



Tertiary education institutions

Results of the 2018 audits

Briefing for the Education and Workforce Committee

November 2019



2018 at a glance

We audit all 27 public tertiary education institutions (TEIs) from Whangarei to Invercargill.

232,000

of which 31,000 were international students. Overall, universities saw increases in domestic and international students, but numbers fell elsewhere.

Number of full-time equivalent students*



Types of TEI and number of EFTS



8 Universities
(136,044)



16 Institutes of Technology and Polytechnics (ITPs)
(72,740)



3 Wānanga
(23,490)

\$5.4 billion

up \$116 million from 2017.

Total revenue



Surpluses and deficits

All universities made a surplus, but 10 of the 16 ITPs made a combined loss of \$81.6 million (2017: 9 ITPs/\$70 million loss). One Wānanga also made a loss.

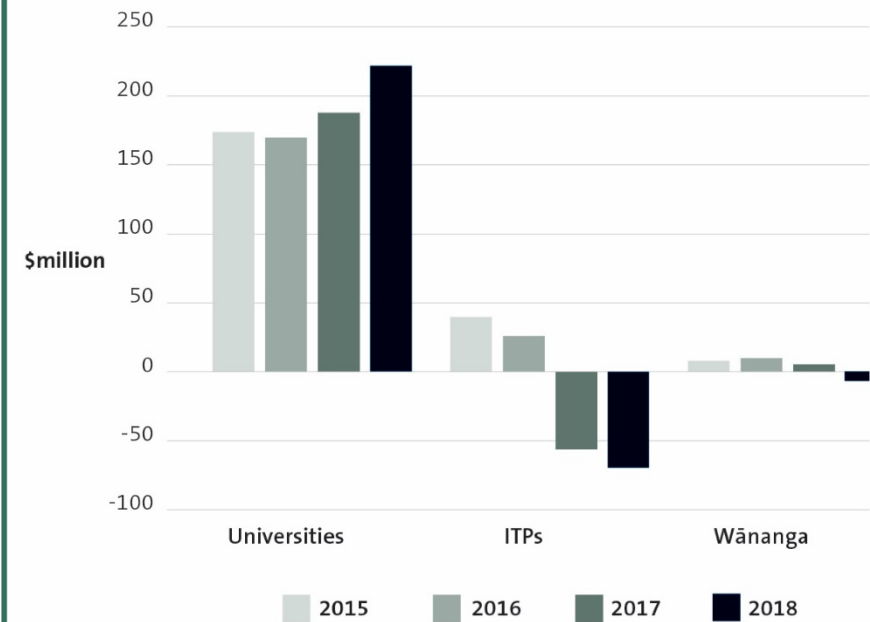


\$14.7 billion in assets
(up \$610 million from 2017)

\$2.36 billion in liabilities
(up \$90 million from 2017)

*The full-time equivalent student value is worked out by course length and complexity – it is not the same as headcount.

Group surpluses/deficits by sub-sector 2015-2018



For further explanation of this briefing, please contact Pat Johnson, Sector Manager, Parliamentary Group on 04 917 1500 or email patricia.johnson@oag.govt.nz

Audit results

24 of 27 reported on time

Tai Poutini Polytechnic, WelTec, and Whitireia Community Polytechnic did not meet their statutory reporting obligations. Several other TEIs were under-prepared, but signed their statements of responsibility on time with a lot of effort and extra cost.



Unmodified audit opinions 24 of 27

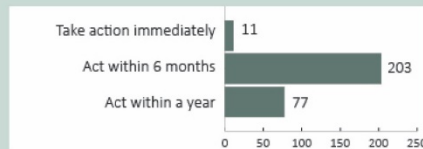
This means you can be assured that the financial statements are a fair reflection of the financial position of the TEI at year-end and its activities during the year. Three TEIs did not report, so we could not give them audit opinions.

126 new recommendations for improvement

TEIs addressed 115 recommendations from previous years, but 165 remained open – making a total of 291.

291

Total number of outstanding recommendations and urgency



Categories for new recommendations in 2018



Top 4

- 1 – improving controls related to expenditure, including payroll
- 2 – improving the application of accounting or other policies
- 3 – improving performance reporting
- 4 – improving IT systems.

“Emphasis of matter” paragraphs

We used these in the 16 ITP audit reports to draw attention to the disclosures about uncertainty created by the Government’s planned reforms of vocational education.

Key issues in this briefing (Ctrl + click to navigate, or page up/page down)

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Headlines from the audits

Audit opinions

- 1.1 We issued 24 **unmodified audit opinions**, which means that the financial statements are a fair reflection of the position for those 24 tertiary education institutions (TEIs) at year-end and of their activities during the year.
- 1.2 We did not issue audit opinions (or audit reports) for Tai Poutini Polytechnic, Wellington Institute of Technology (WelTec), and Whitireia Community Polytechnic. This was because Tai Poutini's Crown Manager, and WelTec and Whitireia's Crown Commissioner, could not sign a statement of responsibility for the financial statements, which had been prepared on a "going concern" basis. Both were awaiting the outcome of a decision by the Government on whether to provide additional funding.
- 1.3 An organisation that is a going concern is assumed to have enough money to pay its bills as they fall due for the "foreseeable future". As a guideline, this will be for at least a year after the date of the audit opinion.
- 1.4 In Tai Poutini's case, it could not produce cash flow forecasts far enough into the future. After the financial year-end, the Government provided extra funding of \$2.25 million for Tai Poutini to meet its obligations until 1 April 2020.
- 1.5 Although they are separate institutions, WelTec and Whitireia have shared management and governance roles. Their cash flow forecasts did not support using the going concern basis.

WelTec was in a stronger position, but it was potentially exposed if Whitireia could not make loan repayments or realise its share of cost savings.

- 1.6 As at 25 November 2019, the Government had not confirmed extra funding for WelTec or Whitireia.
- 1.7 Although we issued unmodified audit opinions, we included an "emphasis of matter" paragraph in the audit reports of the 13 institutes of technology and polytechnics (ITPs) that reported. These paragraphs drew attention to the disclosures in the financial statements about the uncertainty arising from the Government's proposed reforms of vocational education. We discuss those reforms on pages 11-12.

Additional assurance work at Wintec

- 1.8 The Chairman of Waikato Institute of Technology (Wintec) asked us to carry out additional assurance work about certain international travel expenses incurred by the Chief Executive, and past and present members of the executive team. We also reviewed all redundancy and severance payments made to former Wintec employees from 2013 to 2017.
- 1.9 A public organisation must be able to show what it is spending money on and that any expenditure is justified, reasonable, and appropriate in the circumstances. Sensitive expenditure, where there is a perceived potential for private benefit, should be conservative and moderate. There also needs to be transparent and robust processes for approving expenditure.
- 1.10 In both areas we tested, we identified incomplete and inaccurate records of the expenditure, and numerous instances where the expenditure had not been properly

approved. As a result, in many cases, Wintec was unable to provide an account of how it had spent public money. This is unacceptable for a public organisation charged with the stewardship of public resources.

- 1.11 We were particularly concerned about the processes, patterns of behaviour, and level of documentation that we saw in our work on international travel expenditure. Some of these practices do not meet standards acceptable in the public sector and provide an increased opportunity for the misuse of public money. You can read our full report [here](#).

Timeliness of reporting

- 1.12 All 24 TEIs that reported met their statutory reporting deadline.

Preparation for audit

- 1.13 Although a high proportion of TEIs meet their statutory reporting deadlines, there can be hidden costs in meeting the deadlines. These costs are not just financial – they can include extra stress on TEI staff and on the audit teams.
- 1.14 TEIs can do much to ensure that the audit process runs smoothly. Robust governance frameworks and internal controls are vital to good stewardship of organisations and in maintaining public trust and confidence. When they are operating effectively, these frameworks and controls can reduce the amount of work auditors need to carry out.
- 1.15 Preparation for the audit process is also important. Some common issues faced by our auditors this year included:

- auditors not being able to rely on the internal controls, and the TEIs not having all the required information available at the start of the process;
- lack of internal quality review of the annual report (including the financial statements and statements of service performance), relying on the auditors to find errors;
- auditors receiving multiple iterations of the financial statements; and
- TEIs not including enough disclosures in their reporting to explain certain figures.

- 1.16 This year, we approved 11 requests from auditors wanting to charge additional costs to TEIs because of delays and rework caused by the TEIs (and two other requests relating to subsidiary company audits).

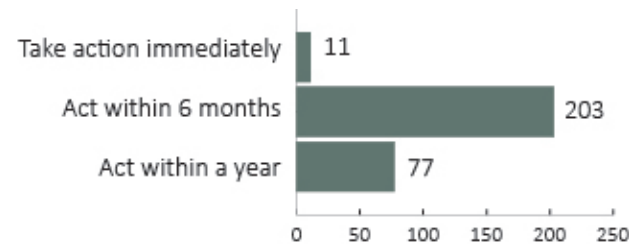
- 1.17 In 2019 and 2020, we intend to work more closely with the senior managers, and Audit and Risk Committees, of some TEIs to help them understand how their oversight can contribute to an improved audit process.

Our assessment of the effectiveness of systems and controls

- 1.18 We have already highlighted the importance of effective systems of control and good governance. Our auditors add value to the organisations they audit and strengthen public accountability by pointing out improvements to increase the effective operation of those frameworks and controls.
- 1.19 Our auditors made 126 new recommendations for improvement resulting from their work on the 2018 audits of TEIs.
- 1.20 TEIs addressed 115 recommendations from previous years, but 165 remained open – making a total of 291 open recommendations.
- 1.21 Figure 1 shows the status of all open recommendations at 30 April 2019. When making recommendations, our auditors indicate the seriousness of the matter by indicating how quickly TEIs should act. We expect TEIs to have cleared all of the recommendations by the time of the next audit, but some recommendations will need an urgent response.
- 1.22 Of the 11 “take action immediately” recommendations in Figure 1, 10 were from previous years.¹ The University of Otago had five of these recommendations, including reinstating an internal audit function (in-house or outsourced), managing conflicts of interest in procurement, and having all

journal transactions independently reviewed. Auckland University of Technology, Massey University, Ara Institute of Canterbury, the Eastern Institute of Technology (EIT), and Otago Polytechnic had one outstanding urgent recommendation each.

Figure 1: Open recommendations at 30 April 2019, by relative urgency for action.



Source: Auditors' reports to the councils of TEIs.

- 1.23 The top four categories of recommendation our auditors made in 2018 were for TEIs to improve:
- controls related to expenditure, including payroll systems;
 - how they applied accounting policies, or adhered with the TEI's own policy framework (such as spending on travel);
 - how well the TEI's annual report tells interested audiences about how it is performing; and

¹ We know some TEIs have acted on some of these recommendations, but we will assess that progress in the 2019 audit.

- information technology systems and controls (such as security and preventing over-rides of rules).

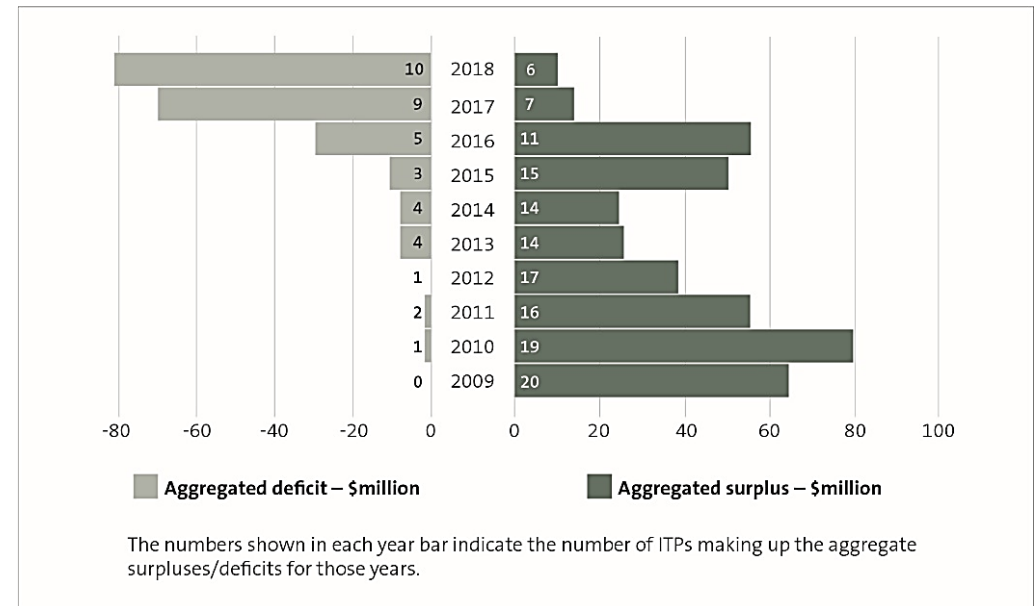
1.24 In 2020, we intend to engage more frequently with the Audit and Risk Committees of those TEIs with the highest number of outstanding recommendations. In our view, those Audit and Risk Committees should be more rigorous in following up on progress in addressing our recommendations.

Financial sustainability of the institutes of technology and polytechnics

Aggregated surpluses and deficits

- 2.1 In our report on [the results of the 2017 audits](#), we focused mostly on the financial performance of the ITP sector.
- 2.2 Although not all ITPs were in financial difficulty, there had been a significant increase in the number that were, and in the size of the combined deficit, between 2016 and 2017.
- 2.3 Figure 2 shows that, by 2018, 10 ITPs returned an aggregated deficit of \$81.6 million. This was an increase of \$11.6 million from 2017, when nine ITPs recorded an almost \$70 million aggregated deficit.
- 2.4 In 2018, six ITPs returned an aggregated surplus of \$10.1 million. This was a decrease of \$3.7 million from 2017, when seven ITPs recorded a \$13.8 million aggregated surplus.
- 2.5 The combination of higher deficits and lower surpluses saw the aggregated overall deficit rise to \$71.5 million in 2018, from \$56 million in 2017.

Figure 2: Aggregated surpluses and deficits, 2009 to 2018

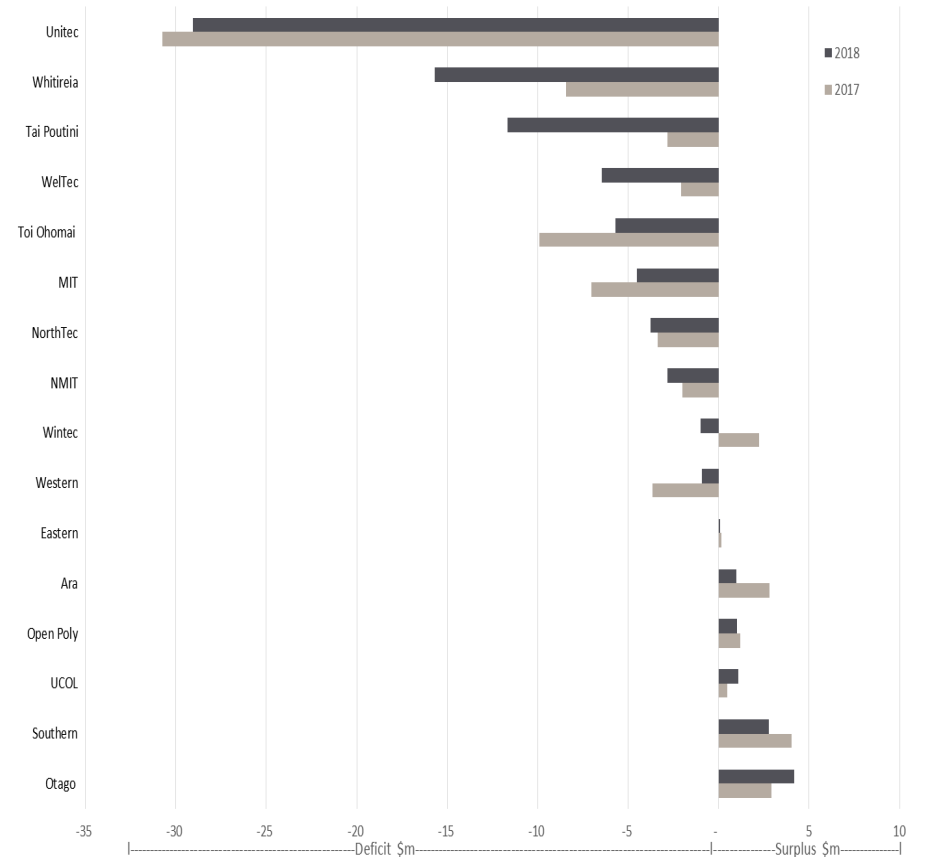


Source: Office of the Auditor-General financial statements database.

Individual ITP surpluses and deficits 2017 and 2018

- 2.6 In 2018, Wintec made a deficit of \$991,000, having made a surplus of slightly more than \$2.2 million in 2017. It became the tenth ITP in a deficit position.
- 2.7 Figure 3 shows that Toi Ohomai Institute of Technology, Manukau Institute of Technology (MIT), Western Institute of Technology at Taranaki (WITT), and Unitec reduced their deficits in 2018 (although Unitec still had a significant deficit of \$29 million). WelTec, Whitireia, Tai Poutini, NorthTec, and Nelson Marlborough Institute of Technology (NMIT) all had larger deficits in 2018 than in 2017.
- 2.8 The Tertiary Education Commission (TEC) has a framework to monitor the financial viability of TEIs. One measure the TEC uses is operating surplus as a percentage of revenue, with a low-risk threshold at 3% or above.
- 2.9 Of the six ITPs making a surplus, only Southern Institute of Technology (SIT) and Otago Polytechnic made a return of greater than 3% of revenue (at 4.5% and 4.1% respectively). Otago Polytechnic’s surplus increased by about \$1.3 million in 2018, while SIT’s surplus decreased by a similar amount.
- 2.10 As with last year, the main reason for revenue shortfalls was a continued decline in the number of equivalent full-time student (EFTS) enrolments. We discuss this further in the next section.

Figure 3: Individual ITP surpluses and deficits for 2017 and 2018



Source: Office of the Auditor-General financial statements database.

Student enrolments

2.11 Figure 4 shows that, overall, student numbers in the ITP sector continued to decline in 2018. Total domestic EFTS fell to 61,079 from 63,289 in 2017, and international EFTS fell to 11,661 from 12,590. International EFTS make up about 16% of the student intake, about the same proportion as in 2016.

Domestic student enrolments

2.12 At the individual ITP level, these effects are not felt equally. Tai Poutini lost more than half of its domestic students between 2017 and 2018 as it restructured its student offerings. NorthTec had 664 fewer domestic EFTS and EIT 396 fewer. WITT’s drop in numbers was lower, but it was the third highest in percentage terms. Otago Polytechnic, SIT, the Open Polytechnic, and the Universal College of Learning (UCOL) increased domestic enrolments.

International student enrolments

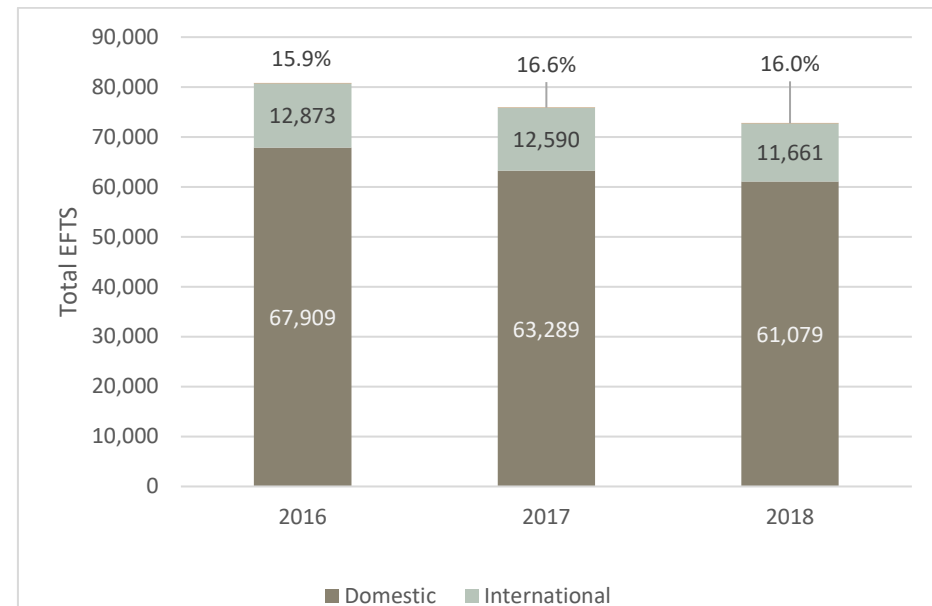
2.13 Whitireia, Unitec, NorthTec, WelTec, and NMIT saw the biggest declines in international student enrolments, while WITT, EIT, and Otago Polytechnic increased their international EFTS by the most.

2.14 A reorganisation at Immigration New Zealand (INZ) caused some delays in processing international student visas. INZ is also vetting some applications more rigorously because of the prevalence of fraudulent applications from some overseas agents.

2.15 INZ expects ITPs to apply the same rigour in accrediting prior learning. INZ noted an increased number of applications

claiming exemption from one or two years of a three-year degree based on prior study in the student’s home location. INZ considers that some of these prior learning claims are not easily verifiable. After we discussed this with NZQA, it told us that it will start to look at the systems for accrediting prior learning of international students in TEIs.

Figure 4: Equivalent full-time student enrolments (EFTS) at ITPs, 2016 to 2018, including the percentage of international students



Source: ITP annual reports.

2.16 On 9 May 2019, INZ and Education New Zealand announced a joint programme of work to “support the education sector in recruiting quality students, communicating key messages, and navigating visa processing issues as they arise”. We will

monitor this issue through our normal engagement with INZ and others in 2019 and 2020. It is currently unclear to us what proportion of visa delays are related to INZ's reorganisation and what proportion are because of the real or perceived increased risk of fraud.

Summary of ITP sector's financial performance

- 2.17 SIT and Otago Polytechnic continue to grow their operations. From 2019, SIT will also operate the Telford Campus of the former Taratahi Institute of Agriculture. SIT's 2018 figures include:
- Music and Audio Institute New Zealand, purchased from Tai Poutini; and
 - full ownership of South Lakes English Language College in Queenstown.
- 2.18 Otago Polytechnic has almost doubled its international EFTS since 2016, with 1116 out of a total of 1436 studying at its Auckland Campus. Its domestic student numbers have also increased after a dip last year.
- 2.19 UCOL achieved a 2.23% return as a percentage of revenue, more than doubling its 2017 surplus, and the Open Polytechnic's domestic student intake has recovered to 2016 levels. Ara and EIT returned small surpluses.
- 2.20 Some TEIs are mitigating some of the effects of further declines in enrolments. WITT is the most notable, having reduced its deficit to \$920,000 from \$3.6 million in 2017.

- 2.21 However, the general picture in many of the ITPs is that cost reductions, even if implemented to plan, are running behind further falls in student enrolments.

The Government's proposed reforms

- 2.22 In August 2019, the Government published its decisions on vocational education and training, and the Education (Vocational Education and Training) Amendment Bill is now at the select committee stage. The Education and Workforce Committee is due to report back to the House by February 2020.
- 2.23 If enacted in its current form, the Bill will convert the 16 ITPs to 16 Crown entity subsidiaries. These will be 100% owned by a new "parent" organisation with the working name of the New Zealand Institute of Skills and Technology. The Government appointed an establishment board for the new entity in September 2019.
- 2.24 Now that the Bill is progressing through the legislative process, we are focused on maintaining accountability during the transition process. Our [submission on the proposed reforms](#) highlighted several risks that need to be managed well. Those risks include maintaining good financial controls and governance, while managing a change process at the same time.
- 2.25 In periods of uncertainty, it is not unusual for staff to leave or to become disengaged. Loss of staff and goodwill can diminish effective safeguards. Basic good practice, such as maintaining separation of duties (for example, in payroll administration or procurement), can deteriorate. This creates

the opportunity for fraud, misuse of public money, and misappropriation of assets from outside and from within the TEI.

- 2.26 We are providing support, consistent with our audit role, to the establishment board for the new institute to help it prepare for the Bill's enactment and set up the new organisation. We can help mitigate some of the transition risks by sharing what we have learnt from similar major transitions and by answering any audit questions as they arise.

Medium-term financial stability of universities

Financial sustainability

- 3.1 In our 2017 report on the TEI audit results, we prioritised ITPs because of the sharp decrease in their financial sustainability since 2016. We concluded that universities were in a stronger position, but this year we looked at their results in more detail. We were interested in understanding whether the operating environment that had led to difficulties in ITPs was likely to have a similar effect on the performance of universities.
- 3.2 Most universities have continued to increase their revenue, surpluses, assets, and equity. All universities have positive net cash flows from operations.
- 3.3 Universities have low levels of debt. Auckland University of Technology (AUT) (15%) and Victoria University of Wellington (VUW) (9%) have the highest debt-to-asset ratio, but all of the others have negligible debt (1% or less).
- 3.4 Universities are also spending more on capital expenditure than the amount their assets are depreciating by. In most cases, this should mean that universities are improving the assets available for teaching, learning, and research.
- 3.5 Universities have also been managing within their means. Total revenue increased by 14.1% and costs by 13.3% since 2015. The universities are engaged in numerous benchmarking groups and collaborative projects to help them understand and manage their costs.
- 3.6 We looked at data on staffing-to-student ratios to see whether universities were managing costs by reducing staff. Overall, the ratio of academic staff to EFTS slightly worsened from 2007 to 2018 – from 16.1 students per staff member to 16.5 students per staff member. However, the ratio of all staff to students went up in all but one university.
- 3.7 VUW, AUT, and the University of Otago's costs ran marginally ahead of revenue in total during 2015-18 (1.9%, 0.8%, and 1.5% respectively), but all have good net cash flow. This indicates some spending to reduce costs in future years,
- 3.8 Massey is the only university to have had a downturn in revenue in 2018. However, it increased its net cash flow from operations, and its equity increased by \$13 million.
- 3.9 Lincoln University returned to a more stable financial position in 2018, mostly because it received the proceeds of an earthquake-related insurance claim. However, Lincoln's small size, its mix of education programmes, and the condition of its physical campus present significant challenges. It still needs to invest heavily in its facilities to attract students.
- 3.10 On 23 November, the Government approved \$80 million to help Lincoln University rebuild its earthquake-damaged science facilities. The investment will take place alongside a modernisation programme covering teaching, research, and partnerships with other agencies.
- 3.11 The financial performance of universities is intrinsically linked to the volume of students they attract. Although most universities have other revenue streams (such as subsidiary companies, research, and charitable giving), the revenue

stream from students (including government funding for domestic students) dominates their income.

Student enrolments

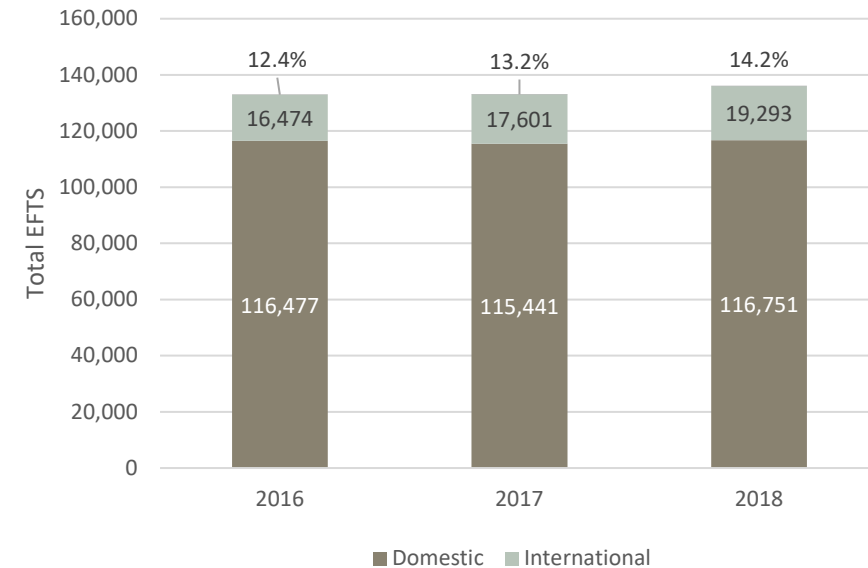
3.12 We looked at the change in enrolments from 2016 to 2018, and in some cases compared the 2018 enrolments to 2007. We chose 2007 because this was the year after some colleges were merged into universities. It was also the year before the global financial crisis. A weakened economy is one factor that can have a positive effect on enrolment into tertiary education. We were also interested to see whether the universities' reliance on revenue from overseas students was increasing. Figure 5 shows the total enrolments expressed in EFTS for 2016 to 2018.

Domestic student enrolments

3.13 For all universities, domestic enrolments increased by 1.14% compared to 2017, are slightly higher than in 2016, and are 2% higher than in 2007. Only Massey University and Lincoln University had fewer enrolments compared to 2017 and 2016.

3.14 Universities have a much more stable flow of domestic students than other types of tertiary provider. Three out of four school-leavers entering tertiary education with a qualification at level 3 choose to go to university. This proportion is not changing much over time, although the number of school-leavers not entering further education straight after leaving school increased sharply between 2017 and 2018. However, the number of school-leavers is expected to start rising again by 2021, from about 60,000 a year to about 65,000 a year.

Figure 5: Equivalent full-time student enrolments (EFTS) at universities, 2016 to 2018, including the percentage of international students



Source: University annual reports.

International student enrolments

3.15 International EFTS enrolments were up 9.61% from 2017 (up 15% since 2007). The proportion of international students has increased to 14.2% from 13.2% last year and 12.4% in 2016.

3.16 However, for most universities, the proportion of revenue from international students and the proportion of revenue from domestic students was about the same in 2018 as it was in 2007. This is partly because the number of international

students is much lower than the number of domestic students and partly because universities are increasing their revenue from other sources.

- 3.17 The Universities of Canterbury, Otago, and Waikato, and VUW have little international EFTS growth as a percentage of the total student population compared with 2007. However, demand at the University of Canterbury will have been affected by the 2010 and 2011 earthquakes, and there are signs that demand has started to increase.
- 3.18 Conversely, the University of Auckland has experienced significant growth in demand from international students since 2007 (up 64%), and international students now make up 15% of its total enrolments. Massey University's international EFTS are now 18% of total EFTS, compared to 14% in 2007.
- 3.19 Lincoln University has the highest exposure to international student markets (38% of total students are international students), compared to 32% in 2007.
- 3.20 We have become aware of an increasing trend of international students enrolling in courses in New Zealand at level 8 and higher on the qualifications framework (such as taught Masters' degrees). These courses are usually of less than a year's duration after allowing for prior learning.
- 3.21 We cannot tell whether the trend is significant enough to contribute to an overdependence on revenue from some international markets. We suggest that the Committee ask the TEC about these trends, as it collects more information than is contained in the annual reports.

Conclusion

- 3.22 Universities are in good financial standing, with low debt and strong equity. Although future international student enrolment patterns might be more volatile than in the past, universities should have enough resources to manage any period of adjustment.
- 3.23 Several other operating environment factors might have a bearing on the future success of universities.
- 3.24 For example, government revenue for level 3 and above domestic student tuition increased by 1.6% from 2019, with a further 1.8% from 2020. Although some costs are rising more quickly than this, universities appear to be managing cost pressures.
- 3.25 The numbers of domestic students should also start to rise again in 2021. If historical patterns prevail, then universities should see further increases in domestic student enrolments.
- 3.26 We are aware that universities are concerned about how their position on various international ranking assessments might affect their ability to attract academic staff and international students. Some universities see this as their major strategic risk, and this is something the Committee could be interested in exploring further with Universities New Zealand, Education New Zealand, and the TEC.