

Te Kōhanga Reo National Trust Board

Independent review of financial controls for
public funding received

12 March 2014



Building a better
working world

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1. Executive summary

We have completed the independent review of the financial internal controls operating within the Trust, against the Terms of Reference published by the Ministry on 16 October 2013.

The review was initiated to assess the appropriateness and effectiveness of the financial internal controls operating within the Trust for the receipt of public funds.

Our assessment of the internal controls operating within the Trust has been conducted against our expectations of organisations receiving public funding of a similar size and complexity to the Trust. Through agreement between the Trust and the Ministry, our review considered supporting documentation up to 31 December 2012.

Based on the results of our work, we believe the Trust's financial internal controls are effective with our expectations with the exception of the areas identified in our report.

Our review does identify some areas within the Trust's internal control processes that can be improved. These are summarised in the table below:

Recommendations and Trust responses

- ▶ Review of credit card policy and controls (see section 4.3.1.6).

Trust response:

The Trust Board has removed all credit cards. The Trust has taken note of the recommendations contained in the report (see section 4.3.1.6) should the credit cards be reissued.

- ▶ Segregation of duties for processing changes to accounts payable and payroll master data (see section 4.3.1.6 and 4.3.2.6).

Trust response:

The Trust has noted this recommendation and applied these to the processes. The Trust has changed its FMIS and the recommendations were implemented as they were brought to the Trust's attention.

- ▶ Maintenance of payroll supporting documentation (see section 4.3.2.6).

Trust response:

The Trust has applied this recommendation and requested the additional report from the payroll service provider.

We have also made some suggestions for the Trust to consider, in terms of how it might choose to focus the way in which the Board establishes expectations of the type of control environment it expects management to operate into the future. These suggestions are:

Good practice recommendations

- ▶ Expansion of the Audit Committee's activities.
- ▶ Expanding scope of internal assurance procedures relating to identified risk areas.

During the course of our review we did not identify any instances of Te Kōhanga Reo National Trust providing public funding to Te Pataka Ohanga (TPO). The nature of costs charged by TPO to individual kōhanga reo is described in section 4.3.5 of this report.

We wish to record our thanks to the Trust's staff involved in supporting us with this review, both for the provision of information necessary for us to be able to complete the work, and for the attitude of cooperation.

2. The role of the Trust

The Te Kohanga Reo National Trust was incorporated in 1983 under the Charitable Trusts Act 1957. The Trust's Deed sets out its objectives which are to promote, support and encourage:

- ▶ The use and retention of Te Reo.
- ▶ The Kaupapa of Te Kōhanga Reo, and in particular the goal of total immersion in Te Reo Māori.
- ▶ The establishment and maintenance within New Zealand of Te Kōhanga Reo.
- ▶ The provision of financial, advisory, and administrative assistance and support for the whānau of Te Kōhanga Reo.

The numbers of individual kōhanga reo peaked at 800 in 1994 with 14,000 attendees. Today there are approximately 460 kōhanga reo affiliated with the Trust.

The Trust's Deed states it acts as the Kaitiaki or guardian of the Kōhanga Reo movement. The Trust provides services through its head office and regional structure to individual kōhanga reo.

2.1 Te Kōhanga Reo National Trust Board structure

The Trust is governed by a Te Kōhanga Reo National Trust Board, nine trustees, the Chief Executive Officer and three General Managers (Operations, Corporate Services and Strategy & Relationships) who have delegation from the Board to implement its strategic direction and uphold policies as set by the Board. The Trust employs 91 people. 38 are based in its Wellington head office. The numbers of individual kōhanga reo peaked at 800 in 1994 with 14,000 attendees. Today there are approximately 460 kōhanga reo affiliated with the Trust by charter with approximately 9,000 attendees. They are funded to operate by the Trust based on the licence held by the Trust, issued by the Ministry of Education. Property is occupied through varied arrangements, the majority being owned by the Trust and held for the benefit of the kōhanga reo whānau and community. Most individual Kōhanga Reo have no legal entity.

TE KÖHANGA REO NATIONAL TRUST BOARD STRUCTURE

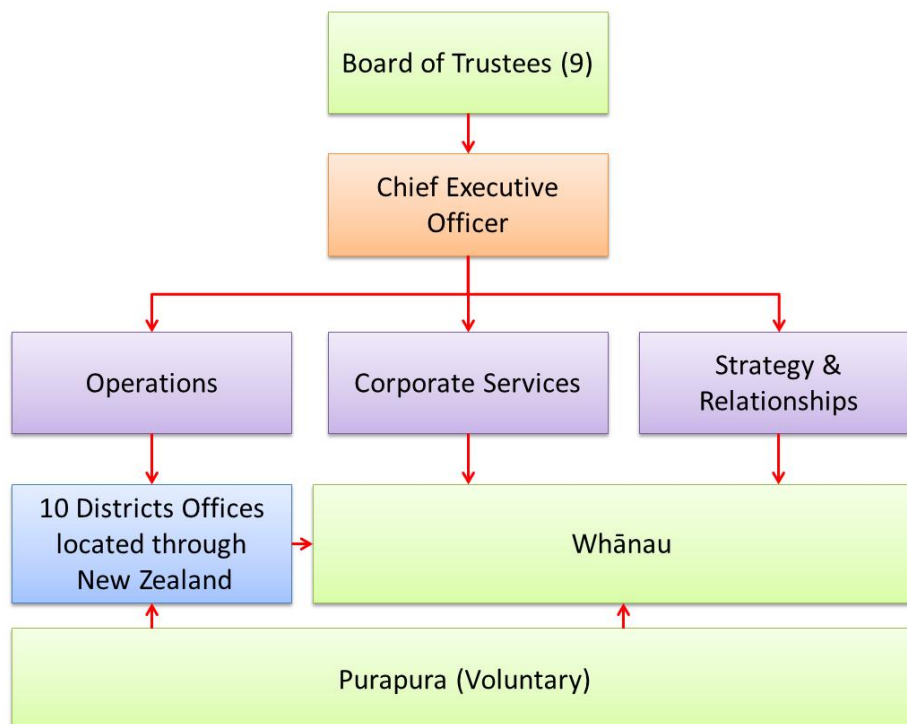


Figure 1: Trust structure

2.2 Terms of Reference

The Terms of Reference for this review was agreed between the Ministry of Education and the Board on 16 October 2013. The object of the review is to assess the effectiveness of the financial internal controls over public funding received by the Trust. The review has covered funding provided through both the Ministry of Education and the Tertiary Education Commission.

The Terms of Reference has six objectives which are:

Review objectives
1. Describe and assess the financial control environment to account for the receipt and use of public funds.
2. To identify instances where there are gaps in the financial controls.
3. Determine the extent to which the key financial controls are operating as intended.
4. To make recommendations on any improvements in financial controls that are required to provide a high level of assurance to the Board and the Crown.
5. Report back on the implementation of any remedial actions the Board takes to address the findings of the review.
6. Establish what, if any, public funding provided to Te Kohanga Reo National Trust may have been provided to Te Pataka Ohanga.

Table 1: Terms of reference

Review objective five will be completed in a timeframe acceptable to the Ministry and the Trust.

2.3 Our approach

Our independent review has been carried out in accordance with ISAE (NZ) 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

Our approach can be summarised as follows:

- ▶ We have conducted interviews with Trust staff making inquiries regarding management and governance style and practices, structures, regular reporting and the control processes in place.
- ▶ Comparison of the Trust’s systems, processes and controls to our understanding of good practice for organisations of a similar size and complexity.
- ▶ Testing of key controls on a sample basis. Samples were selected using our professional judgment. The review has been designed to assess internal controls. Where we have assessed a control to be missing, or not operating effectively, we have not carried out detailed testing to assess the extent to which the control deficiency has impacted the Trust’s reporting.
- ▶ Documentation review. Specifically, we have considered the Trust’s internal management reports, annual reports, communications from the Trust’s external auditors, milestone reports submitted by the Trust to the Ministry in relation to various contracts and Trust policy documents.

The results of this work have formed the basis of the findings in this report.

3. Public funding received or administered by the Trust

During 2012 approximately \$92m of public funding from a variety of sources was received by, or passed through, the Trust.

The Trust has contracts with the Ministry of Education (the Ministry) and the Tertiary Education Commission (TEC) where it is paid to deliver services. The Trust also administers funding on behalf of the individual kōhanga reo. Funding administered on behalf of individual kōhanga reo includes Kaupapa funding and the Targeted Assistance for Participation (TAP) grants.

These income streams are represented in the diagram below:

TE KOHANGA REO NATIONAL TRUST FUNDING STREAMS

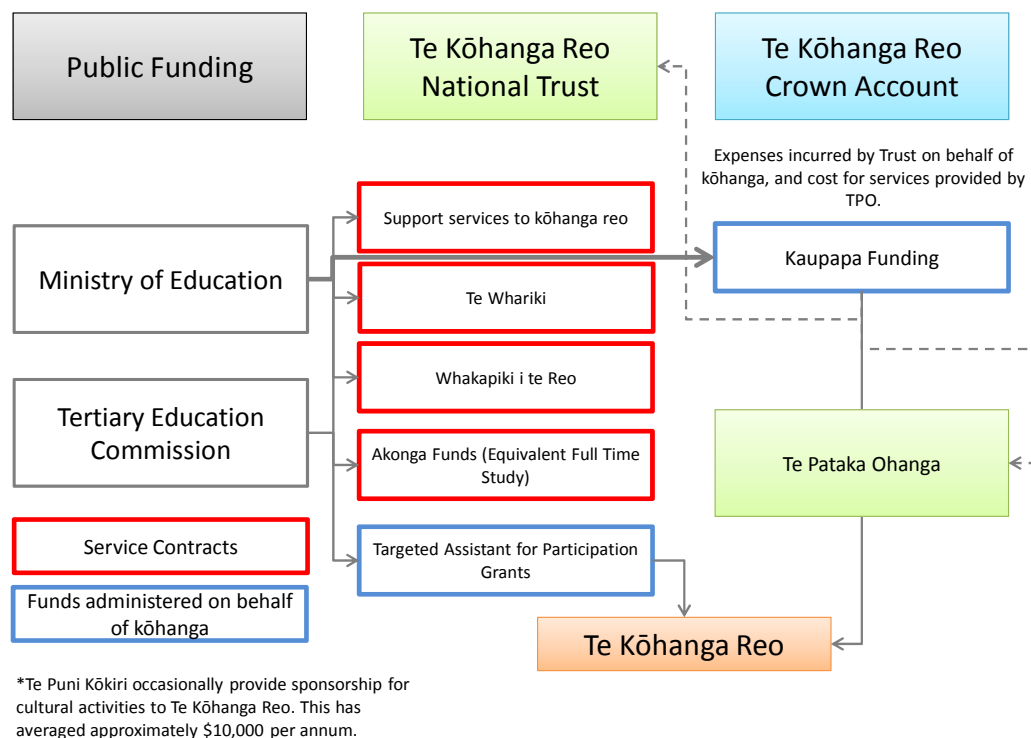


Figure 2: Funding stream map

3.1 Kaupapa funding – funding for kōhanga reo administered by the Trust

While the Trust and kōhanga reo do not see themselves as early childhood education providers, Kaupapa funding is derived from the Early Childhood Education appropriation administered by the Ministry and is made up of sessional and equity funding.

Individual kōhanga reo are licensed under the Education (Early Childhood Services) Regulations 2008. Licenses set out the standards for curriculum, premises and facilities, health and safety, governance and management of licensed services. Sessional funding for kōhanga reo is in accordance with the Early Childhood Education Handbook, which was last updated on 1 July 2013. This funding is described in the Early Childhood Education Handbook as *subsidy or subsidy and 20 hours early childhood education*. Funding is based on hours attended by enrolled children.

465 kōhanga reo received approximately \$79m kaupapa funding in 2012. This funding was paid in arrears in three instalments on the basis of roll information (maramataka) provided by kōhanga reo to the Trust. The Trust reviews and consolidates the roll information and submits it to the Ministry. The Ministry deposits funding into a separate Trust bank account specifically set up to receive

Kaupapa funding. The Trust allocates funding to individual kōhanga reo net of deductions for centrally purchased services. These centrally procured services include:

- ▶ Property, contents, vehicle (Waka), and public liability insurance.
- ▶ IT equipment purchases (Arahiko).
- ▶ Mokopuna Oranga Pumau – the kōhanga reo health scheme operated by Te Pataka Ohanga.
- ▶ Internet service provider charges.
- ▶ Whānau loans - individual kōhanga reo loans relating to property, waka, and financial support to kōhanga reo.
- ▶ Fuel card payments.
- ▶ Xero accounting software subscriptions.
- ▶ Any payments made on behalf of a kōhanga reo by the Trust.

These deductions are paid to Te Pataka Ohanga (a 100% subsidiary of the Trust), with the exception of the Xero accounting software subscriptions and payments made on behalf of kōhanga reo by the Trust. Payments made on behalf of kōhanga reo typically relate to overdue accounts with suppliers or the IRD, and for any up keep of property or outstanding debts occupied by kōhanga reo that have closed.

The Ministry retains an interest in Kaupapa funding, for example in situations where there has been an over-payment of funding based on roll information that is found to contain an error. In such situations the Ministry would seek to recover the over-payment.

The diagram below illustrates the Kaupapa funding flows:

KAUPAPA FUNDING – INTERACTIONS

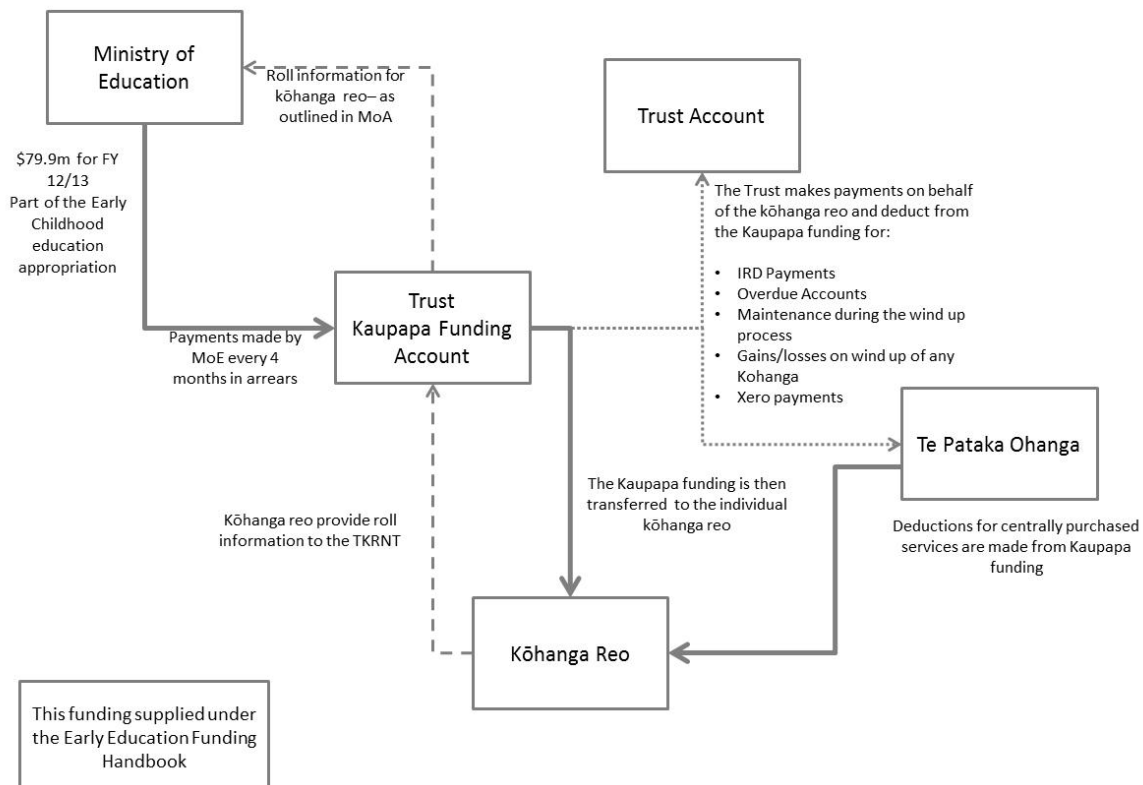


Figure 3: Kaupapa funding processes

3.2 Tertiary Education Commission (TEC) funding (Akonga)

Funding is provided to the Trust under the TEC's performance linked funding. The Trust provides five courses for kōhanga reo whānau. These courses are aimed at developing the language, as well as business administration and information technology skills of kōhanga reo whānau.

The Trust negotiates an investment plan with the TEC. TEC funding is provided through the Student Achievement Component (SAC) fund. The investment plan outlines the expected number of enrolments for each course covered by the plan. The TEC funds the Trust based on this investment plan. Funding for 2012 was approximately \$6m. Funding is subject to successfully meeting performance measures for course enrolments and completion. Failure to achieve the performance measures can result in the level of funding relating to the period being reduced. Investment plans are updated annually and cover a three year period.

During 2013 the Trust identified it had been incorrectly recording students that enrolled in a non-New Zealand Qualifications Authority (NZQA) accredited course, as being enrolled in a separate course offered by the Trust which did have NZQA accreditation. The Trust has conducted its own investigation to identify how this occurred. The conclusions of this analysis are contained in the report authored by Chen Palmer dated 13 May 2013. As a consequence, the Trust repaid \$896,070 (GST inclusive) to TEC in July 2013.

3.3 Memorandum of Agreement (MoA) - contract for support services of individual kōhanga

The MoA is a contract between the Ministry and the Trust and forms the basis on which the Ministry funds the Trust to provide specified services to the individual kōhanga reo. The agreement specifies three distinct services that the Trust will provide:

Outputs	Purpose
The provision of advice and support to kōhanga reo	<ul style="list-style-type: none">▶ Increase participation in kōhanga reo.▶ Increase quality teaching and learning programmes in kōhanga reo.▶ Maintain a sustainable and viable network of kōhanga reo.
Administration of the funding for kōhanga reo	<p>This output is to administer the funding available to individual kōhanga reo for the delivery of Kōhanga reo Kaupapa. This funding includes Kaupapa Funding and Equity Funding.</p> <p>Kaupapa funding is related to mokopuna enrolled in and attending a kōhanga reo.</p> <p>Equity funding is available to all 'licensed' kōhanga reo in addition to the Kaupapa funding and is aimed at reducing educational disparities between different groups in New Zealand.</p> <p>Total Kaupapa funding received for the 2012 year was approximately \$72m with an additional \$7m of Equity funding.</p>
Management of the Targeted Assistance for Participation (Formerly the Discretionary Grants Scheme)	<p>The Trust manages the Targeted Assistance for Participation to kōhanga reo by providing assistance to support applications to the fund, quality training to Kaupapa Kaimahi on the Scheme's requirements and oversight of projects funded by the Scheme.</p>

Table 2: Schedule to Master Agreement to Provide Services in Support of Nga Kōhanga Reo

For these services the Trust has received \$2.56m per annum since the contract start date of 1 January 2008. The original contract was for a three year period to 31 December 2010. The contract's term has been extended by the use of variation letters. The current variation letter expires on 30 June 2014.

3.4 Professional development contracts – Te Whariki and Whakapiki i te reo

The Trust has entered two separate contracts for the supply of professional development to kōhanga reo early childhood educators (kaiako). The contracts are awarded by the Ministry through a tender process. We understand the Trust has been the only participant in the tender process.

Whakapiki i te reo is designed to develop the required skills and knowledge needed for the effective learning of and teaching through the medium of te reo Māori by helping to develop, support and strengthen:

- ▶ Teaching and learning practice that is responsive to the bi-cultural nature of the curriculum.
- ▶ Effective teaching practices that are responsive to Māori and Pasifika learners and their families.
- ▶ Curriculum and teaching practice that enable reciprocal and respectful relationships between teachers and whānau.
- ▶ An evidence and inquiry based culture that informs teachers and learning practices and supports the growth of professional learning communities.

The contract began in May 2010 and provided for 10 quarterly milestone payments of \$106,250 through to 30 June 2012. This contract was extended by variation letter with four more quarterly milestones of \$106,250 being paid up to 30 June 2013.

Te Whariki has been designed to assist kaiako develop effective teaching practices and curriculum for the kōhanga mokopuna. The program was to be delivered by:

- ▶ A kōhanga reo identifying the knowledge areas it wants to improve in.
- ▶ Planning a program of learning.
- ▶ Measurement indicators will be set up to allow kōhanga to track their progress.
- ▶ Program self-evaluation and assessment occurs at each stage of the program.
- ▶ Further evaluation from the Trust if required.

The original contract contained 11 milestone payments of varying amounts totalling \$750,000 between 1 November 2010 and 30 June 2013. This contract has also been extended for a further 12 months, which includes a further four quarterly payments of \$66,015.

The tenders submitted by the Trust included a delivery plan. The delivery plan outlines how the districts will be covered and what work will be undertaken in each district. Trust staff in the districts facilitate the programs at individual kōhanga reo.

Both these contracts include milestone reporting requirements. These milestone reports contain updates against the delivery plans and include information on the development activities completed during the period. Financial information, showing costs the Trust incurred during the reporting period in providing the service, is also included in the milestone reports.

3.5 Targeted Assistance for Participation grants

Kōhanga reo have access to the Ministry's Target Assistance for Participation ('TAP') fund. The fund is designed to establish new early childhood places by providing grants, incentives, and partnership opportunities in communities where new early childhood places are needed most and normal market forces are not creating places quickly enough. In the majority of cases, whānau operate kōhanga reo from property that the Trust has title to. Whānau operate from the property on the basis of their charter with the Trust.

Grants under the TAP fund are made from the Ministry to the Trust. TAP funds are not recognised as revenue by the Trust. The Trust records a liability for unspent TAP funds. The Trust is funded separately to provide support to kōhanga as they develop their grant applications. Once a grant is made, the Trust will often manage the construction project, as the skills required are not available at the kōhanga reo. The project management service is not included in the service contracted for through the MoA.

The Trust operates a competitive tendering process which is used to select a contractor to undertake the project. Materials are purchased centrally by the Trust through arrangements with key suppliers. As work is completed, the Trust makes payments from the funding received.

Any unspent funding at the end of a project is returned to the Ministry. At the end of the 2012 financial year the Trust held approximately \$4m in TAP grants for projects it was managing. This was recorded as a liability of the Trust.

3.6 Te Puni Kōkiri grants

Te Puni Kōkiri occasionally provides sponsorship for cultural activities at Kōhanga Reo, including Matariki celebrations and kaiako graduations. The Trust initially provides funding to the Kōhanga Reo and retains TPK funds as they are received. This funding stream has averaged approximately \$10k per annum.

4. Overview of Trust internal controls

4.1 Introduction

The foundation of a control environment in any organisation can be seen as the extent to which:

- ▶ It demonstrates a commitment to integrity and ethical values.
- ▶ The Board demonstrates independence from management and exercises oversight of the development and performance of internal controls.
- ▶ Management establishes (with Board oversight) structure, reporting lines and appropriate authorities and responsibilities in the pursuit of objectives.
- ▶ Demonstrates a commitment to attract, develop and retain competent individuals in alignment with objectives.
- ▶ Holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

The bullet points above are often collectively referred to as the *tone at the top*. The effectiveness of controls operating within an entity is critically dependent on this “*tone at the top*”. This tone establishes the context in which individuals charged with the operation of control functions perform their roles. Where the tone from the top reinforces the importance of the control environment through communication and behaviours, it is more likely lower level control activities will be performed to a high standard. Evidence of a *tone at the top* that supports and encourages an effective control environment typically manifests itself through a range of corporate instruments (codes of conduct, policies that clarify expectations and guide staff regarding how controls are intended to operate etc.). Perhaps more importantly, an organisation’s commitment to effective controls is evidenced by the behaviours of the Board and senior leaders within the organisation.

In particular, the way in which those leaders deal with and respond to situations where control deficiencies have been identified.

In order for us to understand the internal controls operating within the Trust relating to its handling of public money, we have made inquiries regarding these aspects of the Trust control environment, in addition to the detailed review of controls operating over financial processes.

Our conclusions regarding the Trust’s tone and high level control environment are:

- ▶ In our discussions with Trust staff and managers, we developed an impression that the level of appreciation of the importance of internal control was at a good standard.
- ▶ Expectations of governing bodies continue to grow generally, and specifically in relation to the degree to which Boards and their Audit Committees address risk, control and financial reporting considerations. We note that the Trust does have an Audit and Risk Committee. The Committee’s terms of reference are comprehensive and in line with good practice. In recent times the activities of the Committee have been curtailed as the Trust elected to involve the Board in its management of a number of risks with such broad potential impacts on the Trust that they were more appropriately dealt with by the entire Board.
- ▶ We note the Trust does not have an internal audit function, but has on occasion requested its external auditor to extend the scope of its planned procedures in particular areas. We see this approach as being consistent with the practice used by similar organisations. We encourage the Board to expand audit scope in areas of risk on a rotational basis.

4.2 Financial reporting structure

The Trust's process for recording the receipt of public money, and costs incurred in delivering the services procured from this income, can be illustrated as below:

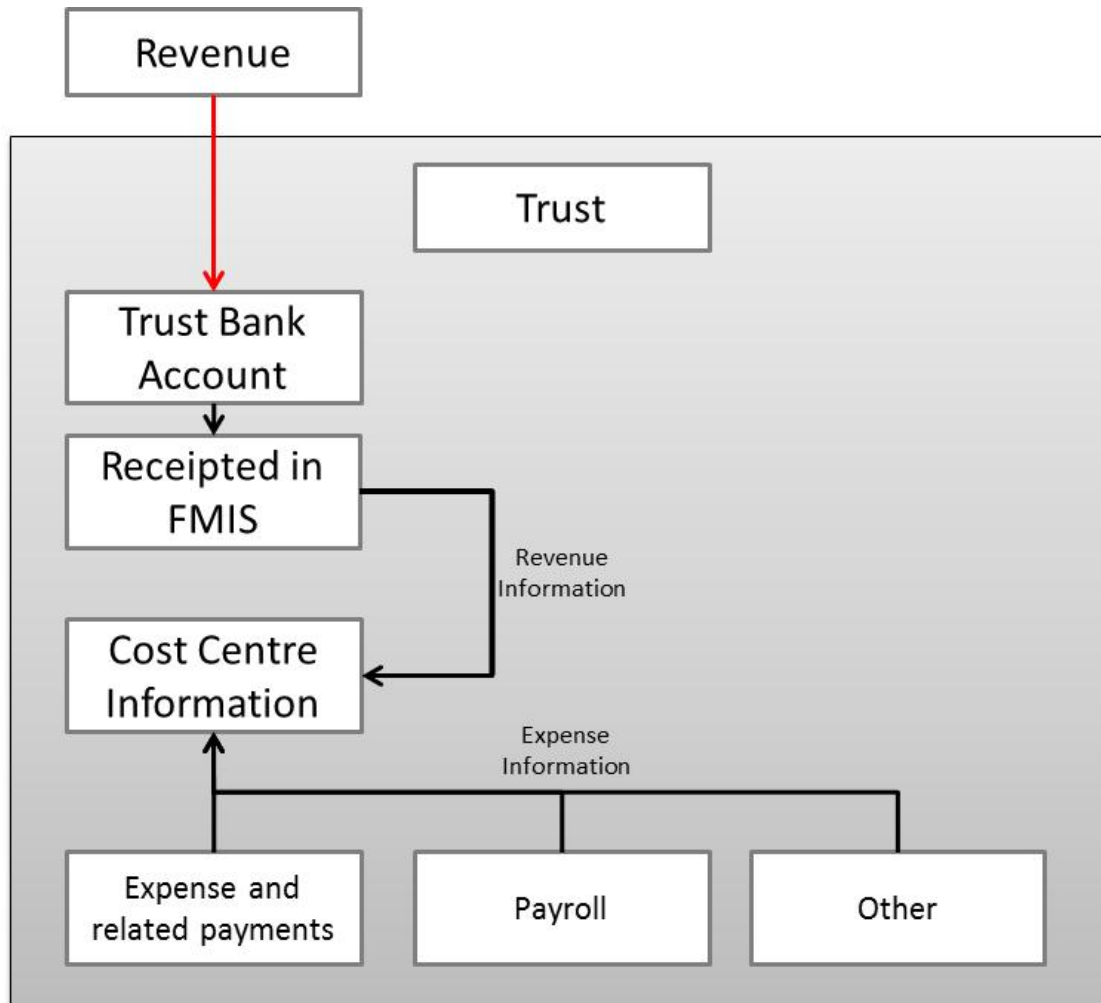


Figure 4: Trust financial processes

The Trust utilised SAP as its primary financial management information system ('FMIS') for the period of our review. The underlying processes operate consistently across the different income streams. The allocation of revenues and costs between the various income sources is key to the Trust being able to accurately monitor and report on the financial results, in its regular reporting to the Ministry and other funding agencies.

4.3 Control expectations and observations

The following section of our report summarises our assessment of the Trust's internal controls. We have summarised our analysis in line with the major financial processes operated by the Trust:

- ▶ Administration of funds on behalf of kōhanga reo.
- ▶ Expenses and related payments.
- ▶ Payroll.
- ▶ Revenue.
- ▶ Milestone reporting.

For each process we have compared the Trust's internal controls against our expectations of the controls we would expect to see present in an organisation of the Trust's size and complexity.

We have assessed the degree to which the Trust has controls in place that address the following control objectives:

Assertions	Control objective
Existence / occurrence / validity	Only valid or authorised transactions are processed.
Completeness	All transactions are processed that should be.
Rights and obligations	Assets are the rights of the organisation and the liabilities are its obligations as at a given date.
Valuation	Transactions are recorded at the correct value.
Presentation and disclosure	Accounts and disclosures are properly described in the financial reports of the Trust.

4.3.1 Expenses and related payments

4.3.1.1 Process description

This process refers to how the Trust makes commitments to suppliers through to settlement of any resulting obligation through payment. The payment process for the Trust covers all methods of payment including:

- ▶ Payments through ANZ Direct Online Banking.
- ▶ Payments via direct debit (including air travel and fuel card purchases).
- ▶ Payments made by Trust cheque.
- ▶ Credit card transactions.
- ▶ Employee reimbursements.
- ▶ Cash settlements.

4.3.1.2 Expectations

Our expectations are that the Trust had internal controls in place to ensure:

- ▶ Supplier information is correctly set up in the vendor master data.
- ▶ Only authorised changes to vendor information are allowed.
- ▶ All expenses incurred are recorded.
- ▶ Expenses are appropriately authorised.
- ▶ All recorded expenses are recorded in the correct reporting period.
- ▶ Expenses are appropriately classified.
- ▶ Expenditure is recorded against correct suppliers.
- ▶ Payments are made to valid suppliers.
- ▶ Payments are appropriately authorised.
- ▶ Expenses are supported by appropriate documentation.
- ▶ Reconciliations between the Trust's accounts payable module and the general ledger are prepared and reviewed in a timely manner.
- ▶ Cost centre managers are provided with regular reports showing performance against budget.

4.3.1.3 Overall assessment

The Trust's process is consistent with our expectations for an organisation of its size and complexity, except for the management of credit card expenditure, and supplier masterfile data.

4.3.1.4 Key controls identified

- ▶ The Trust Board has approved a delegated financial authority policy which was in operation throughout the period of the review and was last updated on 24 October 2013. The policy is comprehensive and easy to understand.
- ▶ Purchase orders are used for non-standard purchases. Purchase orders are approved in accordance with the Trust's delegated authority policy.
- ▶ Invoices are authorised by a staff member with the appropriate delegated authority.
- ▶ Coding of invoices is reviewed by finance staff for appropriateness prior to processing.

- ▶ ANZ Direct batch payment listings are reviewed against supporting documentation / invoices prior to payment.
- ▶ Payments made through ANZ Direct are required to be authorised by two members of the Trust staff with the appropriate access.
- ▶ Cheques are required to be signed by two members of the Trust staff with the relevant delegation.
- ▶ Bank reconciliations are prepared and independently reviewed on a timely basis.
- ▶ Monthly credit card returns are required to be reviewed and approved by the Board of Trustees.
- ▶ All Koha payments are required to be approved by the Chief Executive prior to payment.
- ▶ Travel expenditure is required to be pre-approved by the Chief Executive.
- ▶ The district petty cash reconciliations are reviewed on a timely basis by District Managers.

4.3.1.5 Observations

- ▶ Control over supplier masterfile data is key to ensuring payments are being made to valid suppliers. The Trust's current practice is for changes to vendor information within the accounts payable module of the FMIS to be independently reviewed. The report used as the basis of this independent review can be enhanced to ensure it provides the reviewer information regarding all masterfile changes that have been made.
- ▶ Trust policy requires that the Board conducts a review of credit card returns. We could see no evidence that this control was being performed.
- ▶ The Trust's policy requiring Board approval of all credit card expenditure is not a typical arrangement we see in other organisations. Other organisations of similar scope and size would typically use a 'one-up' review approach to approving these types of expenditure.
- ▶ Credit card returns are required to be supported with appropriate documentation, and completed in a timely manner. We reviewed the 2012 credit card returns in detail and noted many returns did not include relevant supporting documentation. We also noted that many returns had not been signed by the card holder and were not being prepared in a timely manner. We identified monthly credit card returns which were completed up to three months after the expenditure had occurred.
- ▶ The Trust's policy permits cash withdrawals on credit cards in cases where cash is required for koha payments while the relevant staff member is out of town. Our review of credit card expenditure for 2012 noted approximately \$5,000 classified as koha using this payment method. These were generally payments of between \$100 and \$200. This represents approximately 5% of the total koha of the Trust in 2012. We were unable to see evidence that the Chief Executive had pre-approved these koha payments as required by Trust policy.
- ▶ We identified some instances where small koha payments had been made through the district's petty cash reserves. These payments were approved by the District Manager. This is not consistent with the Trust's policy on koha payments that requires Chief Executive pre-approval.
- ▶ During our testing we noted one koha payment of \$50,000 made in December 2012 to a related party. This payment was a matter discussed in Committee by the Board, and related to the substantial contribution made by the recipient during the extended Waitangi claim process. The Board has the authority to make such a payment. We reviewed documentation supporting the payment that shows the payment had the support of all Board members. We note this amount was not included in the related party transaction disclosures included in the Trust's 2012 Annual Report as required by NZ IAS 24 *Related Party Disclosures*.

4.3.1.6 Recommendations

Management of credit cards

During 2012 the Trust operated with six credit cards issued to executives, and the Co-Chairs. In October 2013 the Trust made the decision to cancel the credit cards. Credit cards do provide an effective payment mechanism if the use is controlled appropriately.

In our view the Trust's policy was set up to provide adequate control over use of the cards, but the controls have not been operating in line with the policy. Should the Trust consider reinstating the use of credit cards in the future we recommend:

- ▶ The Trust considers whether the policy of requiring the credit card statements and documentation to be approved by the Board is necessary;
- ▶ Typical practice would be for all executive credit card returns to be signed by their immediate Manager (for the GM's the CEO), with the CEO expenses being reviewed and approved by the Chair;
- ▶ Credit card returns of Board members should be reviewed and approved by the Chair, or a member of the Board that does not hold a Trust credit card;
- ▶ In carrying out a review of credit card statements, we expect the reviewer to assess whether all transactions are in line with relevant policies and relate to the organisation's purpose. The review should be facilitated by card holders being required to annotate the statement with brief narrative regarding the business purpose of the expenditure; and
- ▶ Where centralised purchasing arrangements are in place through the use of petrol cards or travel services via a travel broker, we would not expect that these types of expenditure would be incurred on a Trust credit card.

Segregation of duties for processing changes to accounts payable master data

We recommend that the Trust uses its FMIS vendor master data reporting to generate a report that identifies all changes made to vendor master data in the period. This report should be configured in a way that those responsible for initiating, or entering requested changes to master data, cannot modify the report. The report should be regularly reviewed against relevant supporting documentation and evidenced as reviewed.

Related party disclosures

Where the Board authorises a payment following an in-Committee discussion, it is usual practice for the minutes to reflect the essence of the discussion, and support for why the Board considers the payment to be aligned to the purpose of the Trust. Such documentation is not designed to diminish the Board's authority to make decisions regarding application of the Trust's funds. Rather it serves to record the rationale applied by the Board in arriving at its decision.

The Trust introduces a process to capture all related party transactions as part of its annual financial statement preparation process.

Trust Response

The Trust Board has removed all credit cards. The Trust has taken note of the recommendations contained in the report and will consider if the Trust elects to re-introduce credit cards.

Trust Response

The Trust has noted this recommendation and applied these to the processes. The Trust has changed its FMIS and the recommendations were implemented as they were brought to the Trust's attention.

4.3.2 Payroll

4.3.2.1 Process description / background

The payroll process involves the calculation and payment of employee remuneration. This includes the processing of wages, annual leave, tax deductions such as PAYE, and Kiwisaver superannuation. The payroll function is administrated by the Trust's finance team using Datacom's Datapay application. The large majority of Trust staff are salaried employees and work in the 10 district offices providing support to kōhanga reo. There is 38 staff working in the Trust's head office.

4.3.2.2 Expectations

Our expectation was that the Trust had internal controls in place to ensure that:

- ▶ Notified hours worked are appropriately authorised.
- ▶ Hours worked by an employee are correctly reflected in the payroll system.
- ▶ Payroll transactions are correctly recorded in the general ledger.
- ▶ Payments are only made for time worked.
- ▶ Only authorised changes to employee payroll data (leave taken, changes to pay rate, changes to bank account details, changes to tax code, changes to deductions) are made, and that changes made are accurate.
- ▶ All authorised changes to payroll data are actioned in a timely manner (terminations etc.).
- ▶ Correct pay rates are used in calculating gross pay.
- ▶ Leave records are appropriately maintained.

4.3.2.3 Overall assessment

The payroll process is consistent with our expectations for an organisation of the size and complexity of the Trust. We note the findings identified by the Trust's external auditor relating to retention of documentation on employee files.

4.3.2.4 Key controls identified

- ▶ Access to payroll data and Datapay application restricted by password.
- ▶ Anomalies report is reviewed prior to each pay run. This report identifies large dollar variances per employee between pay periods.
- ▶ New employees are approved by the Chief Executive prior to their employment.
- ▶ New employees sign a contract prior to employment commencing.
- ▶ Any leave taken is required to be approved by the employee's manager.
- ▶ Draft pay run report is reviewed by the Trust's Finance Manager prior to processing by Datacom.
- ▶ The final pay for any departing employee is reviewed by the Trust's Finance Manager prior to processing by Datacom.
- ▶ Employee's account details are deactivated in the Datapay system upon final payment.

4.3.2.5 Observations

- ▶ Control over payroll masterfile data is key to ensuring payments are being made to valid employees. The Trust's current practice is for changes to employee information or the setup of new employees within the payroll application to be independently reviewed. The report used as the basis of this independent review can be enhanced to ensure it provides the reviewer information regarding all payroll masterfile changes that have been made.

- ▶ The Trust's external auditors have identified instances where employee contracts were out of date and supporting documentation relating to the increase in pay rates and changes to employee bank account details were not kept in the employee's file.
- ▶ Evidence of the Finance Manager's approval of the pay run report could not be located for one fortnightly payment run.

4.3.2.6 Recommendations

Segregation of duties for processing of changes to payroll master data

We recommend Datapay's exception reporting is used to identify all changes to employee information. This report should be configured in a way that those responsible for initiating, or entering requested changes to master data cannot modify the report. The report should be independently reviewed against relevant supporting documentation, and the review evidenced.

Supporting documentation

Maintenance of documentation supporting current terms and conditions of employment is key to effective payroll control. We recommend the Trust considers conducting a stock take between employee files and the payroll system. Where documentation is not able to be located, we suggest the Trust confirms the current information with employees through a simple form letter that can be counter signed by staff.

Trust Response

The Trust has applied this recommendation and requested the additional report from the payroll service provider.

4.3.3 Revenue and cash receipting

4.3.3.1 Process description

The revenue processes of the Trust are designed to ensure that the cash receipts for the undertaking of services performed by the Trust are recorded correctly.

4.3.3.2 Expectations

Our expectations are that the Trust had internal controls in place to ensure:

- ▶ Revenue is recognised in line with contract milestone delivery.
- ▶ Revenue is recorded in the correct period.
- ▶ Revenue is classified appropriately against relevant costs centres to facilitate milestone reporting.
- ▶ Revenues are banked in timely manner.
- ▶ Funding is banked into appropriate accounts (separation between funds associated with the Trust acting in its own right, and where it is acting on behalf of kōhanga).

4.3.3.3 Overall assessment

The process is consistent with our expectations for an organisation of the size and complexity of the Trust. We have not identified any major deficiencies in our review of the Trust's revenue and receipting process.

4.3.3.4 Key controls identified

1. Management accounts are prepared for review by the Trust's Board. These management accounts include an analysis against budget to identify any unusual variances.
2. Separate bank accounts have been established for funds related to Trust services, and funding to be allocated to kōhanga reo.
3. Bank reconciliations are prepared and reviewed in a timely manner.

4.3.3.5 Observations

We have not identified any gaps in the controls governing the revenue processes of the Trust.

4.3.4 Milestone reporting

The milestone reporting process describes how the Trust extracts data from its core financial systems to populate report to the Ministry.

We would expect the Trust to have a process in place that ensures that overheads are correctly allocated in reporting to the Ministry.

Overhead cost centres are applied in milestone reports as a 20% loading percentage on top of direct costs. This loading is the Trust's best estimate of how overhead expenses are consumed in the provision of services. Given the Trust's main cost is staff, and staff are not an unreasonable proxy for the consumption of overheads, we believe this is a pragmatic approach to deriving total costs in the Trust's milestone reports.

4.3.5 Administration of funds on behalf of kōhanga reo

4.3.5.1 Process description

This process is used by the Trust to manage the cash receipts and disbursements related to the services the Trust is contracted to provide on behalf of individual kōhanga reo. These include:

- ▶ The administration of Kaupapa funding to kōhanga reo.
- ▶ The administration of Targeted Assistance for Participation (TAP) grants.

The Trust also administers the processing of deductions made from Kaupapa funding to Te Pataka Ohanga and itself. The deductions made from the Kaupapa funding for the 2012 financial year totalled \$4.1m. The Trust received \$0.4m and the deductions paid to Te Pataka Ohanga totalled \$3.7m.

Centrally procured insurance provided by Te Pataka Ohanga provides cover to kōhanga reo for damages. Claims from kōhanga reo up to \$375,000 for a financial year are met by funds generated through the insurance deductions from kōhanga reo. Total damage exceeding \$375,000 is currently underwritten by Lumley Insurance. The contract for the external insurance cover purchased by Te Pataka Ohanga is regularly reviewed against the market by the Trust's insurance broker Crombie Lockwood. The insurance deductions made from the kōhanga reo Kaupapa funding covers both the self-insured and externally underwritten portions of the insurance cover.

Other centrally purchased service arrangements, including internet service provider charges, fuel cards and information technology equipment, are also regularly reviewed against the market by Te Pataka Ohanga. A margin to cover the costs incurred in the administration of these arrangements is applied by Te Pataka Ohanga. The Trust does not formally review margins charged by Te Pataka Ohanga, but through their close association with the subsidiary is satisfied that the charges are reasonable.

4.3.5.2 Expectations

Our expectations are that the Trust had internal controls in place to ensure:

- ▶ Aggregate Kaupapa funding received aligns to roll information submitted by kōhanga reo.
- ▶ Individual kōhanga reo paid correct amounts based on roll data (Maramataka).
- ▶ Only authorised deductions are made from kōhanga reo Kaupapa funding.
- ▶ Payments made from the Trust's *Crown* bank account are authorised.
- ▶ Authorised payments are correctly recorded in the general ledger.
- ▶ Centrally procured services providers are regularly reviewed against market prices and service quality.
- ▶ Contracts are awarded without an appropriate tender process being undertaken.
- ▶ Targeted Assistance for Participation projects represent best value for money.
- ▶ Expenditure against Targeted Assistance for Participation projects is recorded against the correct project.

4.3.5.3 Overall assessment

We have not identified any deficiencies in the controls governing the Kaupapa funding or TAP grants.

The Trust operates a tendering process for the awarding of construction contracts that the Trust administers on behalf of kōhanga reo. Control of expenditure and associated payments under the TAP programme are as per those described above for routine Trust payments.

4.3.5.4 Key controls identified

1. Kaupapa funding paid to each kōhanga reo is agreed by Trust staff against the detailed analysis provided by the Ministry supporting the aggregate funding deposited into the Trust's Crown account.
2. Deductions made from Kaupapa funding are reviewed against invoices provided by the Trust and Te Pataka Ohanga.
3. Deduction payments are approved by the Chief Executive who reviews the schedule of deductions prior to payment.
4. Kōhanga reo roll information (Maramataka) is reviewed against source documentation prior to submission to the MOE.
5. The Trust's Chief Executive ensures that the appropriate reviews have taken place prior to approving the total Kaupapa funding payments.
6. Payments made through ANZ Direct are required to be authorised by two members of the Trust staff with the appropriate access.
7. Bank reconciliations for the Crown account are prepared and reviewed on a timely basis.
8. An independent advisor is used to review tender proposals received for construction projects.
9. The Trust's Project Manager will approve payments to contractors before payment.

4.3.5.5 Observations

- ▶ We have not identified any gaps in the controls governing the administration of funds on behalf of kōhanga reo.

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