

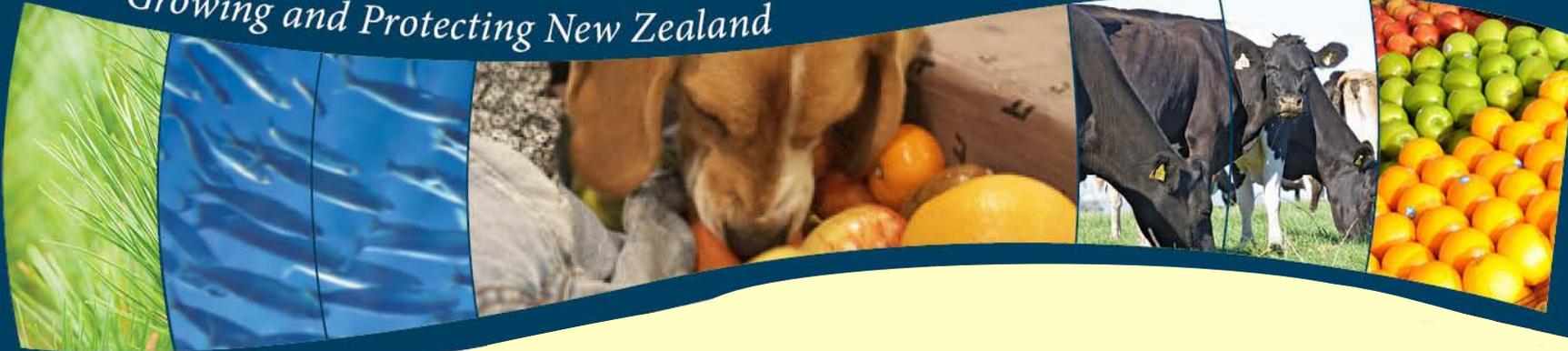


Assurance and Evaluation
Office of the Director-General

**PRIMARY GROWTH PARTNERSHIP FINANCIAL MANAGEMENT: ASSURANCE
ON USE OF PGP FUNDING – W3 WOOL UNLEASHED**

Finalised: 15 March 2018

Growing and Protecting New Zealand



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EXECUTIVE SUMMARY

CONTEXT FOR WORK

1. This report sets out the findings and observations from a review of the financial management systems and records that support the funding that has been claimed by New Zealand Merino Company Limited (NZ Merino) from the crown for the W3 Wool Unleashed Primary Growth Partnership programme.
2. The Primary Growth Partnership (PGP) is a government-industry partnership that invests in significant programmes of research and innovation to boost the economic growth and sustainability of New Zealand's primary and food sectors.
3. The Ministry for Primary Industries (MPI) provides funding to the co-investors for the programmes. The co-investors are required to provide co-funding at least equivalent to the Ministry's funding. Co-funding can be either in the form of cash contributions or in kind contributions.
4. Each contract between MPI and the co-investors provides rights of access to records to carry out an audit of the partner's use of the funds.
5. The Ministry's Assurance and Evaluation team helps provide additional comfort to the Ministry and the Minister for Primary Industries around PGP co-investors' management of funding, and claims for funding, through assurance on the partners' financial management of the programmes.

THE PROGRAMME

6. The W3 Wool Unleashed programme is a partnership between MPI and NZ Merino. NZ Merino is an integrated sales,

marketing and innovation company set up in 2001 with the aim of transforming the NZ Merino sheep industry. The aim of this PGP programme is to derive greater value from and develop new uses and markets, for strong wool.

7. The programme was contracted to begin in February 2016, with an end date of 30 June 2022. The programme consists of four projects:
 - **Social Licence to Operate (total budget \$5.8m):** to maintain and build the consumer appeal for New Zealand sheep products by protecting and enhancing the social licence to operate of the New Zealand sheep industry;
 - **Crossing the Chasm (total budget \$9.7m projected to be spent by end of 2019/20):** to move strong wool from a commodity to a fibre valued by brand partners and targeted consumer segments;
 - **Blue Ocean (total budget \$4.3m projected to be spent by end of 2019/20):** to develop market led new uses and new users for strong wool that goes beyond carpets and floor coverings; and
 - **Primary Sector Extension (total budget \$2.3m projected to be spent by end of 2019/20):** to undertake collaborative work with other primary sector businesses to assist these businesses and strong wool growers to move up the value chain.
8. The total funding approved for this programme is \$22.1m (\$11.05m from government and \$11.05m from industry).
9. The costs of the programme are a combination of direct staff costs, external expenses and a small proportion of in kind costs.

- **Direct staff costs:** the cost of NZ Merino staff time spent on PGP activities; to date this has been between 60 and 70% of the total budgeted costs of the programme;
- **External expenses:** costs of external consultants, suppliers, travel costs etc approximately 30% of budgeted costs; and
- **In kind costs:** cost of growers, brand partners and other partners time contributed to the programme. Represents 6% of the budgeted costs.

OBJECTIVE OF WORK

10. The key objectives of this review work were to provide assurance:
 - That the key elements of NZ Merino PGP financial management systems are suitably robust and effective. Elements of the system assessed to include:
 - Financial monitoring and reporting to MPI and the Programme Steering Group
 - Budgeting, cash flow and forecasting processes
 - Processes for completion of claims for funding
 - Payments and staff payroll processes
 - In kind contributions calculation
 - Cost allocation processes
 - That NZ Merino has sufficient, relevant and reliable records of use of the funding and co-funding that adequately support their funding/ co-funding claims.
11. We were also asked specifically as part of this work, to confirm that there are:

- Valid and appropriate allocation of the costs of NZ Merino FTEs to the programme's activities;
- Processes to define what is part of the programme's activities, versus other NZ Merino activities; and
- Valid and appropriate allocation of costs to the programme, versus other NZ Merino activities

WHAT WE DID AND HOW WE DID IT

12. The approach that we took to this work included:
 - talking to the persons in the Ministry and at NZ Merino who manage the programme of work to understand the systems and processes being used to manage the funding/co-funding and make claims for funding;
 - carrying out walkthroughs of the systems used for making monthly claims to MPI, developing budgets, doing forecasts and re-projections; and
 - for a sample of external expenses and staff time costs incurred, checking documentation which supports any of the amounts being claimed for payment by NZ Merino for the period from February 2016 (the inception of the programme) up to end September 2017.

(this documentation included timesheets, payment invoices, contracts and quotes, evidence of activities from quarterly reports to Programme Steering Group and agreed outputs set out in the original business case).

OVERALL CONCLUSIONS

Key elements of NZ Merino's financial management systems for financial reporting, budgeting and monitoring are suitably robust and effective

13. Our conclusions are that NZ Merino has systems in place for the financial management of the programme that are robust and effective, suitably commensurate with the size and complexity of this programme and consistent with our expectations.
14. NZ Merino has systems in place for developing quarterly financial reports for the Programme Steering Group and MPI, developing annual plan budgets, carrying out regular (three times a year) forecasting and monthly monitoring of spending.

NZ Merino has systems in place to collect and collate the information it needs to support its monthly claims for funding

15. NZ Merino also has effective processes in place for completing the monthly invoices it submits to MPI to bill for MPI's share of the actual programme costs. NZ Merino uses a reputable accounting software system and a number of spreadsheet tools to capture and maintain the financial information and data it needs to complete these monthly invoices.
16. There is a satisfactory audit trail that allows the amounts claimed each month for each of the four projects to be linked back to individual records of time worked by staff and expenses incurred as part of this PGP programme.

NZ Merino has a process in place for identifying staff costs for the PGP programme

17. NZ Merino staff costs are currently and will continue to be the most significant element of cost for this programme. During 2016/17, the first full year of the programme, NZ Merino staff costs represented \$1.64m of \$2.33m spend (or 70% of costs).

This is in line with the programmes financial projections in the Business Case and Annual Plan.

18. NZ Merino has a mechanism in place for recording time that each of their staff work on the programme. They are required to record the number of hours that they work each day, for each of the four projects that make up the programme in a time sheet template that has been set up in Microsoft Excel. NZ Merino staff are not required to provide any more specific description of the work that they were doing on the programme on these timesheets.
19. This process seems to be working well – the timesheets are reasonably well structured and staff seem to be completing them on a timely basis. Each of the four project leads is required to review the time their staff spent on their projects each month. The process has been in place since 2010 and was set up to capture the time worked for the earlier NZSTX PGP programme.
20. As part of our work, we reviewed the time records for ten NZ Merino staff for the most recent year of the programme; 2016/17. Based on this review, we can confirm that these staff have been recording their time to legitimate outputs and activities related to this PGP programme.
21. MPI invests a high degree of trust that NZ Merino management are effectively monitoring the time recorded and have protocols in place for determining the split of staff time between PGP programme work and their other NZ Merino activities. We were not made aware of any documented protocols for differentiating these activities, the Programme Manager and Chief Operating Officer provide verbal guidance where there is any uncertainty.

22. Because of the significant proportion of staff costs for this particular programme, MPI should consider ways of obtaining further assurance that these staff costs relate to PGP activities.
23. MPI should explore whether there is any way of effectively checking the reasonableness of time worked against the progress being made across the various PGP projects and activities.
24. MPI should consider whether there is a need to require greater detail to be recorded on daily timesheets about the tasks and activities being completed for the programme.

The external expenses being claimed are supported by sufficient records and are related to PGP programme activities

25. MPI management can take reasonable assurance that there is sufficient evidence to support NZ Merino spending to date on external expenses related to the PGP programme.
26. External expenses for this programme include consultants, travel, general costs. In 2016/17 these costs represented some \$517k or 22% of the costs for the year. Over 50% of these external expense costs relate to travel, mostly related to the Crossing the Chasm project (\$136k) but also the Social Licence (\$73k) and Primary Sector Extension (\$43k) projects.
27. Based on a review of a sample of twenty external expenses transactions, in our view the consultants and general costs are fully supported and wholly related to PGP activities proposed in the W3 Wool Unleashed Annual Plan.
28. Some of these general costs relate to gifts and entertainment costs incurred during visits of two major brand partners to New

Zealand earlier in 2017. MPI representatives have confirmed that in their view these are legitimate costs of the programme.

29. Much of the Crossing the Chasm travel related spending is related to the costs of several trips to Europe, USA and Asia as part of the Amplification of NZM Model into Strong Wool activities related to introductions to and developing new brand partners. This activity was set out in the programme annual plan for 2016/17 and 2017/18.
30. While our work did not find any costs which we felt were not PGP related, there were a small number of travel costs incurred, which related to international trips which were potentially both PGP and non PGP related.
31. This highlights the need for continued scrutiny by both NZ Merino and MPI of expenses being claimed to determine whether the costs are wholly or only partly claimable as PGP costs.

In kind costs being claimed are valid and appropriate charges against the PGP programme

32. In kind costs represent around 5% of the costs of this programme so are not material to the cost of the programme. We found that the data related to these costs is being collected in the timesheet spreadsheets for two of the project leads.
33. The in kind costs represent time spent by brand partners, sheep farmers in attending meetings, workshops etc to help drive the elements of the Social Licence and Crossing the Chasm.
34. The two project leads provide notes in their timesheet to support significant amounts of time spent by their brand partners and we were able to corroborate some of these meetings and

workshops against other records and reports which gives comfort that these costs have been calculated appropriately.

RECOMMENDATIONS

35. There are no specific actions or recommendations arising from this work for NZ Merino. There are two recommendations for MPI to consider:
- Because of the nature of this particular programme, consider ways of gaining extra assurance staff costs relate to PGP activity. This could include:
 - exploring whether there is any way of effectively checking the reasonableness of time worked against the progress being made across the various PGP projects and activities.
 - considering whether there is a need to require greater detail to be recorded on daily timesheets about the tasks and activities being completed for the programme.
 - give continued scrutiny to external expenses being claimed to ensure the appropriate allocation of costs to PGP.
36. Appendix 1 sets out some further details of the basis of our conclusions on the framework of financial management processes for budgeting, forecasting, making claims for payment and reporting to the Programme Steering Group.

MANAGEMENT COMMENT

NZ Merino and MPI fully support the recommendations made by this audit and will work together to address them. Specific actions that are being taken include:

- Putting in place new processes to provide additional detail into timesheet summaries for any staff member whose time is not 100% focussed on the W3 programme, by 1 March 2018
- Developing agreed protocols providing further clarity and ensuring costs being claimed are appropriately allocated to the W3 PGP programme

APPENDIX ONE: OVERALL ASSESSMENT OF PGP FINANCIAL MANAGEMENT PROCESSES – W3 WOOL UNLEASHED

Process	Key conclusions and observations
<p>OVERALL ASSESSMENT OF FINANCIAL MANAGEMENT SYSTEMS</p>	
<p>The overall framework of financial management processes is satisfactory</p> <ul style="list-style-type: none"> ○ The framework of financial management processes and protocols in place (that combination of programme planning, financial reporting, the day to day financial management practices) appears to be working suitably effectively. ○ We can provide some assurance that day to day financial management practices such as payment processing, book keeping etc have operated throughout the whole life of the programme. ○ We can provide some assurance on the veracity of the budgeting, forecasting, monitoring and reporting disciplines that NZ Merino have in place. 	
<p>Processes for creating funding claims and financial reports</p>	<p>Processes for monthly funding claims to MPI and quarterly reporting to Programme Steering Group on financial performance are satisfactory</p> <ul style="list-style-type: none"> ○ The process for creating the monthly funding claims and quarterly financial reports for the Programme Steering Group appears to be well embedded in NZ Merino practices. Each quarterly report includes a two page financial report which provides details of the spend against budget. These reports provide limited analysis of any variances but they are probably sufficient when weighed against the level of spending being incurred. ○ The financial reporting element of the quarterly reports to MPI and the Programme Steering Group are subject to programme manager and financial controller oversight ○ The underlying systems of accounting and financial record keeping seem to be well managed by the NZ Merino finance team on a day to day basis – general ledger accounting systems seem to have been set up with simplicity in mind. ○ There are effective segregation of duties and oversight of financial management commensurate with an organisation of this size.
<p>Processing</p>	<p>Payment processing practices are satisfactory</p>

Process	Key conclusions and observations
of payments	<ul style="list-style-type: none"> ○ The systems for making payments and processing creditors look to be consistent with the expectations that we would have of any business of the same size and complexity as NZ Merino.
Processes for identifying in kind based costs	<p>Processes for identifying in kind transactions are satisfactory</p> <ul style="list-style-type: none"> ○ The underlying accounting and record keeping systems appear to be commensurate with the size and complexity of the costs being managed for the relatively small amount of in kind costs being accounted for.
Budgeting	<p>Budgeting systems are satisfactory</p> <ul style="list-style-type: none"> ○ There is a process in place for developing the annual plan budget that involves the project leads. The assumptions that are built into budget figures seem to be soundly based on best information at the time. ○ The budgeting tools being used have an appropriate degree of sophistication that is commensurate with the size and value of the funds being managed.
Forecasting	<p>Forecasting systems are satisfactory</p> <ul style="list-style-type: none"> ○ The in year forecasting practices and disciplines are consistent with the expectations for the size and complexity of the programme being managed. ○ There are three points during the year where budgets are re-assessed against actual spending. There is a reasonable degree of rigour associated with this review process. ○ Monthly variance analysis of actual and budget provides a detailed assessment of differences. There are three reforecasts during the year which provide sufficient opportunity to reassess progress and spending.