

Results of the 2019 school audits

November 2020

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Our recommendations

We recommend that the Ministry of Education:

1. ensure that changes to the Novopay system include adding appropriate controls for schools, where possible, to help prevent fraud and error and ensure that all transactions are approved within the school's delegations;
2. follow up unusual transactions and anomalies identified as part of the payroll audit so they do not reoccur, including giving boards additional support and guidance on payroll matters if necessary;
3. improve its guidance to schools on what good controls look like; and
4. provide guidance to schools on accounting for "other activities" (for example, Resource Teacher: Learning & Behaviour clusters) that they receive funding for.

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Completing the school audits

- 1.1 In this Part, we report on how many school audits have been completed, including audits of entities related to schools.
- 1.2 This year, the school audits were significantly affected by Covid-19. Of the 2451 school audits for 2019, we completed 1451 (59%) by the statutory deadline of 31 May 2020.¹
- 1.3 Schools must provide their draft financial statements for audit by 31 March. With the country moving to Alert Level 3 on 23 March, closely followed by a move to Alert Level 4 and national lockdown on 25 March, all schools were closed just as auditors were in the early stages of their school audits. The lockdown meant that schools, service providers (who prepare financial statements on behalf of some schools), and auditors were required to work remotely. For schools, this included switching to teaching remotely.
- 1.4 Schools did not reopen fully until 18 May 2020 after the country moved to Alert Level 2, although some were partially open under alert level 3 from 28 April. The ability of schools, service providers, and auditors to work remotely differed significantly according to their situation. Schools also had other priorities during lockdown and at other Alert Levels. As a result, many audits could not progress as planned.
- 1.5 We made it clear early on that we would prioritise the quality of financial reporting by schools, and the quality of our audits, over timeliness. We appreciate the hard work by schools, service providers, and auditors that went into completing 59% of the school audits on time under such challenging circumstances. We have made steady progress on completing the schools audits since May. As at 31 October 2020, we have completed 2159 (88%) school audits.
- 1.6 For the last few years, about 100 (4%) of the previous years' school audits have remained outstanding at the end of October. Because of the disruptions of Covid-19 and the significant delays experienced this year, as at 31 October 292 (12%) of the 2019 audits were still outstanding. Figure 1 shows the number of school audits outstanding by education region, for 2019 and for earlier years.

¹ The total number of school audits includes the audits of 43 entities related to schools. The 1451 that met the statutory deadline included audits completed up to 2 June 2020 because 31 May fell on a weekend.

Figure 1
School audits outstanding as at 31 October, by region

Covid-19 has meant that more of the current year's audits are outstanding as at 31 October than we would normally expect. The effects of Covid-19 on schools and auditors has been varied, so the impact on school audits differs by region.

Region	2019	Previous years
Auckland	109	24
Bay of Plenty, Wairariki	53	15
Canterbury and Chatham Islands	28	3
Hawke's Bay, Tairāwhiti	27	15
Nelson, Marlborough, West Coast	6	2
Otago, Southland	16	2
Tai Tokerau	10	2
Taranaki, Whanganui, Manawatu	2	2
Waikato	26	2
Wellington	9	0
Entities controlled by schools	6	5
Total	292	72

Source: Office of the Auditor-General.

- 1.7 The details of the school audits that were outstanding at 31 October 2020 are on our website. It has been a difficult year for both schools and auditors for the reasons given above, and auditor delays have contributed to the large number of outstanding audits. Our auditors have plans in place to complete the remaining school audits.

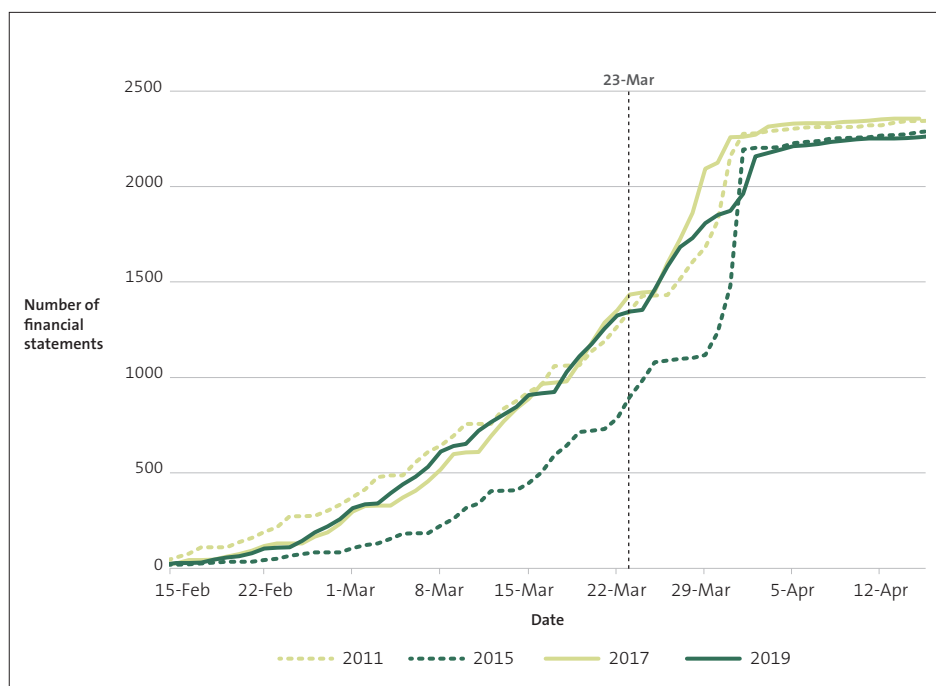
Update on work to improve the timeliness of school audits

- 1.8 We have had problems with the timeliness of school audits since the Novopay system was introduced in 2012. Before this, about 95% of school audits were completed by the 31 May deadline. Schools have until 31 March to provide their financial statements for audit, but in our experience ensuring that all schools meet the 31 May statutory deadline relies on auditors receiving financial statements throughout February and March. For the past few years we have been working with the Ministry of Education (the Ministry) and the school sector to ensure that schools and auditors get the information they need as early as possible.
- 1.9 This year, the Ministry again met the agreed time frames for providing information to schools and auditors, as it did last year. Auditors received 2159 (88% of all schools) financial statements for audit by the statutory deadline of

31 March. This was significantly lower than the 93% we received by the March deadline for the 2017 year. However, Figure 2 shows the rate of receipt of the draft financial statements was slightly better this year than in the 2017 year until 23 March, when schools started to close under Alert Level 3. We have used 2017 as a comparison because the number of financial statements received by the statutory deadline for the 2018 audits was low (90%) as a result of the non-performance of one accounting service provider, which was responsible for over 100 audits.

Figure 2
Numbers of draft financial statements received for audit over the past few years

The rate of receipt of draft financial statements for audit has been returning to pre-Novopay levels (2011) in the past few years. In 2011, which is included in the figure, 95% of audits were completed by the May deadline. However, the closure of schools on 23 March 2020 due to Covid-19 meant more schools than usual missed the 31 March deadline for the 2019 audits.



Source: Office of the Auditor-General.

- 1.10 Although the disruptions resulting from Covid-19 meant that a larger number of schools than normal missed the 31 March statutory deadline, auditors had received 2265 (92%) of draft financial statements for audit within two weeks of the deadline. Of the additional 106 draft financial statements received, 82 were received in the first week of April.

- 1.11 To ensure that audits go as smoothly as possible, schools, service providers, auditors, and the Ministry need to work together. Although the disruptions caused by Covid-19 have meant that we have not improved audit timeliness this year, Figure 2 does show an improvement in when schools provide financial statements for audit. We encourage all involved to keep working together to improve the timeliness of school audits and the accountability of schools.

Completing the school audits for previous years

- 1.12 As we have noted previously, timeliness of reporting is essential to good accountability. Although this has been disrupted this year, it is important that we continue to make progress with the schools that have previous years' audits outstanding.
- 1.13 Figure 3 shows the number of outstanding audits by year. We completed 99 school audits from previous years since we last reported on the results of the school audits in November 2019. There are 72 previous years' audits of 51 schools outstanding at 31 October this year, compared with 47 audits at the same time last year. This reflects several years of poor timeliness for school audits. The disruptions from Covid-19 have meant that auditors (and schools) have had less capacity this year to complete older outstanding audits, but we have still made good progress.

Figure 3
Outstanding audits, at 31 October 2020, by audit year

The number of previous years' audits in arrears has increased compared to the same time last year. Although we have made some progress on older audits, the disruptions of Covid-19 means there has been less capacity to complete these audits.

Audit year	As at 31 October 2020	As at 31 October 2019
2019	292	
2018	44	112
2017	12	23
2016	9	14
2015	5	7
2014	1	2
2013	1	1
Total	364	159

Source: Office of the Auditor-General.

Kura kaupapa Māori

- 1.14 We have noted previously that the list of outstanding audits includes a high proportion of kura. In last year's report, we said that we would like to work with Te Rūnanga Nui o Ngā Kura Kāupapa Māori o Aotearoa (the national collective body of Kura Kaupapa Māori Te Aho Matua communities) and the Ministry to better understand what is preventing kura from completing their audits so we could help to facilitate their completion. Our target was to bring the audits up to date (including the 2019 audits) by the end of this year. Unfortunately, this has been affected by the Covid-19 disruptions to the kura and our auditors. However, we have worked with the Ministry and Te Rūnanga Nui o Ngā Kura Kaupapa Māori o Aotearoa to progress these audits.
- 1.15 Last year, we reported that 10 kura had 21 audits from previous years (relating to the 2017 year and earlier) outstanding. There were also 18 audits from 2018 outstanding. As of 31 October 2020, only 22 of these 39 audits were still outstanding. We have made progress on the older audits, with only 14 audits remaining outstanding for four kura for multiple years. The oldest of these date back to 2015. As with our other arrears, Covid-19-related audit delays have affected our progress in clearing the outstanding audits.

What did our audit reports say?

- 2.1 In this Part, we set out the results of the 2019 school audits² and the results of any audits for previous years that were completed since we reported on the 2018 school audits.

Impact of Covid-19

- 2.2 As part of our audit procedures, we consider any events that might have happened since the school's balance date (31 December) but before the audit report is issued, and whether these might affect the school's financial statements. These are referred to as "subsequent events". Covid-19 and the closure of the schools during Alert Levels 3 and 4 was a significant subsequent event. Because it did not affect the school's financial position as at 31 December, no adjustments needed to be made to the school financial statements. However, schools were asked to explain the impact Covid-19 had on the school in their financial statements.
- 2.3 Because the Ministry continued to fund schools through their operations grants while they were closed, and additional resources were provided to help the transition to remote learning, the impact on most school finances was not significant in the short term. However, schools that are heavily reliant on locally raised funds, and in particular international student revenue, could have a significant loss of revenue. We discuss the implications of this on the financial position of schools in Part 3 of this report.
- 2.4 The audit reports of all schools for the 2019 financial year draw readers' attention to the disclosures in financial statements about the impact of Covid-19.

Modified audit opinions

- 2.5 We issue modified audit opinions if we cannot get enough evidence about a matter or if we conclude that there is an error in the financial information, and when that uncertainty or error is significant enough to change a reader's view of the financial statements. We issued unmodified audit reports on the financial statements of most schools.
- 2.6 Of the audits completed for 2019, nine audit reports contained a modified audit opinion. We also issued a further seven modified opinions for previous-year audits that were outstanding since our last report. We explain the types of modified opinions we issued below.³

2 Including the audits of entities related to schools.

3 These audit reports are for the 2019 year unless noted otherwise.

Disagreements

- 2.7 If a school has prepared its financial statements inconsistently with applicable accounting standards, or we consider that they include a significant error, we issue an opinion that sets out where we “disagree” with the school. We issued this type of opinion for one school.
- 2.8 For the eighth year, we disagreed with William Colenso College for not preparing consolidated (or group) financial statements that included the transactions and financial position for the William Colenso College Charitable Trust. We consider that group financial statements are required because the college “controls” the Trust for financial reporting purposes. The college disagrees with our assessment. As a result, the college is not reflecting all of its transactions and financial position to its community.
- 2.9 Additionally, the auditor reissued the audit report for William Colenso College’s 2018 financial statements on 16 June 2020 because the school reissued its financial statements. The previous 2018 financial statements referred in error to a breach of the borrowing limit. The updated audit report still referred to the disagreement noted above (and reported on last year) and also explained that the school’s financial statements were replaced.

Limitations of scope

- 2.10 We issue “limitations of scope” opinions when we cannot get enough evidence about one or more aspects of a school’s financial statements. The audit report explains which aspect of a school’s financial statements we could not corroborate. We explain the types of limitations of scope that we reported on this year.

Expenditure

- 2.11 We could not get enough assurance over some aspects of spending for the Combined Board of Middle School West Auckland and South Auckland Middle School for 2018, and Te Kura Kaupapa Māori o Te Kura Kokiri for both 2014 and 2015.
- 2.12 Middle School West Auckland and South Auckland Middle School previously operated as charter (or partnership) schools. The contract for the charter schools was terminated in December 2018 and the schools were established as designated character schools. The schools opened as state schools in January 2019. The combined board of trustees appointed to set up the newly established state schools were also members of the Villa Education Trust (VET) board, the previous sponsor of the charter schools.
- 2.13 In August 2020, we completed our audit of the combined board’s initial financial statements for the period from August to 31 December 2018. In our audit report,

we explained that we could not obtain sufficient evidence to confirm the validity of a payment of about \$467,000 for a management fee the combined board paid to VET. We also found no evidence that the conflicts of interest, which resulted from having members in common on both boards, were appropriately managed. This is a matter of some concern to the Auditor-General and we asked the Ministry to investigate. The Office will decide on subsequent action after the Ministry has reported back to us.

- 2.14 In our audit report on the 2014 and 2015 financial statements of Te Kura Kaupapa Māori o Te Kura Kokiri, we explained that we could not get enough evidence to support all expenditure under the direct control of the board of about \$426,000 and \$435,000, respectively, because there was inadequate documentation for payments. We also referred in our audit report to some unusual spending (see paragraph 2.37). We have issued similar opinions every year since 2010.

Locally raised funds

- 2.15 If a school receives funds from its community, it is important that it has appropriate controls in place to ensure that all money received is correctly recorded. We could not get enough assurance about the amounts raised locally for Saint Pius X Catholic School (Melville), Te Kura Kaupapa Māori o Mangatuna, Tinui School, and Taumarunui High School Community Trust. This was because these schools had limited controls over collecting money and recording it. We issued a similar opinion for Te Kura Kaupapa Māori o Mangatuna for 2018 since we reported last.
- 2.16 We reported on insufficient controls over revenues for both Te Kura Kaupapa Māori o Mangatuna for the 2016 year and Taumarunui High School Community Trust for the 2018 year in our report last year. We have not completed the 2019 audits of the other three schools that we reported on in this category last year.

Cyclical maintenance

- 2.17 Schools receive funding for property maintenance as part of their operations grant. Certain types of maintenance are needed only periodically, such as painting the exterior of the school. Because schools are required to maintain the Ministry-owned buildings, they must recognise a provision for this cyclical maintenance in their financial statements. This helps schools to identify the funds needed for periodic maintenance.
- 2.18 School boards are responsible for calculating their cyclical maintenance provision based on the best information available. Historically we have found that some schools do not have evidence to show auditors that their cyclical maintenance provision is reasonable. Last year we reported that more schools than in previous

years (15 in total) could not provide enough evidence that the provision for cyclical maintenance in their financial statements was reasonable. Since our last report we have issued only two opinions referring to a lack of evidence for a schools cyclical maintenance provision. These were for Golden Bay High School and Te Kura Kaupapa Māori o Tuia Te Matangi. Both of these were 2019 audits.

- 2.19 Both schools had similar audit reports for 2018. Of the other 13 schools we reported on last year, two are still to complete their audits. For the other schools, the auditor could get enough evidence for 2019 and we could issue standard audit reports.

Other matters

- 2.20 Vanguard Military School (2018) – This school was newly established as a designated character school after the closure of the previous charter school. We could not get enough evidence about the value of inventory the school included in its financial statements. Because the auditors were appointed in 2019 after the state schools were established, the auditors could not attend the year-end inventory count and verify the inventory held at 31 December 2018.
- 2.21 Blue Mountain College, Pekerau School, and Mountainview High School (2018) – In the previous year for each of these schools, we could not get enough assurance about some of the spending of the Board. For Pekerau School we were also unable to get enough assurance about the completeness of the locally raised funds revenue in the previous year. As a result, in this year’s audit report we have referred to a limitation on the comparative information in the financial statements. For the year being audited, we could get the necessary evidence we needed.

Matters of importance that we have drawn readers’ attention to

- 2.22 In certain circumstances, we include comments in our audit reports to either highlight a matter referred to in a school’s financial statements or note a significant matter a school did not disclose. We do this because the information is relevant to readers’ understanding of the financial statements.
- 2.23 These comments are not modifications of our opinion. We are satisfied that the financial statements fairly reflect the schools’ transactions and financial position. Rather, we point out important information, such as a matter of public interest or a breach of legislation. This includes when we consider schools are experiencing financial difficulty, which we discuss in Part 3.

- 2.24 As explained in paragraph 2.4, we drew readers' attention to the impact of Covid-19 on school financial statements in all our audit reports. Below we set out other matters we have drawn attention to in our audit reports this year.

Matters of public interest

- 2.25 We issued 22 audit reports that referred to matters of public interest. Some of these reports were for previous years.

Potential conflicts between school board of trustees and proprietor

- 2.26 Sacred Heart College (Auckland) (2017) – For the eighth year, our audit report drew attention to the close relationship between the school, its proprietor, and the Sacred Heart Development Foundation (the foundation). The school, the foundation, and the proprietor all have trustees in common, and the principal receives remuneration from the foundation. This gives rise to potential conflicts of interest.
- 2.27 Consistent with earlier audit reports, the 2017 audit report also notes that the school should not pay for hospitality to further relationships between the foundation and former students of the school. Although the foundation is related to the school, it is a private entity that the board does not control. It is not clear whether the school would benefit from the expenditure.
- 2.28 The audit report also drew attention to the school's failure to meet statutory deadlines. The 2018 and 2019 audits for the school are still outstanding.

Overseas travel

- 2.29 Taumarunui High School (2017) – The school spent \$60,475 on two trips during 2017. The principal travelled to Europe to market the school to overseas students, and to the United States to learn about Big Picture learning. Both of these trips were consistent with the school's strategy. However, the school was unable to provide sufficient evidence for \$10,904 of the expenditure incurred by the principal. The amounts spent were also significantly higher than was formally approved by the board.
- 2.30 Te Kura Kaupapa Māori o Mangatuna (2017) – The kura spent \$36,200 on overseas travel. \$18,077 was spent on a professional development trip to Calgary for three staff members and \$18,133 on further travel through the United States, which included visiting Disneyland and other resorts. The board should not use school funds for travel that does not have a clear educational purpose.
- 2.31 We discuss overseas travel further in Part 4.

Other matters

- 2.32 Westlake Boys' High School (2018) – During 2018, the trustees wound up the Westlake Boys High School Foundation and transferred the remaining assets (\$349,000) to a new trust, the Westlake Boys' Community Foundation. Because the Westlake Boys' High School Foundation had been assessed as being under the "control" of the school board for financial reporting purposes, the school had reported as a Group (a combination of the school's and foundation's financial information). The Westlake Boys' Community Foundation is a new legal entity and has not been assessed as a public entity, so the school will not include the financial information for this new foundation in its financial statements.
- 2.33 As a public entity, the Westlake Boys High School Foundation was audited by the Auditor-General. In paragraph 2.39 we refer to our 2018 audit of the foundation.
- 2.34 Lumsden School (2017) – The board transferred \$31,730 of maintenance funding provided to maintain the school buildings to a trust without the approval from the Ministry of Education. We also drew attention to a conflict of interest because the principal is also a trustee of the trust.
- 2.35 Whangamarino School (2017) – We could not verify about \$22,000 of the school's expenditure because there was inadequate documentation. As a result, we could not conclude on whether the expenditure related to the school.
- 2.36 Te Kura Kaupapa Māori o Te Tonga o Hokianga (2016 and 2017) – The kura was subject to a significant fraud over several years. Our audit report referred to the disclosures in the financial statements about the losses from this fraud. The kura's audits were delayed while the alleged fraud was investigated and eventually prosecuted. Our audit report also referred to the fact that this meant the kura had missed the statutory deadlines for reporting.
- 2.37 Te Kura Kaupapa Māori O Te Kura Kokiri (2014 and 2015) – As well as modifying our opinions because of limited controls over payments, we also outlined that the school spent unusually large amounts on: fuel, repairs, and maintenance for cars not owned by the school; marae rentals; and other general expenses. The audit reports for 2016 to 2019 are still outstanding.
- 2.38 We drew attention to five schools that could not reasonably estimate their cyclical maintenance provisions: Arthur Street School, Hagley Community College, Maniototo Area School, Oxford Area School, and Russley School. These schools were uncertain about whether they would need to maintain their buildings in the near future due to significant future building works. The uncertainties for some of these schools arise because they are part of the Christchurch Schools Rebuild Programme.

- 2.39 When a school closes, or is due to close, its financial statements are prepared on a disestablishment basis. This is because the school is no longer a “going concern” and its assets will be distributed after it has closed. We issued audit reports for the closed schools (Figure 4), which refer to the fact the financial statements are prepared on a disestablishment basis.

Figure 4
Schools with financial statements prepared on a disestablishment basis

We referred to the fact that the financial statements of seven schools were prepared on a disestablishment basis. These schools were either closed or due to close.

2019 audits	Previous-year audits
Homai Early Childhood Centre	Avondale School (Christchurch) (2016)
Te Kura o Hata Maria (Pawarenga)	Mapiu School (2018)
Tuturumuri School	Sunnydene Special School (2016)
	Westlake Boys’ High School Foundation (2018)

Source: Office of the Auditor-General.

Reporting on whether schools followed laws and regulations

- 2.40 As part of our annual audits of schools, we consider whether schools have complied with particular laws and regulations primarily about financial reporting. The main Acts that influence the accountability and financial management of schools are the Education and Training Act 2020 (this replaced the Education Act 1989 on 1 August 2020) and the Crown Entities Act 2004.
- 2.41 Usually, schools disclose breaches of the Education and Training Act⁴ and the Crown Entities Act in their financial statements. Sometimes we report on breaches in a school’s audit report. From our audits this year we identified that:
- 31 schools (2018: 42) borrowed more than they were allowed to (Regulation 12 of the Crown Entities (Financial powers) Regulations 2005);
 - two schools (2018: 1) did not use the Ministry’s payroll service to pay teachers, which they must use for all teaching staff (section 578 – previously section 89(2) of the Education Act);
 - three schools (2018: 10) lent money to staff, which they are not allowed to do (section 154 – previously clause 28 of Schedule 6 of the Education Act);
 - five schools (2018: 5) invested money in organisations without the Ministry’s approval (section 154 – previously clause 28 of Schedule 6 of the Education Act);

⁴ References are to the Education and Training Act unless otherwise stated. The Education Act 1989 would still have applied when most of the audits were completed (the Education and Training Act 2020 came into force on 1 August 2020), so we have also included the previous reference in the Education Act 1989.

Part 2

What did our audit reports say?

- six schools (2018: 4) had trustees that did not comply with rules about conflicts of interest (sections 9 and 10 – previously section 103 of the Education Act);
- two schools (2018: 2) did not comply with the banking arrangements set out in section 158 of the Crown Entities Act; and
- two schools (2018: 2) breached legislation for other reasons.

2.42 We have provided details of all the non-standard audit reports issued to schools and breaches of legislation reported, as at 31 October 2020 on our website. The data is also provided as an interactive map.

Schools in financial difficulty

- 3.1 In this Part, we report on the financial health of schools, those schools considered to be in financial difficulty, and why schools get into financial difficulty.
- 3.2 The data provided in this Part is based on the financial information collected by the Ministry as at 14 October. At this time, the Ministry's database had financial information for 2020 schools.

What we mean by financial difficulty

- 3.3 Most schools are financially sound. However, each year, we identify some schools that we consider to be in financial difficulty.
- 3.4 When we issue our audit report we are required to consider whether the school can continue as a "going concern" for the next 12 months. This means that the school has sufficient resources to continue to pay its bills for the next 12 months.
- 3.5 When carrying out our "going concern" assessment we look for indicators of financial difficulty. One such indicator is when a school has a "working capital deficit". This means that, at that point in time, the school needs to pay out more funds in the next 12 months than it has available. Although a school will receive further funding in that period, a school might find it difficult to pay bills as they fall due, depending on the timing of that funding.
- 3.6 A school with an overdraft or low levels of available cash is another sign of potential financial difficulty. As we are considering the 12-month period from the signing of the audit report, we will also consider the school's performance and any relevant matters in the period since the year end.

The financial health of schools

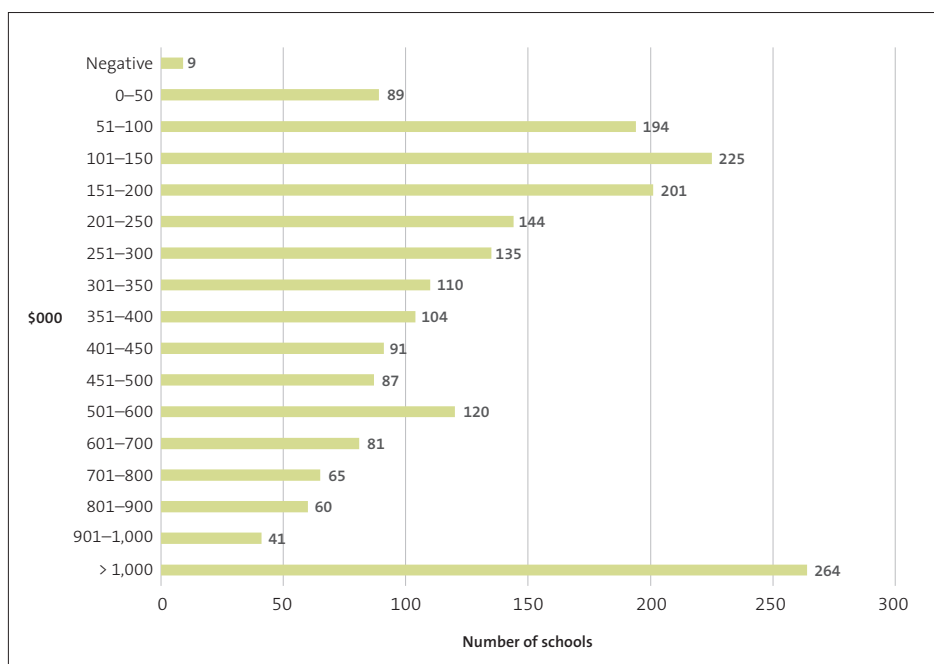
- 3.7 At 31 December 2019, the average cash balances⁵ of all schools was about \$287,700 (2018: \$281,800). Individual school balances ranged from owing cash of \$65,800 to having cash of \$6.8 million (2018: owing cash of \$20,500 to having cash of \$7.1 million). Schools held an average of about \$354,300 (2018: \$339,200) of investments in longer-term deposits, the maximum being \$10.6 million. However, almost a third of schools had no investments.
- 3.8 When reviewing a school's financial position, it is important to consider a school's available cash. By looking at this we can determine whether a school is in a position to continue paying its bills when they are due.
- 3.9 Schools often hold funds on behalf of third parties, including the Ministry for capital projects the school is managing, payments collected from international students for homestay providers, or on behalf of other schools in "cluster"-type arrangements, such as transport networks. If funds held for third parties are

5 This includes funds held in school bank accounts and on term deposit for three months or less.

excluded, the average cash and investment balances of schools were \$568,700. Individual schools range from owing \$49,300 to having \$10.7 million. Figure 5 shows the levels of school-owned cash and investments held by schools.

Figure 5
Levels of school-owned cash and investments held by schools

The graph shows the number of schools with different levels of school-owned cash and investments. About 5% of schools have school-owned cash and investments of less than \$50,000, with nine of these schools having negative balances. Another 10% of schools have balances between \$51,000 and \$100,000.



Source: The Ministry of Education's school financial information database.

- 3.10 As well as cash held for others, cash and investments might be earmarked for a particular purpose, such as a future building project or school trip, or the school might have outstanding bills. This is why we also consider a school's working capital position (its available funds less the amounts due in the next 12 months) when considering whether a school is in financial difficulty.
- 3.11 In considering the seriousness of the financial difficulty, we usually look at the size of a school's working capital deficit against its operations grant. Although many schools receive additional revenue, this is often through donations, fundraising,

or other locally sourced revenue, so it is discretionary. For most schools, the operations grant is the only guaranteed source of income.

- 3.12 At 31 December 2019, we identified 85 (2018: 88) schools with a working capital deficit. Of these:
- 53 (2018: 55) schools had a working capital deficit between 0% and 10% of the operations grant;
 - 20 (2018: 22) schools had a working capital deficit between 10% and 20% of the operations grant; and
 - 12 (2018: 11) schools had a working capital deficit more than 20% of the operations grant.
- 3.13 Figure 6 shows that decile rating does not affect whether schools are in financial difficulty. It also shows relatively similar results between years, with the higher decile schools (decile 6 and above) showing small increases in schools with working capital deficits in 2019.

Figure 6
Schools with working capital deficits at 31 December 2019, by decile

There are 85 schools with working capital deficits across all deciles. There are 12 schools with working capital deficits greater than 20% of their operations grant, which could indicate serious financial difficulty.

	Schools with working capital deficits at 31 December 2019 (2018 figures in brackets)	Schools with working capital deficits greater than 20% of operations grant
Decile 1	9 (9)	1 (2)
Decile 2	10 (14)	2 (2)
Decile 3	9 (10)	3 (0)
Decile 4	4 (5)	0 (2)
Decile 5	6 (11)	1 (2)
Decile 6	11 (9)	3 (1)
Decile 7	9 (4)	1 (0)
Decile 8	12 (9)	0 (0)
Decile 9	5 (8)	0 (1)
Decile 10	10 (9)	1 (1)
Total	85 (88)	12 (11)

Source: The Ministry of Education's school financial information database.

The effect of Covid-19 on school finances

- 3.14 As part of our audit, we need to consider subsequent events (see paragraph 2.2). As explained in Part 2, Covid-19 was a significant subsequent event. Because this did not affect the transactions or financial position recorded by the school as at 31 December, no adjustments were needed to school financial statements. However, auditors did need to consider the effect of Covid-19 and the associated disruptions on the school to determine whether it would affect their audit opinion. This included whether it would change the auditor’s view of the ability of the school to meet its obligations.
- 3.15 Although schools were closed during Alert Level 4 – and many remained closed once the country moved to Alert Level 3 – the Ministry continued to fund schools. It also provided additional Covid-19-related funding. As a result, we concluded that most schools would not be adversely affected financially by Covid-19.
- 3.16 For schools that usually raise a lot of their revenue locally through donations, fundraising, and international students, we expected to see a significant reduction in revenue. With the closure of the borders, some international students were not able to travel to New Zealand and many that had arrived went home early. The changes in alert levels also made it difficult for schools to organise and hold many of the activities that they usually carry out to raise funds.
- 3.17 The ability of schools to manage a significant drop in revenue depends on their financial situation. However, schools did receive some additional funding in 2020, which would have mitigated against some of the loss of revenue. \$20 million of international student transition funding was provided to those schools with international students. This was also the first year of the Donations Scheme, which gave decile 1 to 7 schools an additional \$150 per student if they did not request donations. We discuss these further in paragraphs 3.37 and 3.40.
- 3.18 We take all these factors into account when considering whether the school is, or could be, in financial difficulty. However, the international student transition funding was not announced until the end of July when many of our audits would already have been completed.

Schools considered to be in serious financial difficulty

- 3.19 When we have assessed that a school is in financial difficulty, we ask the Ministry whether it will continue to support the school. If the Ministry confirms that it will continue to support the school, the school can complete its financial statements as a “going concern”. This means that the school can continue to operate and

meet its financial obligations in the near future. If we consider a school’s financial difficulty to be serious, we draw attention to it in the school’s audit report.

- 3.20 Figure 7 shows 38 schools needed letters of support from the Ministry to confirm that they were a “going concern” for the 2019 school audits (2018: 36 schools). We referred to serious financial difficulty in 18 of those schools’ audit reports.
- 3.21 Te Ra School, an integrated school, received a letter of support from its proprietor. The proprietor agreed to provide financial support to the school. We drew attention to this in our audit report.

Figure 7
Schools that needed letters of support in 2019 to confirm they were a “going concern”

Of the 38 schools that needed a letter of support from the Ministry to confirm they were a “going concern”, nine schools also had a letter of support in 2018, and seven schools needed a letter of support in 2018 and earlier.

Schools that needed a letter of support in 2019	Schools that needed a letter of support in 2019 and 2018	Schools that needed a letter of support in 2019, 2018, and earlier
Centennial Park School	Bathgate Park School	Albany Junior High School
Dalefield School	Burnside Primary School	Cambridge East School
Greerton Village School	Green Island School	Kadimah School
Howick College	Halfway Bush School	Mangere Bridge School
Kaihu Valley School	Nelson College	Omanaia School
Kaikorai Valley College	Ōhoka School	Tai Tapu School
Kavanagh College	Our Lady Star of the Sea School (Christchurch)	Waitaki Boys' High School
Kerikeri High School	Pukemiro School	
Logan Park High School	Westown School	
Mercury Bay Area School		
Meremere School		
Nelson Christian Academy		
Northcote College		
Ponsonby Primary School		
Rangikura School		
Raphael House Rudolf Steiner Area School		
Taranaki Diocesan School (Stratford)		
Tauhara Primary School		
Te Kura Kaupapa Māori o Ngati Ruanui		

Schools that needed a letter of support in 2019	Schools that needed a letter of support in 2019 and 2018	Schools that needed a letter of support in 2019, 2018, and earlier
View Hill School		
Wairau Intermediate		
Waitara Central School		

Source: Information taken from school financial statements and the Office of the Auditor-General's audit reports.

- 3.22 We also identified that Nelson College and Pukemiro School for the 2018 year, and Te Kura Kaupapa Māori o Rawhiti Roa for the 2017 year, needed letters of support from the Ministry for previous year audits completed since we last reported.
- 3.23 The number of schools in financial difficulty remains about the same each year (about 40 schools), but they are not always the same schools. Of those schools identified in our report last year, only 14 required a letter of support again this year, with seven needing a letter of support for the past three years or more. Of the remainder, 16 are no longer considered to be in financial difficulty, and the audits of four of the schools are not yet complete.
- 3.24 The potential effects of Covid-19 did not result in significantly more schools being considered to be in financial difficulty. However, this might be different when we complete our 2020 school audits.

Why do schools get into financial difficulty?

- 3.25 Many schools rely on raising funds locally to provide additional funding. In 2019, schools received a total of \$499 million of locally raised funds (excluding revenue from international students and hostels). These funds can be from donations, grants, parent contributions for curriculum recoveries or activities, trading revenue, fundraising, and other revenue such as rent for school houses and revenue from use of the school hall. In most cases, these types of revenue are discretionary. Parents and others can choose whether to give donations to the school or support their fundraising efforts.
- 3.26 Some schools also raise funds from international students and hostels – a total of \$153 million and \$33 million, respectively, in 2019.
- 3.27 For most schools, it can be difficult to suddenly reduce spending if funds that the school is expecting do not eventuate. This is particularly the case when the funding is used for staffing or other expenditure to which the school is already committed. A reduction in funding can occur if the school has a sudden drop in

the number of children attending a school (school roll), or because it is unable to raise funds locally, as has been the case this year due to the restrictions brought about by Covid-19.

Staffing levels

- 3.28 Each school is given an entitlement of teachers that the Ministry will fund. The entitlement is based on the size of the school roll. If a school has more teachers than its allocation, it has to either pay them directly from its own funds, or it will exceed its staffing entitlement and have to repay the Ministry for the additional staffing costs incurred. The amount of overuse is recovered from the operations grant the school receives in the following years.
- 3.29 Schools might get into financial difficulty if they do not actively monitor their staffing entitlements or employ teachers in excess of their entitlement. This can happen if the school's roll has dropped and the school does not reduce the number of teachers accordingly. This might be a conscious decision by the school board, which could choose to keep staff on because they expect that the school roll will increase again. However, if the decision to overstaff is maintained for too long this might affect the financial sustainability of the school.
- 3.30 All schools pay non-teaching staff from their operations grant. Schools can also choose to use their operations grant and other funding for additional teachers. As explained above, a school operations grant is its only guaranteed source of funding. If a school uses a large percentage of its operations grant to pay staff, it will need other sources of funding to meet its other operational costs. When schools are unable to generate revenue from other sources as they anticipate, they might have to spend their cash reserves or find themselves in financial difficulty.
- 3.31 More than two-thirds of the schools we identified as being in financial difficulty for 2019 use the equivalent of more than 70% of their operations grant to pay staff (overall, an average of 89%). This was higher than the average for all schools that use the equivalent of 68% of their operations grant to pay staff.
- 3.32 Figure 8 shows salaries funded by schools as a percentage of their operations grant, by decile. The results are similar for all deciles. However, deciles 9 and 10 have more schools funding salaries that are equivalent to more than 100% of their operations grant. Two-thirds of these schools are funding salaries equivalent to up to 120% of their operations grant.

Figure 8
Payments to board-funded staff as a percentage of the school's operations grant, by decile

The table shows the percentage schools in each decile use their operations grant to fund staffing costs. The percentage reflects the payments for board-funded staff in relation to the schools' operations grant. The table shows the number of schools in each category.

Decile	Percentage of operations grant schools use to pay staff						Number of schools
	0-19%	20-39%	40-59%	60-79%	80-99%	100% +	
Decile 1	1	21	80	67	20	6	195
Decile 2	2	20	74	72	21	6	195
Decile 3	4	14	72	76	26	13	205
Decile 4	4	9	57	81	34	9	194
Decile 5	2	14	68	87	29	10	210
Decile 6	1	12	64	85	27	10	199
Decile 7	1	13	57	75	39	17	202
Decile 8	1	13	38	89	45	17	203
Decile 9	1	14	54	76	31	26	202
Decile 10	1	11	57	75	40	31	215
Total	18	141	621	783	312	145	2020*

* Number of schools entered into the Ministry's database of schools' financial statements, as at October 2020.
Source: The Ministry of Education's financial information database.

- 3.33 About half of the schools that use the equivalent of more than 100% of their operations grant to pay staff have international students. We have identified only seven of these schools as being in financial difficulty. The 24 schools that are funding salaries equivalent to more than 150% of their operations grant are mostly state-integrated schools or special education schools that receive additional funding for staff.

Revenue from international students

- 3.34 For 2019, 511⁶ (2018: 551) schools received revenue from international students. This totalled \$153 million for the year. Figures published by the Ministry show a total of 22,895 international students attended New Zealand schools during 2019,

6 Schools with international student revenue according to the Ministry of Education's information database as at 14 October 2020. The Export Education Levy: Full-year statistics 2019 on the Education Counts website states that 635 schools provided education to international students in 2019. The 635 includes all New Zealand schools, including privately funded schools.

5225 at primary or intermediate schools and 17,700 at secondary, composite, or special schools.⁷

- 3.35 Although schools will incur additional costs for the international students, these are small in relation to the fees charged. For this reason, most schools report a large surplus on this type of revenue. In 2019, the total surplus recorded by schools was \$81 million, an average of \$158,033 for each school. Figure 9 shows that more higher decile schools have international students and the average surplus those schools are making on international education is higher than the lower decile schools.

Figure 9
Revenue and surplus from international students by decile

The table shows the total revenue and surplus recorded by schools in each decile. More higher decile schools have international students and the average surplus recorded by higher decile schools from international education is higher.

	Number of schools	Revenue from international students \$m	Surplus from international students \$m	Average surplus per school \$000
Decile 1	3	0.2	0.1	41
Decile 2	17	1.4	0.8	48
Decile 3	33	4.7	2.3	69
Decile 4	38	7.7	3.0	80
Decile 5	47	9.3	3.7	78
Decile 6	53	11.7	5.6	106
Decile 7	75	23.1	11.1	148
Decile 8	73	22.1	11.4	156
Decile 9	79	44.1	24.2	306
Decile 10	93	28.9	18.6	200
Total	511	153.2	80.8	158

Source: The Ministry of Education's financial information database.

- 3.36 We reported last year on the risks of relying heavily on revenue from international students. Those concerns have been realised in 2020 with the closure of New Zealand's borders. For most schools with international students, the revenue from those students was equivalent to less than 10% of the school's total expenditure (excluding teachers' salaries and notional rents, which are funded directly by the Ministry). However, we identified that for 2019 the revenue for 42 schools was equivalent to more than 20% of the school's total expenditure (excluding teachers' salaries and notional rents). The school that recorded the highest percentage had international student revenue representing 49% of its total expenditure.

7 Export Education Levy: Full-year statistics 2019. Figures include all New Zealand schools.

3.37 The drop in revenue for 2020 for those schools with international students, which will most likely continue into 2021, could have a significant effect if the schools are unable to reduce their expenditure. This will be partly mitigated by \$20 million of international student transition funding announced at the end of July as part of a recovery plan for international education, which was allocated to schools that have international students. This funding was not intended to replace missing revenue but to ensure that staff could be retained to provide pastoral care to those students still in New Zealand and help schools to transition to a future reduction in revenue from this source.

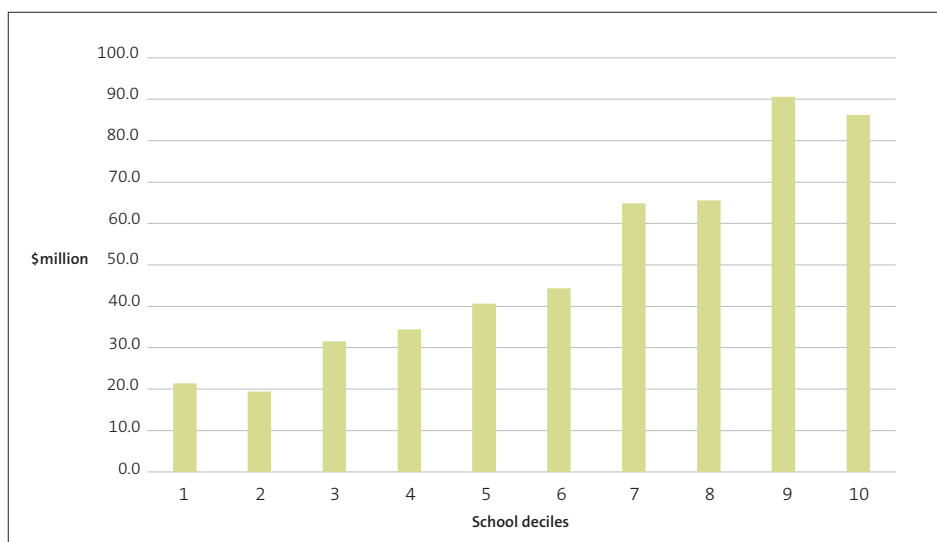
Reliance on other locally raised funds

3.38 Another likely effect of the Covid-19 pandemic is a reduction in locally raised funds. Because of school closures and uncertainties about holding large gatherings, many fundraising events have been cancelled or put on hold. The economic impact of Covid-19 and the associated uncertainties could also mean that parents and communities may be less willing or able to contribute towards school activities and events, as they may have been in the past.

3.39 Figure 10 shows that the total amount of funds raised locally by schools, \$499 million (excluding international student and hostel revenue), differs between deciles.

Figure 10
Total locally raised funds collected in 2019, by decile

The graph shows the total locally raised funds recorded in school financial statements for each decile. The locally raised funds collected by decile 9 and 10 schools is significantly higher than the other deciles.



Source: The Ministry of Education's financial information database.

- 3.40 The impact of a possible reduction in locally raised funds will be mitigated, in part, for those decile 1 to 7 schools that opted into the Donations Scheme. This scheme gives the schools additional funding of \$150 for each student if the school agrees not to ask parents for donations, except for overnight trips such as school camps. For 2020, 92% of decile 1 to 7 schools opted into the scheme.
- 3.41 The schools that opted into the scheme collected \$36 million in donations in 2019. If we compare the donations collected in 2019 with the expected extra funding based on the school's roll for those schools, we estimate that for 75% of schools the additional funding will compensate for the loss of donations, based on previous experience. However, we are aware that schools often record some donations and contributions from payments as "activities" revenue in their financial statements, so this analysis might not have taken into account all parent donations received by the schools.
- 3.42 Whether schools that have relied heavily on locally raised funds, including international student revenue, will get into financial difficulty will depend on the strength of their financial position – that is, whether they have cash reserves they can use, and whether they can put plans in place to reduce spending. Our analysis identified that many schools have healthy cash and investment balances, although these schools might be holding these funds for a particular purpose. It is important that schools budget carefully and take action to reduce their spending if they need to. There is still uncertainty and schools might not be able to rely on the funding sources they have in the past, particularly the international student market.

4

Matters we identified during our audits

- 4.1 In this Part, we set out matters that we identified during the 2019 school audits and make some recommendations for the Ministry.

Publishing annual reports

- 4.2 Schools are required to publish their annual reports online.⁸ A school's annual report consists of an analysis of variance⁹, a list of trustees, financial statements (including the statement of responsibility and audit report), and a statement of KiwiSport funding.
- 4.3 Last year we found that a large proportion of schools had not published their 2017 annual reports. Of those that had published their annual report, many had done so only after being reminded by the auditor. It is important that schools publish their annual report as soon as possible after the school's audit is completed. This ensures that schools do not breach legislation and are accountable to their community.
- 4.4 At the time of this year's audits, we found that 1755 or 82%¹⁰ of schools had published their 2018 annual report on their website. This is a significant improvement on the previous year, when only 68% had published their 2017 annual report. We and the Ministry encourage schools to publish their annual reports as soon as the audit is completed.
- 4.5 If a school does not have a website, the Ministry will publish the annual report on its Education Counts website. We encourage parents and other members of the school's community to contact the school board if the school's annual report has not been published online.

School payroll

- 4.6 The school payroll information is a significant part of a school's financial statements. After Novopay was introduced, the additional payroll reports that schools needed to complete their financial statements contributed to delays in the school audits. However, we have worked with the Ministry in recent years to ensure that this information is provided in a timely manner.
- 4.7 The agreed time frames for providing payroll information to the school sector and the auditors for the 2019 audits were met and, as shown in Figure 2, our auditors started receiving draft financial statements earlier than in recent years. Unfortunately, this was overshadowed by the disruptions caused by Covid-19, but

⁸ The requirement is Section 136 of the Education and Training Act 2020 (previously Section 87AB of the Education Act 1989).

⁹ An analysis of variance is a statement in which a school board provides an evaluation of progress made in achieving the aims and targets set out in its Charter.

¹⁰ 82% of schools that had completed their audits by 31 October 2020.

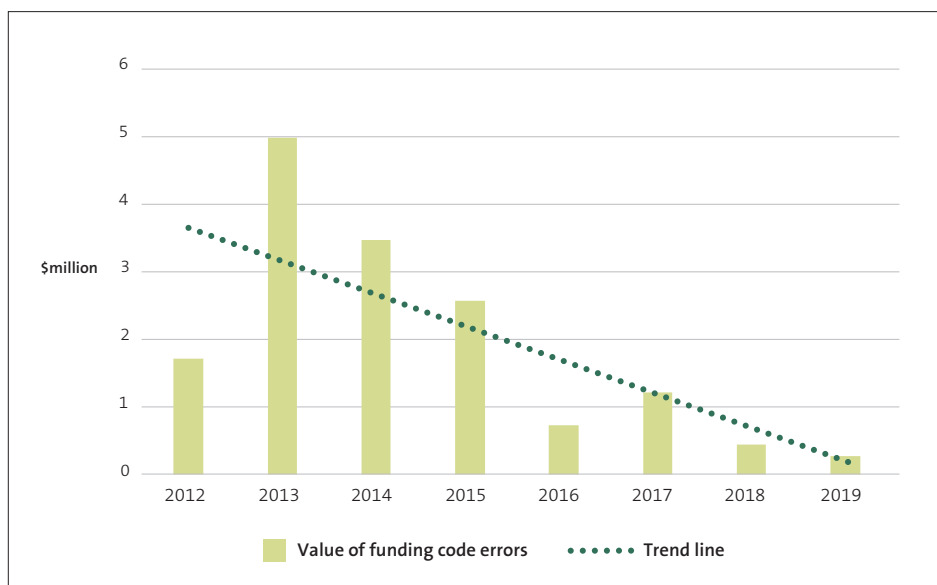
it is encouraging for future audit years. We will work to the same time frame for the 2020 school audits.

- 4.8 Our auditor of the Ministry carries out extensive work on the Novopay system centrally. This includes carrying out data analytics of the payroll data to identify anomalies or unusual transactions and testing the payroll error reports that are sent to schools. We write to the Ministry every year setting out our findings from this work. We continue to see improvements in data quality and fewer errors being raised on school error reports (see Figure 11).

Figure 11
Value of payroll errors, 2012 to 2019

The graphs show the reduction in overpayments and funding code errors by value recorded from 2012 to 2019. Novopay was introduced in August 2012, which meant that 2013 was the first full year using the system. Since then, both the number and value of errors have decreased. Funding code errors are those where payroll payments have been incorrectly funded by either the board or the Ministry. These result in an amount either owed to, or owed by, the school.





Source: Education Payroll Services: Results and communications to the sector to support the audits of schools 31 December 2019 financial statements.

- 4.9 As part of their audit work locally, our auditors follow up any anomalies identified from the data analytics work that the Ministry cannot resolve. Some anomalies are also sent to the pay centre to be resolved. We have seen the extent of the exceptions sent to schools decrease over the years, but some matters reoccur. For the 2019 audits, we identified 2086 exceptions for 922 schools that needed to be followed up by school auditors.
- 4.10 For the 2019 audits, in response to our recommendation, the Ministry built a feedback loop into the process. This allows schools, the pay centre, and school auditors to report what they found from looking into exceptions back to the Ministry. The Ministry can then consider whether additional guidance is required for specific schools or for the sector more widely. The Ministry found that the response rates were low and there were limitations to the information provided. This process will be revisited for the 2020 audits and therefore we have repeated the recommendation below.
- 4.11 A project is under way to make the school payroll system easier to use for schools by replacing Novopay online with a new portal EdPay. This will allow more data entry directly at schools. The EdPay functions are being rolled out in stages after being tested by a small group of schools. This means that most schools are using a combination of EdPay, Novopay online, and the EPL pay centre to process payroll

instructions. Although EdPay will build in some validation checks, which will reduce the number of errors or inappropriate transactions, the controls locally at schools will remain the same. The review of fortnightly payroll reports carried out by the school continues to be the main control that schools rely on to detect errors.

- 4.12 Although schools are responsible for ensuring the accuracy of their payroll, the current payroll reports are difficult to understand and review. We also identify every year that a number of schools are not adequately reviewing them. This could result in schools paying employees the wrong amount and increases the risk of fraud. It is also important that there is a review of the payroll reports by someone independent of the payroll process – that is, someone without access to Novopay. In small schools where the principal has access to Novopay, this might have to be done by a member of the school board. It is important that school boards have some oversight of the school's monthly payroll expenditure, as they do with other expenses.
- 4.13 We are aware that Education Payroll Limited is currently working on identifying and mapping its controls. It is important that consideration of the controls in the payroll system include consideration of all parties involved. We therefore continue to urge the Ministry to ensure that appropriate internal controls are incorporated into the payroll system, where possible, to make it easy for schools to operate appropriate controls to help prevent instances of fraud or error, and repeat our previous recommendation below.

Recommendation 1

We recommend that the Ministry of Education ensure that changes to the Novopay system include adding appropriate controls for schools, where possible, to help prevent fraud and error and ensure that all transactions are approved within the school's delegations.

Recommendation 2

We recommend that the Ministry of Education follow up unusual transactions and anomalies identified as part of the payroll audit so they do not reoccur, including giving boards additional support and guidance on payroll matters if necessary.

Sensitive payments

- 4.14 We refer to some sensitive payments in Part 2, where we considered them significant enough to mention in the school's audit report. If an auditor does not consider a matter significant enough, or it relates mainly to school policies and procedures, the auditor will raise the matter in the school's management

letter. This year, auditors brought fewer matters about sensitive payments to our attention, but our auditors continue to refer to such matters in their management letters to school boards.

- 4.15 Concerns that auditors raised included:
- schools that did not have sensitive expenditure policies;
 - gifts to staff that were either without board approval or inconsistent with the school's gift policy;
 - hospitality and entertainment expenses that seemed excessive; and
 - travel, both domestic and international, where the boards have not followed a clear process of approval before the trip was booked.
- 4.16 Our auditors also identified payments for items that could be seen to bestow a personal benefit, such as gym and Koru Club memberships for principals. Under the Principals' Collective Agreement, any additional benefit requires Ministry approval, so if schools make such payments they need to consider whether in doing so they are breaching the collective agreement. The Ministry's circular states that the school does have some discretion on such sensitive payments, but they must have a business purpose and provide only an incidental private benefit to the principal. The Ministry has told us it is updating the circular to provide more guidance to schools on what is considered to be incidental private benefit.
- 4.17 Almost half of the concerns raised about sensitive payments related to poor controls over the approval of principals' expenses. The main matters raised were:
- principals approving their own expenses;
 - expenses being approved by other staff members;
 - expenses being approved outside agreed delegations; and
 - inadequate or no documentation to support expenditure.
- 4.18 Of the concerns raised, half related specifically to the use of credit cards. As we reported last year, credit cards are susceptible to error and fraud or to being used for inappropriate expenditure, such as personal expenditure. Credit card payments might not go through a school's normal payment processes because schools often pay credit card balances directly from their bank account. Additionally, the money is spent before any approval. However, it is important that expenditure on credit cards is subject to the same controls as other spending.
- 4.19 We remind schools that they should use a "one-up" principle when approving expenses, including credit card spending. This means the board chairperson would need to approve the principal's expenses. It is also important that credit

card users provide supporting receipts for the approver and an explanation for the expenditure. This also applies to fuel cards or store cards.

- 4.20 We have recently updated our good practice guide on controlling sensitive expenditure, which is available on our website. This includes information about the use of credit cards.

Overseas travel

- 4.21 After the updated Ministry guidance in 2017 and the requirement for schools to disclose any significant overseas travel in their financial statements, we have had fewer concerns raised with us about spending on overseas travel. We did draw attention to spending on overseas trips in two audit reports (as set out in Part 2 of this report), but these were both 2017 audits.
- 4.22 We continue to see the use of preloaded foreign currency cards for use abroad. However, when using this type of card, schools need to consider who issues the card and be mindful of the rules in the Education and Training Act about banking and investments. The Act allows schools to hold funds only in New Zealand dollars and in banks with a certain credit rating. Depending on the terms and conditions underlying the use of the card, schools need to consider whether putting funds on a foreign currency card could put those funds at risk.
- 4.23 Covid-19 has prevented many overseas trips from going ahead during 2020. We have had concerns raised with us about the management of refunds for these trips, and in particular how fundraising monies for these trips should be managed.
- 4.24 In our view, how funds collected specifically for overseas trips should be managed is dependent on the source of the funds:
- Funds parents paid directly to the school as a contribution to the trip can be refunded to those parents, to the extent that the school has received refunds for any costs already incurred.
 - Funds raised from fundraising activities carried out in the name of the school cannot be repaid to individuals, because they are funds raised for the trip rather than for the individual participants.
- 4.25 A school raising funds for a specific purpose should “in good faith” use those funds for the purpose for which they were given. If the school is unable to spend the funds on the stated purpose (as is the case currently for funds raised for overseas trips), our expectation would be that, where possible, the school spends the funds in a way that is consistent with the original reason for raising the funds. If the school considers that the uncertainties of Covid-19 would make it not practical to carry forward the funds for future overseas trips, the school needs to consider alternative uses that would be acceptable to those who gave the funds.

Fraud

- 4.26 We collect information every year about fraud or suspected fraud in schools that our auditors are told about as part of their audits. We report fraud trends on our website each year. This includes details of the methods and reasons for fraud, types of fraud, and how the fraud was detected.
- 4.27 Many incidences are relatively minor, such as the theft of small amounts of cash or equipment, or misuse of credit or debit cards. However, there have been several more significant frauds in the past few years, which often involve fraudulent payments. These thefts are carried out mainly through using false invoices – for example, employees with delegated authority entering false or overstated invoices for payment. We have seen an increase in cybercrime, and this has been an increasing threat since Covid-19.
- 4.28 For individuals to be motivated to commit fraud, it is considered that three elements must come together:
- Motivation – a perceived pressure, either financial or emotional, pushing a person towards fraud.
 - Opportunity – the ability to execute the fraud without being caught.
 - Rationalisation – a personal justification for the dishonest actions.
- 4.29 Motivation and rationalisation are usually personal to an individual and employers are unlikely to be able to affect or control these. However, because opportunity refers to the circumstances that allow fraud to occur, this is something employers can control. Circumstances that provide opportunities for committing fraud might include:
- weak internal controls, which an employee is able to circumvent; or
 - poor “tone at the top” being the board’s and senior management’s commitment towards acting with integrity.
- 4.30 One of the best ways for an entity to mitigate against fraud is to ensure that adequate internal controls are in place. We recommend that schools:
- ensure that they have good segregation of duties (needing more than one person to complete a task);
 - encourage electronic payment for fees or large invoices, rather than cash payments;
 - obtain and review supporting documentation before payments are made, which should then be marked as paid;
 - require a second person to review and authorise all changes to supplier details;

- verify changes to supplier bank accounts directly with the supplier; and
 - investigate all suspicious invoices.
- 4.31 We understand that schools, particularly small schools, can find it difficult to segregate duties because they have few administration staff. However, where this is the case, the school needs to consider what mitigating controls it can put in place. This could be through additional monitoring by management or the board.
- 4.32 Cybercrime continues to affect public entities. Common cybercrime threats include compromising an employee's email account and phishing scams (where employees are tricked into giving up log-in details or they allow ransomware to be loaded onto the network). We have also seen instances in the public sector where employees are tricked into paying an invoice outside the entity's usual processes. This type of fraud can happen when organisations:
- override their existing controls;
 - have a lack of controls for changes to supplier details;
 - have not adequately assessed, or understood, the risks of cybercrime; and
 - do not have an adequate cyber-incident response plan.
- 4.33 There is evidence that entities are less susceptible to fraud when they provide specific training for all employees, and employees are aware of fraud policies and see them in action. This is because employees will be more alert to, and more aware of, fraud risks and will know what to do if they suspect fraud.
- 4.34 Boards should have a fraud policy in place. A fraud policy should contain the entity's position on reporting actual or suspected fraud to the appropriate law enforcement authority. However, a fraud policy is effective only if the board communicates this to its staff regularly and acts on it when a potential fraud is identified. The Ministry has published a model policy on Theft and Fraud Prevention in its Model Financial Policies.
- 4.35 In previous reports, we recommended that the Ministry improve its guidance on internal controls and fraud. The Ministry told us it is reviewing its guidance to schools on internal controls and developing tools to assist boards to assess their systems of internal controls. We have repeated the recommendation below.

Recommendation 3

We recommend that the Ministry of Education improve its guidance to schools on what good controls look like.

Conflicts of interest

- 4.36 As noted in Part 2, this year we identified an increase in the number of breaches of legislation about conflicts of interest. Two instances were where schools entered into contracts that totalled more than \$25,000 with organisations in which a trustee had an interest. This is not allowable unless the trustee obtains Ministry approval.¹¹
- 4.37 The risk of conflicts of interest in small communities, which many schools operate in, is inherently high, because the board, principal, and other employees are often living and interacting in the same communities their school services. There is a particular risk of conflict in the decision-making processes used to appoint new employees and contractors, as well as the purchase of goods and services. The small size of some schools can make the segregation of duties, which might otherwise prevent conflicts arising, difficult to achieve.
- 4.38 In June 2020, we published updated good practice guidance: *Managing conflicts of interest: A guide for the public sector*. We are looking to raise the profile of conflict of interest management more generally and have created an interactive quiz, covering a range of scenarios where interests might conflict.
- 4.39 The other conflicts of interest identified from our audits related to more than one member of staff being on the board of trustees. A permanent member of staff is excluded from being on the board unless they are the principal or the staff representative.

Non-compliance with the Holidays Act 2003

- 4.40 The issue of non-compliance with the Holidays Act 2003 has arisen because entities might have incorrectly interpreted clauses of the Act or employment agreements when calculating holiday entitlements. As previously reported, the Ministry has identified that there is an issue with holiday pay for employees on the school payroll.
- 4.41 This year, the Ministry has continued its work on identifying and resolving the non-compliance with the Holidays Act. It has not yet been able to identify the amounts attributable to each employee.
- 4.42 Because school boards are the employer of all teachers, they need to recognise a potential liability for this non-compliance with the Holidays Act. However, until further detailed analysis has been completed, the potential effect on any specific individual or school and any associated liability cannot be reasonably estimated. For 2019, as for 2018, all school financial statements disclosed a contingent liability for non-compliance with the Act.

Following up on previous years' recommendations

- 4.43 The Ministry has made good progress on many of the recommendations from our previous reports. We comment on some of those matters below. The Appendix updates progress on all our previous recommendations.

Incomplete school budgets

- 4.44 Schools are required to disclose budgeted figures for the statement of their revenue and expenses, the statement of their assets and liabilities (balance sheet), and the statement of their cash flows.¹² Our auditors are still finding that many schools are not preparing a budget balance sheet or a budget cash flow statement.
- 4.45 Schools need to include their approved budget figures in their financial statements. Auditors will check that the figures included in the school's financial statements are those from the approved budget. This information is required by legislation. If schools do not disclose these figures, they are breaching legislation.
- 4.46 In last year's report, we asked the Ministry to provide more guidance to schools on proper budgeting. It has done so, including identifying this as an area for improvement in its Annual Reporting Circular and Annual Reporting webinar. For the 2020 school audits, we will be collecting information on those schools that are not preparing a full budget and sharing it with the Ministry.

Accounting for "other activities"

- 4.47 We raised concerns in our report on the results of the 2017 school audits about the accounting arrangements for "other activities" carried out by schools. A number of these activities are carried out on behalf of a number of schools, and are referred to as cluster arrangements. One school is considered to be a "lead school" and is responsible for the receipt of the funding and, if applicable, employing the teachers. The most common of these arrangements include clusters for Resource Teachers of Learning and Behaviour (RTLb), activity centres, and Resource Teachers of Literacy (RTLit).
- 4.48 How these arrangements are accounted for by the schools is determined by the governance arrangements, which are usually set out in a Memorandum of Agreement between the schools. This determines whether the school is working as an "agent" in administering the funds or whether the board is in a governance position and the activity is therefore a function of the school. If it is a function of the school, it must record the revenue and expenditure in its financial statements. An example of this is a Teen Parent Unit.
- 4.49 The most significant of these clusters are RTLbs. These received about \$97 million of funding in 2019. The lead school of a cluster includes a note on its financial statements setting out the RTLb funding it has received and how it has been spent.

¹² See section 87(3)(i) of the Education Act.

Although this is audited as part of the school financial statements, the depth of audit work and testing will vary depending on its significance to the school.

- 4.50 We have identified the following matters related to these clusters:
- The current note disclosure sets out the funding and how it has been spent. We are aware of some RTLB clusters that have used funding to purchase assets. These are currently not recorded on any school's balance sheet.
 - We have found instances where there is no signed Memorandum of Understanding, so the governance arrangements are not clear.
 - There is some confusion with the schools about our role in auditing the information. In particular, the guidance to RTLB lead schools refers to the RTLB being audited as part of the school's audit. As noted above, we do not carry out an audit of the RTLB.
- 4.51 We have asked the Ministry to consider whether the current accountability arrangements for RTLBs are adequate. We also understand that the new Learning Co-ordinators work with several schools and many schools are working together as part of a Community of Learning. It is important that where new arrangements are put in place, the accounting implications are considered and appropriate guidance is provided to schools. We repeat our previous recommendation.

Recommendation 4

We recommend that the Ministry of Education provide guidance to schools on accounting for "other activities" (including Resource Teacher: Learning & Behaviour clusters) that they receive funding for.

Appendix

Update on progress with our previous recommendations

In this Appendix, we provide the Ministry's progress on responding to our recommendations in our report *Results of the 2018 school audits*. We also refer to some recommendations from earlier reports that we followed up during our 2019 audits.

Recommendation	The Ministry's progress	Our comment
<p>School annual reports</p> <p>We recommended that the Ministry actively monitor schools' compliance with the legislative requirement to publish their annual report online.</p> <p><i>2017 recommendation:</i></p> <p>We recommended that the Ministry reinforce its guidance to schools on publishing their annual report, and consider how it can confirm that schools are reporting to their communities by publishing their annual reports online, in a timely manner</p>	<p>The Ministry checked the website of each school who submitted their annual report following completion of their annual audit to determine whether its annual report has been published. Schools who had not published their annual report for 2019 have been contacted to remind them of their obligation to do so.</p> <p>As at 21 September 71% of schools that had completed their audits had published their 2019 annual reports.</p> <p>Schools were reminded of their obligation to publish their annual report on a website controlled by the board in the following communications:</p> <ul style="list-style-type: none"> • Annual Reporting Circular (November 2019); • Annual Reporting Roadshows held in four locations in September 2019; • School Bulletin issued on 28 May and 28 July 2020; and • by email confirmation when submitting annual reports to the Ministry through the School Data Portal. <p>Guidance is available in the Ministry's Financial Information for Schools Handbook (FISH), supplemented by a set of frequently asked questions that were published on the Ministry's website in July 2020.</p>	<p>As noted in Part 4 of the report, we identified that 82% of schools whose audits have been completed had published their 2018 annual reports. We will follow up on the publishing of 2019 annual reports as part of our 2020 school audits.</p> <p>Addressed.</p>

Recommendation	The Ministry's progress	Our comment
<p>School payroll reporting</p> <p>We recommended that the Ministry:</p> <ul style="list-style-type: none"> ensure that changes to the Novopay system include adding appropriate controls for schools, where possible, to help prevent fraud and error and ensure that all transactions are approved within the school's delegations; and follow up unusual transactions or anomalies identified as part of the payroll audit so they do not reoccur, including giving boards additional support and guidance on payroll matters if necessary. 	<p>Through the implementation of EdPay, Education Payroll Limited (EPL) have introduced some validations to prevent data entry errors at and are progressively releasing an allowance rules engine to assist with this process. EPL have a number of reports to identify errors and irregularities and follow up unusual transactions with the intention to resolve with the schools. EPL also use this process to educate and advise School Payroll Administrators on an ongoing basis. The EPL Risk and Assurance Team have produced a payroll controls guide to assist in preventing payroll fraud by staff.</p> <p>Lessons from the 2019 audits will help refine the information provided to school auditors with the unusual payroll transactions for the 2020 audits. This is expected to result in better quality information being returned to the Ministry to inform additional targeted guidance.</p>	<p>Recommendations on school payroll reporting have been repeated. See Part 4.</p>
<p>Kura Kaupapa Māori (also a 2017 recommendation)</p> <p>We recommended that the Ministry support kura by:</p> <ul style="list-style-type: none"> monitoring how effectively kura follow its guidance and, if necessary, provide more targeted guidance; and continuing to work with those kura that have audits outstanding to help facilitate the completion of those audits. 	<p>Ministry staff have attended two Te Kura Kaupapa Māori (TKKM) hui during 2020, to present the Ministry's Finance 101 materials, to assist in raising financial literacy, capability, and awareness within the management and governance of kura.</p> <p>The Ministry is collaborating with Te Rūnanga Nui o Ngā Kura Kaupapa Māori o Aotearoa (TRN) on strategies to provide more targeted guidance and support. This includes identifying key areas of financial guidance for which Te Reo translations will be prepared and continuing to participate in regional hui.</p> <p>The Ministry has partnered with TRN and OAG to agree an action plan for addressing the outstanding audits. The status of each has been established and any matters stopping the audits being completed have been identified.</p>	<p>As noted in Part 1, progress has been made on the kura audits in arrears but this has been affected by Covid-19. We will continue to work with the Ministry and TRN to ensure plans are in place to complete the remaining audits.</p>

Recommendation	The Ministry's progress	Our comment
<p>Budgeting</p> <p>We recommended that the Ministry prepare additional guidance to schools on how to budget effectively, including how to prepare a budgeted balance sheet and cash flow budget.</p>	<p>The Ministry is reviewing its guidance and developing tools to assist boards with preparing budgets, including a balance sheet and cash flow budget.</p> <p>This project has been resourced and will be completed during the final quarter of 2020.</p> <p>The Ministry's presentation materials on budgeting have recently been reviewed and refreshed. These are used by School Finance Advisors to brief individual schools, or groups of schools.</p>	<p>As indicated in Part 4 we will obtain information on those schools that are not preparing their budgets correctly. We will share this information with the Ministry so they can engage directly with those schools.</p>
<p>Internal controls (also a 2017 recommendation)</p> <p>We recommended that the Ministry:</p> <ul style="list-style-type: none"> • improve its guidance on what good controls look like; • continue to encourage schools to have fraud policies and report suspected fraud. 	<p>The Ministry is reviewing existing guidance on internal controls and developing tools to assist boards to assess their systems of internal controls.</p> <p>This project has been resourced and will be completed during the final quarter of 2020.</p> <p>This Ministry continues to encourage schools to have fraud policies and report suspected fraud to the appropriate authorities. This is included in the Ministry's guidance materials and will be reinforced in the 2020 Annual Reporting webinar.</p>	<p>Recommendations on internal controls have been repeated – see Part 4.</p>
<p><i>2017 recommendation:</i></p> <p>Cyclical maintenance</p> <p>We recommend that the Ministry ensure that schools are complying with its property planning requirements by having an up-to-date cyclical maintenance plan. The Ministry's review of a school's 10-year property plan should include a review of the cyclical maintenance plan, to ensure that it is reasonable and consistent with the school's condition assessment and any planned capital works.</p>	<p>The Ministry's property team implemented improvements to processes and guidance from 1 June 2019. This includes school property advisors talking to schools about their maintenance obligations during school visits and a requirement for them to review the school's maintenance plans at that visit. A review of the school's maintenance plans is specifically mentioned on the Annual School Visit Reference Sheet.</p>	<p>As noted in Part 2, we issued fewer audit opinions that referred to a lack of evidence for school's cyclical maintenance provisions. We will continue to monitor this for the 2020 school audits.</p>

Appendix
Update on progress with our previous recommendations

Recommendation	The Ministry's progress	Our comment
<p><i>2017 recommendation:</i></p> <p>Leasing school equipment</p> <p>We recommended that the Ministry provide guidance to schools to help them:</p> <ul style="list-style-type: none"> • decide whether to lease or buy equipment: and • ensure that they get value for money if they decide to lease, including how to access all-of-government contracts. 	<p>The Ministry developed a “Lease vs Buy” model to help schools with purchasing decisions. This was published on the Ministry’s website in May 2020.</p>	<p>Addressed.</p>
<p><i>2017 recommendation:</i></p> <p>Schools leasing IT equipment to students</p> <p>We recommended that the Ministry consider the adequacy of the guidance available to schools on managing laptop schemes for their students, including through a third party.</p>	<p>Guidance on schools leasing IT equipment to students was included in the Ministry’s 2019 annual reporting workshops and will be repeated in key messages for 2020.</p>	<p>We agreed to provide information to the Ministry on arrangements of concern. We did not identify any from our 2018 school audits.</p>
<p><i>2017 recommendation:</i></p> <p>Principal’s remuneration – concurrence</p> <p>We recommended that the Ministry give schools practical guidance on how to assess the extent of private benefit for a sensitive payment to a Principal, and how it evidences this assessment, so the school complies with the Ministry’s circular.</p>	<p>Circular 2013/27 – Principal Concurrence is being updated to include further guidance on the meaning of “incidental private benefit”, an illustrative example, and guidance on how to evidence the board’s assessment of the extent of private benefit.</p>	<p>Addressed.</p>

Recommendation	The Ministry's progress	Our comment
<p><i>2017 recommendation:</i></p> <p>Accounting for “other activities”</p> <p>We recommended that the Ministry:</p> <ul style="list-style-type: none"> • provide guidance to schools on accounting for “other activities” (including <i>Resource Teacher: Learning & Behaviour clusters</i>) that they receive funding for; and • consider whether the funding schools receive for Communities of Learning should be disclosed separately in school financial statements. 	<p>The Ministry is still considering the financial reporting requirements for the 40 <i>Resource Teacher: Learning & Behaviour</i> (RTLB) clusters, for discussion with the OAG in 2021.</p> <p>As an interim measure, additional disclosure has been incorporated into the Kiwi Park model financial statements to ensure that the activities of the RTLB clusters are disclosed in the host schools' financial statements.</p>	<p>We will follow up as part of our 2020 school audits.</p>