Controller and Auditor-General
Tumuaki o te Mana Arotake

B.29[12i]

Parliamentary paper

Education sector: Results of the 2011 audits

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Education sector: Results of the 2011 audits

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Education is important to every New Zealander. We all have a stake in the outcomes of our investment in education, and, unsurprisingly, many people have a view on how that education should best be offered. This makes education a contested and often controversial area of endeavour. My office has an enduring interest in assuring the New Zealand public that, in the face of regular adjustment and reprioritisation, their education investment is spent as intended and the results are reported appropriately.

This report is primarily about the assurance my office provides on public education expenditure. The annual audit of public entities in the education sector is a central tool for that assurance.

As well as annual audits, my staff carry out other audit work that builds on the information we gather from annual audits and from our contact with public entities. The section on tertiary sector subsidiaries is a good example of that work, where we aim to raise questions and add to the wider information base.

Where relevant to either the tertiary or compulsory education sector, this report also describes changes in auditing policy, standards, or other auditing requirements. Readers might also find it useful to refer to our report on the 2011/12 audit results for central government, which we expect to publish in early 2013.

I report each year to Parliament on the work of my office. My office has started publishing sector reports to better profile important aspects of government investment. We will publish more sector reports for the 2011/12 year and intend to maintain this kind of sector focus.

I will continue to maintain an ongoing and significant interest in the education sector, as my five-year focus on education for Māori demonstrates.

Lyn Provost
Controller and Auditor-General

1 December 2012

Part 1
Introduction

1.1 Successive governments have identified education and skills as central to building a strong society and economy. For 2012/13, the Government budgeted $9.6 billion for Vote Education and $2.8 billion for Vote Tertiary Education.[1] Education remains one of the largest (and steadily increasing) categories of government spending.

1.2 As a percentage of gross domestic product, New Zealand's spending on education is among the top of the Organisation for Economic Co-operation and Development (OECD) countries. However, in absolute terms, New Zealand's spending on education for each student remains below the OECD mean.[2]

1.3 New Zealand has a highly devolved education system that relies on the contribution of education providers such as schools and tertiary education institutions (TEIs) and education professionals.[3] Third-party monitoring of education providers and external reporting by education providers are important checks and balances in any devolved system.

1.4 Our Office plays an important part in this system. The primary value we add is through our annual audits, which provide independent, professional assurance of the quality of education providers' public reporting. The assurance we provide on the financial and (where applicable) the non-financial performance information tells readers whether that information, in our opinion, fairly reflects the public entities' performance. If it does fairly reflect performance, then Parliament and the public can evaluate it and it should provide confidence in decision-making (for example, on funding). Relevant parts of this report provide an overview of the results of our annual audits of education providers in 2011.

1.5 We intend our audit work to contribute to the quality of financial and (where applicable) non-financial performance reports and, consequently, to effective and efficient management and performance. We also aim to help education providers manage risk and prioritise business needs. In this report, particularly in Parts 2 and 4, we have sought to use some of the data we have gained from our audits of education providers to highlight potential risk and pose relevant questions.

1.6 In Part 2, we briefly note recent changes to the operating environment for TEIs and the Government's current tertiary education priorities. We report on the audit results for 2011, including the nature of our audit reports, the timeliness of the audits, and other focus areas, and note what we will focus on during the 2012 TEI audits. We then provide some comparative financial information on TEIs.

1 *Education and science sector, Information supporting the estimates*, 24 May 2012, pages 10 and 153.

2 OECD Publishing (2012), *Education at a Glance 2012*. Based on 2009 figures.

3 Nusche D., et al (2012), *OECD Reviews of Evaluation and Assessment in Education: New Zealand 2011*, OECD Publishing.

1.7 We have been working with public entities for some years now to lift the quality of non-financial performance reporting in the public sector. In Part 3, through a review of a small selection of TEIs' 2011 annual reports, we re-confirm important elements of a good performance framework, identify attributes specific to annual reports, and give illustrative examples from TEIs' reporting, where appropriate.

1.8 We noted in our December 2011 report, *Education sector: Results of the 2010/11 audits*, our view that many TEIs needed to better assess the business need for their subsidiaries, and their reporting about those subsidiaries. Part 4 gives the results of some initial information we have gathered, which poses questions that might assist with any such assessment and improve any related reporting.

1.9 Part 5 reports on the results of our 2011 school audits. We note non-standard audit reports and any significant matters coming out of the nearly 2500 audits. We give a summary of the process we used to appoint school auditors for 2012-14 and provide progress reports on certain matters raised in previous reports – integrated schools, principals' remuneration, and financial management in kura kaupapa Māori.

1.10 Part 6 highlights changes to financial reporting in New Zealand during the past 12 months, which include high-level changes to the financial reporting framework and proposed changes to financial reporting standards. We comment on how these changes are likely to affect public entities in the education sector.

1.11 Part 7 notes our recent and ongoing work in the education sector. We summarise our recently completed reports and other work on fraud, school governance, the financial health of schools, internal moderation of the National Certificate of Educational Achievement (NCEA), arrangements for training, registering, and appraising teachers, child obesity, and education for Māori.

Part 2
Our audits of tertiary education institutions

2.1 This Part briefly discusses the current operating environment for TEIs, sets out the results of our annual audits of TEIs for 2011, and compares selected financial information on TEIs.

2.2 The financial year for TEIs ends on 31 December, to align with the academic teaching year.

Government initiatives and the tertiary operating environment

2.3 In December 2009, the Government released its *Tertiary Education Strategy 2010–2015* (the Strategy). The Strategy states that the Government's continuing reform of the TEI sector is focused on making tertiary education more relevant and more efficient, so that it meets the needs of students, the labour market, and the economy.

2.4 The Strategy outlines the Government's priorities for the five-year period and how it will achieve them. It states that the global economic downturn and recession in New Zealand have influenced the Government's mid-term priorities for tertiary education.

2.5 The Government has been moving tertiary education funding away from "low-quality" qualifications (such as those with low completion rates or poor educational or labour market outcomes) to fund growth in "high-quality" qualifications that benefit New Zealanders and contribute to economic growth.

2.6 To achieve the short-term priorities and long-term direction, the Government wants TEIs to:

- target priority groups;
- improve system performance;
- support high-quality research that helps to drive innovation; and
- provide young New Zealanders with the skills and knowledge to actively participate in the economy and support innovation.[4]

2.7 The Government's direction is for tertiary education providers to manage costs, seek efficiency gains, ensure that the qualifications offered best meet student and employer needs, and explore additional sources of revenue. To improve the efficiency of public investment in tertiary education, the Government is seeking an increase in course and qualification completion rates. Educational performance indicators (EPIs) managed by the Tertiary Education Commission (TEC) have been implemented to contribute to this improvement effort.

4 See Part 2 of the *Tertiary Education Strategy 2010–2015* on the Ministry of Education website, www.minedu.govt.nz.

2.8 In March 2010, the Government announced that it would introduce performance-linked funding to the tertiary education system from 2011. This means that EPI results now have funding implications for the sector.

Better Public Services

2.9 The Government has set Better Public Services[5] targets to increase the educational achievement of New Zealanders. As such, there is a heightened emphasis in the tertiary sector on results (or outcomes) and targets.

2.10 Of particular relevance to tertiary education is the Better Public Services target that, by 2017, 55% of those aged 25 to 34 have a qualification of level 4 or above.[6]

Results of the tertiary education institution audits for 2011

2.11 Like many other parts of the New Zealand economy, the TEI sector continues to face challenges due to a sluggish world economy, the high New Zealand dollar, funding constraints, and increased performance expectations (as noted above). Several of the TEIs are still dealing with the effects of damage caused by the Canterbury earthquakes.

2.12 In our view, closer government involvement in appointing Institutes of Technology and Polytechnics (ITPs) councils' chairpersons and deputies, and a reduced size in council and cross-council appointments, has contributed to better governance at some TEIs.

2.13 We continue to monitor the effects on the TEI sector as it responds to the Government's direction for TEIs to widen and increase their revenue base. Although investment aimed at expanding TEIs' revenue could return benefits to TEIs and to the country as a whole, there are risks involved, especially where TEIs establish a presence overseas.

2.14 At an audit level, TEI performance in the preparation of annual reports and forecast information (investment plans) remains variable. In Part 3, we comment on TEIs' non-financial performance reporting.

5 See www.ssc.govt.nz/better-public-services.

6 In New Zealand's qualifications framework, levels 1 to 4 are certificates. Levels 5 and 6 are diplomas. Level 7 is Bachelors' degrees and graduate diplomas and certificates. Level 8 is post-graduate diplomas and certificates and Bachelors' degrees with Honours. Level 9 is a Masters' degree, and level 10 is a doctorate.

Results for 2011

2.15 We issue audit reports on the financial statements of each TEI (usually referred to as "the parent accounts"), of each TEI subsidiary that is also a public entity, and of the combined entities (of the "parent" and its subsidiaries) that represent the TEI group (usually referred to as "the group accounts").

2.16 We issued unmodified audit opinions for all 29 TEI group accounts in 2011. This means that the financial statements that we audited complied with generally accepted accounting practice and fairly reflected each TEI group's financial position and the results of their operations and cash flows for the year ended 31 December 2011.

2.17 These audit opinions also mean that the performance information reported by the TEIs fairly reflected their service performance achievements, as measured against the performance targets adopted for the year ended 31 December 2011.

2.18 Some audit reports mention matters that are not presented or disclosed in the financial or non-financial performance information but, in the auditor's judgement, are important in the context of public accountability and/or relevant to readers. These matters are referred to as "emphasis of matter" or "other matter" paragraphs. When the auditor is unable to obtain sufficient or appropriate audit evidence or there are material misstatements, then the audit opinion is modified. Depending on the extent of the issue, a modified opinion can include a disclaimer of opinion, an adverse opinion, or a qualified opinion about a particular aspect.

2.19 The unmodified audit reports of two TEIs contained "emphasis of matter" or "other matter" paragraphs:

- University of Auckland – we drew readers' attention to the Partnerships for Excellence funding, which the Crown provided as capital funding for increasing the University's capability. In our view, the University should have recognised this funding as equity and not as income in advance.
- Tairāwhiti Polytechnic – we drew readers› attention to disclosures about preparing the financial statements (appropriately) on the "disestablishment basis". The polytechnic was disestablished and incorporated into the Eastern Institute of Technology from 1 January 2011.

2.20 The unmodified audit reports for six TEI subsidiaries contained "emphasis of matter" or "other matter" paragraphs:

- Institutes of Technology and Polytechnics of NZ – we drew readers' attention to disclosures about preparing the financial statements (appropriately) on the "disestablishment basis". The Society stopped operating in 2010 and resolved to formally disestablish in 2011.

- New Zealand Tertiary Education Consortium Limited – we drew readers' attention to disclosures about preparing the financial statements (appropriately) on the "disestablishment basis". The company stopped operating from 31 December 2011 and returned its equity to its shareholders.
- Papatoa Forestry Limited – we drew readers' attention to disclosures about preparing the financial statements (appropriately) on the "disestablishment basis". The company was deregistered on 19 March 2012.
- iPredict Limited and group – we drew readers' attention to disclosures about preparing the financial statements (appropriately) on the "realisation basis" because the company has negative equity.
- Predictions Clearing Limited – we drew readers' attention to disclosures about preparing the financial statements (appropriately) on the "realisation basis" because the company has no equity and its immediate parent has negative equity.
- WaikatoLink Limited and group – we drew readers' attention to disclosures in the financial statements about uncertainties in the valuation of particular investments. The uncertainties could have a material effect on the statement of comprehensive income and statement of financial position.

2.21 The audit reports of two TEI subsidiaries were modified:

- Tertiary Accord of New Zealand – our audit was limited because we could not offer an opinion on the comparative figures presented or the balances in the statement of financial position as at 1 January 2008. This was because the previous year's financial statements had not been audited.
- Massey Ventures Limited and group – our audit was limited because we could not verify that financial information about the company's associates was properly recorded and disclosed in the financial statements. The associates, which were not public entities, were not within the Auditor-General's mandate and their shareholders elected not to have an audit carried out.

2.22 Part 4 includes more information about TEI subsidiaries.

Audit timeliness

2.23 An important aspect of the accountability of public entities is issuing their audited financial statements within statutory time frames. We want those interested in the performance of public entities to receive information about the results of entities' operations and their achievements as well as our audit assurance as soon as possible after the end of the financial year. That information is most useful to decision-makers when it is available as quickly as possible.

2.24 For the 2011 TEI audits, the statutory deadline (that is, when audit reports must be issued) was 30 April 2012. Audits of all but one of the 29 TEI group accounts were completed by this deadline: the audit report for Whitireia Community Polytechnic was issued on 16 May 2012.

2.25 As in previous years, it is the timeliness of TEI subsidiary audits that create most of the audit arrears in the TEI sector.

Themes arising from the 2011 audits

2.26 Each year, we identify particular themes that arose during the audits. This year, these themes largely matched the issues our auditors identified going into the 2011 audit round.

Financial viability, sustainability, and reputational risk

2.27 Spending restrictions and specified performance reporting benchmarks put increased pressure on TEIs to perform and find ways to cap or cut costs. This pressure was compounded by the global recession, with the consequential adverse effect on domestic and foreign student enrolment numbers. Our auditors noted that many TEIs commented on their need to manage their business finances more closely.

2.28 Our auditors monitored how TEIs responded to the pressure, which manifested at a council level in discussions about finance, the ability of the TEI to deliver quality courses, and the effect any deterioration in either would have on the TEI's reputation.

2.29 Restructuring activities continued, with closures, mergers, amalgamations, and consolidation of TEIs during the year.[7] They included arrangements such as shared governance and management appointments between TEIs. TEIs continued with both investment and divestment off-shore. Our auditors maintained a watching brief on these activities and will follow up in our 2012 audits as required.

Non-financial performance reporting

2.30 We have been working with public entities for some years now, aiming to lift the quality of non-financial performance reporting in the whole public sector. Part 3 discusses non-financial performance reporting in more detail, including how our auditors will be assessing TEIs' non-financial performance reporting in 2012 and beyond.

2.31 For 2011, TEIs' statements of service performance (SSPs) reported on their performance compared with the outcomes stated in their investment plans. The

7 In 2011, Tairawhiti Polytechnic merged with the Eastern Institute of Technology, and Telford Rural Polytechnic with Lincoln University. The latter merger significantly affected Lincoln's 2011 EPI results.

SSP requirement is set out in section 220(2B) of the Education Act 1989. Our audit work on the 2011 SSPs focused on:

- determining whether the SSP fairly reflected performance against the measures and targets outlined in the investment plan at the start of the year; and
- checking the reported levels of achievement for significant performance measures.

2.32 The TEC introduced EPIs for all TEIs to report against in 2011. Generally, TEIs adequately reported against their performance measures and targets and their EPIs in their 2011 SSPs.

2.33 Assessing improvements in the quality of non-financial performance reporting will continue to be an important area of our work during the 2012 audits.

TEI subsidiaries

2.34 We noted in our 2010 report on the education sector that many TEIs could improve their assessment of the business need for their subsidiaries and their reporting about those subsidiaries. This theme continued during our 2011 audits, and we discuss TEI subsidiaries in more detail in Part 4.

Capital asset management and expenditure

2.35 TEIs own or manage a substantial portfolio of assets, mostly land and buildings. Assets in the TEI sector in 2011 totalled $7.838 billion (2010: $7.728 billion). TEIs collectively forecast that they will spend around $7 billion between 2012 and 2021 to address deferred maintenance and to acquire new facilities.[8] We note that TEIs have historically tended to overestimate their forecast capital expenditure by around 15-20%.[9]

2.36 Capital asset management (CAM) is about effectively managing assets during their economic lives, which includes improving the quality and relevance of information to support decision-making and asset performance.

2.37 Asset management continues to be a priority for central government entities, including TEIs. In line with the Treasury's work on a CAM framework for the state sector, the TEC has been working collaboratively with TEIs to encourage stronger planning practices and to seek better information on TEIs' assets. As part of this, the TEC has been developing a CAM Monitoring Framework for the TEI sector. This framework includes capital intentions reporting, management standards,

8 Based on the TEC's data from its 2012 capital intentions returns from TEIs.

9 Anecdotal feedback from TEIs is that capital expenditure intentions tend to be moderated annually by TEI councils.

independent reviews of asset management, and the development of relevant tools, such as business case guidelines.

2.38 Given the extent of the assets in the TEI sector and the significant capital investment taking place, CAM remains an area of audit focus. Although there is financial pressure on many TEIs, several are planning new construction and campus developments.

2.39 Most capital development is focused on repairing and replacing existing assets, although there is a small but material amount of new construction, particularly in large metropolitan centres. Campus development and renewal is seen as necessary, not just to replace old facilities or provide for expansion, but also as a means to attract students from New Zealand and abroad.

2.40 The financing of this expenditure, and the effect it will have on each individual TEI's financial position, will continue to be a focus of our future audits.

Canterbury earthquakes

2.41 The Canterbury earthquakes of 2010 and 2011 have continued to have a localised and national effect on TEIs and our audits. Our auditors for the University of Canterbury, Lincoln University, and Christchurch Polytechnic and Institute of Technology cited earthquake impairment to property, property revaluations, and accounting treatment of insurance proceeds as their three main risks.

2.42 Nationally, the effect on the ability of property to withstand earthquakes has emerged as an issue in our TEI audits. Since early 2012, the TEC has been ascertaining the number and seismic compliance of buildings owned or managed by TEIs. This exercise will provide a range of data, including the potential cost of upgrading buildings and increasing their compliance with the relevant building standard.

Focus for our 2012 audits

2.43 Our auditors will continue to consider the major themes and areas of risk outlined above as part of our standard audit plan and process for 2012.

Comparative financial analysis of tertiary education institutions

2.44 We have used an analytical approach to better understand the uncertainty that surrounds the TEI sector's capability to deliver its objectives. This builds on the information we provided in our December 2011 report, *Education sector: Results of the 2010/11 audits*, and is part of a broader analysis of financial risk and performance we are doing in various parts of the public sector.[10]

2.45 Understanding the uncertainty or risk[11] entities in a sector face is important because the greater the magnitude and variety of risks:

- the more difficult it will be for the entities to perform;
- the less precise entities can be about the delivery of objectives;
- the more management effort is required in delivering the objectives;
- the more overall guidance is required from monitoring agencies to co-ordinate sector aspirations; and
- the more resources will be required by monitoring agencies to oversee and understand the sector.

2.46 Our own audit role also focuses on the risks to the entity, and the results of this analysis will be used to inform our audit teams about sector risks and to investigate further any entities that are consistently and/or materially outside of what is usual for the sector.

2.47 The TEC uses a financial monitoring framework (commonly referred to as "the FMF") to provide a structured approach to financial monitoring of TEIs. The TEC does this as part of its responsibility under section 159KBA of the Education Act to monitor the financial performance of all TEIs.

2.48 We expect our work to complement the TEC's framework because it provides a different perspective on the sector's performance, which could help inform the TEC's monitoring work. However, our approach does not seek to replicate the TEC's framework because:

- we use only audited financial statement data;
- our audience is Parliament and the public; and
- our intent is not to manage or guide but to inform our audience.

10 We used the financial data that relates to the TEI's own activities and not the consolidated activities of all its subsidiaries. There was a small amount of financial statement information that we could not collect for some TEIs. Because the analysis is sector-wide, we do not consider that this affects our overall findings.

11 For simplicity, we use the terms "risk" and "uncertainty" interchangeably to mean the potential for variation. In a public entity, a large operating surplus is as much an indicator of potential uncertainty (or risk) as a large operating deficit.

2.49 Many of the indicators we used in our approach are commonly used to analyse financial performance in the public and private sectors. However, we intend to discuss the method and refine the approach with the TEI sector.

Understanding financial uncertainty

2.50 The information within audited financial statements is important in aiding our understanding of public entities' performance. Although many public entities' objectives are not measurable in monetary terms, the financial statements still describe and summarise many of the factors that reflect the uncertainty or risks of achieving those objectives (such as the underlying revenue, costs, liabilities, and assets).

2.51 Uncertainty within the TEI sector arises from many different sources and can include economic, political, and structural changes within and outside of a TEI. Our approach does not seek to identify or understand the root causes of risk, but instead uses financial statements to help assess the aggregate affect on three aspects that relate to a TEI's ability to deliver on its objectives. The three aspects are:

- The **stability** of a TEI's activities (operations, capital, investing, and financing) is about how reliable an entity is in planning, budgeting, and delivering financial resources. To help understand this aspect, we focus on financial statement data that indicates the consistency and accuracy of these activities (for example, comparing actual performance with budget/forecast).
- The **resilience** of TEIs to short-term unanticipated events reflects how well the entity can "bounce back". To help understand this aspect, we consider the financial information that indicates the entity's ability to respond without major structural or organisational change. We focus on, for example, cash flow and income statement items such as fixed costs, interest payable, and surplus/deficits, together with balance sheet items that have short- or medium-term effects on an entity's cash flow, such as current assets and current liabilities.
- The **sustainability** of TEIs looks at how durable the entity is to long-term uncertainties and in maintaining itself indefinitely. To help understand this aspect, we consider the financial information that indicates how longer-term uncertainties are managed. We focus, for example, on balance sheet items such as assets, liabilities, and debt, together with related items such as capital expenditure, depreciation, and debt-servicing costs.

2.52 To assess TEIs' ability to cope with uncertainty, we analysed various indicators of stability, resilience, and sustainability from 2007 to 2011.

2.53 As with all financial analysis, there are limitations to what can be inferred.[12] Any TEIs that are consistently and/or materially outside of what is usual for the sector are not necessarily more risky in delivering on their objectives – they may simply warrant further investigation.

The results of our analysis of the TEI sector

2.54 Our analysis of TEIs' financial statements for 2007 to 2011 indicates that the uncertainties faced by the sector have not materially affected its ability to deliver on its objectives. The sector's medium-term resilience and longer-term sustainability are reasonably strong. There are two possible reasons for this:

- the sector's operations, investments, and financing activities are subject to a low level of underlying uncertainty and risks; and/or
- many of these risks are familiar or able to be managed by TEIs in a uniform and consistent way.

2.55 However, the sector's reliability in its planning and budgeting activities (the sector's stability) is mixed. The main issues potentially affecting TEI's ability to perform and that might need further investigation include:

- over-estimation of TEI capital needs – in particular, why this occurs and what it might mean for longer-term capital asset sustainability;
- the variability in planning and budgeting for operating activities and whether the consistency in 2011 can be maintained; and
- the high levels of fixed costs that many TEIs face.

2.56 The following section discusses how TEIs have changed over time. We have used graphs to summarise these changes. When looking at the graphs, note that:

- the individual data points (the square blocks) represent individual TEIs;
- the TEI sector is grouped by year, vertically; and
- what we consider "normal" lies within the upper and lower bounds (plus or minus one standard deviation) shown on each graph.

12 We use a standardised measure of variation on either side of the average to assess what is normal (in other words, plus and minus one standard deviation). Statistically speaking, this assumes a regularity that may not always be correct. Furthermore, to help reduce the effect of outliers that vary greatly from the average (for example, where zero is part of a ratio) we have capped the indicator's values at zero and two.

The stability of TEIs

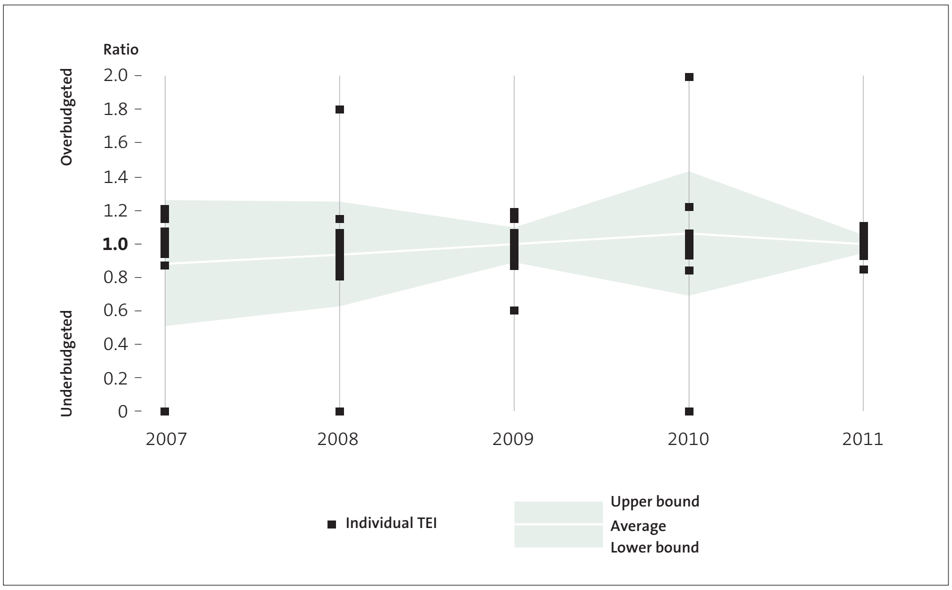
2.57 We used two ratios to show the consistency and accuracy of planning, budgeting, and delivering resources within TEIs. These are:

- budget to actual cash flows for operational expenditure; and
- budget to actual cash flows for capital expenditure.

Budget to actual cash flows for operational expenditure

2.58 Figure 1 compares the TEIs' actual expenditure with what was originally budgeted. A ratio of 1.0 indicates accurate budgeting.

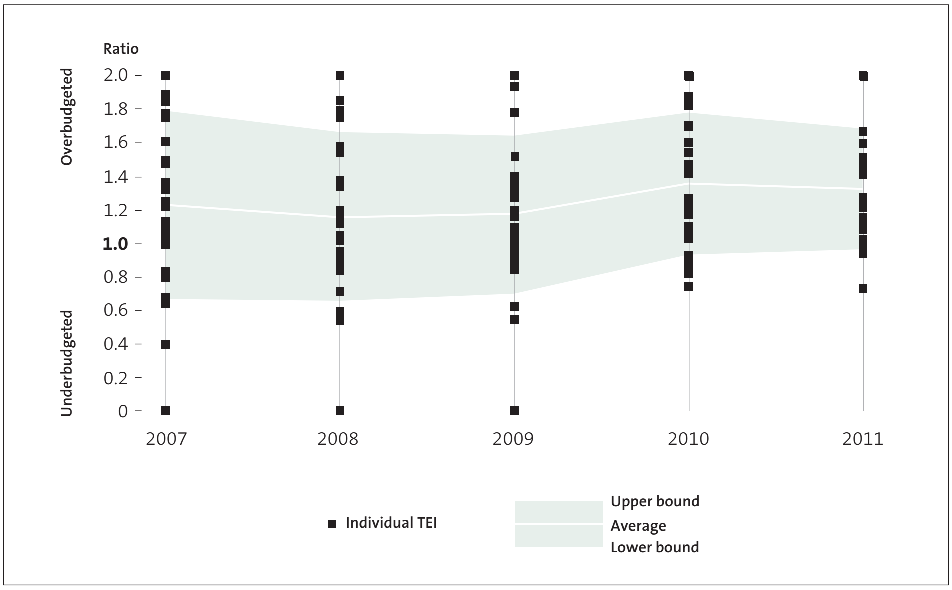
Figure 1
Accuracy of budgeting for operations



Budget to actual cash flows for capital expenditure

2.59 Figure 2 compares TEIs' actual capital expenditure with what was originally budgeted. A ratio of 1.0 indicates accurate budgeting.

Figure 2
Accuracy of budgeting for capital expenditure



What the graphs show about stability

2.60 TEIs' ability to plan and budget for operational activities is satisfactory but has varied during the five years shown in Figure 1. The result for 2011 showed good accuracy in budgeting and considerably less variability between TEIs than in most other years.

2.61 However, TEIs consistently budgeted more than they needed for capital expenditure. Many of the TEI cash flow statements show the surplus being used to acquire other investments and financial assets or to cover variances in other areas.

2.62 Several TEIs showed a consistent pattern of significant over-budgeting in their capital expenditure activities.

The resilience of TEIs

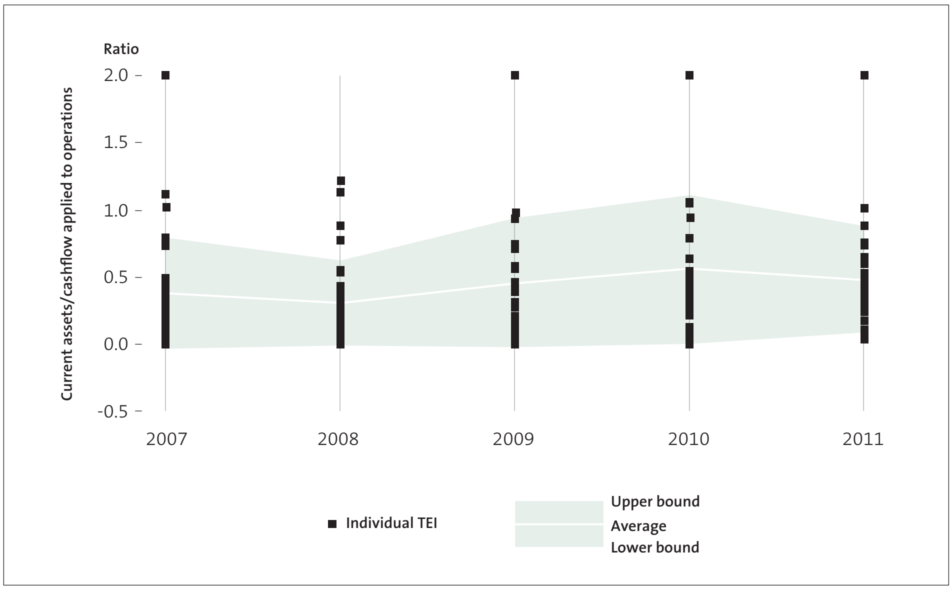
2.63 We used three ratios to illustrate the capability of TEIs to respond to unexpected events without major structural or organisational change. These are:

- current assets to operating cash flows;
- current assets to current liabilities; and
- fixed costs to operating and capital cash flows.

Current assets to operating cash flows

2.64 Figure 3 shows how long the operational cash flows of TEIs could be supported using only current assets as funding. A ratio of 1.0 indicates that current assets would cover one year of operating cash flows.

Figure 3
Potential to use current assets for operating costs

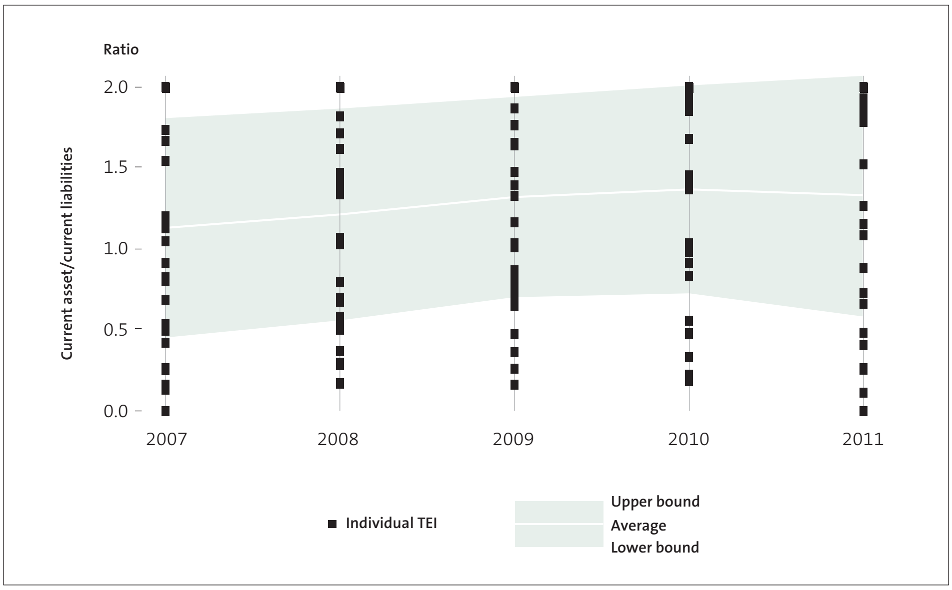


Note: A ratio of 2 equates to 24 months, 1.5 to 18 months, 1 to 12 months, and 0.5 to six months.

Current assets to current liabilities

2.65 Figure 4 shows whether TEIs' current assets can cover their current liabilities. A ratio of 1.0 indicates that current assets would cover the value of current liabilities.

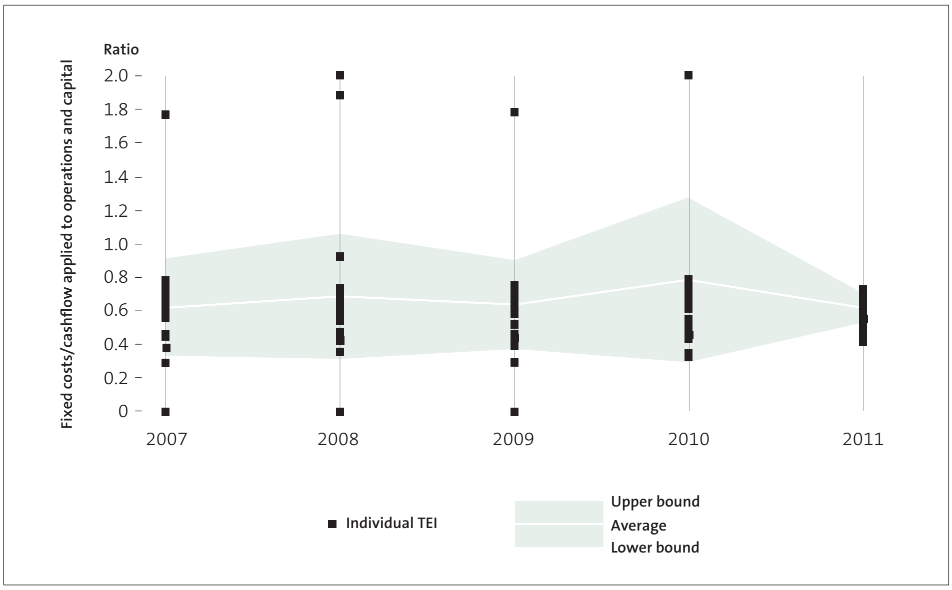
Figure 4
Potential for current assets to cover current liabilities



Fixed costs to operating and capital cash flows

2.66 Figure 5 shows the flexibility of TEIs' cost structure and ability to change in response to changing circumstances. A ratio of 1.0 indicates that all operating costs are fixed and not easily changed.

Figure 5
Level of fixed costs



What the graphs show about resilience

2.67 TEIs' capability to respond to unexpected events is supported by reasonable levels of current assets and current liabilities. As a sector, current assets cover about half a year's operating cash flows and working capital is positive and increasing.

2.68 However, many TEIs showed very high or very low working capital (outside what we would consider normal), and, for several, there was a consistent pattern over time. Furthermore, the levels of fixed costs are also reasonably high and variable throughout the sector. In 2010, fixed costs averaged 78% of operating and capital flows but declined to 62% in 2011.

The sustainability of TEIs

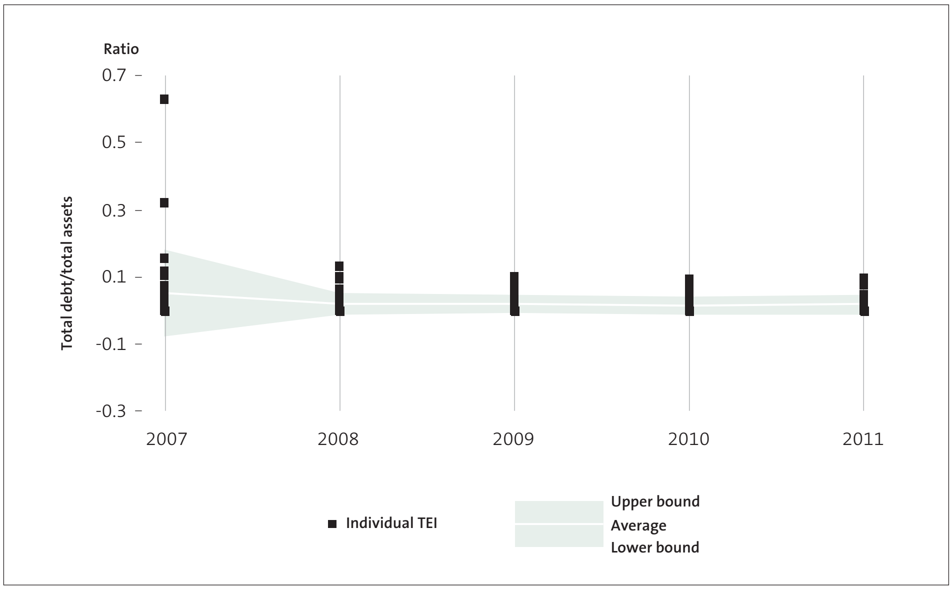
2.69 We used three ratios to show longer-term uncertainties and TEIs' ability to deal with them. These are:

- total debt to total assets;
- total liabilities to total assets; and
- capital expenditure to depreciation.

Total debt to total assets

2.70 Figure 6 shows whether the value of TEIs' assets would cover the value of their debt. The lower the ratio, the easier it is for a TEI's assets to cover its debts.

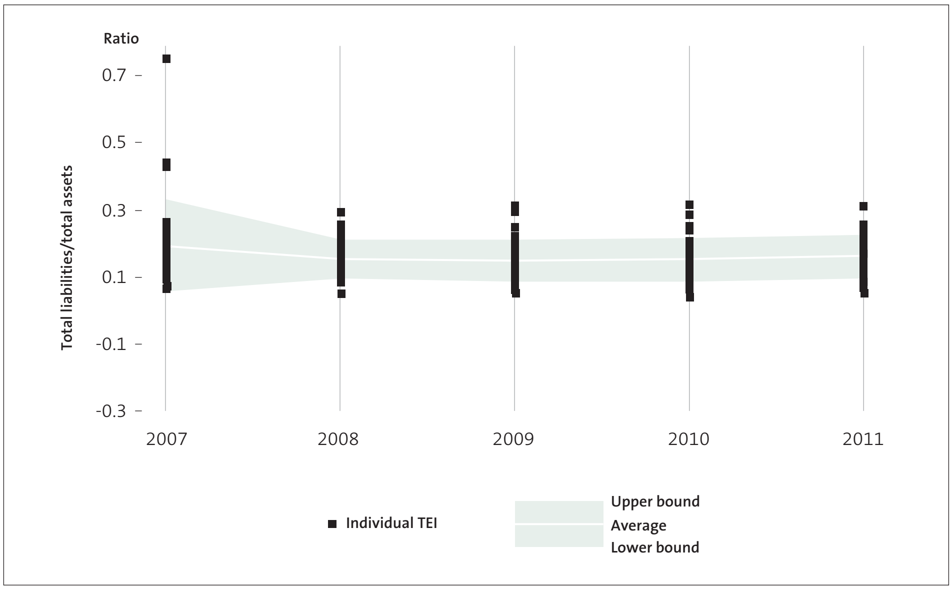
Figure 6
Level of debt compared to assets



Total liabilities to total assets

2.71 Figure 7 shows whether the value of TEIs' assets would cover the value of their liabilities. The lower the ratio, the easier it is for a TEI's assets to cover its liabilities.

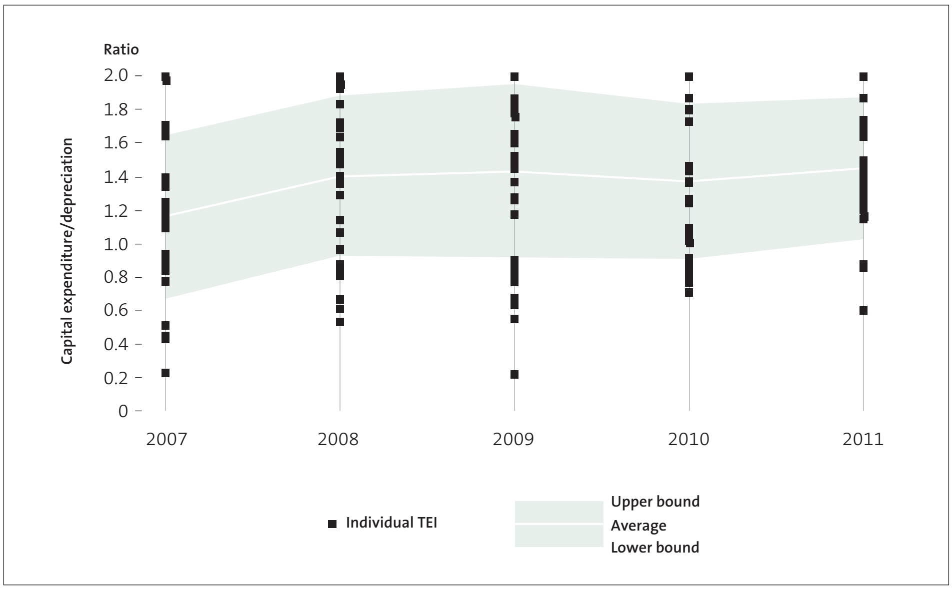
Figure 7
Value of total liabilities to value of total assets



Capital expenditure to depreciation

2.72 Figure 8 shows the amount of capital expenditure required to maintain the existing asset base. Depreciation is assumed to be a reasonable estimate of the amount of capital expenditure needed to maintain the existing asset base. A ratio of 1.0 or above supports sustainability.[13]

Figure 8
Capital expenditure compared with depreciation



What the graphs show about sustainability

2.73 Our findings indicate that TEIs are capable of managing longer-term uncertainties with relatively low levels of debt and total liabilities (many TEIs have no debt at all, and the average debt level is declining).

2.74 Capital expenditure levels are also above depreciation estimates, which supports sustainability. It is less clear whether this is enough to maintain the existing asset base, because spending on new assets is not listed separately in the financial statements.

2.75 Finally, about 30% of the TEIs showed a ratio of capital expenditure to depreciation that was consistently outside what we would consider normal for the sector. This suggests a variety of assets and/or asset management practices in the sector.

13 However, because capital expenditure also includes spending on new assets, we expect the ratio to be above 1.0 (possibly well above 1.0) in growing sectors.

Part 3
Non-financial performance reporting in the tertiary sector

3.1 This Part builds on an article in our December 2011 report, *Education sector: Results of the 2010/11 audits*. The observations and examples presented in that article were based on our review of TEIs' investment plans. In this Part, we discuss aspects of performance reporting that could be improved in TEIs' 2012 annual reports, based on our review of a selection of TEIs' 2011 annual reports.

3.2 We confirm the essential elements of a good performance framework, identify attributes specific to annual reports, and give illustrative examples, where appropriate.

3.3 We have been working for some years now to lift the quality of non-financial performance reporting in the public sector. We published guidance about this in our June 2008 report to Parliament, *The Auditor-General's observations on the quality of performance reporting*. This and other relevant guidance is readily available on our website.

3.4 We have noted that entities that are doing well in their non-financial performance reporting have integrated their strategic planning and objectives with their reporting requirements and use both these processes to enhance their governance and wider performance.

3.5 Non-financial performance reporting should provide an easily understood picture of core activities during the reporting period and give a sense of progress and where improvements are being made. It should help with making choices and setting priorities.

3.6 One of the Auditor-General's auditing standards, AG-4 (revised), is about auditing performance information. Under AG-4 (revised), our auditors attest whether what is reported is a "fair reflection of the performance of the entity".

3.7 We have applied this standard to audits of local government entities since 30 June 2010 and to large government departments and Crown entities for the year ended 30 June 2011. We are continuing to progressively apply it to the rest of the public sector. We will audit TEIs in keeping with this standard beginning with the 2012 audits.

3.8 Our auditors have been working with TEIs to help ensure that their reporting for 2012 will be a fair reflection of their performance (for 2011, the audit report attested only to whether the SSP reported faithfully against the forecast SSP or investment plan).

Areas of focus

3.9 Services provided by TEIs are primarily teaching[14] and research (for universities and some ITPs). Our opinion on whether the non-financial reporting fairly reflects TEIs' performance will be informed by whether the annual report for these entities clearly outlines the services the TEI is providing, how well it is providing them, and the effects of the services on the student community (impacts/outcomes).

3.10 We will also consider whether the annual report includes enough performance measures to give a balanced and rounded performance story about service delivery and the effect of those services. Ideally, the performance story will also be represented in a one-page performance framework that demonstrates a logical flow between the core services the TEI offers and the effects/outcomes it seeks as a result of offering those services.

3.11 Each TEI needs performance measures to capture what is most relevant to its performance – it should base its external performance reports on the information used to guide its internal performance management. This will help ensure that information and measures are highly relevant to the business decisions of the TEI.

3.12 Legislation and government policy implemented through the TEC sets TEIs' non-financial performance reporting requirements. The TEC's guidance[15] for the 2013 investment plans notes that reporting on mandatory performance commitments, including EPIs and participation rates of targeted priority groups,[16] should not be assumed to cover the full scope of a TEI's activities.

3.13 The EPIs all relate to student achievement[17] and are therefore "impacts", in that student achievement is a consequence of the teaching or course provision output. Student achievement/EPIs and participation rates are useful as measures of the knowledge and skills a student has gained, but measures for teaching, research, or other outputs are also required if the full scope of the TEI's performance is to be assessed.

3.14 We expect the annual report of a TEI to include more measures that relate directly to service quality and the direct effects of services provided (that is, impact measures, including EPIs) than higher-level measures that indicate the broader outcomes intended from the services. We give examples in Figure 9.

3.15 Auditors will continue to work with individual TEIs on their plans for reporting performance, to consider what would most appropriately reflect the TEI's performance for the year. It is perfectly acceptable to report on more measures

14 We use the term teaching broadly, to encompass concepts such as training, educating, or providing courses.

15 Available on the TEC's website, www.tec.govt.nz.

16 These measures are in the TEC's template of *Performance Commitments*.

17 Successful course completion, student retention, qualification completion, and student progression.

than those signalled in the investment plan, provided the TEI discloses that a measure is new and the relevance of the measure is clear.

Attributes and examples of appropriate performance reporting

3.16 Our review of a small selection of TEI annual reports suggests that some TEIs already use a reasonably broad range of performance measures for how well they deliver their services. They also monitor one or two higher-level indicators, such as graduate employment levels. We found examples of the performance elements in Figure 9 relatively easily. However, most TEIs' annual reports are likely to need some improvements to provide a complete service performance reporting framework.

3.17 In some instances, performance information is discussed in narrative information but not captured in performance measures – for example, the results of external evaluations and reviews. Although narrative information is useful to explain the importance of the measures, we encourage TEIs to set formal performance measures and targets for all important aspects of performance in their investment plans and then report against these in their annual reports. This would clearly convey the TEI's performance intentions and also help assure readers, at year's end, that the TEI's performance is fairly reflected in the annual report.

3.18 As well as setting out examples from the 2011 annual reports (or investment plans) in Figure 9, we have repeated most of the examples presented last year. Other TEIs will have similar examples that we could have used.

Figure 9
Attributes and examples of appropriate performance reporting

Attribute	Examples
Performance framework presented A performance framework clearly identifies the relevant aspects of performance (outcomes, impacts, services), logically presents these, and explicitly attaches measures to these aspects. (We noted last year that outcomes, impacts, and services tended to not be explicitly presented and were sometimes confused with inputs.)	Victoria University of Wellington's outcomes framework, set out on page 49 of its 2011 annual report (see Appendix 3). A further important step would be to explicitly identify the University's outputs/services in the framework.

Attribute	Examples
Outcomes and/or impacts defined Outcomes are changes in the state, condition, effects on, or consequences for the community, society, economy, or environment resulting from the existence and operations of the entity. Impacts are the contributions made to an outcome by a specified set of outputs. They represent the relatively immediate or direct effect on stakeholders of the entity's outputs.	*Outcome: A more educated and skilled workforce and society.* *Impact: Victoria's graduates raise the skills and knowledge of the current and future workforce to meet labour market demand and social needs.* (Victoria University's 2011 annual report, page 49). *Impact: Graduates who are advanced practitioners, highly sought after and who will make an impact.* (AUT, 2011-13 Investment Plan, page 9).
Outcomes/impacts measured TEIs' performance information should give some indication of the effects of services on the community (as well as how well the services are delivered). We acknowledge that there are sector initiatives, such as the longitudinal study of graduates' outcomes. We also recognise that research carried out by TEIs is often, by its nature, related to societal well-being and outcomes. The annual reports we reviewed gave useful snapshots of the type of research carried out.	*1. Proportion of graduates gaining employment or going on to further study (annual graduate destination survey)* *2. Relevant qualifications (annual employer satisfaction survey)* *3. Work readiness of graduates (annual employer satisfaction survey)* (WelTec, 2011-13 Investment Plan, page 21). Lincoln University also reports on graduate employment outcomes (Lincoln University's 2011 annual report, page 29). **Research** • *Revenue from commercialisation* (Lincoln University's 2011 annual report, page 33). • *Value of external (non-PBRF) research contracts gained* (Wintec's 2011 annual report, page 82). • *Percentage of Research, Development and Transfer activity undertaken in collaboration with industry/ community* (Wintec's 2011 annual report, page 82). (The two Wintec measures are more in the nature of proxy impact measures.)
Impact/proxy quality measures	• Student progression rates; • qualification completion rates; • student retention rates; and • course completion rates. (These are mandatory EPIs.)

Attribute	Examples
Services identified Teaching is clearly a universal service for TEIs, as well as research for universities and for some ITPs. There may be other services that TEIs choose to identify and formally report on in their SSP. For a complete performance framework, these should include all services, not just those funded by the Crown.	UCOL reports against the *Performance Commitments* from its investment plan (they are proxy impact measures), but also presents its services and associated performance measures under six output classes relating to different faculties. It gives a brief, explicit description under each output class. For example: *Output 1: Agriculture, Horticulture and Science* *Objective: To provide to students training and education through the provision of programmes and courses in Agriculture, Horticulture and Science.* *Programmes at degree, diploma and certificate levels were offered during 2011 in science, animal science, exercise physiology, and general sciences. Secondary Tertiary Alignment Resource (STAR) programmes were also provided.* (UCOL's 2011 annual report, page 18). UCOL also presents generic measures for each of these output classes. The measures are explained at the start of this section of its annual report. University of Otago identifies three services (outputs) – research and postgraduate teaching, teaching and learning, and community service. The next step would be to display these in a performance framework, explicitly linking these services to the six strategic objectives in the SSP, under which the performance measures are set out (University of Otago's 2011 annual report, page 32).

Attribute	Examples
Service delivery measured Appropriate performance information will cover a range of dimensions of performance. Quality is an important aspect of performance – the examples focus on measures of quality. References to quality standards or criteria and/or approval processes should guide the reader to a summary or easy viewing of those standards, criteria, or approval processes. Survey measures should disclose the sample size and response rate.	Lincoln University reports on the proportion of students evaluating lecturers as "excellent" or "good", and on a further five student satisfaction measures. It also indicates the frequency and number of evaluations in supporting narrative (Lincoln University's 2011 annual report, pages 28-29). University of Otago reports on a survey of its graduates' perceptions of their improvement in various attributes, such as independent judgement (University of Otago's 2011 annual report, page 36).* External Evaluation and Review reports "High Confidence" in both Educational performance and Capability in Self Assessment (NMIT, 2011-13 Investment Plan, page 106). Courses provided with the TEI's formal Academic Board's approval (UCOL's 2011 annual report, page 17). Improved student engagement – active learning, student/staff interactions, supportive learning environment (benchmarked, percentage-based measures from the Australasian Survey of Student Engagement – AUSSE; involvement suspended in 2011 due to the earthquakes) (University of Canterbury's 2011 annual report, page 20). Percentage of students who would recommend the TEI to others (AUT, 2011-13 Investment Plan, page 26). Student satisfaction with student support services and facilities (Unitec, 2011-13 Investment Plan, page 41). Student engagement – proportion of students who are withdrawn by the Polytechnic because of non-engagement (Open Polytechnic, 2011-13 Investment Plan, page 17). **Research** • *Premium research publications* • *Revenue from PBRF* (Lincoln University's 2011 annual report, page 33)

* As with the EPIs, this could be seen as either an impact of the TEI's services or a quality measure of its services. Narrative would help the reader understand the TEI's perspective on what performance story these measures tell.

Attribute	Examples
Supporting narrative and disclosures Performance measures are often just the starting point for the performance story. Useful supporting narrative will explain the relevance of the performance measures and what the results actually mean.	The annual reports that we reviewed had useful supporting narrative, either in separate sections or accompanying the performance measures. For example: • The University of Canterbury explains the relevance of its performance measure on international students and how it monitors the risk of over-exposure to a few source countries (University of Canterbury's 2011 annual report, page 17). • The University of Otago is transparent about the combination of factors that have contributed to the improvement in student achievement levels. For example, it provides comment on the changes to its enrolment policies (University of Otago's 2011 annual report, page 35). • The University of Waikato discusses what might lie behind the difference in course completion results over the last couple of years (University of Waikato's 2011 annual report, page 95). **Information on courses** Brief narrative on the number of courses and changes to courses can provide useful information to the reader. The University of Otago reports the number of programmes compared with the previous year, and identifies new programmes introduced (University of Otago's 2011 annual report, page 20). UCOL also explains the levels of courses – useful background for the external reader. (UCOL's 2011 annual report, page 13).
Costs of services disclosed Disclosing the costs of each output in the annual report gives an indication of relative expenditure in each area and may inform service delivery prioritisation decisions.	The University of Otago identifies the costs of outputs for three outputs: • Research and postgraduate teaching; • Teaching and Learning; and • Community Service. Each output is broken down into four academic divisions – Commerce, Health Sciences, Humanities, and Sciences – and "Service Division". The Research and postgraduate teaching output is also broken down into: postgraduate thesis supervision, teaching-related research, and project-based research (university funded, externally funded). As noted earlier, the next step would be to link these to the performance measures under the strategic objectives in the SSP (University of Otago's 2011 annual report, pages 32-33). UCOL reports on the gross costs for each EFTS and the total cost for each of its six output classes (UCOL's 2011 annual report, page 18).

Attribute	Examples
Comparative information Comparative information over time allows the reader to see trends in performance.	Baseline data for the previous year is commonly presented by TEIs.
Variances explained Where a target was not met, the TEI should comment on this.	With the number of EFTS generated by Pacific students being less than the target, the University of Waikato notes that the proportion is higher than the demographic for the region, and that it has prepared a Pacific Plan as part of its strategic planning framework. The formal infrastructure, with relevant responsibilities and accountability, will be established in 2012 (University of Waikato's 2011 annual report, page 93).

Measures and targets

3.19 Further attributes and examples of appropriate performance reporting are:

- All measures and targets identified in the forecast SSP in the investment plan must be clearly presented and reported on.
- All performance measures need to be reliable (that is, supported internally by detailed definitions and appropriate systems to collect the relevant data).

Part 4
Subsidiaries of tertiary education institutions

4.1 The number of subsidiary entities in the TEI sector has increased significantly in recent years (see Figure 10 and Appendix 1). In our December 2011 report, *Education sector: Results of the 2010/11 audits*, we expressed our view that TEIs need to better assess the business need for their subsidiaries and their reporting about those subsidiaries.[18]

4.2 For our purposes, we work with an extended definition of subsidiaries.[19] Under financial reporting standards in the Public Audit Act 2001, any entity that is effectively controlled by one or more public entities is itself a public entity. This extends beyond companies to include trusts, incorporated societies, and other bodies.

4.3 The governance, management, and financial sustainability of subsidiaries vary from institution to institution. It has been difficult for us to obtain a view of the sector because of the different reporting requirements.

4.4 To improve our information about TEIs' subsidiaries, our auditors collected:

- general information, such as names of parent TEIs, names of subsidiaries, administrative support arrangements, number of employees, operating status, type of entity, shareholding relationship, and purpose/core activities;
- sources of capital;
- financial information; and
- governance information.

4.5 As well as improving our own information (because we use it in risk assessments for our audit work), we wanted to ask questions that TEIs might find useful to consider. Our information remains incomplete, but, with the help of others in the sector, we will continue to improve it.

4.6 We discuss the information under four headings:

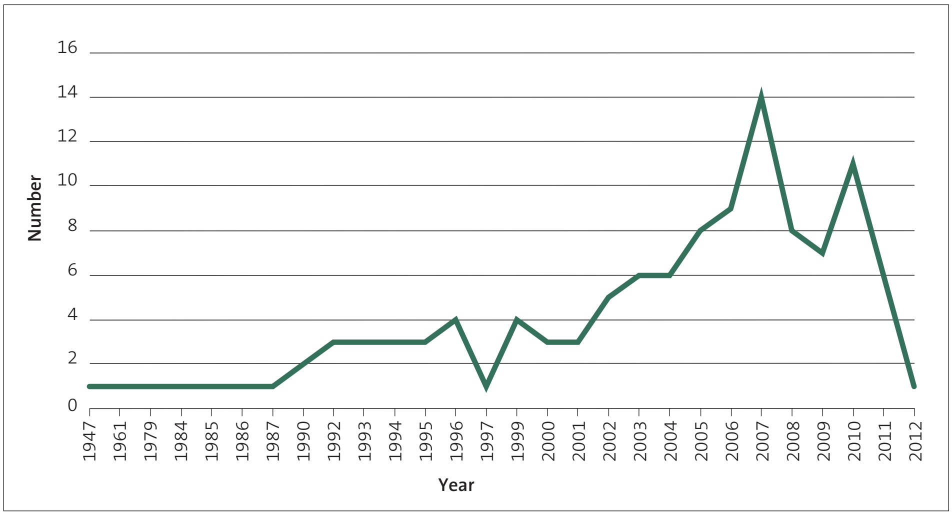
- legal structure and purpose;
- governance;
- administrative support and employees; and
- our financial observations.

18 See Part 2: Results of tertiary education audits for 2010, page 27.

19 We use the terms "parent" and "subsidiary" to indicate relationships having any level of shareholding or other form of ownership. This differs from the definition of those terms under NZ IAS 27: *Consolidated and Separate Financial Statements*, as applied for financial reporting purposes. It also differs from the definitions of "holding company" and "subsidiary" under the Companies Act 1993.

4.7 At this stage, we have identified 134 subsidiaries[20] in the TEI sector.[21] Figure 10 shows the number of new subsidiaries established between 1947 and 2012. Most subsidiaries were established within the last 10 years, with 81 established since 2002. We have not collated information on disestablished subsidiaries, so Figure 10 does not show how long the subsidiaries trade or operate before they are disestablished.

Figure 10
Number of new subsidiaries established from 1947 to 2012



Source: Information returned to us from auditors. Includes operating and dormant subsidiaries, including those that were to be disestablished in 2012.

Legal structure and purpose

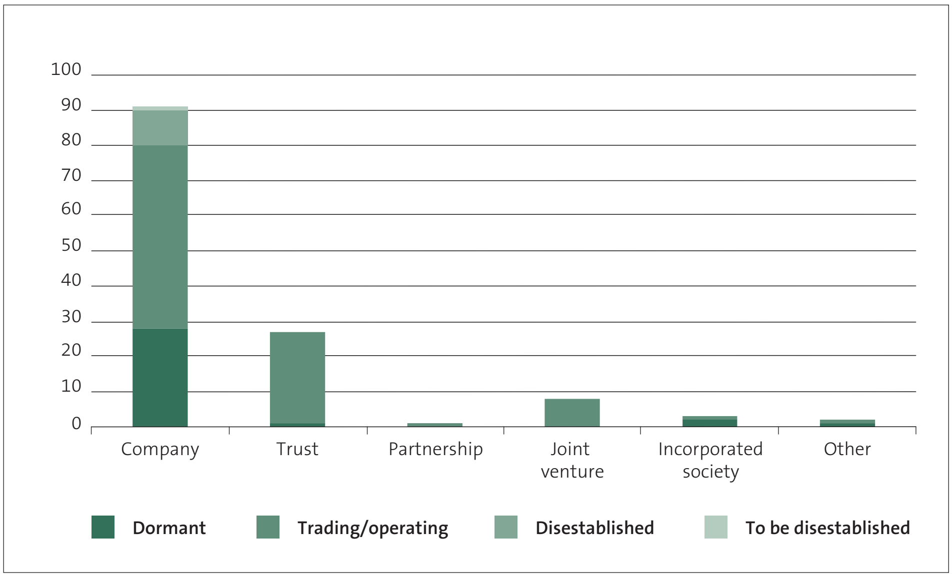
4.8 We collated information on the different types of subsidiaries (legal structure), the shareholding relationship between parents and subsidiaries, and the purpose and core activities of subsidiaries. Subsidiaries in the TEI sector include companies, trusts, partnerships, joint ventures, incorporated societies, and a small number of other structures. Figure 11 shows the subsidiary types by their current status.

4.9 Most subsidiaries are either companies (93) or trusts (27), so our discussion focuses on those types of subsidiaries.

20 See Appendix 1 for a full list of parent entities, their associated subsidiaries, and the subsidiaries of those subsidiaries.

21 We do not have all of the information that exists on TEIs' subsidiaries. We did not collect information on subsidiaries that are incorporated and domiciled overseas.

Figure 11
Number and legal structure of subsidiaries and their status (as at 31 December 2011)



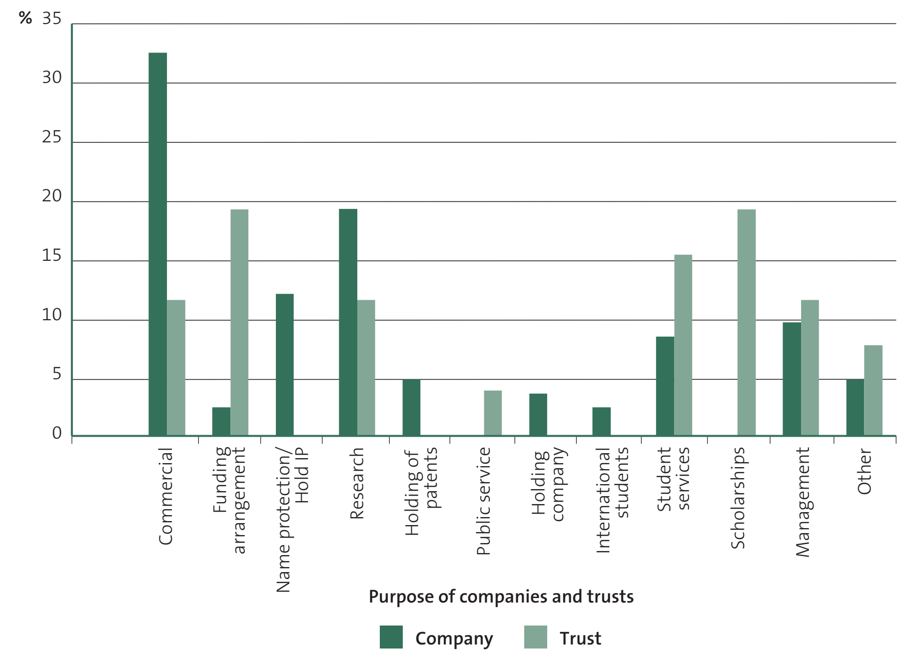
4.10 A significant number of TEI subsidiary companies are dormant (28 of the 93). This might suggest the need for more robust planning before a subsidiary is set up. Although the costs of setting up a subsidiary might be minimal, we question whether TEIs have fully considered the cumulative costs of maintaining a dormant entity against alternative means of achieving the original purpose of the entity.

Have the cumulative costs of maintaining a dormant entity been fully considered against alternative means of achieving the original purpose of the entity?

4.11 Figure 12 presents a comparison of the purposes for which companies and trusts were set up. Although there is not a direct correlation between the legal structure and the purpose of the subsidiaries:

- there is a stronger tendency to establish companies for commercial, research, and name protection/intellectual property purposes;
- trusts are largely established for funding arrangement and scholarship purposes;
- dormant subsidiaries largely exist for name protection purposes; and
- the purpose “funding arrangements” could be more clearly reported, especially the extent to which these arrangements are under the control/governance of the parent or are driven by current funding mechanisms.

Figure 12
Purposes for establishing companies and trusts



4.12 We were unable to obtain information on the reasons behind the creation or purpose of a number of subsidiaries. It is not clear where the information gap exists – whether the original purpose was not clearly outlined at the time the subsidiary was set up or records were not maintained. Not knowing the core purpose of a subsidiary makes it difficult to assess whether it is delivering the goods or services it was set up to deliver, and therefore how well it is performing.

4.13 We encourage TEIs to choose the most appropriate type of subsidiary entity, based on its purpose and business model, and to regularly reassess the costs and benefits of maintaining each subsidiary.

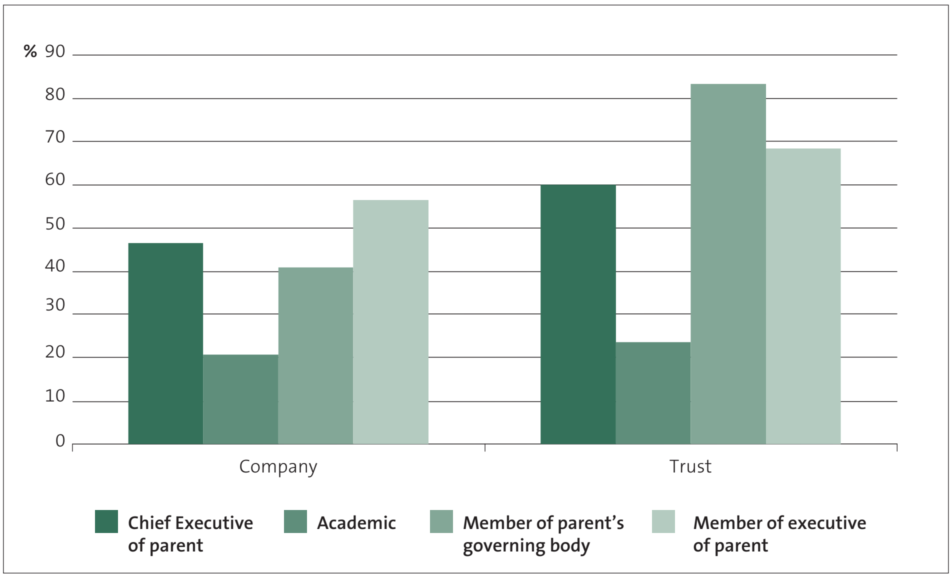
Governance

4.14 We collated information on the governance arrangements of subsidiaries, including board membership (the numbers and mix of external and internal board members).

4.15 The average size of a company board was four members, and the average size of a trust board was six members. Slightly more than half of the boards contained members external to the parent.

4.16 Figure 13 shows subsidiary type and percentage of internal board membership on companies and trusts. Slightly less than half of the companies and about 60% of the trusts have the chief executive of the parent on the board. A member of the governing body of the parent is on the board for most trusts, but for only about 40% of the companies.

Figure 13
Percentage of entities with different parent employees on the board (internal members)



4.17 Where the chief executive of the parent or members of the parent's governing body are on a subsidiary's board, conflicts of interest need to be appropriately managed to make transparent the level of influence over the business decisions of the subsidiary. In this context, the role that the external and internal members play on boards is important.

Are procedures in place to differentiate between the objectives of the parent and the objectives for the subsidiary?
Are there potential independence issues?
Are reserves being retained in the subsidiary for future growth?

Administrative support and employees

4.18 We collated information on the administrative support the parent provides to subsidiaries and the administrative support they provide themselves. We also collated information on the number of employees in the subsidiaries.

4.19 Nearly three-quarters of all subsidiaries (69%) rely on the parent to provide all administrative support.

How does the parent recover the cost of providing administrative services?
Are charges from the parent to the subsidiary for administrative or other support being charged on an arm's-length basis?
What resources are allocated in providing this support?
Does the financial performance of the subsidiary reflect the true cost of its operations?
What tax risks does the arrangement present to the parent and the subsidiary?
What kind of incentives do these arrangements create for staff?
Do these arrangements mask inefficiencies or spare capacity or prioritisation issues in TEIs' operations?

4.20 Most subsidiaries do not have employees. However, where they do have employees, there is a considerable range – one subsidiary has 689 employees. Consideration needs to be given to who does the work in or for the subsidiary, and what facilities (if any) the subsidiary uses or needs.

4.21 The average number of employees for companies was seven,[22] and for trusts it was one. Most subsidiaries simply hold investments and do not provide services.[23]

4.22 There is a predictable correlation between those subsidiaries that do provide services and the number of employees.

How are subsidiary employees remunerated?
Does the parent employ them or does the subsidiary?
Does the parent recover these costs or other costs associated with delivering services from the subsidiary?

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22 To avoid distorting the average for companies, we excluded the subsidiary with 689 employees.

23 For subsidiaries that have full-time employees, the average value of non-current assets was $1.4 million. For subsidiaries with no employees, the average value of non-current assets was $6 million.

Our financial observations

4.23 We collated information on the financial activities of subsidiaries. This included:

- capital injections (share capital) – including whether there was an interest-bearing or non-interest-bearing loan from the parent;
- revenue – external or intra-group;
- expenditure – external or intra-group;
- dividends paid by the subsidiary to the parent;
- current and non-current assets;
- current and non-current liabilities;
- net equity; and
- inter-group loans, including detail on amounts due from or owing to the parent and amounts due from or owing to other group entities.

4.24 We note that:

- Forty-three of 134 subsidiaries have intra-group transactions with their parent.
- On average, a capital injection of about $1.7 million has been made to subsidiaries by the TEI parent. The amount is significantly higher for those subsidiaries that have been formed for commercial purposes, where the average is about $3.4 million.
- Subsidiaries appear to be generally asset poor. Only 20 of 134 subsidiaries have non-current assets in excess of $1 million.
- Twenty-nine out of 134 subsidiaries (22%) report paying dividends to the parent/s.
- Our information on intra-group loans is sparse, and we suspect that our information on dividends is incomplete.
- From the limited information available on subsidiaries' current liabilities, it appears that a large proportion of subsidiaries depend on third-party working capital (likely to be capital from the parent).
- TEI subsidiaries are largely profitable. However, profitability might depend on subsidiaries' leveraging of parent/s' capital and administrative support.

What percentage of the total revenue and expenditure of the subsidiary is transacted with its parent or a related entity? Do these percentages justify having a separate legal subsidiary if trading is predominantly intra-group?

What is the return on investment for the parent? Is it in line with the original business plan? How is this monitored? What action is taken for under-performance?

How much are these subsidiaries leveraging off the parent's asset base? Does the parent recover these costs? What risk is the parent carrying in the event of a liquidation of a subsidiary?

Is it intended that subsidiaries retain capital?
Could intra-group loans be an area of risk?

Concluding comments

4.25 It is clear that there are gaps in our information on TEI subsidiaries. They incur additional costs and place pressure on the governance and resources of parent entities.

4.26 In our view, TEIs could improve their business planning and due diligence before creating and investing in subsidiaries. After setting them up, TEIs need to regularly reassess the costs and benefits of subsidiaries and make sure that subsidiaries clearly report to the parent and external stakeholders.

4.27 In carrying out this work, we became aware of 15 subsidiaries that we were not previously aware of. Because they are owned by TEIs, these subsidiaries are also public entities and subject to audit by the Auditor-General.

4.28 In collaboration with the sector, we will continue to collect and refine our information on TEI subsidiaries. As noted in Part 2, we continue to consider subsidiaries in the TEI sector an area of audit risk.

Part 5
Our audits of schools

Results of the school audits for 2011

5.1 In the period from 1 December 2011 to 30 September 2012, nearly 2500 school audits, including subsidiaries of schools, were due for completion. This Part summarises the results of those audits, and others from previous years that were completed in the period.

5.2 Schools vary widely in size. The smallest have less than $200,000 expenditure a year, while the largest have more than $20 million and are 100 times larger than the smallest. Schools are governed by boards of trustees, mainly parents from the local community. There are about 18,000 trustees throughout the country.

5.3 Boards are required by the Education Act 1989 to prepare annual financial statements and have them audited. The annual cost of these audits for the period was about $10 million, an average of nearly $4,000 for each school, varying from $1,900 to $13,000. They took about 105,000 hours of audit time, which is the equivalent of 50 full-time people, and varied from 20 to 100 hours for each school.

5.4 The results of each school audit is contained in the audit report we issue, which is a public document attached to the annual financial statements of each school, and a management letter, which is addressed to each board of trustees.

5.5 Most schools receive standard audit reports – that is, the financial statements can be relied on for accountability purposes and the audit has not found anything that our auditors consider important enough to draw to the attention of the public.

Audit report issues

5.6 We have issued non-standard audit reports[24] to some schools. A non-standard audit report can contain a modified opinion and/or an “emphasis of matter” or “other matter” paragraph. We express a modified opinion when there is a misstatement about the treatment or disclosure of a matter in the financial information or a limitation in scope because of insufficient appropriate evidence to support the audit opinion. We modify an opinion by expressing a qualified or an adverse opinion or disclaiming an opinion.

5.7 We express a qualified opinion when we are unable to obtain sufficient appropriate audit evidence on which to base the opinion, but conclude that the possible effects on the financial information of undetected misstatements, if any, could be material but not pervasive.

24 A non-standard audit report is issued in keeping with the International Standard on Auditing (New Zealand) 705: *Modifications to the Opinion in the Independent Auditor’s Report* and/or the International Standard on Auditing (New Zealand) 706: *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*.

5.8 We express an adverse opinion when, having obtained sufficient appropriate audit evidence, we conclude that misstatements, individually or in the aggregate, are both material and pervasive to the financial information.

5.9 We disclaim an opinion when we are unable to obtain sufficient appropriate audit evidence on which to base the opinion (that is, a limitation in scope) and conclude that the possible effects on the financial information of undetected misstatements, if any, could be both material and pervasive.

5.10 In certain circumstances, we include additional comments in the audit report in an "emphasis of matter" paragraph, to draw readers' attention to a matter that is fundamental to a reader's understanding of the financial information, or in an "other matter" paragraph that is relevant to readers' understanding of the financial information.

Timeliness and statutory deadlines

5.11 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 of Education (the Ministry) by 31 May.

5.12 Of the 2494 audits, including school subsidiaries, due for completion in our reporting period, draft financial statements for 2309 (93%) were available for audit by the statutory date of 31 March 2012. There were 185 (7%) that did not achieve this deadline.

5.13 There were 2381 audits (95%) completed by the statutory deadline of 31 May 2012, leaving 113 (5%) that were not completed by this date. Twenty were exempt from the deadline because of the Canterbury earthquakes. Based on past experience, we expect less than 1% of school audits to remain outstanding more than a year after the balance date.

5.14 Seven school audit reports had not been issued at the time of writing this report, and had been outstanding more than a year after balance date (they were all for the 2010 financial year). The seven, and the reasons why the audit reports had not yet been issued, were:

- Avondale Intermediate – there is a disagreement between the school and the Ministry about capital works funding;
- Hamilton's Fraser High School – there are financial management issues, which we noted in the reports on the 2008 and 2009 audits (see the section on modified audit opinions);
- Hatea-A-Rangi School – there are financial management issues;

- Hukarere College – there are doubts about the financial viability of the school, which we noted in the report on the 2009 audit;
- Otepopo School – the school has closed and some records are missing;
- Te Aute College – there are doubts about the financial viability of the school, which we noted in the report on the 2009 audit; and
- Te Kura Kaupapa Māori ō te Kura Kōkiri – there are financial management issues, which we noted in the report on the 2009 audit (see also paragraphs 5.16 and 5.17).

5.15 We will continue to try to complete these audits as soon as possible, so that accountability to the public is achieved.

Modified audit opinions

5.16 In the reporting period, 22 school audit reports (less than 1% of the total) contained a modified audit opinion because:

- The auditor was not able to obtain assurance over all the school's income and/or expenditure:[25]
  - College Street School – a closed school where some of the invoices were missing;
  - Edendale School (Auckland) – the recoverability of money was unclear;
  - Red Beach School – limited controls over locally raised income;
  - Te Kura Kaupapa Māori o Otepou – limited controls over some transactions;
  - Te Kura Kaupapa Māori ō te Kura Kōkiri (for the 2009 audit) – opening balances were not supported;
  - Te Kura Kaupapa Māori o te Whanau Tahi (for the 2010 and 2011 audits) – limited controls over income;
  - Te Kura Ngā Ruahine Rangi (for the 2009 audit) – limited controls over income and expenditure;
  - Te Wharekura o te Rau Aroha (for the 2010 audit) – limited controls over expenditure; and
  - Waimauku School – limited controls over locally raised income.
- The results of a forensic investigation into financial management were not known:
  - Hamilton's Fraser High School (for the 2008 and 2009 audits) and Fraser Community Childcare Society Incorporated (for the 2010 audit); and
  - Mayfield Primary School (Auckland) (for the 2010 audit).

25 This means that the auditor could not confirm that all the school's income had been recorded, or that all the expenditure was properly incurred, rather than there had been a loss of public money.

- The auditor was not able to obtain reliable evidence to support the cyclical maintenance provision:[26]
  - Saint Patrick's Catholic School (Taupo); and
  - Wellington East Girls' College.
- Other reasons:
  - Hato Paora College (for the 2010 and 2011 audits) – this integrated school had not been managed by a properly constituted board of trustees, which was a breach of the Education Act 1989 (sections 75 and 94);
  - Kaikohe Christian School – the board of trustees of this integrated school incurred expenditure of $43,000 on the relocation of classrooms, which was the responsibility of the proprietor, without the approval of the Ministry; and
  - Wanganui City College – the board of trustees did not prepare consolidated financial statements, including the transactions and balances of its subsidiary (College House Hostel Trust), as required by accounting standards.

Emphasis of matter paragraphs on probity and similar matters

5.17 Some audit reports mention matters that are not concerned with the presentation of the financial statements but are considered important in the context of public accountability. In the reporting period, eight audit reports mentioned matters concerned with probity, prudence, or waste. These were:

- Ferguson Intermediate (Otara) – The School spent $68,000 on overseas trips, domestic travel and accommodation, and hospitality and gifts. This expenditure contributed to the School's operating deficit. In our view, this spending showed a lack of probity on the part of the board. We made a similar comment in the School's 2009 report.
- John McGlashan College – The board made a contribution of $350,000 to the proprietor towards a new sports centre, without the approval of the Ministry. The amount was repaid in full in May 2012.
- Mairehau School – The board made a contribution of $100,000 to a trust to build a hall on Crown land without a formal agreement with the trust or the Ministry. In our view, this spending showed a lack of prudence on the part of the board. We understand that the board has now requested that the trust repay the money.
- Marcellin College and Saint Paul's College (Ponsonby) – The previous proprietor had continued to operate and carry out the responsibilities and obligations under the integration agreement and legislation, but without legal authority. We understand that these responsibilities were to be transferred to the new proprietors of the Colleges in 2012.

26 This means the estimated amount to maintain the school's buildings during the next 10 years.

- Sacred Heart College (Auckland) (for the 2010 and 2011 audits) – The financial statements referred to relationships between the College and related organisations on three matters:
  - There were conflicts of interest with the College's Foundation, which had three members in common with the board, one of whom was the principal who received additional remuneration in his role as chief executive of the Foundation. These members did not exclude themselves from board meetings when it considered matters concerning the Foundation, which is a breach of the Education Act (clause 8(8) of Schedule 6).
  - In 2010, the College modified the distribution of parental donations between itself and the Foundation, which resulted in it having an operating deficit of $500,000.
  - The new proprietor had not been operating and the previous proprietor continued to act without authority. We understand that a formal transfer is to take place in 2012.
- Te Kura Kaupapa Māori ō te Kura Kōkiri (for the 2009 audit) – Some of the expenditure appeared to have been personal and inconsistent with the expectations of the Ministry. For example, an overseas trip to the Cook Islands, traffic fines, shipping clothing and household items overseas, tyres and repairs of vehicles not owned by the school, and a satellite TV subscription. In our view, this spending shows a lack of probity on the part of the board.

Serious financial difficulties

5.18 The financial statements show most schools are financially sound. For example, the information available indicates that about 2250 schools have a combined working capital of nearly $600 million. However, about 200 have a working capital deficit, which could affect the school's ability to pay its bills. For a few, the deficit is large enough to be serious. Deficits arise for different reasons (such as spending more on staff or assets than can be afforded or a declining number of students).

5.19 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. Nevertheless, it is important that we draw the public's attention to schools that have financial difficulties to resolve, which they normally achieve by constraining expenditure for some time.

5.20 In the reporting period, 45 audit reports (nearly 2%) drew attention to the financial position of the school. These schools are aware of their financial position and are taking action to resolve their difficulties. During 2012, they might have improved their position enough that they are no longer in serious financial difficulty.

5.21 Given the public interest in the financial health of schools, we had intended to carry out a special audit project, analysing the last few years' information for all schools. However, we have been unable to complete our data-set and now intend to analyse the 2012 financial information, with a view to reporting in about November 2013. During the next year, we also intend to strengthen our processes for ensuring consistency in the reporting of serious financial difficulties, so that our report next year can provide a more comprehensive summary.

Compliance with financial and other legislation

5.22 We ask auditors to consider whether schools have complied with certain legislation. Most schools comply with the legislation that auditors consider. Where our auditors identify a breach of legislation, it might be reported in the audit report or the financial statements. During the 2011 audits, the breaches of the Education Act that auditors identified were:

- 33 borrowed more than they were legally permitted (section 67);
- 16 gave loans to staff (section 73);
- 10 had conflicts of interest (section 103A and/or clause 8(8) of Schedule 6);
- six invested school money in organisations that had not been approved (section 73);
- five paid one or more of their teachers directly (rather than through the Ministry's payroll system, section 89); and
- 15 breaches were for other reasons.

5.23 We have not given details of all the schools that breached legislation in 2011 because some of the breaches were comparatively minor or had been disclosed by the school in its financial statements. However, the more important ones that were mentioned in audit reports were:

- College Street Normal School – The board paid a company owned by one of its trustees $87,000 for building and repair work without the approval of the Ministry.
- Northland College – The College, which is in serious financial difficulty, borrowed $273,750 more than is permitted without the approval of the Ministry. It has also acquired $436,000 in company shares without approval.
- Rotorua Boys' High School – The school, which is in serious financial difficulty, obtained approval for borrowing above its permitted limit, but did not comply with the conditions of the additional borrowing (because its hostel did not make a surplus in the year).
- Rotorua Girls' High School – The school lent money to a childcare trust, without Ministry approval, to help with building renovations. The outstanding balance had been brought down to $15,047 at 31 December 2011.

- Sacred Heart College (Auckland) – The College breached the conflict of interest legislation (see also paragraph 5.17).
- Te Kura Kaupapa Māori o Otepou – The board paid a company owned by one of its trustees $45,000 for running a bus contract, without the approval of the Ministry (see also paragraph 5.16).
- Timaru Boys' High School – The school invested $170,000 without approval in organisations other than approved banks.

Appointing school auditors for 2012-2014

5.24 In this section, we explain the process we use to:

- appoint auditors for schools for the next three years; and
- ensure that those audits are cost-effective, of a satisfactory quality, and meet the Auditor-General's auditing standards.

5.25 Under the Public Audit Act 2001, the Auditor-General is the auditor of all state and state-integrated schools – currently about 2460 schools. The Auditor-General appoints auditors to carry out those audits on her behalf. About 60 auditors are appointed from a range of audit firms – from small local firms through to the major international firms.

5.26 Appointed auditors must audit schools in keeping with the Auditor-General's auditing standards and instructions, and we subject them to regular quality assurance reviews.

5.27 The audit agreements between the Auditor-General and appointed school auditors expired with the 31 December 2011 audits. New three-year agreements are now being put in place, following a process that allows for consultation between schools, appointed auditors, and our Office.

5.28 In most instances, the current appointed auditors will be re-appointed for a new three-year period. However, for about 100 schools, the appointed auditor will be changed because:

- the previous appointed auditor no longer met the Auditor-General's independence requirements;
- an audit firm has withdrawn from auditing schools and their audits needed to be re-allocated;
- either the school or the appointed auditor requested a change (in about 60 other instances, issues were resolved without changing the appointed auditor); or
- the portfolio of audits of some appointed auditors needed to increase to improve their "critical mass" of audits (for example, staying abreast of the Auditor-General's auditing standards, the school audit brief, and current school audit issues).

5.29 The Auditor-General allowed only a very limited set of circumstances in which appointed auditors could increase audit fees (that is, the Ministry's new payroll system, significant changes in the school, repeated poor quality accounts prepared by the school, and cost inflation of 2-3%).[27] We discussed those circumstances with the Ministry before we discussed them with appointed auditors.

5.30 We expect that all auditor appointments for the new three-year period will be made in time for the start of audit work for the financial year ending 31 December 2012.

State-integrated schools

5.31 There are 332 state-integrated schools, comprising 14% of all state schools, and they have about 88,000 pupils. Integrated schools used to be private schools but have become part of the state education system. They provide education within the framework of a particular or general religious or philosophical belief.

5.32 Integrated schools are governed by elected boards of trustees (boards), which are Crown entities, in the same way that other state schools are governed. The boards are responsible for the teaching of their pupils and the operation of their schools, and are publicly accountable.

5.33 However, integrated schools differ from other state schools because they have proprietors, which are private entities. Proprietors appoint representatives to boards and provide and maintain the school buildings and land. Most proprietors own the land and buildings, but a small number lease the property from a third party. They also have responsibility for maintaining the "special character" of their schools – that is, their religious or philosophical character.

5.34 Boards and proprietors both receive funding from the Government, and both can also raise funding directly from private sources. The Private Schools Conditional Integration Act 1975 (the Act) sets out which matters boards and proprietors are each responsible for and gives proprietors some capacity to set compulsory charges for attendance at the school (known as "attendance dues"). There are also limits on what attendance dues can be used for.

5.35 The Ministry is responsible for most of the public funding for integrated schools and administers the Act. The Government funds boards for the teaching and operating costs of integrated schools and for minor maintenance, in the same way that it funds all other state schools. Boards of integrated schools receive more than $500 million a year for these purposes.

5.36 The boards of integrated schools have to work in partnership with proprietors. The different funding streams and split responsibilities between the board and

27 We will be working with the Ministry of Education during the next few months to minimise the additional work that auditors have to carry out, and to ensure that schools are able to sign off their payroll reports – and their annual financial statements – with confidence.

the proprietor make this a complex model. It is not always easy to draw clear lines between public and privately funded activities. It can also be hard to provide clear information and accountability to parents, given the different bodies involved, which each have different reporting obligations.

5.37 As the auditor of all public entities, we audit the financial statements of each board of trustees, which captures the state funding and any donations to, or funds raised by, the school. We do not audit the financial statements of the private sector proprietor.

Relationships between boards and proprietors

5.38 We consider that, 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 private and public money.

5.39 However, in some instances, the financial relationship between the board and the proprietor is blurred. There are about 2000 trustees on the boards of integrated schools, many of whom are in that position for only a few years, and some can lack knowledge about how they are expected to operate.

5.40 The Ministry has taken several steps to improve the relationship between boards and proprietors:

- Unlawful funding of proprietors' buildings by boards in previous years has been corrected.
- The Ministry is exercising stronger control over the funding of proprietors' buildings by boards.
- The Ministry has issued guidance to boards and proprietors on the fees that may be charged to parents.
- The Ministry has issued guidance to manage conflicts of interest on the part of proprietors' representatives.
- The Ministry has issued model financial statements, which recommend that all transactions between boards and proprietors be disclosed.
- The Ministry has specified new requirements for proprietors' attendance dues accounts, including providing guidance material and a model set of accounts. After considering legal advice and a High Court declaratory judgment, the Ministry has also reviewed the levels of attendance dues charged by all proprietors. This review was due to be completed by mid-November 2012.
- In 2007, the Ministry commissioned an audit of how proprietors use the property funding it provides, which resulted in a number of recommendations. For example, the Ministry requires proprietors to maintain separate bank

accounts and separate ledger accounts for their different funding streams.
- In 2008, the Ministry carried out a detailed review of integrated schools. The review recommended that the Ministry impose specific accounting and planning requirements on proprietors. These included separating money received and spent, and establishing independent audits to ensure compliance with Crown requirements.

5.41 The Ministry has not told us whether the recommendations described in the last two items listed above have been implemented.

5.42 There are some further issues that have not yet been resolved. For example:
- Accounting standards have not yet been revised to define proprietors as "related parties" of boards and to require transactions between them to be disclosed.
- A very small number of proprietors make additional payments to the principal for normal duties, which is unlawful.
- A similarly small number of proprietors make additional payments to the principal of a higher amount than the Ministry would allow a board to make for the same purpose.
- The Ministry has not yet determined the form of documentation for board-funded capital works of proprietors' buildings.
- A very small number of integrated schools have weak governance arrangements, in that formal decisions of the board are made in combined meetings with the proprietor.
- In a few instances, the proprietor has transferred its responsibilities to another body without the approval of the Ministry.

5.43 Overall, we consider that the separation between public and private funds is clearer than it once was. Nevertheless, the relationship between boards and proprietors remains an important area of risk in the school sector, and one that we will continue to actively monitor.

Parental donations

5.44 In February 2010, we reported on the accountability for public funding of integrated schools, and our decision to defer a performance audit of how the Ministry manages the Crown's financial interest in integrated schools.[28] In that report, we noted that, in our view, the accountability arrangement for parental donations was a major outstanding area. Therefore, we decided to collect some information on the issue and to report to the Secretary for Education.

28 *Central government: Results of the 2008/09 audits*, Part 9 – Accountability for public funding of integrated schools.

5.45 The parents of pupils at integrated schools can be asked for money by various bodies:

- 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 payment of compulsory attendance dues.[29] These amounts are approved by the Ministry and can be used to provide land and buildings.
- The proprietor may seek voluntary contributions.[30] These may be used for any purpose.
- Parents may also be asked for donations by other bodies, such as trusts that may be connected to the board or the proprietor. Again, these 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).

5.46 Parental fees and donations can appear in four different sets of financial statements – the financial statements of the board, the proprietor's attendance dues account, the proprietor's voluntary financial contributions account, and the financial statements of another entity (for example, a trust).

5.47 The first three sets of accounts have to be audited. The Auditor-General appoints the auditors of boards while proprietors appoint auditors for the attendance dues and financial contributions accounts. The Auditor-General is responsible for auditing the board's financial statements, but is not responsible for the other audits.

5.48 When a proprietor or another body raises funds from parents, it is a transaction between two private sector parties, even though the school office often provides administrative support. This fundraising has been the subject of public interest, usually because of concerns about the size of the donations sought, confusion about whether the contribution is voluntary or compulsory, or a lack of clarity about whether the donation is for the board (public sector) or the proprietor (private sector).

5.49 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;

29 Section 36 of the Private Schools Conditional Integration Act 1975.

30 Section 37 of the Private Schools Conditional Integration Act 1975.

- 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.

5.50 Some of this complexity is inevitable, given the legislated model for 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.

5.51 We asked our auditors, during the 2011 school audits, to collect information from a sample of integrated schools on the amounts raised from parents and on which entity benefits. Some initial findings are:

- The total amount collected from the parents of pupils at the 89 integrated schools included in the sample is about $80 million a year – $24 million for boards, $36 million for compulsory attendance dues, and $18 million for voluntary financial contributions.
- The amount collected by individual schools for each pupil varies widely – ranging from nothing to more than $5,000 a year.
- About 10 schools arrange for the collection of donations on behalf of another body (in two instances, the amounts are large).
- Some schools appear to collect voluntary amounts purely for the benefit of the board, while others collect purely for the benefit of the proprietor.

5.52 We are analysing the information obtained and intend to report separately in more detail to the Secretary for Education and, if necessary, publicly.

Kura kaupapa Māori

5.53 In December 2011, we reported on the findings of our review of financial management in kura kaupapa Māori (kura, or Māori language immersion schools).[31] Overall, most of the 72 kura had good policies and processes to manage their finances, comply with the law, and appropriately manage sensitive expenditure and conflicts of interest. However, the policies and practices in a significant minority of kura (about 20%) did not reflect the good practice set out in the guidance that the Ministry has provided to schools.

5.54 We noted that the information provided by the Ministry should be enough for kura to be aware of, and meet, their responsibilities to comply with the law and manage finances, sensitive spending, and conflicts of interests.

31 *Education sector: Results of the 2010/11 audits*, Part 6 - The financial management of Māori immersion schools.

5.55 The Ministry told us that it was revising the model financial management policies it makes available to schools. The revised policies, which the Ministry planned to publish in December 2011, would include more detailed guidance about sensitive expenditure and delegations. The Ministry was also reviewing its Handbook to more clearly and explicitly link the information about financial advances to staff to relevant legislative provisions.

5.56 In our report, we recommended that the Ministry monitor the effectiveness of its guidance and compliance with it in kura and other small schools and, if necessary, produce more targeted guidance.

5.57 The Education and Science Committee's report on its hearing into our report noted that the Ministry had confirmed that it would issue 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 and financial model when the Ministry published them. The Committee also noted that we would monitor the issue and, if necessary, ask the Ministry to issue targeted advice to the kura in question.

5.58 Progress since the select committee hearing in May 2012 includes:

- We have asked the auditors of kura to provide for a follow-up exercise in their 2013 audits. The results of this exercise should be available by late 2014.
- The Ministry has revised its Handbook to more clearly and explicitly link the information about financial advances to staff to relevant legislative provisions.
- The Ministry has not yet managed to issue its revised policies, including the guidelines on sensitive expenditure and delegations, partly because of revising its priorities after the Canterbury earthquakes. Because of the delay in publishing these policies, the Ministry is carrying out another round of consultation to ensure that the proposed model policies are still current and fit for purpose.
- With our recommendation for the Ministry to produce more targeted guidance for kura, the Ministry has been exploring appropriate vehicles for producing such guidance. This matter is yet to be resolved.

Payments above a principal's normal salary

5.59 In December 2010, we reported on the results of our review of the additional remuneration paid to secondary school principals.[32] In 20% of the 400 schools reviewed, auditors found that either additional remuneration had been paid without the approval of the Ministry or it was not clear whether some payments were remuneration that would need the Ministry's approval.

32 *Central government: Results of the 2009/10 audits (volume 1)*, Part 8 - Payments above a school principal's normal salary.

5.60 In most instances, the additional payments were not large. However, the underlying principles are important. Firstly, payments that are remuneration are lawful only if they are approved by the Ministry. 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 by the New Zealand Police.

5.61 After we published our report, the Ministry issued comprehensive guidance to schools to clarify when its approval is required. It has 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 unlawful payments are made.

5.62 For the most common forms of possible unlawful remuneration (for example, home telephone, Internet, or insurance bills, or the use of a car), the Ministry anticipated increased numbers of requests for its approval. In 2011 and 2012, the Ministry has noticed an increase in the number of applications for such payments. We intend to look at a small sample of schools in our next school audits to assess whether all necessary applications are being made.

5.63 We understand that the Ministry is still considering the issues we raised about payments by proprietors – that is, the possibility that some of the payments were unlawful, equality of remuneration for all state schools, and the proper management of conflicts of interest. The select committee's report on its hearing (held in May 2012) noted that, to improve transparency and prevent these "double payments" (when proprietors pay principals for matters already covered by the salary paid by the Ministry), school auditors are now asked to ensure that the financial disclosure note includes all transactions between proprietors and the boards of trustees and also boards' employees.

5.64 The Ministry also said that it would consider requiring boards of integrated schools to disclose financial transactions with proprietors in their financial statements. This would help maintain the transparency of any remuneration received from proprietors by principals. The Ministry is still considering this.

Part 6
Financial reporting changes

6.1 In this Part, we highlight changes to financial reporting in New Zealand during the past 12 months, including strategic changes to the financial reporting framework and proposed changes to financial reporting standards. We comment on how these changes are likely to affect entities in the education sector, and we provide some concluding comments.

Strategic changes to New Zealand's financial reporting framework

6.2 Since 1 July 2011, the External Reporting Board (the XRB)[33] has had responsibility for both preparing and issuing financial reporting standards. The XRB determined a proposed strategy for different classes of entities and for tiers of financial reporting within those classes, which it consulted on in September 2011.[34] After consultation, the strategy was finalised, and it was approved by the Minister of Commerce on 2 April 2012.

6.3 The strategy establishes what has become known as a "multi-standards approach" to financial reporting. The approach distinguishes three classes of entities:

- for-profit entities in the public and private sectors;
- public benefit entities in the public sector; and
- public benefit entities in the not-for-profit sector.

6.4 The approach also distinguishes different tiers of reporting for classes of entities, with each tier having different financial reporting requirements.

6.5 At the heart of the multi-standards approach is a recognition that financial and non-financial information should meet the information needs of users of general purpose financial reports. In future, those needs are expected to be best met by having financial reporting standards tailored to particular classes of entity and tailored to particular sizes of entity.

6.6 The multi-standards approach is also expected to better align the costs of producing general purpose financial reports with the benefits realised by the users of those reports. For some entities, this should mean that the cost of preparing their general purpose financial reports reduces.

6.7 The XRB has established a transition plan that takes into account proposed legislative changes. That plan aims to have the new financial reporting framework fully operational within the next two to three years.

33 The XRB was previously the Accounting Standards Review Board. The previous Board had a narrower role than the XRB.

34 This consultation followed consultation about similar matters carried out by the Accounting Standards Review Board in 2009.

6.8 The new financial reporting framework will affect the reporting by public sector entities. It will mean that public entities could report under one of six categories, depending on the nature and size of the entities.

6.9 The categories for public benefit entities in the public sector are:

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

6.10 The categories for for-profit entities in the public sector are:

- full reporting (tier 1); and
- reduced disclosure reporting (tier 2).

6.11 Entities that are "publicly accountable"[35] will report fully (tier 1) regardless of size. This will include all "issuers" (such as entities that issue shares or bonds).[36] All other entities will be allocated to a category based on their size and can elect to report in keeping with the requirements that correspond to that category.

6.12 The size criteria for allocating public benefit entities in the public sector to tiers are:

- 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 and expected to be for very small entities.

6.13 The size criteria for allocating for-profit entities in the public sector to tiers are:

- tier 1 – operating expenditure of more than $30 million; and
- tier 2 – operating expenditure of $30 million or less.

6.14 The education sector consists predominantly of public benefit entities, but there are some for-profit entities. We expect entities in the education sector to be in four of the six different categories. TEIs and any related entities that are public benefit entities are expected to report in keeping with the requirements for public benefit entities in tier 1 or tier 2. Schools and any related entities that are public benefit entities are expected to report in keeping with the requirements for public benefit entities in tier 2 or tier 3. For-profit subsidiaries in the education sector are expected to report in keeping with the requirements for for-profit entities in tier 2.

35 As defined in the XRB's exposure draft ED XRB A1 (FP Entities + PS PBEs).

36 As defined in section 4 of the Financial Reporting Act 1993.

Proposed changes to New Zealand's financial reporting standards

6.15 The XRB has established a sub-board called the New Zealand Accounting Standards Board (NZASB) and has delegated responsibility to it to develop the financial reporting requirements for the classes of entities and the tiers that the XRB has determined. The NZASB is doing a lot of work to develop the financial reporting standards that will be used when the new financial reporting framework is fully operational.

Public benefit entities

6.16 The new financial reporting framework will result in new standards and requirements for all public benefit entities in the public sector. The NZASB is currently consulting on a new suite of financial reporting standards for public benefit entities in tiers 1 and 2. The new suite of financial reporting standards for public benefit entities is largely based on International Public Sector Accounting Standards (IPSAS) and is proposed to apply for reporting periods beginning on or after 1 July 2014.

6.17 At present, IPSAS are generally aligned to the current financial reporting standards applied by most public benefit entities in the public sector, which are based on International Financial Reporting Standards (IFRS). The alignment is because most IPSAS were developed using IFRS as a starting point. However, over time, we expect the level of alignment to reduce, as the approaches taken by the two international standard-setters diverge.

6.18 Although generally aligned at present, there are a few significant differences and some subtle differences in the proposed new suite of standards. Therefore, as part of the consultation process, we are carefully reviewing the new standards. We expect to provide comments to the NZASB in December 2012 to help it finalise the new suite of standards.

6.19 The NZASB is still working on its proposals for reporting by public benefit entities in the public sector in tiers 3 and 4. We expect the proposals for tier 3 to be consulted on between December 2012 and March 2013.

For-profit entities

6.20 The new financial reporting framework retains the existing suite of financial reporting standards for for-profit entities that are based on IFRS but will change some of the requirements for for-profit entities at tier 2. Currently, smaller for-profit entities can apply a differential reporting regime that includes some different accounting requirements and fewer disclosure requirements. That regime is going to be replaced with a new reduced disclosure reporting regime, which is expected to be published before the end of 2012.

6.21 The reduced disclosure reporting regime for tier 2 for-profit entities will require those entities to follow the same accounting requirements as tier 1 entities but have a lot fewer disclosures than the previous regime. The reduced disclosure reporting regime aligns with the requirements in Australia for smaller for-profit entities.

6.22 Apart from the change to a reduced disclosure reporting regime, for-profit entities will have the usual ongoing changes to deal with as new standards are developed or existing standards revised. In that regard, a number of new standards were issued recently that will need to be applied in the next year or two.

Effect on entities in the education sector

6.23 These changes to financial reporting standards will affect all entities in the education sector to some extent in the next two to three years. We expect schools to be most affected.

6.24 About 40% of schools will, as public benefit entities in tier 2, be able to report with fewer disclosures. The remaining 60% or so will be able to use simple format accrual reporting (because they are in tier 3). For these tier 3 schools, the reporting requirements are expected to be less onerous than the current reporting requirements.

6.25 The split in the financial reporting standards for schools under the new financial reporting framework is significant. Currently, all but the largest of secondary schools report on the same basis, which is at a differential reporting level.

6.26 The Ministry will need to consider the appropriateness of this new regime for schools, including how well the needs of users will be met by following the regime. If the Ministry decides that users' needs would be best served by all schools reporting on the same basis, it could require the 60% of schools that qualify to use simple-format accrual reporting (those in tier 3) to report instead using public benefit entity reduced disclosure reporting (for those in tier 2). This would result in consistent financial reporting throughout the school sector.

Concluding comments

6.27 We support the strategic changes and the broad direction of the proposed financial reporting standards that are starting to take shape. In future, we expect to see greater divergence of financial reporting standards internationally. The expected divergence would have made it increasingly difficult to have one cohesive set of financial reporting standards based on IFRS that were suitable for all entities in New Zealand to apply. Therefore, we consider that the new suite of financial reporting standards for public benefit entities in the public sector will be a more appropriate base from which future changes are made.

6.28 Although supportive of the new suite of financial reporting standards for public benefit entities in the public sector, we do not regard it as a "silver bullet" that resolves all the concerns that have been previously raised about financial reporting. Nevertheless, in our view, the change is necessary, and it provides the best platform for financial reporting by public benefit entities in the public sector in future.

Part 7
Our recent work and ongoing work in the education sector

7.1 In this Part, we provide summaries of our recent reports and ongoing areas of work in the education sector. Copies of our education-related reports are available on our website (www.oag.govt.nz/reports/education).

Fraud survey

7.2 New Zealand generally has a "clean" image when it comes to fraud. We consistently rank highly in international and domestic surveys that measure public trust in government and the effectiveness of systems and processes that deal with fraud and corruption. We attribute the general absence of systemic large-scale corruption in the private and public sectors to the integrity of our standards and controls, underpinned by strong and shared common values, within a small and cohesive society.

7.3 However, we cannot be complacent if we are to keep our good record of keeping fraud at bay. It is particularly important to be vigilant in the current global economic climate, because there is an increased risk of fraud when people struggle to make ends meet.

7.4 In June 2012, we published a report on a survey we commissioned of fraud awareness, prevention, and detection aimed to provide better insight into fraud in the public sector.[37] The results of the survey confirm a strong commitment within the public sector to protecting public resources.

Fraud survey results for tertiary education institutions

7.5 According to our survey respondents, TEIs:

- have fraud policies, which they communicate regularly;
- have protected disclosure policies;
- review their fraud policies regularly, and as part of every fraud investigation; and
- have designated people responsible for fraud risks.

7.6 Thirty-seven percent of the respondents were aware of at least one incident of fraud or corruption in their TEI within the last two years.

7.7 The most frequent types of fraud within TEIs were:

- theft of cash (38%);
- fraudulent expense claims (16%); and
- falsifying invoices (11%).

37 *Fraud awareness, prevention, and detection in the public sector.*

7.8 Our report on the fraud survey results for TEIs is on our website.[38]

Fraud survey results for schools

7.9 Respondents from schools told us that their schools had good anti-fraud frameworks, with policies, a code of conduct, high levels of confidence in the school leaders' awareness of their role and responsibilities, proactive approaches to fraud, and pre-employment checks. School cultures are receptive to staff raising concerns, and expense claims and credit card expenses are monitored.

7.10 Eight percent of the respondents were aware of at least one incident of fraud or corruption in their school within the last two years. This was one of the lowest rates in the public sector.

7.11 Most of the fraud incidents in schools (75%) were committed by one internal person acting alone, typically at an operational staff level.

7.12 The most frequent types of fraud within schools were:

- theft of property, plant, and equipment or inventory (25% combined);
- theft of cash (19%); and
- fraudulent expense claims (19%).

7.13 Our report on the fraud survey results for schools is on our website.[39]

Lessons for the education sector

7.14 One of our messages from this work is the need for education providers to always report suspected or detected fraud to their auditor. All staff in the public sector need to recognise that "doing the right thing" does not mean keeping quiet about suspected or detected fraud in an effort to be fair to the person or people suspected of fraud.

7.15 "Doing the right thing" means speaking up, and that includes telling the appointed auditor about each and every suspected or detected fraud. We are not sure that this is always happening and intend to monitor the extent of reporting to our auditors. A suspected or detected fraud is a sign that controls are working and that the environment is supportive of employees voicing their concerns.

7.16 Using the information that auditors receive from public entities, we will continue to regularly update and share information with the sector about fraud incidents. From this, it will be possible for people to see which sorts of controls or procedures are working to identify potential fraud in their workplaces or similar workplaces. We intend that the cumulative effect of this co-operation and sharing will be stronger controls and a still cleaner New Zealand public sector.

38 See www.oag.govt.nz/2012/fraud-summary-tertiary.

39 See www.oag.govt.nz/2012/summary-of-our-fraud-survey-results-for-schools.

School governance

7.17 We had intended to carry out a performance audit in 2012 on the role of school boards of trustees in raising student achievement through effective strategic planning and review, including data use, prioritisation, and resource allocation. However, a reprioritisation of our work programme has meant that we were not able to progress this review.

7.18 Our work on Māori education (see below) will consider some aspects of school governance, and we note the new policy work and analysis that is under way in this area. We will continue to monitor developments in school governance.

New Zealand Qualifications Authority: Assuring the consistency and quality of internal assessment for NCEA

7.19 In May 2012, we published a report that set out the results of an audit of one aspect of performance by the New Zealand Qualifications Authority (NZQA). We examined the work that NZQA does to ensure that the internally assessed portion of NCEA qualifications is consistently administered throughout the country and of a high quality.

7.20 The report noted both areas of success and areas for improvement. We reported that:

- NZQA was aware that it needed to continue to work with the Ministry to improve the timeliness of exemplars for teachers, and continue to streamline its communications with teachers;
- NZQA needed to provide more consistency in the feedback it gave teachers through moderation reports, and work with teachers on the timeliness of its appeals process and feedback on particular examples of students' work;
- students, their parents and caregivers, employers, and TEIs can be confident that NZQA has effective systems to support the consistency and quality of internal assessment for NCEA; and
- NZQA is continually enhancing its processes and practices, which is helping schools to better carry out internal assessment.

Institutional arrangements for training, registering, and appraising teachers

7.21 In June 2012, we published a paper that described how public entities, and people in certain roles, influence the quality of teachers through initial teacher training, teacher registration, and monitoring teachers' performance. The paper was intended to inform Parliament and the public at a time when there was significant interest in the quality of teachers, given that a Ministerial Inquiry and a Ministerial Review were looking at aspects of how teacher quality is managed.

7.22 The paper was deliberately descriptive of the highly complex environment in which discussions about the quality of teaching take place. We reached the view that improving teacher quality within this system requires the system as a whole to work well. The significantly interdependent work of the public entities and other roles that support the quality of teachers collectively influence the quality of teachers.

Performance audits on child obesity

7.23 We will be carrying out two performance audits between now and mid-2014, examining the question:

> *Is the public service effectively preventing and reducing obesity to improve children's health now and into the future?*

7.24 We started the first audit in late October 2012 and will examine the following sub-questions:

> *Do the Ministries of Health and Education and Sport New Zealand understand the extent of child obesity? Are they effectively planning for the delivery of services to prevent and reduce its prevalence and effects, taking into account what works for children and their families/caregivers?*

7.25 The second audit will examine the sub-question:

> *Are interventions delivered by these public entities effectively preventing and reducing the prevalence and effects of child obesity now and for the future?*

7.26 The focus of the second audit will be to examine the effectiveness and efficiency of interventions. We will do this by examining the delivery of services from public entities through to end users, testing systems, processes, and relationships.

7.27 We expect to present the report on our first audit to the House of Representatives by the end of June 2013. The expected publication date for our report on the second audit is the end of June 2014.

Education for Māori: Context for our proposed audit work until 2017

7.28 In August 2012, we published a report that described the history of education policy and developments for Māori, set out some leading research and statistics, and described the role of the various public entities involved in education. The report set out the work we intend to do during the next five years on how the education system serves Māori.

7.29 Improving the education system to support Māori students to achieve their full potential is a complex challenge. During our scoping work for this report, we decided on some questions that we considered would make this challenge more manageable. Those questions helped us prepare a framework to guide our future Māori education audit activity under one overarching question:

> *How well does the education system currently support Māori students to achieve their full potential and contribute to the future prosperity of New Zealand?*

7.30 Our August 2012 report encouraged people to think about our list of other possible audits in education for Māori and share their thoughts with us.

7.31 For 2012/13, the audit focus will be:

> *Ka Hikitia is the educational strategy for supporting young Māori to thrive academically, socially, and culturally for New Zealand's future: Are there proper processes and practices in schools and other educational agencies to support that strategy?*

7.32 Our audit team is currently carrying out fieldwork for this audit and will consider evidence from education sector stakeholders, including students, whānau, iwi, and community groups. The team will also draw on the advice of a respected group of Māori education advisors. We expect that our report on this audit will be presented to the House of Representatives in the first half of 2013.

Appendix 1
Tertiary education institutions and their subsidiaries

Figure 14 presents a list of tertiary education institutions (TEIs) and their associated subsidiaries. We use the terms "parent" and "subsidiary" to indicate relationships having any level of shareholding or other form of ownership. This differs from the definition of those terms under NZ IAS 27: *Consolidated and Separate Financial Statements*, as applied for financial reporting purposes. It also differs from the definitions of "holding company" and "subsidiary" under the Companies Act 1993.

The nature of the relationships appears complex. We can see seven kinds of ownership relationships between TEIs and subsidiaries. A TEI can own:

- one or more jointly owned subsidiaries in partnership with at least one other entity (the other parent/s can include polytechnics, universities, schools, territorial local authorities, district health boards, or Crown research institutes);[40]
- one or more individually owned subsidiaries;
- a subsidiary that owns a subsidiary, while also being a subsidiary of another subsidiary;
- a subsidiary of a subsidiary being jointly owned by another subsidiary;
- an individually owned subsidiary that owns one or more subsidiaries by itself;
- an individually owned subsidiary that owns one or more subsidiaries in partnership with at least one other entity; and
- a jointly owned subsidiary that owns one or more subsidiaries.

Figure 14
List of tertiary education institutions and their associated subsidiaries

	Levels of subsidiary, joint venture, or associate	
Aoraki Polytechnic	Artena Society Limited (has 12 parents)	
		Student Management Software Solutions Limited
	Polytechnics International of New Zealand Limited (has 16 parents)	
		NZ Tertiary Education Consortium Limited (has 5 parents)
	Skills for NZ Limited (has 13 parents)	
	Training Solutions Limited	

40 In one instance, a subsidiary is owned by 16 TEIs.

	Levels of subsidiary, joint venture, or associate	
Auckland University of Technology	Auckland University of Technology Foundation	
	AUT Enterprises Limited	
	AUT/Millenium Ownership Trust	
	LCO New Zealand Limited (has 4 parents)	
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand (has 8 parents)	
	New Zealand Tertiary Education Consortium Limited	
	NZ Universities Academic Audit Unit (has 8 parents)	
Bay of Plenty Polytechnic	Artena Society Limited	
		Student Management Software Solutions Limited
	Polytechnics International of New Zealand Limited	
		NZ Tertiary Education Consortium Limited
	Skills for NZ Limited	
	Tertiary Accord of New Zealand Limited (has 7 parents)	
Christchurch Polytechnic Institute of Technology	Canterbury Innovation Incubator Limited (has 3 parents)	
		HITLAB NZ Limited
	Christchurch Polytechnic Foundation	
	CPIT Holdings Limited	
	Otautahi Education Development Trust	
	Polytechnics International of New Zealand Limited	
		NZ Tertiary Education Consortium Limited
	Te Tapuae O Rehua Limited (has 4 parents)	
	Tertiary Accord of New Zealand	
	Tertiary Accord of New Zealand Limited	

	Levels of subsidiary, joint venture, or associate		
Eastern Institute of Technology Hawke's Bay	Arena Society Limited		
		Student Management Software Solutions Limited	
	Eastern Institute Of Technology Limited		
		Skills for NZ Limited	
		Polytechnics International of New Zealand Limited	
			NZ Tertiary Education Consortium Limited
	Tertiary Accord of New Zealand Limited		
	Eastern UT Limited		
	College Limited		
	Tuatara Trust		
	Regional Indoor Sports & Event Centre Trust		
Lincoln University	Agra One Limited (has 2 parents)		
	Canterbury Innovation Incubator Limited		
		HITLAB NZ Limited	
	Ivey Hall & Memo Hall 125th Anniversary Appeal Gifting Trust		
	Ivey Memo Hall 125 Anniversary Appeal Taxable Activity Trust		
	The Massey Lincoln and Agricultural Industry Trust (has 2 parents)		
	Lincoln University Property Joint Venture Limited		
		Lincoln Ventures Limited	
		Lincoln Hospitality Limited	
		Lincoln University Property Joint Venture No. 2 Limited	
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	NZ Universities Academic Audit Unit		
	Te Tapuae O Rehua Limited		
	New Zealand Synchrotron Group Limited (has 10 parents, including 3 Crown Research Institutes)		

	Levels of subsidiary, joint venture, or associate		
Massey University	E-Centre Limited		
	Agra One Limited (has 2 parents)		
	The Massey Lincoln and Agricultural Industry Trust		
	New Zealand School of Music Limited (has 2 parents)		
	Massey University Foundation		
	Massey Ventures Limited		
		Standard Limited	
			Standard Holdings Limited
	Meat Biologics Research Limited (has 3 parents, including AgResearch (Meat Biologics Consortia) Limited and IRL BIOSOL Limited)		
		Meat Biologics Research Limited	
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	NZ Universities Academic Audit Unit		
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	New Zealand Synchrotron Group Limited		
Nelson Marlborough Institute of Technology	Artena Society Limited		
		Student Management Software Solutions Limited	
	Nelson Polytechnic Educational Society Incorporated		
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
	Tertiary Accord of New Zealand Limited		
Northland Polytechnic	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
	Tertiary Accord of New Zealand Limited		

	Levels of subsidiary, joint venture, or associate		
Otago Polytechnic	Dunedin City Tertiary Accommodation Trust (has 2 parents)		
	Upstart Incubation Trustee Company Limited (has 3 parents, including Dunedin City Council)		
		Upstart Incubation Trust	
			Upstart Angels Limited
	Tertiary Accord of New Zealand Limited		
	The Open Education Resource Foundation Limited		
	Otago Institute of Design (has 2 parents)		
Southern Institute of Technology	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
	Southern Education Charitable Trust		
Tai Poutini Polytechnic	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
	Tai Poutini International Limited		
	West Coast Climbing Wall Trust		
	Qatar Technical Institute		
Tairawhiti Polytechnic	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
Te Wananga o Aotearoa Te Kuratini o Nga Waka	Aotearoa Scholarship Trust		
	Open Wananga Limited		
		Open English Limited	
	Papatoa Forestry Limited		

	Levels of subsidiary, joint venture, or associate			
Te Wananga o Raukawa	Te Wananga-o-Raukawa Charitable Trust			
Te Whare Wananga o Awanuiarangi	McAlister Holdings Limited			
The Open Polytechnic of New Zealand	Skills for NZ Limited			
Unitec Institute of Technology	Polytechnics International of New Zealand Limited			
		NZ Tertiary Education Consortium Limited		
	UNITEC Apprenticeship Training Trust			
	UNITEC Recreation Trust			
	UNITEC Trust			
	UNITEC Limited			
Universal College of Learning (UCOL)	Minerva International Education Limited			
	Southern North Island Educational Development Trust			
		Chilton Holdings Limited		
	Polytechnics International of New Zealand Limited			
		NZ Tertiary Education Consortium Limited		
	Skills for NZ Limited			
	Tertiary Accord of New Zealand Limited			
	UCOL International Limited			
	UCOL Developments Limited			
	UCOL Holdings Limited			
		UCOL School of International Cuisine Limited		
			LCB Management NZ Limited (has 2 parents)	
				Le Cordon Bleu New Zealand Institute Limited Partnership
	Cybus (has 2 parents)			

	Levels of subsidiary, joint venture, or associate		
University of Auckland	Auckland Uniservices Limited		
		Kumanu Limited	
		Bloktech Systems Limited	
	Eversdale Holdings Limited		
	Intellicontrol Systems Limited		
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	NZ Universities Academic Audit Unit		
	Telsar Investments Limited		
	New Zealand Synchrotron Group Limited		
University of Canterbury	Canterbury Innovation Incubator Limited		
		HITLAB NZ Limited	
	Canterbury Tertiary Education Millenial Trust		
	Canterbury TX Limited		
	Canterprise Limited		
		Entre Limited	
		Canterprise Trustees (No2) Limited	
		Canterprise Nominees Limited	
		Canterprise Trustees ArcActive Limited	
			ArcActive Limited
	University of Canterbury Alumni Association Inc		
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	NZ Universities Academic Audit Unit		
	New Zealand Synchrotron Group Limited		
	Te Tapuae O Rehua Limited		

	Levels of subsidiary, joint venture, or associate		
University of Otago	University of Otago Foundation Studies Limited		
	Dunedin City Tertiary Accommodation Trust		
	LCO New Zealand Limited		
	Otago Institute of Design		
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	NZ Universities Academic Audit Unit		
	New Zealand Synchrotron Group Limited		
	Otago Holdings Limited		
		Otago Innovation Limited	
		Immune Solutions Limited	
		NZ Tertiary Education Consortium Limited	
		New Zealand Genomics Limited	
		Unipol Recreation Limited	
	Te Tapuae O Rehua Limited		
	University of Otago Foundation Trust		
	New Zealand Centre for Reproductive Medicine (has 2 parents, including Canterbury District Health Board)		
	Upstart Incubation Trustee Company Limited (has 3 parents, including Dunedin City Council)		
		Upstart Incubation Trust	
			Upstart Angels Limited

	Levels of subsidiary, joint venture, or associate	
University of Waikato	LCO New Zealand Limited	
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand	
	New Zealand Tertiary Education Consortium Limited	
	NZ Universities Academic Audit Unit	
	Student Campus Building Fund Trust	
	New Zealand Synchrotron Group Limited	
	The University of Waikato Foundation	
	The University of Waikato Research Trust	
	U Leisure Limited	
	New Zealand Institute of Rural Health (has 2 parents, including Waikato District Health Board)	
	Hamilton Fibre Network Limited (has 4 parents, including Waikato Regional Council and Hamilton City Council)	
	Waikatolink Limited	
		11 Ants Analytics Limited
		Aldera Limited
		AngelLink Limited
		Aquatrac Limited
		BioActivity Certification NZ Limited
		Data Mining Components Limited
		Gen 3.0 Limited
		Graftoss Limited
		High Growth Investment Limited
		ILink Apps Limited
		Kiwi Innovation Network Limited
		Nouvoa Limited
		Novatein Limited
		NZ PowerCo Limited
		Obodies Limited
		Rural Link Limited (now changed name to Lite Wire)
		Solenza Limited
		WaikatoLink Technology Limited
		Zygem Corporation Limited

	Levels of subsidiary, joint venture, or associate		
Victoria University of Wellington	Victoria University of Wellington Foundation		
	LCO New Zealand Limited		
	New Zealand School of Music Limited		
	New Zealand Vice Chancellors' Committee, trading as Universities New Zealand		
	New Zealand Tertiary Education Consortium Limited		
	NZ Universities Academic Audit Unit		
	Research Trust of Victoria University of Wellington		
	Te Puni Village Limited		
	New Zealand Synchrotron Group Limited		
	Victoria Link Limited		
		iPredict Limited	
			Predictions Clearing Limited
		Wetox Limited (has 2 parents, Victoria Link Limited and Victoria University of Wellington)	
	VUW Art Collection Funding Trust		
	VUW School of Government Trust		
Waiariki Institute of Technology	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
Waikato Institute of Technology	Motortrain Limited		
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Prima Group Limited		
		Learning Works Limited	
		Waikato International Limited	
		Wintec Education and Training Associates Limited	
		Prima Limited (has 2 parents, including Hamilton City Council)	
	Soda Inc. Limited (has 2 parents, including Hamilton City Council)		
	The Wintec Foundation		
	Hamilton Fibre Network Limited (has 4 parents, including Waikato Regional Council and Hamilton City Council)		

	Levels of subsidiary, joint venture, or associate		
Wellington Institute of Technology	Artena Society Limited		
		Student Management Software Solutions Limited	
	WelTec Connect Limited		
		LCB Management NZ Limited	
			Le Cordon Bleu New Zealand Institute Limited Partnership
	Cybus		
Western Institute of Technology at Taranaki	Artena Society Limited		
		Student Management Software Solutions Limited	
	NZ Institute of Highway Technology Limited		
	L.A. Alexander Agricultural College Trust Board Inc. (has 4 parents, including New Plymouth Boys' High School, New Plymouth Girls' High School and Spotswood College)		
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
Whitireia Community Polytechnic	Artena Society Limited		
		Student Management Software Solutions Limited	
	Polytechnics International of New Zealand Limited		
		NZ Tertiary Education Consortium Limited	
	Skills for NZ Limited		
	Whitireia Foundation		
	Whitireia New Zealand Limited		

Appendix 2
Tertiary education institutions' financial management, student management, and payroll systems

Our auditors routinely consider financial management, student management, and payroll systems and controls during audits. They examine entity-level controls such as risk management, and activity-level controls such as routine security over networks. We also consider risks to IT systems, such as IT disaster recovery planning and information security.

During the 2011 audits, our Audit New Zealand Information Systems Audit and Assurance team looked at what providers and systems TEIs use for managing their:

- financial information;
- student information; and
- payroll.

We have included this information as an Appendix because we consider that it might be useful to the sector. Given the relative homogeneity of requirements of these systems, there could be potential for greater collaboration between TEIs that would lower costs and provide greater resources for managing risk within these systems.

Figure 15 provides an example of the different types of financial management information systems that TEIs use. TechOne predominates (10 out of 25 TEIs), and eight other systems are used.

Figure 15
Types of financial management information systems

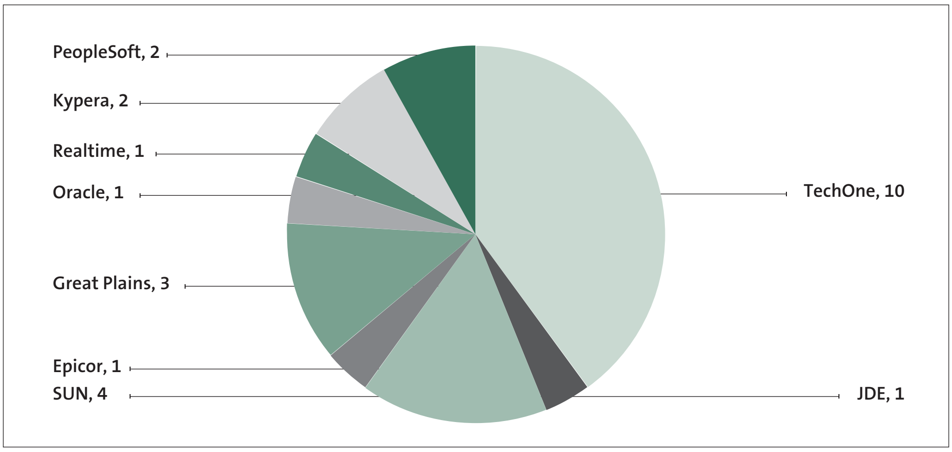
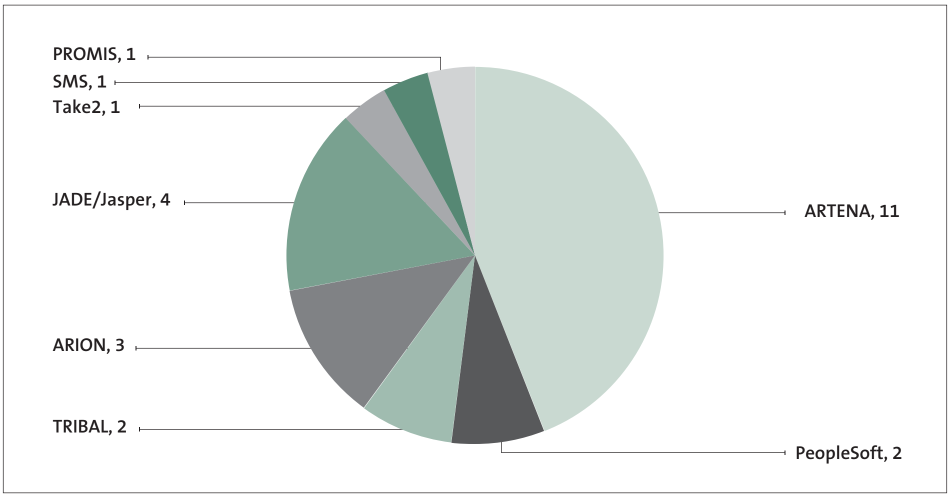


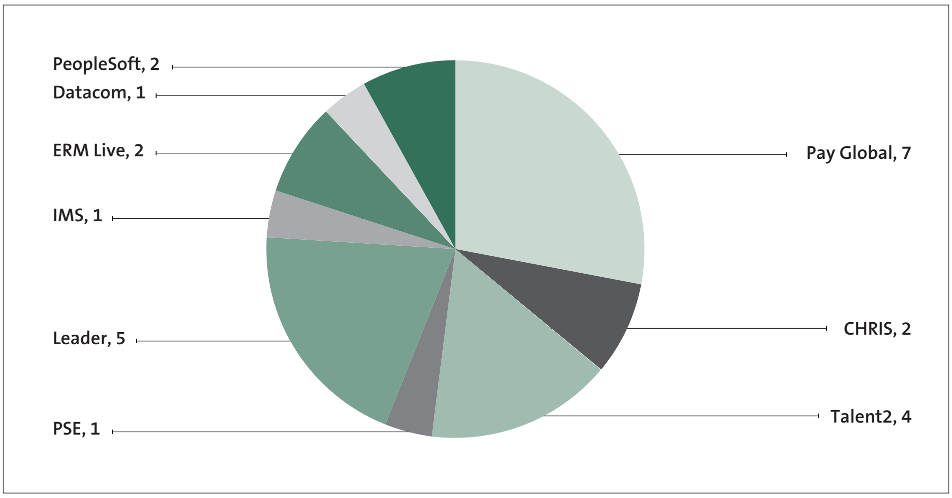
Figure 16 shows the different types of student management systems that TEIs use. There is less variation than there is with financial management information systems, with 11 TEIs using Artena.

Figure 16
Types of student management systems



TEIs use several different types of payroll systems (see Figure 17). PayGlobal is the most common system, with seven TEIs using it. Eight other payroll systems are used by the other TEIs.

Figure 17
Types of payroll systems



Appendix 3
Victoria University of Wellington's outcomes framework

The following information is taken from the statement of service performance in Victoria University of Wellington's *Annual Report 2011*, page 49.

The following table sets out the connections between the Government's long-term strategic direction for tertiary education, Victoria's proposed outcomes, why these are important, what they contribute and the steps needed to achieve them.

Victoria's outcomes framework

New Zealand Government's long-term strategic direction for tertiary education

"Create and share new knowledge that contributes to New Zealand's economic and social development and environmental management."
Tertiary Education Strategy 2010–2015 (TES) page 18

Victoria's high-level outcomes What is Victoria seeking to influence, over the next three to five years, to create long-term positive change in social state for New Zealanders?	**Outcome 1** New knowledge from Victoria's research supports sustainable economic growth and prosperity for New Zealanders.	**Outcome 2** A more educated and skilled workforce and society.	**Outcome 3** Improved social, cultural and environmental development of New Zealand.
Impact What difference is Victoria making?	High-quality research builds on New Zealand's knowledge base, responds to the needs of the economy and addresses environmental and social challenges.	Victoria's graduates raise the skills and knowledge of the current and future workforce to meet labour market demand and social needs.	Academic staff contribute to systems of governance and policy that are strong, responsive and value for money.
Outputs What is Victoria committed to delivering in a particular year?	The University's annual outputs and the outcomes to which they contribute are detailed in its SFSP. Taken together the outputs and outcomes influence the Government's desired high-level outcomes of economic, social and environmental development. This SSP reports on the 2011 outputs proposed in the SFSP within the 2011 Investment Plan.		
Processes How Victoria is going to do this.	Enhance leadership capability in research, and make appointments that strengthen areas of research excellence.	Foster student success, with particular attention paid to students in their first year, and focus on recruiting the best possible students.	Recruit and develop people who apply their scholarly and professional expertise to areas that support New Zealand's sustainable economic growth, social development and environmental management.

Publications by the Auditor-General

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

- Roles, responsibilities, and funding of public entities after the Canterbury earthquakes
- Effectiveness of arrangements to check the standard of services provided by rest homes: Follow-up audit
- Inquiry into aspects of ACC's Board-level governance
- Education for Māori: Context for our proposed audit work until 2017
- How the Far North District Council has administered rates and charges due from Mayor Wayne Brown's company, Waahi Paraone Limited
- Reviewing financial management in central government
- Realising benefits from six public sector technology projects
- Annual Plan 2012/13
- District health boards: Quality annual reports
- Fraud awareness, prevention, and detection in the public sector
- Institutional arrangements for training, registering, and appraising teachers
- New Zealand Qualifications Authority: Assuring the consistency and quality of internal assessment for NCEA
- Statement of Intent 2012–2015
- Public entities' progress in implementing the Auditor-General's recommendations 2012
- Inquiry into how Christchurch City Council managed conflicts of interest when it made decisions about insurance cover
- Overview of the Auditor-General's work in the transport sector

Website

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