KPMG

Assessment of Financial Controls Environment

Oranga Tamariki – Ministry of Children

May 2022

kpmg.com/nz

Contents

Disclaimers

Inherent Limitations

This report has been prepared in accordance with our Consultancy Services Order (CSO) variation dated 23 February 2022. Unless stated otherwise in the CSO, this report is not to be shared with third parties. However, we are aware that you may wish to disclose to [central agencies and/or relevant Ministers' offices elements of any report we provide to you under the terms of this engagement. In this event, we will not require central agencies or relevant Ministers 'offices to sign any separate waivers. The services provided under our engagement letter ('Services') have not been undertaken in accordance with any auditing, review or assurance standards. The term "Audit/Review" used in this report does not relate to an Audit/Review as defined under professional assurance standards. The information presented in this report is based on that made available to us in the course of our work/publicly available information/information provided by Oranga Tamariki. We have indicated within this report the sources of the information provided. Unless otherwise stated in this report, we have relied upon the truth, accuracy and completeness of any information provided or made available to us in connection with the Services without independently verifying it. No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, Oranga Tamariki consulted as part of the process.

Third Party Reliance

This report is solely for the purpose set out in *Appendix 1: Objective, Scope and Approach of our work* of this report and for Oranga Tamariki's information, and is not to be used for any other purpose or copied, distributed or quoted whether in whole or in part to any other party without KPMG's prior written consent. Other than our responsibility to Oranga Tamariki, neither KPMG nor any member or employee of KPMG assumes any responsibility, or liability of any kind, to any third party in connection with the provision of this report. Accordingly, any third party choosing to rely on this report does so at their own risk. Additionally, we reserve the right but not the obligation to update our report or to revise the information contained therein because of events and transactions occurring subsequent to the date of this report.

Internal Controls

Due to the inherent limitations of any internal control structure it is possible that errors or irregularities may occur and not be detected. Our procedures were not designed to detect all weaknesses in control procedures as they are not performed continuously throughout the period and the tests performed are on a sample basis. As such, except to the extent of sample testing performed, it is not possible to express an opinion on the effectiveness of the internal control structure.

1. Executive summary

Introduction

In late 2021, Oranga Tamariki (OT) identified that it was likely to breach its appropriations for the 2021/22 financial year. Decisions made by OT in how initiatives would be delivered (e.g., permanent versus fixed-term roles) and the nature of the funding (time limited), has created significant pressure on baseline funding for the Ministry.

OT has taken several steps to address this, including a reprioritisation of the current work programme and a detailed expenditure review, with support from the Treasury.

The fiscal pressure on baseline funding which OT is experiencing demonstrates the need to assess whether the financial controls, including the current system, processes, and practices, are fit for purpose.

KPMG undertook a high level "diagnostic" review of the financial control environment in December 2021 which was limited in terms of the number of stakeholders consulted and documentation reviewed. The findings outlined in the following report build on the findings from the December review and assessed the financial control environment in greater detail.

Objectives

The objectives of this review were to build on the "diagnostic" report to:

- Identify how soft controls (i.e. cultural and behavioural elements) may be contributing to the breakdown of controls over financial expenditure.
- Assess the design and operating effectiveness of financial controls such as delegated authorities, approvals of expenditure and budget monitoring and reporting controls.

This work was delivered alongside two other reports, firstly a review of 2021/22 expenditure forecast and secondly a review of the Funding and Performance operating model. The findings in this report directly fed into the "Governance and Control" element of the operating model review.

Key findings/observations

In performing this review, we undertook interviews across a range of teams, conducted 'voice of customer' (i.e. budget holders) and 'voice of team' (Funding and Performance) surveys and reviewed supporting documentation.

Through this work we heard common themes relating to weaknesses in the financial control environment. But equally important, we heard that there were challenges in the culture and behaviours of staff and senior leaders as they relate to financial management and accountability that can undermine the financial control environment.

To achieve a robust financial control environment, OT needs to ensure that appropriate controls are in place and that these controls are supported by a culture that recognises the need for stronger financial disciplines.

Behavioural and cultural elements

In section 2 of this report, we have assessed the behavioural factors that are impacting OT's financial control environment using KPMG's Soft Controls Model. The key elements that we observed as having the greatest impact on financial management and accountability are:

- **Clarity**: budget holders have little clarity around what their budget is and how they are tracking against it. Expectations for managing within budget vary and there is a lack of consistent guidance around meeting the needs of tamariki in a fiscally responsible way.
- **Commitment**: front-line budget holders are not involved in setting their budgets and therefore do not either understand the components of the budget or feel a sense of ownership for their budgets. There has also been a view among some budget holders that additional funding will always be available (as has been the case in recent years), which impacts on budget holder's commitment to operate within budget.

- **Achievability**: feedback from budget holders is that they feel budgets are not always achievable as budget are made without their input. Their budgets are also impacted by decisions made by other teams (e.g. Partnering for Outcomes) for which they are not always consulted, further eroding their sense of ownership for operating within budget.
- **Reinforcement**: there is a lack of consequences for failing to achieve budget. Conversely those who have operated within budget now feel that they are being unduly disadvantaged by having their budgets cut in order to make up for overspends by other budget holders.

Financial control elements

In section 3 of this report we have identified some of the key control elements that need to be in place to ensure a robust, sustainable control environment. These include:

- **Governance**: given the financial pressures on OT during this and following financial years, a specific governance/steering group should be put in place to oversee and drive cost saving initiatives. This should be chaired by the CFO to ensure a strong financial focus. Additionally, overall responsibility and ownership for delivering these initiatives at the Leadership Team level need to be clearly established.
- **PfO operating model**: the PfO operating model needs to be reviewed to ensure that there is appropriate engagement and consultation between Funding and Performance team and impacted business owners when commissioning new initiatives and renewing existing contracts. A framework for assessing value-for-money should be established to assess the value of new initiatives more objectively and to help prioritise investment.

  Additionally, PFO contract management processes need to be reviewed to include site and regional input into assessing provider performance and ensuring that OT receives the services it has procured and assessing whether outcomes are being achieved.
- **Budget management**: the way in which budgets are set needs reviewing to ensure an appropriate mix of top-down and bottom-up input. Particularly as OT moves to a regionally led, centrally supported model, consideration needs to be given as to how regional and site managers will input into the budget process to ensure that budgets are achievable and reflect the needs of each region.

  Budget holders need greater clarity around expectations regarding expenditure and how to meet the needs of the child while being fiscally responsible. Budget holders need more regular and targeted training to improve financial literacy. For example, training on how to use the financial information provided, how budget is made up and how to manage budget, etc. It is challenging to enhance the overall financial knowledge with a large volume of individual budget holders and cost centres. In connection with *Assessment of Governance* in KPMG Review of Finance Operating Model report, OT should consider reducing the amount of budget holders.

  Work also needs to be done to improve and refine the financial information provided by Funding and Performance to ensure it is meeting the needs of budget holders and is presented to them in a useable format.
- **Understanding the cost base**: OT does not have a good understanding of its cost drivers. This impacts the ability to accurately forecast expenditure and to identify potential savings opportunities.
- **Managing actual expenditure**: processes need to be refined to include appropriate controls over expenditure. In particular, when hiring new staff outside of establishment and in managing high leave balances.

Key recommendations

While OT is taking a number of steps to address this financial year's challenges, actions are required to address control issues in order to prevent similar challenges arising in subsequent financial years. Success in delivering these will require support from senior leaders, changes in culture and behaviours, and the financial control environment.

Our key recommendations are:

Culture and Behavioural Elements

A cultural change is required at OT that establishes an appropriate level of focus on financial management. Clarity is required around how staff balance organisational values of "we put tamariki first" and "we are tika and pono" when making decisions around service effectiveness and fiscal disciplines. To achieve this, our key recommendations are:

- Establishing a clear set of expectations, agreed by the Leadership Team, around the management's desired behaviours and budget management. These then need to clearly, and regularly, communicated to staff and budget holders. Training may be needed to ensure budget holders are aware of their responsibilities in respect to budget management.
- Obtaining buy-in from budget managers by ensuring that they appropriately consulted and communicated with during the budget setting process. Budget managers need to understand how their budgets have been set, the assumptions that it is based on, can provide feedback, and have a sense that their budgets are achievable. This will help drive commitment to achieving budgets and implementing appropriate financial disciplines.
- Establishing an environment where financial performance is discussed in an open and transparent way (including ensuring that budget managers get clear, timely and accurate financial information). Good behaviours should be encouraged, celebrated and reinforced. Behaviours that do not align with expectations should be able to be called out with clear accountabilities established.

Further details on culture and behaviours are provided in **Section 2**.

Financial Controls

To achieve ongoing improvements in how budgets and expenditures are managed at OT, improvements are required to establish a robust financial control environment. Our key recommendations are:

- Establishing a financial governance/steering group to oversee financial improvement and a dedicated project manager responsible for the delivery of cost-saving and financial control improvement initiatives. This will help ensure that there is appropriate focus and accountability for these improvement initiatives.
- Reviewing the PfO engagement model to ensure that key stakeholders across OT are involved at the right time when commissioning new work. This could include the establishment of a 'funding committee' to review significant funding decisions (e.g. over a certain value or risk profile) and establishing a framework for assessing and prioritising funding decisions.
- Ensuring budget managers are receiving quality financial information, analysis and advice in an easily understandable and useable format. Training needs to be provided to ensure that budget managers have the appropriate skills to be able to understand financial information and to be able to use this proactively to take action as necessary.
- Establishing tools/models for Funding and Performance to better understand demand drivers for OT services and how these impact OT's cost base. This would enable Funding and Performance to perform more detailed analysis and to identify potential areas for cost savings.

Further details on financial controls are provided in **Section 3**.

2. Culture and Behavioural Drivers

Soft control

'Soft' controls are the people-centred components that make up the behavioural and cultural environment of an organisation which are ultimately the driving force of every human organisation. The hard controls are propelled by the beliefs and motivations of the people who implement them. **Without strong behavioural drivers in place, i.e., soft controls, hard controls can be undermined.**

KPMG has developed a Soft Controls Model to help understand, identify, measure, and monitor behaviour and its impact on the control environment. It is comprised of eight behavioural drivers shown as below.

We have assessed each Soft Control area in OT based on discussions with staff from various teams such as Funding and Performance, Partnering for Outcome (PfO) and Internal Audit, and from the responses to the 'voice of customer' and 'voice of team' surveys. A culture change is needed in OT to mature its finance processes and practices and address budget problem in long term.

Culture change

There is no one definition of "good culture". Culture depends on the performance desired to meet organisational goals. A strong organisation culture has clear vision and values which define how work gets done and unite the employees together to work toward a same goal. It impacts the types of people the organisation attracts and staff engagement. Creating a positive culture relies on leadership team to foster an open and transparent environment where they lead by example.

We identified four key soft control areas and discussed in below sections that will lead to culture change in the financial environment. To facilitate the culture change, we recommend:

- A dedicated culture change lead is needed to champion the culture change and ensure action points raised in below sections are consistently implemented.
- Incorporate behaviors identified for the organisational culture into capabilities for role descriptions to reinforce the right people for the right culture
- Clearly articulate the culture in recruitment, analysis and on-boarding efforts to reinforce culture behaviors
- Strategy is in place to continuously monitor and maintain the right culture

2.1 Clarity

What we heard and observed

Inconsistent messages around meeting budget expectations

While our 'voice of customer' survey indicated that most budget holders believed they understood the desired behaviours for budget and expense management, we heard conflicting views on how staff balance decisions around meeting the needs of tamariki and being financially prudent.

There are several factors contributing to the variety of perspectives on budget management practices:

- As budget holders have different backgrounds and experiences, their understanding of OT's value "We put tamariki first" varies. Some staff take this value literally that they prioritise children's needs before anything, while some staff balance the need of tamariki and finance obligations. To provide a consistent understanding of OT values and financial implications, the Leadership Team need to first reach an agreement on what the expected financial behaviours are and then communicate to all staff in a consistent manner.
- Currently there is no active finance strategy in place although we understand the Funding and Performance team is planning to establish one. A clear finance strategy can provide the organisation with direction for financial activities and decision-making, including budget practices.
- Financial information, including budgets and tracking of actual expenditure are not clear to budget holders. Not all budget holders are consulted with during the budget-setting process or are informed of how their budgets have been calculated and their responsibilities in managing this budget. Even though some budget holders understand their budget targets, the budget information is not regarded as reliable due to multiple changes in budget allocations during the financial year. Budget holders advised that it is a challenge to perform their work and manage expenditure within budget when there is a lack of clarity and certainty in their budget allocation.
- There is a lack of clarity in the financial reports provided to budget holders. The financial reports provided by Business Partners contain a lot of accounting jargon with limited explanation and ambiguous action points. For example, one of the budget assumptions was to reduce annual leave balance. However, it is hard for budget holders who have limited financial knowledge to understand how this contributes to achieving budget. For more detailed findings relating to financial reporting please refer to *Assessment of Data and Reporting* in the KPMG Review of Finance Operating Model Report.

Comments from survey

"Others see sticking to budget as a 'nice to achieve if possible' but not an absolute must. The message about doing whatever the tamariki and whānau need has been taken very literally and has led to sloppy financial decisions."

"I have worked in a group within OT that takes budget management seriously – our DCE was very clear with us 'if we don't have the money then we don't spend it'. As a result, my budget has been on track to come in on budget. "

"I don't really think too much about my budget when making spending decisions it is more around what is best for the clients and staff. "

"I am left not knowing whether funding showing in my budget one day will be there to tomorrow or actually even if it is showing if it is legitimately able to be spent as intended. "

Why it matters

It is crucial for the Leadership Team to communicate clear strategies and guidance and set out what behaviours are expected. If staff do not understand how OT's priorities (such as "we put Tamariki first") apply to their everyday decision-making, their interpretation of the organisation's values and priorities might be different and not align with the organisation's long-term vision.

Clarity around how OT's values of "we put tamariki first" and "we are tika and pono" are supported by responsible financial decision-making.

Timely and reliable financial information is critical to support budget holders' decision making. It helps budget holders to understand their financial situation and allocate resources. As budget holders, particularly at site level, in OT often have a limited financial background, it is important to produce easily understandable financial reports with key rationales, such as explaining the relationship between reducing staff annual leave balances and financial savings.

What does 'good' look like?

Leadership Teams deliver clear and consistent messages from the top. Staff are clear on the rules, procedures and desired behaviours, and will speak up when there are ambiguities.

Recommendations

- The Leadership Team should set clear expectations around desired behaviours for budget and expense management, how these link to OT's values and apply the same rules to all parts of Oranga Tamariki.
- Ensure that the Leadership Team's expectations are clearly communicated to budget holders.
- Regular organisation–wide training should be provided to budget holders to deliver clear and consistent messages around budget management.
- In connection with the recommendation raised in *Assessment of Data and Reporting* in KPMG Review of Finance Operating Model Report, financial information and decisions should be explained in plain language and delivered to all budget holders in a timely manner.

2.2 Commitment

What we heard and observed

Budget setting beyond budget holders' control

Staff in the 'voice of customer' survey indicated budget holders are not in control of their budgets, which demotivated them to operate within their financial constraints. Currently, budgets are developed at the DCE and tier 3 level with limited consultation and input from regional managers or site managers who make up the majority of the budget holders. Without involving budget holders in the budget setting process, it is difficult for budget holders to understand the logic behind budget allocations and expected budget behaviours.

Different attitudes to budget management

We noted through our interviews and the 'voice of customer' survey that the level of commitment to managing within budget varied across the DCEs, resulting in inconsistent messages being communicated from senior leaders to site managers. Some DCEs set clear expectations of managing within budget, while others believe that you "cannot trade-off children" and additional funding will always be available. This finding also links to section *2.1 Clarity* in our assessment.

Finance systems and processes to support budget management are not adequate

The complex finance system and budget process is one of the barriers in upholding OT's budget practise. The current finance tools are not easy for budget holders to use. There are mixed views on the quality of financial reports available to help budget holders track progress against their budget and make financial decisions. It is a challenge for budget holders to perform good budget management without adequate finance tools and information.

We understand the new FMIS system will be implemented in March 2023 which will enhance system functionality. However, it is important to ensure adequate budget services are still provided to all budget holders during the transition and change management is in place to mitigate potential disruptions caused by the new FMIS system on budget process.

Comments from survey

"We are accountable for expenditure we actually have little control over, where decisions taken elsewhere in the organisation have material impact on our budget. For example, the PfO contracts have a significant impact my budget which I don't have control of."

"It is difficult to understand the logic behind budget allocation, and link between practice requirements and operational costs."

"I'm left completely in the dark about how my budget is tracking. I understand that there is the IBM portal, but it is impossible to use and understand."

Why it matters

Creating a culture where staff are committed to achieving desired outcomes is dependent on their understanding of what must be done, and the extent to which they are motivated to meet these expectations. Excluding budget holders from budget setting and decision-making related to their budget can create confusion and a lack of buy-in from budget holders. Budget holders might not see the link between budget assumptions, budget decisions and overall financial direction, and therefore may not consider the consequences if OT fails to achieve budget.

Commitment to good budget practices must come from the top. Leadership's role modelling will influence individual's beliefs and attitudes. Therefore, it is important for the OT Leadership Team to have a consistent understanding of budget practices and their role as financial stewards.

What does 'good' look like?

Staff are committed to following the proper budgeting and expenditure policies and processes.

Budget holders are motivated to fulfil expectations, because they understand why it is important to follow the policies and processes.

Recommendations

- Review the budget setting process to ensure that budget holders are appropriately consulted/informed on how their budgets are set.
- Align Leadership Team views on budget practise and expectations and ensure these are consistently and clearly communicated to budget holders.

2.3 Achievability

What we heard and observed

The majority of budget holders in the survey indicated their budget targets are not realistic or achievable. As mentioned above in section 2.2 *Commitment*, the budget development process did not involve individual budget holders in the regions and sites, thus the budgets allocated to them do not always consider different area's special circumstances. For example, the budget did not consider differences in travel requirements between rural and urban areas and therefore regional managers responsible for rural areas have a 'tighter' budget.

The Finance Business Partnering team is responsible for the budget setting process. After the Finance Business Partnering team has consolidated each DCE's budgets, adjustments are made by the Funding and Performance Team from Finance's perspective. As only half of the budget holders believe the Funding and Performance Team understands their business, the financial decisions made by the Funding and Performance Team on their budgets may not always be suitable for each DCE and the related budget holders.

The financial decisions from the Funding and Performance Team are not always achievable and sometimes conflict with reality. For example, a key assumption in the 2021/22 budget setting process was to reduce annual leave balance. However, staff in the survey commented it is hard to take leaves due to short of resources. High annual leave balance not only means high financial liability but also potential staff health and safety issues. This should be resolved by working closely with People and Leadership Team.

Comments from survey

"My region covers a significant geographical area comprising communities which have diverse and different needs (city vs rural). The budget settings do not appear to take different types of needs into account and when pressure is placed on budgets it becomes more difficult to ensure the young people receive the appropriate interventions. "

" Lately unachievable goals have been set, with no means to communicate this pressure to the strategic partners."

Why it matters

Unrealistic goals can have a negative impact on the organisation and its employees. When budgets are regularly set too tight, staff will constantly fail to meet them. Over time, this failure can almost become accepted. Similarly, if budgets are set too loose, this can result in a lack of focus on financial disciplines.

Unrealistic expectations will also lower staff morale. If goals are constantly unrealistic, staff can feel like they are not achieving, which can impact self-esteem, motivation and productivity. This will have a detrimental impact on budget management in the long-term.

What does 'good' look like?

Organisations set appropriate expectations and provide the necessary resources to support and enable staff to do the right thing.

Recommendations

— In connection with recommendation raised in *2.2 Commitment*, ensure budget holders are consulted/involved in budget setting and consider budget holders' specific circumstances.

— During budget setting stage, ask budget holders for feedback on whether the budget assumptions are realistic and budget targets are achievable. Where staff feel targets are unachievable, management could demonstrate how targets can be achieved, and where possible, show staff how the targets have been achieved in the past.

— When adjusting budgets across all DCE areas, hold a round-table discussion with all DCEs to prioritise spending. The discussion should be facilitated by the CFO to provide financial insight and suggestions.

— Funding and Performance Team should work closely with People and Leadership Team to provide staff support in reducing annual leave balances while still ensuring business continuity, further recommendations please refer to below *3.5 Managing Expenditure*

2.4 Reinforcement

What we heard and observed

The vast majority of budget holders in the 'voice of customer' survey indicated good financial results are not recognised and rewarded in OT. Staff commented that during the budget reprioritisation, all business areas' budgets were cut regardless of whether some business areas were achieving their budget targets. Although some business areas in OT have good budget practices, these are not recognised and promoted within the whole organisation.

Effective budget management is not included as part of the budget holders' performance review. Staff feel that there is no consequence when they deviate from the budget allocation and there is little incentive to manage budgets in the right way.

Comments from survey

"Not all Budget Managers have been held to account to manage within budget. As a result, those of us who have maintained discipline regarding budgets (public funds) have been disadvantaged, and we are all lumped into the same bucket!"

"I would like to see us all manage within our allocated budgets and not have to have cuts to accommodate those who have exceeded their allocations. I would like to see those who have created or exacerbated this financial crisis be held accountable."

Why it matters

People have a desire to be appreciated and valued. Providing positive feedback or rewards when things are done right can provide people with a sense that they are valued and that their compliance is recognised and appreciated. Positive reinforcement often leads to increased effort in following the correct processes and procedures in the future. If staff are not able to see that compliant behaviours are recognised and rewarded, they are unlikely to be motived to comply with good budget management practices.

By reinforcing what good looks like, and by ensuring that undesired behaviours are appropriately addressed, this will have positive implications for both commitment and achievability. Moreover, by highlighting and rewarding examples of good budget management practices, these behaviours will be made more visible to other staff, enabling them to replicate the good practice of others.

What does 'good' look like?

Staff demonstrating desired behaviours are recognised and rewarded. There are tangible consequences for staff who demonstrate undesirable behaviour.

The way the behaviours are reinforced (either positively or negatively) are appropriate and in proportion to the circumstances.

Recommendations

— In connection with recommendation raised in *2.1 Clarity*, present and recognise teams with good budget management practices in the organisational-wide training. Informal approaches such as thank you email, etc could be used to deliver recognition as well.

— Budget performance should be included in budget holders' annual performance appraisal cycle.

2.5 Other Soft Control Areas

Our observations and findings for remaining four soft control areas are summarised as below:

Role Modelling

DCEs hold different attitudes toward budget management. Some DCEs strictly manage costs within budget however some DCEs prioritise children's needs before financial obligations. This means front-line budget holders are influenced by different budget behaviours and budget expectations demonstrated by DCEs.

Due to a lack of recognition of good budget practices, role models for good budget practices are not visible to all budget holders. Actions of role models can provide budget holders clear guidance on desired budget behaviours and demonstrate how budget targets can be achieved.

Please see section *2.1 Commitment* and *2.4 Reinforcement* for detailed findings and recommendations.

Call someone to account

Even though majority of the budget holders believe they are responsible for their budgets, there is a lack of mechanism to recognise desired budget behaviours and discourage unwanted behaviours. As a result, there has been limited accountability measures put in place to respond to OT's current financial situation.

This finding links to section *2.4 Reinforcement*.

Transparency

As not all budget holders are involved in budget setting, there is lack of transparency in budget making decisions where budget holders do not understand the reasons behind the decisions. For example, one of the budget assumptions was that annual leaves balance will be reduced to 20 days without explaining the rationale to budget holders.

Openness to discuss

OT provides a safe environment for staff to speak up when they are facing issues or concerns. The majority of budget holders we heard from indicated they feel comfortable to escalate issues with more than half of budget holders having escalated issues to the Funding and Performance Team in the past. Almost all of the Funding and Performance Team we heard from through the survey are comfortable to raise their concerns. We encourage OT to continue providing staff with sufficient channels and support to discuss issues and concerns.

3. Financial Controls

Hard controls are structured activities, procedures and rules that guide individuals' behaviour, ensuring the fulfilment of organisational goals, detecting and preventing fraud or mistakes. Efficient and effective hard controls can prevent errors and irregularities, identify problems and ensure that corrective action is taken. In undertaking our work we identified the following hard control areas that need improvement to provide a robust financial control environment. The nature of our work focussed on the design of the control environment with limited detailed testing performed

3.1 Governance

Findings

Establishing governance over financial expenditure

Given OT's current financial challenges, governance arrangements over the monitoring of financial expenditure need to be enhanced.

Currently, oversight of expenditure is largely done as part of standard Leadership Team meetings. Financial reports are assessed as part of the standard Leadership Team agenda. However, this may not be adequate to provide the level of oversight and to drive actions required to address the current financial challenges.

A governance group tasked with specific focus on expenditure would ensure that savings required are actually delivered/achieved and importance of budget management is actively promoted.

Establishing clear ownership and responsibility for delivering financial savings and improving financial controls

To deliver the savings required over this and the following financial year will be extremely challenging. There is currently no clear ownership for driving the required cost-saving activities. Additionally, there needs to be clear responsibility for the implementation of recommendations from this report.

By default, this lands with the Leadership Team and Funding and Performance Team to oversee these activities, but with no clear responsibilities for delivery. Given the importance and scale of the activities required, delivering this alongside other business-as-usual requirements may not produce an effective and timely outcome. A dedicated "project manager" with authority and responsibility would ensure that there is ongoing, targeted focus on delivering these initiatives.

Ongoing assurance programme over financial controls

OT needs to ensure that there is an ongoing programme of assurance over its financial control activities. This should cover activities performed across each of the three lines of defence[1], including:

- Line 1: Management control activities (e.g. setting of financial plans, authorising expenditure, etc.)
- Line 2: Support and monitoring from Funding and Performance (e.g. policy setting, monitoring compliance with delegated authorities, reviews of significant transactions and trends, etc.)

[1] The Three Lines Model, developed by the Institute of Internal Auditors, https://www.theiia.org/globalassets/site/about-us/advocacy/three-lines-model-updated.pdf

- Line 3: Internal Audit activities (independent and objective assurance and advice over the financial control environment).

OT's Internal Audit function has conducted regular reviews over the financial control environment. During our review of internal audit reports, we noted that many of the financial control issues discussed in this report have previously been identified by Internal Audit. However, the issues raised by internal audit did not seem to have resulted in the necessary action to remediate these. Appropriate processes need to be implemented to ensure identified deficiencies are addressed timely and relevant risks are mitigated.

Impact of our findings

- Without appropriate senior oversight of financial expenditure, required savings initiatives may not receive appropriate support/importance to ensure timely delivery.
- A lack of ownership/responsibility for the delivery of cost-saving activities may result in OT being unable to deliver required cost savings.

Recommendations

- Establish a financial expenditure governance/steering group to provide oversight, accountability and decision-making powers for ensuring OT delivers its required savings. This forum should be chaired by the Chief Financial Officer and include the Chief Executive and senior representatives from key expenditure areas (i.e. Services for Children and Families, Partnering for Outcomes, Care Services).
- Establish a dedicated project manager responsible for the delivery of cost saving and financial control improvement initiatives, supported by a team with representatives from across the organisation. This may fall under the remit of the "Finance Capability Uplift" team recommended in the KPMG Review of Finance Operating Model report.
- Establish an assurance framework over key financial control activities. This would be designed to provide ongoing assurance to the Leadership Team that financial controls are in place and effectively mitigating risk.
- Implement a process for ensuring that financial control issues identified by Internal Audit are appropriately remediated in a timely manner. This can be achieved by reporting to the financial governance/steering group and following up on the remediation plan on a regular basis.

3.2 Partnering and Contract Management

Findings

Partnering for Outcomes engagement model

The Partnering for Outcomes (PfO) engagement model needs to be reviewed. While PfO has established processes for engaging with various personnel across OT, this appears to be too reliant on project managers engaging with the right people at the right time. We heard examples from across the business where:

- New initiatives do not have robust, detailed financial analysis.
- Funding & Performance and People & Leadership Teams are not consulted early enough to provide meaningful input into finance and people impacts.
- Regional and site managers impacted by the services being procured (both in delivery and financial impacts) are not adequately consulted.
- Regional and site managers are not consulted when assessing performance of suppliers and renegotiating contracts.
- Various forms of contracts are used that may not include appropriate terms and conditions – in particular, commercial clauses that may enable OT to hold providers to account and recover funds if services are not delivered.

This has led to concerns that PfO driven initiatives may not have appropriate consideration for the financial impacts on OT or that they are appropriately aligned with the needs of the business and its customers. An effective procurement function works closely with all impacted business areas including finance team to deliver quality procurement outcomes in terms of service effectiveness and value for money.

Value for money investment framework

OT does not have a framework for determining the extent to which initiatives represent value for money. Value for money is about achieving the right balance between cost and service effectiveness. In relation to public spending, it implies a concern with economy (cost minimisation), efficiency (output maximisation) and effectiveness (attainment of the intended results). It must also support the value of equity.

With pressures on funding, it is important that OT has a way to objectively compare competing priorities to ensure that future investments are appropriately prioritised. Additionally, such a framework can be used to support decisions to continue or discontinue ongoing programmes.

We acknowledge that such a framework is more challenging to implement for the social services sector. It can be difficult for the social services sector to quantify the effectiveness of its services and as the value of output is not solely determined by dollar value but more by the social impact, which may take time to realise.

However, it does not mean evaluating the benefits of outputs can be neglected. Instead, social service sectors should consider both financial impact and social impact of their work. Establishing a framework to evaluate both the financial and social benefits from projects and including the framework as part of the funding policy could help OT maximise the outcome from its funding decisions.

Contract and performance monitoring

Currently it is hard to ascertain if OT "got what we paid for" from service providers. There is a lack of robust processes to ensure that service providers are delivering against contractual requirements and achieving desired outcomes. We heard that some PfO contracts did not contain appropriate commercial clauses to enable OT to hold providers accountable or "claw back" payments for non-delivery/under performance or FTE vacancies. OT does not have a performance management framework to enable them to adequately measure whether the services are delivering value-for-money.

Instead, these activities appear to be performed in a more ad-hoc and informal manner. The majority of these services providers are Non-Government Organisations (NGO's) and therefore may not have established commercial disciplines necessary to adequately assess whether they are achieving the outputs/outcomes desired.

Impact of our findings

- New initiatives may not have appropriate robust analysis to fully consider ongoing financial implications.
- Initiatives may not be well aligned to business needs.
- Funding may not be appropriately prioritised.
- Lack of formal contract management and performance monitoring may result in ineffective/inefficient spending and contribute to a negative culture for service providers to achieve agreed performance targets.

Recommendations

- Review the PfO engagement model to ensure that Funding and Performance, impacted budget holders and People and Leadership (where new roles or changes to existing roles are needed as a result of a new initiative) are appropriately consulted on the establishment of future initiatives.
- Work with Partnering for Outcomes (PfO) to understand the commissioning process and how financial impacts for decisions are considered. If required, improve the process to ensure the financial impacts are understood by budget holders before decisions are finalised (*per KPMG Finance Operating Model Report)*
- Develop a RACI[2] matrix to ensure roles and responsibilities are clearly understood for PfO procurement and contract management activities.
- Implement a value for money investment framework to enable a more objective assessment of initiatives and to prioritise funding. The framework should evaluate each initiative from service effectiveness, cost and risk perspective.
- Consider establishing a "funding committee" to review and approve significant funding decisions (e.g. those that exceed a certain financial value or risk profile). The committee should involve senior managers across OT. Regular meetings should be held to assess and approve significant funding decisions.
- Establish standard terms and conditions required for all service provider contracts including measurable commercial clauses to evaluate service delivery and performance.
- Establish a contract management framework for the on-going contract management and performance assessment of service providers. This should include how front-line staff can provide feedback to contract managers on provider performance and improvement opportunities.

[2] The RACI acronym stands for "Responsible, Accountable, Consulted, and Informed".

3.3 Budgeting management

Findings

Budget setting and reforecasting

OT needs to review its processes for budget setting and subsequent reforecasting. The budgeting process is largely a top-down driven process, using last years' actual spend as a base, then taking into account organisational priorities and known new initiatives.

As OT is moving towards a more regionally led, centrally supported way of working, OT should review the budget holder structures and how to include all budget holders into the budget setting process. Currently, due to the large volume of budget holders, the process is set at DCE level with limited input below this. Consideration of the number and structure of budget holders is discussed in KPMG's Finance Operating Model report.

Feedback from regional and site managers highlighted that this process often results in budgets that may not reflect reality and therefore are seen as unachievable. This was particularly the case for the December 2021 reforecast. Our report on OT's current appropriation identified that assumptions made in the reforecast were not appropriately supported by robust evidence. This is exacerbated by OT not having a clear understanding of its demand drivers (refer finding *3.4 Understanding Demand Drivers*).

There is also a lack of clear ownership of the budget setting process. The budget process is run by Finance Business Partnering Manager without a dedicated Leadership Team member having clear ownership of the process and final decision making.

A good budget setting practice should involve all necessary parties with clear roles and responsibilities established. Budget should be made on robust assumptions with limited adjustments needed once finalized.

Quality financial information provided to budget holders

Financial information provided to budget managers is not being presented in a way that is easily understandable and useable. Some finance reports contain too much technical accounting terminology and the suggested action points are ambiguous. Further detail findings on finance report please refer to *Assessment of Data and Reporting* in the KPMG Review of Finance Operating Model Report.

The quality of analysis by the Finance Business Partnering team also requires uplift to better help budget holders understand their performance and the causes of any significant over or under spends. This is discussed in detail in the Finance Operating Model report.

Financial information should be presented in a way that is easily understood by people with limited finance background with clear highlights on any significant issues or actions required.

Training for budget holders

Budget holders receive limited training on how to analyse, interpret and use financial information. Currently only 2% of the Funding and Performance Team's time is spent on providing training to budget holders and leadership. Budget holders receive basic financial training upon induction, but then receive no further on-going financial training. Instead, they rely on ad-hoc and informal discussions with their business partners to address gaps in financial knowledge. Some budget holders indicated through the survey that they rely heavily on experience from previous workplace's finance processes to perform their work.

There are clear policies and guidance on internal costs such as travel expense, gift expense, etc. However, as mentioned in *3.5 Managing Expenditure*, no guidance on children's cost is available and no training is provided to explain what appropriate children costs are and expected behaviours.

Targeted on-going training should be available in the organisation to uplift budget holders' financial literacy. The training should be used as a channel to communicate desired behaviours in budget management.

Impact of our findings

- A lack of budget holder involvement may result in budgets being seen as unachievable and not driving an appropriate level of buy-in.
- Assumptions made in the budget setting process may result in unrealistic or unachievable budgets that do not reflect actual practices.
- A lack of clear understanding of the root causes of budget variances makes it difficult for budget holders to identify issues and take appropriate action. Moreover, understanding the common causes of overbudgeting will help the Funding and Performance Team to detect overspending signals and remediate these at an early stage.
- Financial information provided to budget managers may not be suitable and may not drive the required actions and decisions.
- Budget managers may not have appropriate financial literacy to interpret and act on the financial information that they receive.

Recommendations

- Redesign budget setting process by:
  - In connection with recommendation G2 in *Assessment of Governance* from KPMG Review of Finance Operating Model report, review the cost centre and budget holder structure.
  - In connection with recommendations in *2.2 Commitment*, ensure budget holders are appropriately involved in budget setting process.
  - Determine ownership and accountabilities for the budget setting process and document these in the Budget Instructions.
  - Ensure budget assumptions are appropriate evidenced and tested with relevant business holders such as People and Leadership, Partnering for Outcome, etc.
  - Establish robust budget monitoring systems to provide regular report to the financial expenditure governance/steering group as recommended in above *3.1 Governance.*
- In connection with recommendation P3 in *Assessment of People* from KPMG Review of Finance Operating Model report, use reporting templates and analytics dashboards created by Finance Capability Uplift team to provide budget holders quality financial information.
- Implement an on-going financial literacy programme for budget managers.
- Develop guidance and reference material for budget managers to help set expectations around appropriateness of costs. The outcome of the *3.4 Understanding demand drivers* would support the development of the guidance document.

3.4 Understanding demand drivers

Finding

OT does not have a good understanding of what are the demand drivers for children's cost. While the number of children in care has decreased over recent years, overall costs have increased.

The Funding and Performance team only spends limited time on understanding how demand is impacting OT's work and subsequent cost implications. As a result, there is limited understanding within the Funding and Performance team on the underlying cost drivers of children's care.

There has been some analysis to understand cost drivers with some high-level observations (e.g., OT now manages a higher proportion of high-needs children who require more intensive interventions and services). However, there is no overarching model to understand how service demand impacts cost across different levels of needs, and therefore there are limitations in being able to identify opportunities to prioritise funding and make savings.

There are several challenges in understanding the demand drivers and subsequent cost implications for OT:

- The Funding and Performance team has limited understanding of the core business in OT such as Services for Children and Families, Partnering for Outcomes, etc. Budget holders indicated in the survey that one of the biggest improvement opportunities for Funding and Performance is to better understand budget holder team's and strategies. Without a deep understanding on the operation of the business, Finance will not be able to analyse the spending patterns and identify the underlying causes for the increases in children's cost.
- Analytics in Funding and Performance team are mainly descriptive. The current OT finance operating model maturity is aligned with being a "cost manager" as described in KPMG Review of Finance Operating Model report. This means Funding and Performance team mainly focuses on analysing and describing what happened in the past with limited short-term forecasting. In addition, we heard disappointment at the lack of modelling and forecasting from the budget holders survey. To shift toward predictive analytics requires Funding and Performance team to be able to estimate future costs and understand demand drivers.
- The ability to undertake detailed cost analysis may be limited by the ability to interrogate data from OT's various systems. Details please refer to *Assessment of Technology* and *Assessment of Data and Reporting* in KPMG Review of Finance Operating Model report.

Impact of our findings

Without a clear understanding of OT's cost base and the key drivers for the cost of children in care, it is difficult for finance to:

- Accurately forecast expenditure.
- Provide insights into spending patterns and trends.
- Identify opportunities for cost savings.

Recommendation

- Undertake a project to build a cost model for different cohorts of children in care (e.g., high-needs vs. low-needs, urban vs. rural, etc.) and incorporate estimated costs in forecasting. This may need to be undertaken in multiple phases, starting with an investigation phase to understand what data is available, the quality of data and how it can be interrogated for use in a cost model. This was also identified in the *KPMG Review of Finance Operating Model report* and *KPMG memo on the Forecast Expenditure*.

3.5 Managing expenditure

Findings

Employing staff outside of establishment

Controls over the creation of new positions over and above established headcount are not adequate. The implementation of new initiatives often requires additional headcount to stand up and operate each initiative.

This has been a key contributor to the current financial challenges that OT faces. The establishment of new positions creates long-term financial commitments that cannot easily be undone.

Currently, neither Funding and Performance nor People and Leadership are required to approve the creation of new positions. We were advised of instances where additional positions were created on the assumption that savings can be made in other areas – however, these are non-specific and are not tracked to ensure the savings are achieved.

When creating new position, a robust process will ensure the creation can be funded within existing budgets and approval from relevant departments such as finance team and HR team is obtained.

Setting expectations for, and monitoring of, front-line expenditure

There is a lack of guidance for front line staff about how money is spent and what is a reasonable amount to spent on meeting tamariki's need. It is largely up to the social worker's experience and judgement (with input from site managers) when establishing financial plans to determine what activities are appropriate for each tamaiti.

Even though the financial plans require approval from site managers, they mainly rely on social worker's judgement due to lack of appropriate expenditure guidance. We heard consistently that the needs of the child are put first with limited consideration of the financial implications of these decisions. There are contrasting views on children's cost across OT which means children allocated to different social workers may receive different services and support.

Guidance on standard costs may help social workers ensure that care plans appropriately consider cost implications. While a "one-size fits all" approach cannot be taken, this can help highlight anomalies (e.g. significant over or under spend from the norm) and enable budget holders to take appropriate actions.

Additionally, there is a lack of monitoring controls in place to ensure that actual expenditure is reasonable and aligns with the child's care plan. Once the plan has been approved, there is no requirement for expenditure to be independently approved when it is incurred. While this was a conscious decision to ensure providing care is not held up while awaiting authorisation, there should be some monitoring or reporting to ensure expenditure is being incurred as planned.

Managing purchase card

OT issues purchase cards to front-line social workers to streamline the purchasing process for low-cost, high-volume transitions. OT's policies regarding the use of purchase orders are clear and appropriate guidance is provided to staff around OT's expectations of the types of expenditure that purchase cards should be used for. However, during our interview we heard there have been situations the purchase cards were not used in adherent to the policy.

While purchase cards create efficiency in transaction processing, without appropriate controls, they can be misused and could result in inappropriate or unauthorised expenditure being incurred.

Management of annual leave balances

There are limited monitoring and enforcement controls over annual leave balances. This was an area where potential savings were identified during the 2021/22 budget setting process. However, the assumptions around the taking of annual leave did not materialise.

Ongoing messaging to budget managers regarding high annual leave balances has not resulted in the desired reduction in leave balances. Budget managers may not have a clear understanding of how managing annual leave balances can impact budgets.

There appears to be an ongoing expectation to reduce annual leave balances, yet this has not been supported by changes to controls or business practices.

Survey responses indicated that some sites have difficulty in getting staff to take annual leave due to workload pressures. While this impacts OT's leave liability, it also has wider and more significant implications around kaimahi ora. It is essential that messaging around taking of annual leave is driven by People and Leadership with support from Funding and Performance.

Impact of our findings

— The establishment of unfunded new positions may create financial pressures impacting OT's ability to achieve budget.

— Without understanding and prescribing what constitutes appropriate expenditure for children, social workers will apply their individual judgement when making decisions which may not align with the organisation's expectations.

— Without an effective monitoring and review system in place, it is hard to ensure each child costs are incurred as per the agreed plan and it also create fraud risk.

— Ongoing assumptions and expectations around management of high leave balances may not materialise.

Recommendations

— Establish principles for managing headcount and the creation of new positions outside of establishment. The principles should consider financial implication, workflow, culture impact, etc. This could be achieved by:

- Ensuring Funding & Performance and People & Leadership pre-approval is obtained for the creation of new positions outside of establishment. This should be reflected in the OT delegation framework.
- Ensuring the creation of new positions is supported by robust financial analysis showing that the new positions can be funded within existing budgets.
- Where new positions will be funded through "savings" in other areas, ensuring these are specific and establish a process to track and monitor these to ensure they are followed through.

— Develop a co-ordinated plan to address high annual leave balances:

- Ensure that messaging around management of annual leave is driven through People and Learning, highlighting the kaimahi ora implications of accruing high annual leave balances.
- Establish clear expectations around the actions need to address high annual leave balances and ensure these are clearly communicated to people managers and staff.
- Ensure people managers develop annual leave management plans for all staff with balances greater than 20 days.
- Develop ongoing monitoring and reporting processes for annual leave balances.

— Perform spend analytics on children's cost and develop guidance on appropriate expenditure for budget holders and social workers. The guidance should be included in OT's policy and compliance of the spending guidance should be monitored on a regular basis. *This is in connection with recommendation DR5 in Assessment of Data and Reporting in KPMG Review of Finance Operating Model report.*

— Develop processes to allow site managers to monitor actual expenditure versus child plans.

— Ensure that controls around purchase cards are in place to prevent, detect and respond to instances of non-compliance with the purchase cards policy. For detail please see *Appendix 3 Purchase Card Key Controls*

Appendices

Appendix 1: Objective and Approach for our work (extract)

Objectives

Following on from the Phase 1 "diagnostic" review of the financial control environment, this workstream focused on verifying the initial findings with a specific focus on:

- Assessing the operating effectiveness of "hard" controls such as delegated authorities, approvals of expenditure and budget monitoring and reporting controls.
- Identifying the cultural and behavioural elements may be contributing to the breakdown of controls over financial expenditure.

This work also contributed to the information in the governance/controls layer in KPMG's report reviewing the financial operating model.

Approach

In undertaking this work we undertook the following activities:

Assessment of operating effectiveness of hard controls

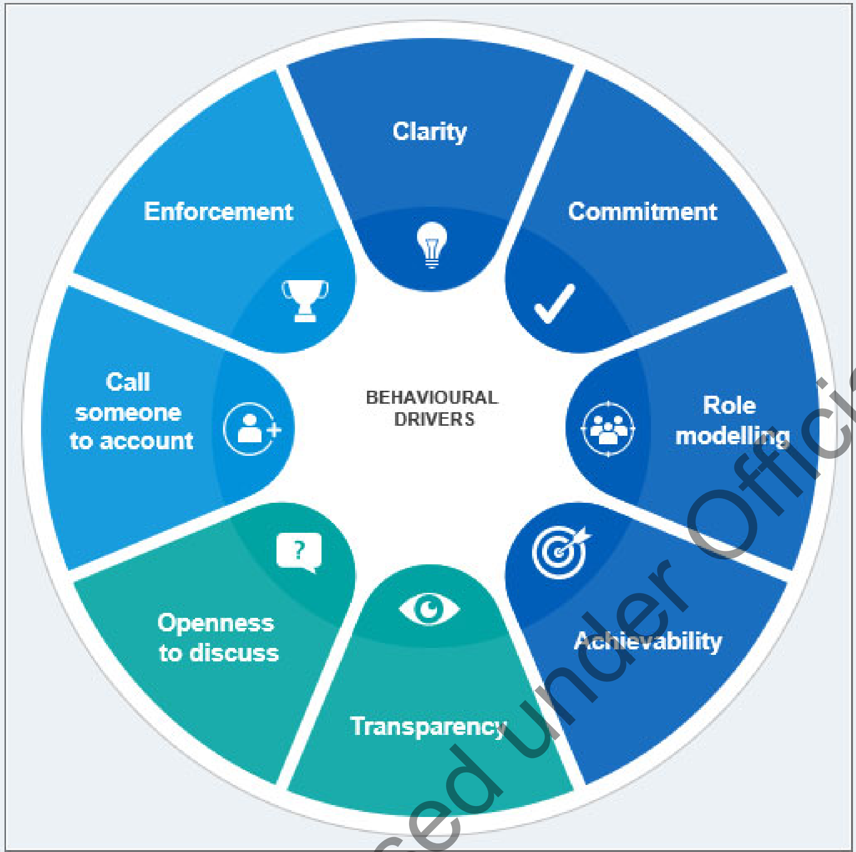
Through interviews with a sample of budget holders, finance staff, Partnering for Outcomes, and Internal Audit, and review of documentation assess the operating effectiveness of controls over:

- Business planning and budgeting process
- Budget preparation templates and sign offs
- Additional funding (new initiatives) proposal template and sign offs
- Delegated authorities
- Purchase orders and expenditure approvals
- Budget versus actual tracking and management reporting
- Governance reporting of financial performance.

Assessment of soft controls

Throughout our work we also considered the impact of the people-centred components, that make up the behavioural and cultural environment of an organisation, and may be contributing to control issues experienced by Oranga Tamariki. To achieve this we utilised KPMG's soft controls model.

Appendix 2: Soft Control Model



PREVENTION

Clarity
Are rules, procedures and desired behaviour clear?

Commitment
Do employees feel motivated and engaged to uphold organisational standards?

Role modelling
Do managers set a good example?

Achievability
Are activities and targets realistic?

DETECTION

Transparency
Are people's behaviours visible to others?

Openness to discuss
Do people feel comfortable to voice their opinion, raise issues and discuss dilemmas?

RESPONSE

Enforcement
Is desired behaviour rewarded and undesirable behaviour sanctioned?

Call someone to account
Are people being held accountable by others in the organisation for misconduct?

Appendix 3: Purchase Cards Key Controls

The following table outlines good practice controls that should ensure that purchase cards are used in line with management expectations:

Prevent	Detect	Respond
— Policies and procedures in place clearly outlining OT's expectations over the use of purchase cards. — Purchase cards are issued to staff based on need. — Chief Executive approval is required for a staff member to obtain a purchase card. — All card holders must sign a Certificate of Undertaking. — Training is provided to all new card holders. — Each card is assigned a monthly transaction limit based on the staff member's needs. — Temporary limit increases must be approved and are entered into the system with automatic expiry dates. — System controls restrict use of purchase cards at some merchants. — Purchase cards cannot be used to withdraw cash. — Transactions cannot be processed without a tax declaration, expense description and supporting documentation being attached without additional explanations. — Purchase cards are ordered as needed, no inventory of cards is retained on site.	— All expenses must be approved in line with OT's financial delegations framework (systems enforced control). — Automated emails are sent to staff and managers to inform them that transactions are waiting to be processed. — Funding and Performance team review all transactions to ensure transaction has been correctly coded and that appropriate supporting documentation is attached. — Automated emails sent to the Funding and Performance team of any individual transactions greater than prescribed value.	— Policy outlines disciplinary procedures that are available should breaches of policy occur. — Processes are in place to recover funds where purchase cards are used for personal expenses. — Follow up processes are in place to chase up transactions that have not been processed in a timely manner (including reducing the employees card limit to zero until matters are resolved).