate of pay (\$110 per hour).
- 3.23 We had some questions about the document and how the details in it had been established. For example, we wanted to know why a single hourly rate had been used, rather than different rates to reflect the different levels of experience and expertise of the individuals who contributed to the establishment services. We also wanted to understand how the hourly totals had been calculated.
- 3.24 Shortly before our interviews with Establishment Board members, we were provided another document (which was also undated). This was broadly similar to the first one, but it included some additional detail about the nature of the tasks that had been performed. Some of the information in the more detailed document conflicted with the original document we had been provided. In the second document:
- the total number of hours was 4130 hours¹⁰ (compared to 4090 hours in the original); and
 - the hourly rate was \$108 per hour (compared to \$110 per hour in the original).
- 3.25 During our interviews with members of the Establishment Board, we were told that the total fees had been determined on a global basis, and the hourly rate and

⁹ A services agreement between the Board and Villa Education Trust has been in force since 1 January 2020, but it did not exist during the relevant period.

¹⁰ The total number of hours recorded also did not align with the workings in the document, and the hourly rate and total hours did not agree with the amount charged.

hours had been calculated afterwards. When we asked why the hourly rate had changed between the two documents, the answer was that “there were more hours allocated here”. Put another way, the hourly rate changed because the way it was calculated was based on the total fees (\$250,000 and \$200,000) divided by the estimated hours worked, so that the hourly rate was “for want of a better word ‘a balancing figure’”.

- 3.26 Use of a global figure would not be concerning in itself, but the Establishment Board was unable to provide us with any documentary evidence from the time that recorded how the fees had been calculated. We were told that the governance facilitator appointed by the Ministry advised the Establishment Board that the fees were acceptable provided they were at a market rate. However, it appears the Establishment Board did not receive this advice until after it had paid the \$450,000 management fees to Villa Education Trust. The governance facilitator told us that although he was officially appointed from 10 September 2018, his first discussion with the Establishment Board as governance facilitator did not occur until 18 September 2018 (after the Establishment Board paid Villa Education Trust the management fees on 11 September 2018). The Establishment Board was unable to provide any evidence showing that it had considered market comparisons before it paid the management fees.
- 3.27 During interviews it was confirmed that the breakdown of hours worked was not prepared when the invoices were created and paid in September 2018. Instead, the breakdown was prepared during the audit of the financial statements for the period ended 31 December 2018, in response to questions from our auditor.
- 3.28 The lack of a pre-agreed (and recorded) scope of works and payment terms is particularly concerning because the management fees were paid in advance and covered services to be delivered over an extended period. All the Establishment Board members that we interviewed told us that some of the establishment services had been delivered after the new schools opened. Indeed, most told us that some establishment activities were still ongoing when we conducted our interviews in April 2021, more than two years after the new schools opened.
- 3.29 Without a scope of works or any other documents from the time, it is not clear that the Establishment Board understood exactly what it was paying for when it paid the management fees.
- 3.30 Clearly documenting the contractual terms was particularly important in these circumstances because the individuals entering into the arrangement were essentially agreeing to pay themselves, given the trustees of the Establishment Board were also trustees of Villa Education Trust. We discuss the implications of the conflicts of interest in Part 4.

Establishing appropriate delegations and approval processes

- 3.31 We expect all public organisations to have clear processes for approving spending and authorising payment. We also expect these processes to be well understood throughout the organisation, especially when spending is approved under a delegated authority.¹¹
- 3.32 This expectation is also set out in legislation. Section 152 of the Education and Training Act 2020 (previously clause 25 of Schedule 6 of the Education Act 1989) requires school boards to perform their functions and exercise their powers in a way that is financially responsible.
- 3.33 The Ministry's Financial Information for Schools Handbook also sets out the importance of a school having strong internal controls. It lists the key internal controls that all schools should implement. These include:
- having segregation of duties – which means that no one person should have control of ordering goods, approving expenditure, and authorising payments; and
 - ensuring that all expenditure is verified, approved, and authorised before it is paid, and that authorisation is in line with delegation policies.
- 3.34 Clearly recording who has approved spending and authorised payment can help public organisations demonstrate that they have appropriate controls. In turn, this helps to build public trust and confidence in the financial information that those organisations produce.
- 3.35 Because there was no pre-agreed scope of work or documentation from the time to show how the fees had been calculated, and the full amount was paid before the work was done, we wanted to understand how the Establishment Board got assurance that the fees represented good value for public money. We were particularly concerned because the same people were on both sides of the transaction.
- 3.36 We wanted to understand the process for approving spending and authorising invoices for payment if they needed to be paid before the next meeting of the Establishment Board, as happened in this instance. We asked the members of the Establishment Board about processes for approving spending and how these invoices were authorised for payment.
- 3.37 There is no documentary record of who authorised the invoices for payment and, when interviewed, Establishment Board members could not recall specifically who had authorised the invoices for payment:
- One Establishment Board member suggested that the chair of the Establishment Board might have authorised the payment.

11 By this, we mean that one or more members has been delegated authority to approve the spending (up to relevant financial limit(s)), rather than the whole governing body being required to approve the spending.

- The chair of the Establishment Board said that the Board member who was also the chief executive of Villa Education Trust would have authorised the payment.
- Another Establishment Board member said that a sub-committee of the Establishment Board responsible for approving spending (which included the chair and the Board member who was also the chief executive of Villa Education Trust) would have authorised the payment.

3.38 In our view, \$200,000 and \$250,000 represent significant spending for a public organisation such as this and it is unacceptable that there is no record showing unequivocally:

- who approved the spending as being valid;
- who authorised the invoices for payment; and
- whether they had the appropriate authority to do so.

Determining how the delivery of services will be monitored

3.39 Good procurement practice does not stop when a contract or agreement is signed. It continues while the work is carried out.

3.40 We expect public organisations to be able to clearly demonstrate value for public spending. Organisations can do this by having:

- appropriate systems to monitor what the supplier has delivered under the agreement; and
- agreed actions that will be taken if delivery does not meet expectations.

3.41 We were particularly interested in how the Establishment Board monitored the work that was being carried out, because the full amount of the management fees were invoiced and paid before the establishment services were delivered. That is, they were not paid in instalments based on progress or the proportion of work that had been carried out or paid in full after all work had been completed.

3.42 We were told that the Establishment Board received regular updates at meetings about how the various tasks were progressing, but that a lot of these updates were verbal. We have not seen any minutes recording the updates to the Establishment Board, and the Establishment Board members acknowledged during interviews that they “could have been better with the documentation”.

3.43 It also appears most of the updates were provided by a member of the Establishment Board who was also the chief executive of Villa Education Trust and had been involved in many aspects of the establishment services that were delivered.

- 3.44 It does not seem to us that this Board member could provide independent oversight over Villa Education Trust's delivery of services to the Establishment Board. We further discuss how conflicts of interests were handled in Part 4.

Overall comment

- 3.45 Public organisations should be able to clearly explain their spending decisions and support those explanations with appropriate evidence. Not only is this good procurement and cost management practice but it also supports the public's trust and confidence that public money is being spent well.
- 3.46 In this case, as we have outlined, there are several aspects where the Establishment Board has not met the expectations of good practice. In general, there is no reliable evidence from the time about how the Establishment Board calculated the fees, developed a scope of work to outline what would be provided for the fees, approved the payments, or actively managed the services that were delivered.
- 3.47 It is especially concerning to us that members of the Establishment Board, who were collectively responsible for the governance of the new state schools, were unable to identify a standard practice for approving spending.
- 3.48 Being able to show how and when you have spent public money means that the public and other stakeholders (such as the Ministry in this case) can have confidence that the services that have been paid for have been delivered and priced appropriately. That confidence is missing in this case.

4

Conflicts of interest were not appropriately managed

4.1 In this Part, we discuss:

- the importance of managing conflicts of interest;
- the conflicts of interest that arose;
- whether the Establishment Board managed those conflicts appropriately; and
- the consequence of not managing conflicts of interest.

It is important to manage conflicts of interest well

4.2 As well as being interested in how well the procurement was managed generally, we wanted to know how conflicts of interest were managed, because of the close relationship between the Establishment Board and Villa Education Trust.

4.3 As we say in our good practice guide about managing conflicts of interest,¹² having a conflict of interest does not necessarily mean you have done anything wrong. What is important is recognising that there is a conflict of interest and then putting in place appropriate mitigations.

4.4 Conflicts can arise in many situations. Some are serious, some are less so, and some are unavoidable. However, in any situation where activities are carried out in the public interest or paid for out of public funds, the public needs to be confident that decisions are:

- made impartially and for the right reasons; and
- not influenced by personal interests or ulterior motives.

4.5 Where transactions involve related parties, there is an increased risk those transactions might be perceived as unusual or inappropriate, because of the possibility they might be seen as benefiting an individual or a private organisation.

4.6 This increased risk makes it even more important to appropriately record decision-making processes and conflict of interest mitigations at the time to demonstrate awareness of the potential risks.

4.7 The Ministry's Financial Information for Schools Handbook identifies the types of situations that might give rise to conflicts of interest in a school context. Some examples include where:

- the school contracts the spouse of a Board of Trustees member; or
- a Board of Trustees member owns a company that is contracted by the school.

Conflicts of interest crystallised when the Establishment Board considered engaging Villa Education Trust

- 4.8 In this case, the Minister’s decision to appoint the members of Villa Education Trust as trustees of the Establishment Board resulted in a potential conflict between the interests of Villa Education Trust and the Establishment Board (because the trustees were effectively wearing two hats).
- 4.9 That potential conflict of interest crystallised into an actual conflict of interest that needed to be carefully managed when the Establishment Board considered engaging Villa Education Trust to deliver the establishment services.
- 4.10 Examples of the conflicting interests some members of the Establishment Board needed to manage during and after the decision to engage Villa Education Trust include:
- being a Villa Education Trust employee and performing termination activities while also being engaged by the Establishment Board to perform establishment activities;
 - invoicing the Establishment Board (as a Villa Education Trust employee);
 - approving invoices as an Establishment Board member for payment to Villa Education Trust (and as a Villa Education Trust employee delivering the services the invoices related to);
 - monitoring and reporting on the work being delivered (as an Establishment Board member); and
 - receiving payment for the work (as a Villa Education Trust employee).
- 4.11 The Establishment Board told us there was no conflict of interest because the Minister appointed the trustees to the Establishment Board knowing that they were also trustees of Villa Education Trust.
- 4.12 We disagree with the Establishment Board’s position, which we discuss further in Part 5. In brief, the potential conflict of interest did not become an actual conflict of interest until the Establishment Board considered engaging Villa Education Trust. The Minister was not involved in that decision. The Minister also put the Establishment Board on notice, in the letters appointing each member of the Establishment Board, that “[i]t is important that the roles, functions, and responsibilities of Villa Education Trust and the [Establishment Board] remain separate”.

Conflicts of interest were not managed appropriately

- 4.13 We asked Establishment Board members how they maintained separation between the performance of their different roles, as the letters of appointment and good practice required them to do. All those we spoke to repeated their view that there were no conflicts of interest. As a result, they could not point to any specific steps taken to mitigate or manage the conflicts.
- 4.14 In a situation like this, we expect a public organisation to recognise that there is a conflict that needs to be managed and put in place a process to do that. Where a decision is made that results in payments being made to the decision-makers (even if they are acting in a different legal capacity), there is the risk that it could be seen as a personal benefit. If this risk is not carefully managed, it could call into question the integrity of that decision and the purpose for paying the money in that way.
- 4.15 Options for managing a situation such as this could include:
- agreeing a scope of works so that there are clear expectations about what services will be provided and when;
 - agreeing and recording the basis for the fees in advance;
 - clearly documenting the respective roles and responsibilities of those involved in receiving, evaluating, approving, and paying invoices;
 - having a clear process for receiving, evaluating, approving, and paying invoices and documenting that process so those involved in the process understand it; and
 - ensuring that someone who is not involved in performing the work (and, specifically, not the person who provides the invoice for payment) is responsible for approving the invoice or having a clear explanation of why this is not possible.

Consequence of the Establishment Board's failure to manage conflicts of interest

- 4.16 Because the Establishment Board took no steps to manage the conflicts of interest, it is unable to assure the public that the decision to engage Villa Education Trust and the amount of the management fees were not influenced by the personal interests of Establishment Board members.
- 4.17 There is also a risk that the Establishment Board could have paid Villa Education Trust (using establishment funding) for termination activities that Villa Education Trust was separately funded for by termination funding.

- 4.18 We asked the Establishment Board members how they differentiated between termination and establishment activities. We were told that the main way was through updates provided at Board meetings. For example, we were told that Villa Education Trust members were updated about the progress of termination activities at Villa Education Trust meetings and that updates on establishment activities were given at meetings of the Establishment Board.
- 4.19 However, we understand that the distinction between the two Boards might have become blurred on occasions. In particular, when the Establishment Board was first established, meetings for both the Establishment Board and Villa Education Trust Board were held on the same day and the original meeting minutes for the 6 September 2018 meeting where the decision to engage Villa Education Trust was made included items of business relating to Villa Education Trust.
- 4.20 The Board told us that practice changed after 6 September 2018, and the 6 September 2018 minutes were amended to remove references to Villa Education Trust business. However, the merging of Establishment Board and Villa Education Trust business in the original minutes illustrates the challenges when the same people are acting in multiple roles and why it is so important to have appropriate processes and controls to maintain a clear separation of responsibilities and accountability.
- 4.21 During interviews, some Establishment Board members told us that Ministry representatives and the governance facilitator advised them about the importance of keeping the two roles separate and making sure that there was a clear break between the two meetings.
- 4.22 We understand that, after the approval of an alternative constitution, parent and staff representatives now sit on the current Combined Board, along with the principal of each school, three trustees appointed by Villa Education Trust, and up to two co-opted members. These changes have reduced, but not eliminated, the risk that roles cross over or become confused.

5

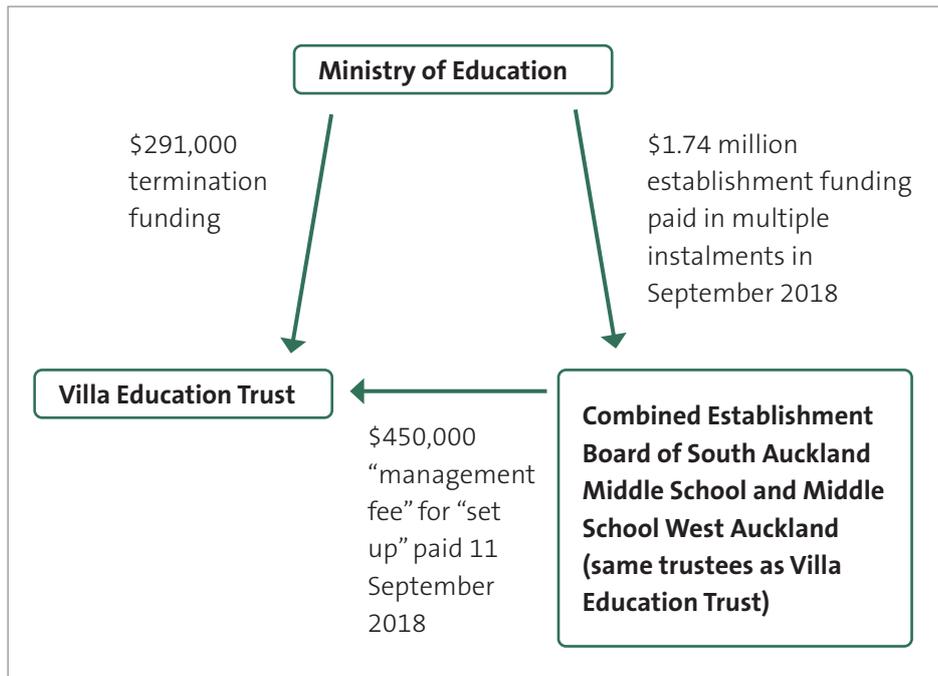
The Ministry of Education's role

- 5.1 The Establishment Board told us that there was no conflict of interest because the Minister appointed the trustees to the Establishment Board knowing that they were also trustees of Villa Education Trust. The Establishment Board also said the Ministry knew the Establishment Board had engaged Villa Education Trust to provide establishment services and never raised any concerns.
- 5.2 We do not accept that the Minister or the Ministry's roles absolved the Establishment Board of its responsibility to identify and manage conflicts of interest:
- As discussed, although the Minister's decision to appoint the trustees of Villa Education Trust as trustees of the Establishment Board resulted in a potential conflict of interest, that conflict did not crystallise until the Establishment Board considering engaging Villa Education Trust to provide establishment services. There is no evidence that either the Minister or the Ministry was involved in that decision.
 - When the Minister appointed the trustees to the Establishment Board, he specifically recorded that it was important that the roles, function, and responsibilities of the Establishment Board and Villa Education Trust remain separate. This should have alerted the Establishment Board to the possibility of a conflict of interest.
 - There is no evidence the Minister or the Ministry were aware of (let alone approved) the full arrangement between the Establishment Board and Villa Education Trust, which included that the Establishment Board would pay \$450,000 in advance without a scope of works or agreed basis for the fees. Regardless, the Establishment Board was responsible for managing conflicts of interest, not the Minister or the Ministry.
- 5.3 Although our report has focused on the actions of the Establishment Board, the Ministry might consider additional steps to support the appropriate use of establishment funding in the future. The Ministry appointed a governance facilitator to help the schools with establishment (which included help with managing conflicts of interest). However, the governance facilitator was only appointed on 10 September 2018 (the same day the Establishment Board received the first tranche of establishment funding from the Ministry). The governance facilitator did not meet with the Establishment Board until after the Establishment Board had paid the \$450,000 management fees to Villa Education Trust.

- 5.4 The Ministry told us that:
- it was unable to properly assess whether the \$450,000 management fees paid to Villa Education Trust was appropriate spending;
 - as self-governing entities, school boards “have full control over how they elect to spend the funding the Ministry provides”;
 - it had no ability to recover the management fees if they had been an inappropriate use of public money; and
 - there was nothing more it could do on the matter.
- 5.5 Additional steps the Ministry could consider when providing establishment funding in the future include:
- ensuring that the new state school is supported by a governance facilitator before providing establishment funding; and/or
 - considering some form of mechanism or guidance, so schools understand how they can spend the funding and the Ministry can effectively understand whether the school has used the money as intended and how it has managed any conflicts of interest.
- 5.6 We particularly encourage the Ministry to consider additional steps to support schools when (as was the case here) the Ministry is aware that the new school board is used to operating as a private body and needs to manage a significant potential conflict of interest.

Appendix 1

Flow of funds



Appendix 2

Timeline of key events

Date	Event
November 2017	The Government indicated that no new charter schools would be opened and that it would assess options for those already operating to be brought into the state school system on a case-by-case basis.
7 May 2018	Villa Education Trust submits applications to establish South Auckland Middle School and Middle School West Auckland as designated character state schools.
7 June 2018	Notice of Termination for South Auckland Middle School and Middle School West Auckland Charter Schools.
28 August 2018	The Minister of Education establishes South Auckland Middle School and Middle School West as designated character state schools. The Minister of Education appoints a Combined Establishment Board for South Auckland Middle School and Middle School West Auckland (the Establishment Board), made up of trustees from Villa Education Trust (the sponsor of the disestablished schools), plus the principal of each school (after they have been appointed).
6 September 2018	The Establishment Board agrees to contract Villa Education Trust to manage the establishment of the new designated charter state schools.
10 September 2018	The Establishment Board receives the first tranche of establishment funding for the two new schools from the Ministry (\$420,503 for Middle School West Auckland and \$363,791 for South Auckland Middle School).
11 September 2018	The Establishment Board receives invoices from Villa Education Trust for \$200,000 and \$250,000 relating to management fees for 2018 “set up”. The Establishment Board pays Villa Education Trust \$450,000 for the establishment services, as invoiced.
14 November 2018	Villa Education Trust signs termination agreements for South Auckland Middle School and Middle School West Auckland Charter Schools.
7 December 2018	Termination date.
31 December 2018	End of financial period for the Establishment Board.
Term 1 2019	Middle School West Auckland and South Auckland Middle School open as designated character state schools.
25 January 2019	Target date for most of the disengagement activities under the termination agreement.
27 August 2020	Qualified audit opinion issued for the Establishment Board for the period ended 31 December 2018, because the Appointed Auditor could not obtain sufficient, appropriate audit evidence for the management fees paid to Villa Education Trust, and so was unable to determine how much of the management fees was valid expenditure.

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