

# Auditing of ITOs

## Operational Policy Discussion Paper

February 2010

<b>Name</b>	<b>Reference &amp; Status</b>	<b>Distribution</b>
Auditing of ITOs	OPERATIONAL POLICY DISCUSSION PAPER	ITO Investment and Implementation Design Group <b>Contact:</b> Industrytrainingprogrammes@tec.govt.nz

## Purpose

1. This paper has been prepared as part of the consultation relating to the operational policy for industry training.
2. The Tertiary Education Commission (TEC) invites feedback from the tertiary education sector on the questions presented in this paper and on any other relevant matters. Please use the separate Feedback Template to submit responses.

## Aims

3. In undertaking this consultation, the TEC will be guided by the following aims:
  - *Minimising transaction and compliance costs*: the operational policy framework should take account of administrative and compliance costs, and where possible seek to reduce these.
  - *Maximising transparency and accountability*: the recipients of Government funding should be accountable for the results they generate, and related information should be available to interested parties.
  - *Minimising any perverse incentives*: the operational policy framework should be designed in such a way as to minimise and mitigate any perverse incentives.
  - *Maximising value for money*: the operational policy framework should ensure a strong focus on results and avoid arrangements that would lead to the funding of activities by government that would otherwise be funded by other parties.
  - *Providing an appropriate degree of dynamism for ITOs based on performance*: the operational policy framework should provide suitable incentives for ITOs to manage and improve their own performance.
  - *Providing for consistent treatment of other forms of industry training*: the operational policy framework should take account of other forms of industry training and contribute, where possible, to a common approach<sup>1</sup>.

## Principles

4. The consultation on the audit policy for industry training will be based on the following principles and considerations:
  - upholding the aims of the consultation process (outlined above);
  - learning from the implementation of the industry training system over the past 17 years;
  - drawing on relevant experience and expertise across the tertiary education sector;
  - exposing proposed changes to scrutiny;

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<sup>1</sup> Such as industry training arranged by organisations funded through the Student Achievement Component.

- providing sufficient information on the general approach that the TEC intends to take in relation to the matters discussed; and
- avoiding costly or time-consuming changes unless there are good reasons for believing they will bring significant improvements over time.

## Scope

5. This paper seeks feedback from the sector on the development of operational policy relating to the auditing of ITOs. This paper has been prepared as part of the TEC's wider consultation on industry training operational policy.
6. This paper has been prepared after consultation with the New Zealand Qualifications Authority (NZQA).
7. This paper seeks to determine how to best ensure that the auditing of ITOs is fit for purpose and aligns with the Government's objectives for industry training set out below.
8. The paper provides background information including the existing processes for auditing ITOs.

## Method

9. This paper:
  - sets out the Government's objectives for tertiary education;
  - describes a framework for the development of operational policy in this area;
  - examines current practice and issues arising from this practice; and
  - identifies possible options for change.

## Government's objectives

10. The Government's objectives for tertiary education include raising the skills and knowledge of the current workforce to increase the productivity of individuals, and to underpin the ability of firms to innovate and adapt to competitive challenges. ITOs have an important role to play by providing, for example, opportunities for employees to complete nationally recognised qualifications, and creating effective pathways towards advanced trade qualifications at level four and above.
11. Cabinet also agreed in May 2009 to re-balance the tertiary education system by shifting away from the current emphasis on central steering and front-end planning and moving towards greater responsiveness to market signals [CAB Min (09) 15/13].
12. Cabinet agreed on the following mechanisms to achieve these shifts:

- incentives to ensure that tertiary education primarily responds to demand from students and employers;<sup>2</sup>
  - improve quality assurance measures, and back-end accountability; and
  - stronger links between funding and past performance.
13. This paper should also be considered in the context of the recently released Tertiary Education Strategy (TES) which describes the Government's strategic direction for tertiary education over the next five to 10 years. The TES also outlines the Government's priorities in terms of the shifts it expects to see, and intends to do something about, over the next investment plan cycle, starting in 2011.

## Framework

14. The following reports describe the principles that underpin the funding relationship between public entities (for example the TEC) and third parties (for example ITOs):
- *Principles to underpin management by public entities of funding to non-government organisations*, Office of the Auditor General (OAG), June 2006
  - *Guidelines for Contracting with Non-Government Organisations for Services Sought by the Crown*, New Zealand Treasury, April 2009
15. The report of the OAG notes that a public entity is accountable for ensuring that public funds devolved to third parties are used lawfully, effectively, efficiently and with integrity. To do this, the public entity should have regard to the following principles:
- **Lawfulness:** Have activities, resourcing, and accountability requirements been undertaken within the authority granted by Parliament?
  - **Accountability:** Have public entities given full and accurate accounts of their activities? Are governance and management arrangements suitable to address any concerns?
  - **Openness (transparency):** Is the nature of the funding arrangement, and the way in which it was entered into, clear to all parties?
  - **Value for money:** Are resources used effectively and efficiently, without waste, and in a way that optimises the public benefit?
  - **Fairness and Integrity:** Are public entities and NGOs that are involved in funding arrangements together meeting Parliament's and the public's expectations of an appropriate standard of behaviour in the public sector?<sup>3</sup>

<sup>2</sup> Cabinet also reaffirmed this commitment in October where it directed that there should be a '...focus on ensuring that the tertiary sector is better aligned to the needs of business.' (STR Min (09) 21/1 refers).

<sup>3</sup> Principles to underpin management by public entities of funding to non-government organisations, Office of the Auditor General (OAG), June 2006, pp 6-7

16. While these principles should be considered holistically, for the purposes of this discussion more weight is placed on the principles relating to accountability, and value for money. This reflects expectations that public entities are required to:
  - take account of the risks associated with relying on information provided to the public entity by the third party to verify the measureable achievement of goals; and
  - use processes such as monitoring, review and evaluation to demonstrate effectiveness and value for money.<sup>4</sup>
17. Importantly, the OAG recommends that public entities should take a risk-based approach in relation to monitoring arrangements, and make use of information that the third party is already collecting.<sup>5</sup>
18. Taking these matters into account it is possible to describe a hierarchy of factors that a public entity (such as the TEC) must be assured of. These factors are:
  - whether the organisation has the capability to achieve the results expected of it;
  - whether the public entity can have confidence in the results reported as achieved by the organisation; and
  - whether the quality of those results are sufficient to retain the confidence of the public entity.
19. Incumbent on the public entity is the need to ensure that it takes reasonable steps to assess and judge the performance of third parties, and apply appropriate rewards and sanctions depending on the outcome of that judgement. In doing so, the approach taken must have regard to the nature and magnitude of the risks involved.
20. The following discussion examines the specific considerations relevant to ITOs, and assesses whether and how the current arrangements facilitate the meeting of these obligations.

### **Operational considerations**

21. For the purposes of this discussion, the key considerations that should drive the development of operational policy in this area is the need to ensure that the TEC can be satisfied that the organisations it funds:
  - act ethically and with integrity when using public funding;
  - maintain the TEC's confidence in their ability to meet expectations relating to the eligibility of the organisation for funding;
  - report accurately and comply with the funding rules and conditions imposed by the TEC<sup>6</sup>; and
  - provide confidence that they are reflecting critically on their performance.

<sup>4</sup> Principles to underpin management by public entities of funding to non-government organisations, Office of the Auditor General (OAG), June 2006, pages 18-19

<sup>5</sup> Principles to underpin management by public entities of funding to non-government organisations, Office of the Auditor General (OAG), June 2006, pages 5

<sup>6</sup> This is particularly important given the increased links between funding and past performance signalled in the recent Tertiary Education Strategy.

## Recent issues

22. During the past 12 months, a number of issues have come to the TEC's attention including:
- ITOs claiming as valid trainees a significant number of trainees who are either 'inactive', including a number whose employment had terminated and the employer was defunct;
  - ITOs enrolling trainees in programmes that result in a funding claim equivalent to significantly more than 70 credits per annum at either one ITO, multiple ITOs or multiple tertiary education organisations (TEOs);
  - information to indicate an apparent failure to account for subsidies paid to employers as a deduction from industry cash contribution;
  - Modern Apprenticeships Co-ordinators (including a number of ITOs) subcontracting their brokerage function without the consent of the TEC;
  - the reporting of a significant number of trainees as Modern Apprenticeships who were not eligible to be reported as such;
  - inadequate monitoring of trainees who had not achieved credits and were enrolled well beyond their expected completion date;
  - ITOs enrolling trainees in Limited Credit Programmes with no clear intention to progress to enrolment in a National Certificate;
  - a significant mismatch between the credits reported as achieved to NZQA and the TEC; and
  - subcontracting of training activity amongst ITOs that involved one ITO arranging the training and another ITO reporting and claiming funding for the arranging of the training.
23. These recently highlighted issues were not within the scope of the current quality assurance system agreed to by the NZQA and the TEC. NZQA is changing the way it quality assures ITOs to focus on the quality of an ITO's achievements and its results for trainees. If warranted, non-compliance can be a focus area in external evaluation and reviews of ITOs.

## Are there systemic reasons?

24. The issues identified above suggest that there may be systemic reasons for the failure to identify these issues through the current quality assurance arrangements. Appendix one attempts to identify whether this is the case, and if so, what the relevant deficiencies might be. This appendix then compares the factors that a public entity must take into account with the various interventions that seek to provide the relevant assurance.
25. The preceding discussion suggests that the current interventions are not having the desired effect, ie that there has been a greater focus on systems compared to verifying the accuracy of the individual transactions. This appears to have contributed to an environment that suggests that some non-compliance has occurred. There may therefore be merit in considering possible changes to the TEC's approach to quality assurance and audit.

## Possible changes

26. The two most significant areas of possible change relate to ensuring:
- compliance of ITOs with the expectations of the purchaser (the TEC); and
  - alignment of the various quality assurance and compliance mechanisms.

### Compliance

27. In light of the various issues noted above, the TEC is considering undertaking a programme of compliance audits that would:
- identify the level of risk associated with each ITO
  - inform the audit approach for each ITO based on that level of risk;
  - result in further review of ITOs where the level of risk was deemed to be high; and
  - support ITOs to improve their performance.

28. The following sections describe each of the components of the approach in turn.

### Assessing the level of risk

29. In assessing the level of risk associated with each ITO, it is proposed that initially this would focus on the performance metrics outlined in previous consultation papers, as well as the:
- number and proportion of trainees that have achieved fewer than 20 credits per year;
  - number and proportion of trainees that have achieved zero credits per year;
  - number of programmes where the duration reported for funding purposes is less than the average duration of enrolment of trainees;
  - number and proportion of trainees still in training more than two quarters beyond their expected completion date; and
  - proportion of STMs associated with enrolments in LCPs.
30. The TEC would take account of any information that has come to hand, including:
- information about the internal capability and capacity of the relevant ITO;
  - information about the environment in which each ITO operates given, for example, the differences between industries in terms of economic circumstances, history of engagement with training, composition of those industries and regulatory context; and
  - the results of reviews by other agencies.
31. As better quality data becomes available, it may be appropriate to expand these measures to include measures such as:
- the extent of any mismatch between credits reported to NZQA and those reported to the TEC;
  - the rate of progression from LCPs to National Certificates; and

- whether a trainee reported as enrolled by an ITO is in employment.
32. These measures would, wherever possible, use information collected by ITOs for reporting to the TEC and NZQA.
33. Feedback is invited on alternative or additional measures that would inform assessments of the level of risk associated with ITOs.

#### Informing the audit approach

34. The TEC would vary its approach depending on the level of risk and the nature of any issues that have been identified. Naturally, the information collected as part of the assessment of risk would be discussed with NZQA.
35. This discussion may lead to the TEC determining that any issues may be addressed as part of the quality assurance work undertaken by these agencies. However, where the level of risk is deemed to be high, this may lead the TEC to undertake compliance audits.
36. Compliance audits could be undertaken on a random basis having regard to the level of risk. This could be expected to have several positive effects including:
- an inherent demonstration effect (ie that all ITOs could be audited);
  - a reward for those ITOs with high levels of compliance (ie that the ITO is less likely to be audited and if they are, positive consequences of high performance in terms of funding and recognition), and
  - a sanction for those ITOs with low levels of compliance (ie that the ITO is more likely to be audited, that there would be funding implications, and the negative consequences of public transparency).
37. It should be noted that reports arising from these audits could be discoverable.

#### Undertaking compliance audits

38. Compliance audits would focus on the extent to which individual ITOs are complying with the operational policy governing industry training, and the wider requirements placed on all TEOs.
39. Such audits are likely to involve extensive testing of the accuracy of the record-keeping of the relevant ITO. This may involve, for example, a number of review actions including:
- sampling training agreements;
  - verifying the eligibility of trainees;
  - confirming with trainees and employers that the trainee remains in employment and engaged in industry training;
  - establishing whether appropriate steps are being taken to monitor the performance of trainees;
  - determining whether appropriate steps are being taken to ensure that the duration of industry training programmes for funding purposes align to the actual average length of time trainees are enrolled in this programmes;
  - ascertaining whether funding provided to ITOs for the purposes of industry training is being used for that purpose;

- verifying the accuracy of the financial information (including the industry cash contribution) reported to the TEC; and
  - determining whether the reporting of credit and qualification achievement is accurate.
40. Feedback is invited on what other areas may be appropriate for the TEC is focus on.

#### Supporting ITOs

41. The results of compliance audits will be shared with ITOs with an appropriate opportunity for management comment. Feedback from ITOs will inform the final audit report and any actions that the TEC will take.
42. Compliance audits will aim to ensure that public funding is being used appropriately, as well as supporting ITOs to meet the expectations and requirements associated with that funding.
43. There will be consequences associated with evidence of non-compliance including but not limited to the recovery of funding, and reviews of the appropriateness of ongoing recognition of the organisation as an ITO.
44. Additionally, the TEC will seek to identify opportunities for clarifying best practice for ITOs in terms of the appropriate administration of industry training arrangements.

#### **Alignment with other audits**

45. It is not proposed at this stage to consider changes to the current quality assurance and audit activities (including the proposed external evaluation and review, and the results-focused audits). This is principally because of the changes to NZQA's approach to quality assurance of ITOs.
46. The changes to the approach taken by NZQA are set out in appendix two.
47. It may be desirable to defer any effort to ensure an appropriate alignment between the various audits until the current external evaluation and review pilots have concluded, and the methodology and results of the TEC's proposed compliance audits are developed.

#### **Consultation Feedback**

48. The TEC invites and welcomes any comments from the tertiary education sector. Individuals as well as organisations are welcome to provide feedback on the direction and decisions outlined in the paper and on how these can be further developed.
49. All feedback relating to this Consultation paper should be responded to using the feedback templates provided on the TEC website. Please only send a response using the feedback templates provided. Send any feedback to [industrytrainingprogrammes@tec.govt.nz](mailto:industrytrainingprogrammes@tec.govt.nz). All feedback should include the subject line **"ITO operational policy – feedback"** and be submitted no later than 5pm, 12 March 2010.

## Questions for consultation

50. The areas where consultation feedback is sought are set out in the related feedback template.



**Appendix one**

<b>Factor</b>	<b>Examples</b>	<b>How is this assessed by external agencies?</b>	<b>Examples of non-compliance</b>
Capability to achieve results	<p>Governance and strategic management processes</p> <p>Financial management systems</p> <p>Training management systems</p> <p>Systems to fulfil statutory roles</p>	<p>Audit NZ results focussed audits</p> <p>NZQA Quality Assurance Framework (expires 30 June 2010) and will be replaced by the NZQA External Evaluation and Review (from 1 July 2010)</p>	<p>Absence of conflict of interest and disaster recovery policies</p> <p>No reserves policy</p> <p>No system to monitor trainees progress and achievement</p>
Confidence in results	Accuracy of reporting	<p>TEC data validation</p> <p>Anecdotal evidence</p>	Refer to recent issues in paragraph 22 above
Quality of results	Educational outcomes for learners, business and the community	NZQA External Evaluation and Review (from 1 July 2010)	To be assessed from 1 July 2010

## Appendix two

## **NZQA quality assurance of ITOs**

The New Zealand Qualifications Authority (NZQA) quality assurance of ITOs is mandated by sections 6, 7 and 10 of the Industry Training Act 1992, which requires NZQA to provide advice to TEC on the recognition of ITOs. Currently, NZQA's advice is drawn from audits against the "QA Standard for ITOs" and information about ITO standard-setting and moderation.

The QA Standard for ITOs covers:

- 1.1 Defining goals and objectives
- 1.2 Systems to achieve goals and objectives
- 1.3 Development and review of unit standards and national qualifications
- 1.4 Arrangements for industry training
- 1.5 Trainee information and support
- 1.6 Workplace assessors
- 1.7 National external moderation
- 1.8 Recording and reporting on trainee achievement

NZQA audits started in 2006. To date, audits have only focused on the workplace assessors and national external moderation elements of the standard. The intention was to broaden the audits to the full standard over time.

### Changes being implemented

From 1 July 2010, NZQA will change to a new quality assurance framework for industry training organisations (ITOs). Component of this new framework are:

- NZQA advice to the TEC on recognition of any new ITOs entering the system
- Ongoing self-assessment by ITOs
- Periodic external evaluation and review of ITOs by NZQA
- Consequences of poor quality and performance

It is expected that an external evaluation and review of an ITO will reach judgements about ITO performance and capability in self-assessment.

NZQA's evaluation methodology will be appropriate to the distinctive role and function of ITOs. Key evaluation questions and indicators for ITOs have been developed and piloted in consultation with ITOs, agencies and education representative bodies.

Evaluative quality assurance is focused on the outcomes of education and training and the key processes that contribute to these outcomes. A key difference from traditional audits is that evaluative quality assurance looks at processes from the perspective of impact of processes on achievement for trainees. Consequences for poor ITO performance include:

- Remedial actions that are agreed with the ITO and documented in an action plan
- Advice to TEC

- Where warranted, the withdrawal of accreditation to register assessors for the NQF