St Joseph's School Grey Lynn

Audit Findings

For the year ended 31 December 2017

1. Introduction

We set out below our findings from the audit work we have performed during the audit of your financial statements for the 2017 financial year. Matters raised in this report have been discussed with your management team during the audit fieldwork.

Our work focussed on the systems and controls set by your board and implemented by your management team, to the extent necessary in forming an audit opinion. Any matters arising from the audit are detailed in this letter.

2. Expected content of our formal audit report

Subject to receipt of signed financial statements, letter of representation, and final update of events subsequent to balance date, we expect to issue an unmodified audit report in our standard wording.

However, we intend to include in our audit report an Emphasis of Matter paragraph regarding your financial situation with the following wording:

> ***Emphasis of Matter - Serious Financial Difficulties***
>
> *Without modifying our opinion, we note that the school has a working capital deficit of $28,956. Note 25 to the financial statements explains the situation regarding the ongoing use of the going concern assumption. The school is reliant on the continued support of the Ministry of Education to continue as an operational entity. The school is managing the situation by maintaining close contact with the Ministry of Education and their accounting service provider to try to return the school to a healthier financial position and is taking action to address the factors that have resulted in the working capital deficit.*

We also refer you to the serious financial difficulty point later in this letter.

3. Governance

Areas of Significant Audit Focus

We believe it is best practice to communicate with you as the governing body regarding matters which form an important part of our audit process.

An independent audit of your financial statements is a key part of ensuring that your organisation has appropriate controls in place regarding financial management and financial reporting. However, ultimately it is you, the governing body that remains responsible for your financial systems, internal controls including the detection and prevention of fraud, and financial statements.

While our audit necessarily involves evaluating your overall system of financial controls and reporting, the following are areas and issues we assessed as potentially significant risk areas in relation to your school during our audit. Accordingly we believe that they are important issues that should be of interest to you in your governance capacity. In the case of your organisation in the current year these assessed areas of significant focus were as follows:

- Payroll controls in place at your school and accurate recording of payroll accruals
- Recognition and recording of locally raised funds income and expenditure
- Risk from limited segregation of duties
- Revenue recognition and treatment of income in advance
- Expenditure being valid and appropriate for your school's purposes (probity of expenditure)
- Cyclical maintenance expense and provisioning being appropriate
- Recognition and disclosure of related party transactions
- Validity of the going concern assumption
- Appropriate treatment of proprietor monies received by the school

In addition, we sought to ensure that your financial statements were in compliance with generally accepted accounting practice in New Zealand as appropriate to public benefit entities that qualify for Tier 2 reporting. That is that Public Benefit Entity Standards - Reduced Disclosure Regime (PBE Standards RDR) have been appropriately adopted and that the mandatory Kiwi Park model has been followed.

We are pleased to advise that our testing of these assessed risks did not identify any significant issues or concerns other than any observations and recommendations related to these topics as detailed below.

Required Communications

We are required by auditing standards to report specific matters to you as follows:

- We have had no disagreements with management during our audit nor any serious difficulties in dealing with management
- We have not identified any breaches of legislation during our audit
- We have not identified any instances of fraud involving management, or any other frauds that caused a material misstatement of the financial statements
- We have not noted any significant risks or exposures that are required to be separately disclosed in the financial statements.

Audit Independence

We reaffirm we are independent of your school, and that we have no relationship with your school that could impair our independence.

Breach of Legislation – Statutory Borrowing Limit

The Board appears to have breached the statutory limitations for external borrowing.

Section 67 of the Education Act 1989 and clause 12 of the Crown Entities (Financial Powers) Regulations 2005 permit a Board to borrow within a specified limit. Boards need Ministerial approval to exceed this limit.

A note has been added to your financial statements explaining this situation, which means that we do not need to mention the issue in our audit report. However, it is important that the Board resolves this breach as soon as possible. We suggest that further discussions be held with the Ministry.

If any future borrowings are to be made in excess of the limits imposed by section 67 of the Education Act 1989 and the associated regulations, please remember that you have to get ministerial consent before the borrowing is entered into.

If the Board is contemplating further borrowing, we recommend that you first discuss this with the Ministry.

Serious Financial Difficulty

Your financial statements reflect a further deterioration in your school's financial position. Your operating statement results have worsened by $24,604 from last year to an operating deficit achieved in 2017 of $52,243. We also note that this was considerably worse than your budgeted surplus of $18,309. As a result, your working capital is now in a deficit position of $28,956 (2016: deficit of $6,503), and the school has actually now run into a negative equity position at balance date ($7,501). As your school has no term investments or other available funds, this means that your current liabilities exceed your current liabilities, which indicates that as at year-end your school was technically not able to meet its financial commitments.

As you will be aware from past letters to your board and a meeting we attended with the board last year, we have previously raised concerns with regard to your declining financial position. This is unsustainable and has steadily been eroding your school's working capital and equity. The trends in your financial performance and financial position over the past three years can be seen in the following table of key factors from your audited financial statements:

	2017	2016	2015
Revenue	755,767	772,992	892,423
Surplus/(Deficit)	(52,243)	(27,640)	(3,703)
Working Capital	(28,956)	(6,503)	9,861
Equity	(7,501)	44,740	72,381

Because your financial position raises concerns about the validity of your ongoing use of the going concern assumption in the preparation of your financial statements we have been required to contact the Ministry to confirm their ongoing support. The Ministry of Education have provided your school with a letter of support stating that they will support the school for the foreseeable future.

As your financial statements disclosed details of your school's financial situation and the Ministry's confirmation of support, we were able to issue an unmodified audit opinion. However, due to the seriousness of the school's financial difficulty, the situation has required us to add an emphasis of matter paragraph to our audit report to highlight your financial situation to readers.

We recommend that your Board continue to monitor this situation closely and take action to curtail expenditure and/or generate additional revenue wherever possible to help restore your school to a sounder financial position. We also suggest you may wish to contact the Ministry's Northern Region Financial Advisor, Carmel Riordan, to discuss your financial situation further.

4. The financial statements

Unadjusted differences

Appendix A details unadjusted journal differences that we identified during the audit.

Adjustments made

There were no journal adjustments made to the financial statements as a result of our audit.

5. The day to day accounting system

It is important that we report any observations and areas for improvement in respect of the financial control environment at your school. As part of the RSM audit approach we review the accounting systems established by the board to the extent that they could have a significant impact on the annual financial statements. The following observation are brought to your attention.

Budgeted Cash Flow Statement

Schools are required by S87(3)(i) of the Education Act 1989 to report budgeted figures for the cash flow statement that is now mandatory in your financial statements. Further, we consider that it is important to monitor the cash position of your school to ensure that funds are always available to meet day to day financial obligations.

We note that while your school has presented a cash flow statement budget in your year-end financial statements, this has been generated from your income statement and balance sheet budgets as part of the financial statements preparation process.

In future, we recommend that the preparation of a cash flow budget be integrated into your annual budgeting cycle so that this is available to your board and management for monitoring purposes at the commencement of the year, as well as to enable this to easily be included in the annual financial statements.

GST treatment and recognition of Trading Income

Income received by the school from the rental of classrooms and the hall is currently being classified as donation income. We noted that GST is only charged on some of these transactions. As this income is received in exchange for the provision of a service (the use of the school's premises) it should be classified as trading and have GST included.

Incorrect treatment of this income may leave the school vulnerable if the IRD were to audit your GST payments. Additionally, this treatment offers poor quality information to the decision makers for the school.

We reiterate that monies received should be correctly classified not only as for reporting purposes but also for effective forward planning and budgeting requirements.

We have accepted that the impact of the unrecorded GST is immaterial to the financial statements but recommend an internal review to calculate the impact and adjust your next GST return accordingly, as well as ensuring this is rectified in the future.

Recognition of Revenue

We noted that revenue from rental of the hall or classrooms is only recorded in the General ledger when cash is received. For financial reporting purposes, revenue is earned when the goods or service are supplied, not when the payment is received.

Recognition of revenue only when payment is received also increases the risk that the school may not track monies owed to it and therefore receive income on a timely basis.

Entering invoices into the general ledger on an accruals basis when revenue is earned, and the tracking of accounts receivable, would highlight any outstanding invoices enabling the school to follow up in a timely manner and ensure payment is received.

Expenditure Policies

We noted that your school does not appear to have a policy in place regarding sensitive expenditure.

To follow best practice and to further improve your internal controls we recommend that your school consider developing and implementing a policy in these areas to provide appropriate guidance for your school team. The Auditor General and the MOE suggest such items of sensitive expenditure be covered by specific policies to provide clear guidance to the school's staff as to what is acceptable. The Financial Information for Schools Handbook on the MOE website has a model policy. This can be found at:

https://www.education.govt.nz/school/running-a-school/school-finances/

In our experience the clarity from having such written approved policies can be helpful in dealing with potential issues proactively. Additionally, we recommend a one up approval policy for expenditure items, for example travel expenses of the Principal should be approved by the Board.

Cyclical maintenance provision calculation

The Ministry's Financial Circular 2007/2, the Financial Information for Schools Handbook (FISH) and the school model financial statements explain the requirement for schools to account for property maintenance obligations.

We noted that the treatment cycles for two items were increased during the current period, however, the expected year of next treatment was not amended. We recalculated the provision amending both inputs and we have agreed with your management team's assessment that the variance between the calculations was not material to the financial statements, taken as a whole. Whilst we agree that the amount is immaterial, this does however result in an unadjusted error that we are required to include in Appendix A of this report.

We recommend that any changes to the inputs of this calculation be made consistently.

Receipts from students

Currently, cash received from students in the office is sometimes recorded in the receipt book or lists from the classrooms. However, in some cases, no record of this receipt is made. Furthermore, details relating to each student are not able to be reconciled back to a bank deposit made. Therefore, we were unable to trace bank deposits made back to the student records from the cash book or class list.

It is important to maintain adequate audit trail for all funds received from students. This to ensure that any disputes regarding payments received from a student can be adequately addressed by tracing through the system.

We recommend that a cash book is maintained which records details of the student and the nature of the receipt, and that this is reconciled to each bank deposit made. This will allow for detailed management review and stronger oversight of the cash collection process.

We strongly recommend that receipts be written wherever possible as this provides the person providing the funds to your school evidence that your organisation has received the funds sent to them. This also acts as a control mechanism for the school ensuring all cash received is properly recorded and banked.

GST treatment not consistent across similar transactions

A sample of uniform sales showed that in some cases, GST had not been included in the sale. Failure to correctly account for GST can expose your school to unnecessary penalties and an undue level of ongoing interest from the Inland Revenue Department.

Care should be taken to ensure that GST is not mistakenly omitted on relevant transactions. We also recommend that a comprehensive GST review be undertaken to ensure that the IRD requirements are being adhered to in the processing of transactions.

Furniture and Equipment grant received recognised in profit and loss

Furniture and equipment grants received by the Ministry are seen as capital contributions and should be recognised in equity.

We note that a furniture and equipment grant was received during the current period. This was recorded in the statement of comprehensive revenue as "other grants" and recorded a GST element. We have agreed with your management team's assessment that the amount is not material to the financial statements, taken as a whole. Whilst we agree that the amount is immaterial, this does however result in an unadjusted error that we are required to include in Appendix A of this report.

We recommend that furniture and equipment grants are recorded as per PBE Accounting Standards Reduced Disclosure Regime requirements.

2018 Budget does not include depreciation

The 2018 budget currently projects a surplus of $13,535. This calculation however, excludes a depreciation expense estimate for the period.

Budgets are an important monitoring tool and should be prepared to keep a track of your prospective financial results. Having a budget which establishes the governing body's financial expectations assist in the ability to subsequently monitor your school's performance. Such monitoring against budget can enable identification of areas that require intervention.

We recommend that all relevant non-cash items, including depreciation, are included in the budget to provide an accurate estimate of expected financial results.

Inadequate Budgeting for Government Grants

The Government Grants figure of $541,370 in your school's 2018 budget appears unrealistically high when compared to the actual revenue of $483,422 in the previous financial year. The same is seen in the 2017 cashflow budget of $ 167,374 when compared to actual Government Grants of $139,265 for 2017.

To ensure monthly reporting against budget is more useful, and to avoid a high year-end adjustment, we suggest a more appropriate Government Grant estimate be provided in future years' budgets.

Appendix A

Unadjusted differences arising from our audit

The following differences have been identified during our audit and remain unadjusted at the conclusion of our work. Whilst we request that these do be ammended, given their value, we nevertheless are still able to provide an unmodified opinion should they remain unadjusted in the final approved financial statements.

Date	Name	Account No	Debit	Credit	Income Statement		Balance Sheet	
					DR	(CR)	DR	(CR)
31/12/2017	Rental of school premises	RSM2		-12,251.00		-12,251.00		
31/12/2017	Donations	14017	14,089.00		14,089.00			
31/12/2017	GST Clearing Account	93047		-1,838.00				-1,838.00
	To recognise GST implications and trading revenue on use of premises income recognised as donations income							
31/12/2017	F & E Grant	RSM3		-1,998.00				-1,998.00
31/12/2017	MoE - Other Grants	10064	1,737.00		1,737.00			
31/12/2017	GST Clearing Account	93047	261.00				261.00	
	Being the recognition of the annual MOE furniture and equipment grant							
31/12/2017	Cyclical Maintenance - Adjust Provision	71415		-3,874.00		-3,874.00		
31/12/2017	Prov for Cyclical Maintenance	93057	10,222.00				10,222.00	
31/12/2017	Prov Cyclical Maint. Non-Curr	98025		-6,348.00				-6,348.00
	Being the adjustment of the cyclical maintenance provision according to audit reperformance with new inputs							
31/12/2017	Depreciation - Total Curr Year	80200		-326.00		-326.00		
31/12/2017	Lease Liability (Current)	93050		-833.00				-833.00
31/12/2017	Orig Cost - Leased Assets	95270	2,019.00				2,019.00	
31/12/2017	Lease Liability (Term)	98050		-860.00				-860.00
	Being the adjustment to align the leased asset and liability calculation per audit workings							
31/12/2017	Teachers' Laptop Expense	25090		-8,781.00		-8,781.00		
31/12/2017	Depreciation - Total Curr Year	80200	8,031.00		8,031.00			
31/12/2017	Finance Costs	88012	750.00		750.00			
31/12/2017	Lease Liability (Current)	93050		-3,745.00				-3,745.00
31/12/2017	Orig Cost - Leased Assets	95270	3,745.00				3,745.00	
	Being the recognition of finance leases currently classified as operating leases							
31/12/2017	Acc Rec - Tch Sal HP Grant	91025	1,500.00				1,500.00	
31/12/2017	Accrual - Salaries	93025		-1,500.00				-1,500.00
	Being the recognition of the funding code error per the Novopay report							