

PRIMARY GROWTH PARTNERSHIP: ASSURANCE ON DAIRYNZ'S MANAGEMENT OF PGP FUNDING

Growing and Protecting New Zealand



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SECTION 1: EXECUTIVE SUMMARY

OBJECTIVE OF WORK

The key objectives of our work were to provide assurance that DairyNZ's financial management systems for PGP funding and co-funding of the Dairy Value Chain Transformation Pre Farm Gate sub programme are suitably robust and effective and to ensure that DairyNZ could demonstrate that they have sufficient, relevant and reliable records to support the use of the funding and co-funding claims made to the Ministry.

At the request of the Ministry, we also reviewed the financial management systems in place at Livestock Improvement Corporation (LIC) (the second largest co-funder by dollar value to the pre-farm gate PGP programme after DairyNZ), to ensure they were suitably robust and effective, and that LIC could demonstrate claims made for reimbursement from PGP funds were able to be supported by sufficient, relevant, and reliable records.

OBSERVATIONS

Overall conclusions

1. We conclude that DairyNZ's financial management systems (including systems for budgeting and forecasting, financial management reporting and monitoring, cost allocation and payment processes) for PGP funding and co-funding are suitably robust and effective.
2. We also conclude that the funding being provided by the Ministry for Primary Industries (MPI) and co-investors is being used to meet the costs of the pre farm gate PGP programme. We conclude that:
 - Amounts being claimed from the Ministry are supported by documentary evidence.

- Amounts being claimed are relevant and appropriate costs to be borne by the partnership programme.
- An adequate process exists to value DairyNZ contributions to the programme.

3. We further conclude that LIC's financial management systems (with respect to management of Objective 2.1 of the pre-farm gate PGP programme) are suitably robust and effective, and that claims made for reimbursement from PGP funding by LIC were able to be supported by sufficient, relevant, and reliable records.

RECOMMENDATIONS

There are three recommendations

- **Recommendation A for MPI and DairyNZ:** MPI to work with DairyNZ to reach mutual understanding of the PGP Agreement with respect to timing of claims for reimbursement of expenditure from PGP funds.

Management comment:

Agree, DairyNZ will meet with MPI to discuss DairyNZ's approach.

- **Recommendation B for DairyNZ:** DairyNZ to develop and implement a revised reporting approach for the PSG which allows for greater clarity and transparency. This should include more information on how each Project links to the achievement of Theme Objectives and details of any additional costs being funded by levies DairyNZ for any given project.

Management comment:

Agree, the Programme Steering Group to meet in August to discuss programme reporting alignment. DairyNZ will change its reporting accordingly.

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- **Recommendation C for DairyNZ:** Review processes for capturing in kind contributions and clarify the nature of LIC's ongoing provision of \$100,000 per annum of in-kind contribution to the PGP programme.

Management comment:

Agree, at the end of the 4th quarter DairyNZ, LIC and Synlait will provide a table showing the breakdown of each organisations in-kind contribution.

SECTION 2: INTRODUCTION

OBJECTIVES OF WORK

4. The key objectives of our work were to provide assurance that DairyNZ's financial management systems for PGP funding and co-funding of the Dairy Value Chain Transformation pre farm gate sub programme are suitably robust and effective and to ensure that DairyNZ could demonstrate that they have sufficient, relevant and reliable records to support the use of the funding and co-funding claims made to the Ministry.
5. At the request of the Ministry, we also reviewed the financial management systems in place at LIC (the second largest co-funder by dollar value to the pre-farm gate PGP programme after DairyNZ), to ensure they were suitably robust and effective, and that LIC could demonstrate claims made for reimbursement from PGP funds were able to be supported by sufficient, relevant, and reliable records.

CONTEXT FOR WORK

6. The Primary Growth Partnership 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.

7. The Ministry provides funding to the partners for the programmes. The partners are required to provide co-funding at least equivalent to the Ministry's funding. Co-funding can be in the form of cash contributions and in kind contributions.
8. Each contract between the Ministry and the partners provides rights of access to records to carry out an audit of the partner's use of the funds.
9. Grant Thornton New Zealand Limited was engaged by the Ministry to provide additional comfort to the Ministry and the Minister over DairyNZ's management of funding and claims for PGP funding, via an assurance programme that reviewed DairyNZ's financial management of the programme (DairyNZ is contracted by the Ministry to manage the pre-farm gate PGP programme, responsible for delivering Themes 1 and 2. It in turn has entered into co-funding agreements with industry Partners, and has engaged a number of organisations to provide goods/services in support of the PGP programme). This assurance programme includes a review of the following:
 - Financial management reporting processes
 - Budgeting, cash flow and forecasting processes
 - Cost allocation processes
 - Payments processes
10. In addition, at the request of the Ministry, we conducted a review of the financial management systems and processes in place over PGP funding at LIC (the second largest provider of co-funding to the pre-farm gate PGP programme after DairyNZ).

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11. The total funding for the pre- and post-farm gate seven year programme is \$171m (\$85m from government and \$86m from partners) and the five themed programmes started in April 2011.
12. The DairyNZ pre-farm gate element of the programme has approved funding of \$97.77M (\$53.11M from government and \$44.66M from industry co-investors) to cover delivery of a programme of eight objectives across two of the five themes. These themes and objectives are:
 - Theme 1 On-farm innovation and research
 - *Objective 2.1 Increased genetic gain – gene sequencing*
 - *Objective 2.2 Increased genetic gain – phenotypic data*
 - *Objective 2.3 Designer milks*
 - *Objective 2.4 Improved pasture performance*
 - *Objective 2.5 Precision agriculture*
 - *Objective 2.6 Dairy industry network*
 - Theme 2 Building capability for a sustainable future
 - *Objective 2.7 Train the trainer*
 - *Objective 2.8 Increase capability and competency*
13. The head contract holder (for the pre-farm gate aspect of the PGP programme) is DairyNZ, which is responsible for overall management of the scheme. It also provides funding, along with other industry co-funding Partners (LIC, Synlait, New Zealand Young Farmers, Landcorp, Agriculture Services Limited).
14. To the end of 2013/14 a projected \$54.67M will have been invested in the pre-farm gate element of the programme. Table 1 details how this expenditure has been funded to date. Most of this expenditure comprises the costs of research and development which is being undertaken by DairyNZ and other contracted organisations.

Table 1: Split of funding of expenditure to date

Period	MPI funding	Industry funding	Total
2010/11	\$6.16M	\$4.62M	\$10.78M
2011/12	\$8.93M	\$7.08M	\$16.01M
2012/13	\$7.81M	\$6.38M	\$14.19M
2013/14 (projected)	\$7.31M	\$6.38M	\$13.69M
Total to date	\$30.21M	\$24.46M	\$54.67M

15. The split of funding for the pre farm sub programme is 55% government funded and 45% funding from DairyNZ and industry co-investors. The pre-farm gate programme leverages Fonterra funding of the post-farm gate element of the programme to ensure that overall government funding is less than 50% of the total cost of the programme.

WHAT WE DID AND HOW WE DID IT

16. We obtained an understanding of the financial and management systems in place for PGP funding and co-funding, via discussions with key Ministry (Investment Manager, and Audit Manager), DairyNZ (CFO, Financial Controller, and Business Manager), and LIC (R&D Support Services Manager, and R&D Project Manager) staff.
17. We obtained complete listings of PGP expenditure from DairyNZ for the period 1 January to 31 December 2013, and corroborated a sample of expenditure amounts to supporting documentation (e.g. Investment Schedules, supplier invoices, Contracts, and other documents). We also checked the separation between PGP- and DairyNZ- funded expenditure.
18. We reviewed the budgeting and forecasting processes in place at DairyNZ, and examined the system employed by DairyNZ to monitor progress made by co-funder and provider entities (including oversight of milestone achievement).

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19. We also carried out testing over the systems and processes in place at LIC over PGP funding, by: reviewing their annual budgeting process; verifying the reasonableness of LICs overhead allocation methodology; corroborating a sample of expenditure items (claimed for reimbursement from PGP funding) to supporting documentation; examining compliance with key Contractual obligations (with respect to the split of PGP/LIC funding, and timing of claims for reimbursement).

SECTION 3: FINDINGS & RECOMMENDATIONS OUR CONCLUSIONS

20. Our conclusion is that DairyNZ's financial management systems (including systems for budgeting and forecasting, financial management reporting and monitoring, cost allocation and payment processes) for PGP funding and co-funding are suitably robust and effective.
21. We also conclude that the funding being provided by MPI and co-investors is being used to meet the costs of the pre-farm gate PGP programme (we base this conclusion on our review of the documentation and information supplied by DairyNZ and LIC to support the transactions we sampled as part of our audit testing). We conclude that:
- Amounts being claimed from the Ministry are supported by documentary evidence.
 - Amounts being claimed are relevant and appropriate costs to be borne by the partnership programme.
 - An adequate process exists to value DairyNZ and LIC contributions to the programme.
22. Appendix One provides details of the basis on which our assessment of the main elements of the financial management process has been made.

SPECIFIC OBSERVATIONS FOR MPI AND DAIRYNZ TO CONSIDER

Clarification of payment timing

23. The Primary Growth Partnership Agreement (between Ministry of Agriculture & Fishery (now MPI), DairyNZ, & Fonterra) sets out the terms for timing of the Ministry funding of the costs incurred by the programme.
24. There appears to be a difference in understanding between the parties around when claims for reimbursement should be submitted for payment:
- Ministry understanding is that no expenditure can be claimed for reimbursement by the partner, until the work has been undertaken and in the case of third parties an invoice has been received from the provider of the good/service procured.
 - DairyNZ's approach to claiming reimbursement is that they allow quarterly progress payments to be made to suppliers, subject to receipt of an invoice from the supplier and that satisfactory progress towards achievement of relevant milestones has been made, as measured via DairyNZ's online milestone tracking tool.
 - LIC claim reimbursement for funding of expenditure once a contractual obligation has been entered into (i.e. between LIC and the supplier) even if the good or service has not yet been received.
25. The Ministry understanding is based on the principle that it does not 'pre-fund' activities using public funds. DairyNZ make these progress payments because some of its suppliers are smaller entities that rely on the cash-flows from progress payments to fund ongoing work (note DairyNZ have oversight of supplier progress; refer Appendix 1).
26. LIC's largest contract is for gene sequencing services. It is generally their policy to wait until the 'last possible moment' to place orders for these

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gene sequencing services (from an overseas provider) to take advantage of downward pricing trends (to ensure they receive the best value for money in said procurement).

27. While we consider:

- DairyNZ has sufficient oversight of suppliers to have comfort suppliers are continuing to work toward milestone achievement throughout the year, and have the ability to delay/stop payment should unsatisfactory progress be made; and
- LIC is able to demonstrate that they have entered into a contractual obligation with suppliers (for their major expenditure item) prior to submitting a claim for reimbursement for said expenditure from PGP funding.

It is the Ministry policy for PGP programmes that no expenditure can be claimed for reimbursement by the partner, until work has been undertaken and an invoice has been received from the provider of the good/service procured.

Recommendation

Ref	Recommendation	Agreed/not agreed? (comments)
A	MPI to work with DairyNZ to reach mutual understanding of the PGP Agreement with respect to timing of claims for reimbursement of expenditure from PGP funds.	Agree, DairyNZ will meet with MPI to discuss DairyNZ's approach.

SPECIFIC OBSERVATIONS FOR DAIRYNZ PGP MANAGEMENT TO CONSIDER

Programme reporting

28. The eight objectives within the pre-farm gate PGP programme are delivered by means of 23 individual projects and two subcontracts.
29. The individual projects are covered by a (typically annual) contract ('Investment Schedule'), agreed between DairyNZ and the partner entity, which details the funding amount (and nature e.g. PGP, Levy, Co-funder) and specifies the milestones to be delivered (and due-dates). The two subcontracts are for the delivery of Objective 2.1 (LIC) and Objective 2.3 (Synlait), and set out the annual budget for the life of the programme.
30. DairyNZ has two systems in place to track the delivery of the PGP programme – milestone tracking, and financial tracking.
31. The milestone tracking utilises an online tool, which is accessible by the delivery partners (i.e. those entities that are tasked with milestone delivery). The delivery partners record their progress against the milestones via the online tool, which is overseen by DairyNZ specialist staff (NB: this does not apply to LIC or Synlait, which submit quarterly reports and declarations to DairyNZ).
32. Financial tracking is carried out by the Financial Controller (with oversight by the CFO), using a number of spreadsheets. There are a number of views provided, including tracking of actual expenditure against budget (per the Investment Schedule/Sub-contract), split of PGP vs Levy funding, et cetera.
33. Each quarter, DairyNZ provides reporting to the PGP Project Steering Group (PSG). This reporting details milestone achievement progress, and

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summarised financial information (split by Objective, and detailing quarterly invoiced amounts). Limited variance reporting is included.

34. The information presented to the PSG does not provide a comprehensive perspective on the financial progress achieved each quarter. The schedule of information does not fully capture details of the planned expenditure for the year nor does it show where additional funding has been provided. One of the things that the audit found was that DairyNZ was using additional levy funding (over and above the budgeted DairyNZ PGP funding) to support certain projects but was not reporting and disclosing this to the PSG in its report.
35. To this end, we recommend DairyNZ adopt a 'bottom-up' approach to its financial reporting to the PSG to provide greater clarity and transparency around the financial performance and progress of the programme. This reporting approach should include a presentation that links the annual budget (per the Investment Schedule/Sub-contract) for each project, organised by Objective, and linked through to the overall PGP Theme. This in turn could be linked more effectively to the milestone progress reporting.
36. Each quarter could then show variances between actual to budget on a per-project basis.
37. This approach should also provide a mechanism for DairyNZ to show where additional Levy funding is being used to support a given project.
38. This would improve the level of detail provided to the PSG and the Ministry providing greater linkage between individual project spends to achievement of Theme Objectives, and increasing the transparency of the reporting.

Recommendation

Ref	Recommendation	Agreed/not agreed? (comments)
B	DairyNZ to develop and implement a revised reporting approach, for the PSG which allows for greater clarity and transparency. This should include more information on how each Project links to the achievement of Theme Objectives and details of any additional costs being funded by levies DairyNZ for any given project.	Agree, the Programme Steering Group is to meet in August to discuss programme reporting alignment. DairyNZ will change its reporting accordingly.

Valuation of in-kind contribution

39. LIC have been sub-contracted by DairyNZ to deliver Objective 2.1 of the PGP programme (increased genetic gain – gene sequencing).
40. The contracts make references to an amount of \$100,000 per annum of 'in-kind' contribution to be made by LIC to cover intellectual property.
41. When asked to provide support for the \$100,000 per annum in-kind contribution LIC stated they did not have this information readily available. They further stated this figure is not well documented within LIC, and has not to date been explicitly quantified.
42. Due to the contractual requirement to provide the \$100,000 per annum in-kind contribution, we consider it prudent for DairyNZ and LIC to be able to demonstrate it is providing it as required and for DairyNZ to discuss and clarify the nature of this provision with the Ministry.

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Recommendation

Ref	Recommendation	Agreed/not agreed? (comments)
C	Review processes for capturing in kind contributions and clarify the nature of LIC's ongoing provision of \$100,000 per annum in-kind contribution to the PGP programme.	Agree, at the end of the 4th quarter DairyNZ, LIC and Synlait will provide a table showing the breakdown of each organisations in-kind contribution.

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APPENDIX ONE: OVERALL ASSESSMENT OF DAIRYNZ PGP FINANCIAL MANAGEMENT PROCESSES

Process	Conclusions and observations
Budgeting, cash flow and forecasting processes	<p>Overall conclusion</p> <p>The budgeting, cash flow, and forecasting processes in place at DairyNZ over the delivery of the pre-farm gate PGP programme are suitably robust.</p> <ul style="list-style-type: none"> ○ Each Theme contains a number of objectives; with the exception of Objective 2.1 and Objective 2.3 (subcontracted to LIC and Synlait, respectively), each of these objectives is delivered by one or more Projects. The Projects are budgeted for via a (typically annual) Investment Schedule, which is agreed between DairyNZ and the provider entities. The Investment Schedules have oversight by operational specialists (Strategy & Investment Leaders) and financial specialists (CFO/Financial Controller), and are approved by the DairyNZ CEO (and a suitable equivalent within the Provider entity). ○ The Financial Controller maintains a number of spreadsheets to track and report progress on each project against annual budgets, and monitors and reports any variances.
Financial management reporting processes	<p>Overall conclusion</p> <p>There are satisfactory processes in place to report financial information within DairyNZ.</p> <ul style="list-style-type: none"> ○ DairyNZ specialist staff (Strategy & Investment Leaders and Business Managers) track the progress of each project assigned to them via a combination of regular interaction with providers (including site visits, where appropriate) and the use of an online reporting tool (which tracks progress achieved against contractual milestones); these staff are required to authorise any provider invoices for payment prior to providers receiving reimbursement from PGP funding. ○ The Financial Controller maintains a number of spreadsheets, which track the actual spend per month for a given project against the budgeted expenditure (per the Investment Schedule/contract); the CFO has oversight of this process. ○ Internal quarterly reporting is prepared, in addition to the external quarterly reporting to the PGP Project Steering Group (PSG). ○ The DairyNZ Annual Report also includes a summary of the PGP programme, with expenditure per programme included in the report. Additionally, expenditure items within the Financial Statements are split between PGP and non-PGP amounts – these amounts (and the additional disclosures in the front of the report regarding project expenditure) are independently audited each year. <p>Observation</p> <p>The quarterly reporting provided to the PSG includes summarised financial information, which does not provide sufficient detail to link individual Project-level expenditure to Objectives to Themes.</p>

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Process	Conclusions and observations
	RECOMMENDATION FOR DAIRYNZ (recommendation B in the main body of report): DairyNZ to develop and implement a revised reporting approach, for the PSG which allows for greater clarity and transparency. This should include more information on how each Project links to the achievement of Theme Objectives and details of any additional costs being funded by levies DairyNZ for any given project.
Cost allocation processes	<p>Overall conclusion</p> <p>There are satisfactory processes for allocating, splitting and attributing costs between costs borne by DairyNZ and those claimed from the Ministry.</p> <p>Costs for the delivery of the pre-farm gate programme are split 45/55 between DairyNZ and the Ministry. We verified the total split was consistent with this, by reviewing the total allocation between PGP and non-PGP funding per-project (and confirming the recorded figures were consistent with individual Investment Schedules/subcontracts)</p> <p>The split of funding for the pre farm sub programme is 55% government funded and 45% funding from DairyNZ and its funding partners. The pre farm programme leverages Fonterra funding of the post farm gate element of the programme to ensure that overall government funding is less than 50% of the total cost of the programme.</p> <p>DairyNZ allocates internal costs based on invoices from suppliers, and allocation of FTE staff time.</p> <p>For externally provided services, costs are allocated per the individual Investment Schedules/subcontracts (nb: it was not within the scope of this audit to verify value-for-money of the Investment Schedules/subcontracts. Also note: no work was performed over the co-funding provided by Synlait, as this was not within the scope of our review).</p>
Processing of payments	<p>Overall conclusion</p> <p>There are satisfactory processes for making and recording payments and these include:</p> <ul style="list-style-type: none"> ○ Sufficient checking, oversight and approval of payments. ○ Effective separation and segregation of duties between procurers of services and accounts payable processing function and other accounting functions. ○ Controls over access to the accounts payable processing system (not tested). ○ Effective workflow processes embedded within the accounting system.
Review of documentation and information	<p>Overall conclusion</p> <p>The amounts being claimed from Ministry for actual cash costs are supported by sufficient, relevant and reliable records and the criteria for the funding are being met. This is based on:</p> <ul style="list-style-type: none"> ○ A review of 20 transactions selected for the period 1 Jan 2013 to 31 Dec 2013, which amounted to \$2.8M of expenditure. ○ Agreeing claimed amounts to supporting documentation (approved invoices, Investment Schedules, Contracts). ○ Reconciling closing balances per the General Ledger (as at 31 May 2013) for a sample of project accounts (both PGP, and Levy funded) to Investment Schedules/contracts.

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APPENDIX TWO: OVERALL ASSESSMENT OF LIC PGP FINANCIAL MANAGEMENT PROCESSES

Process	Conclusions and observations
Budgeting, cash flow and forecasting processes	<p>Overall conclusion LIC's budgeting, cash flow and forecasting processes over Objective 2.1 appear satisfactory.</p>
Financial management reporting processes	<p>Overall conclusion LIC's reporting processes over Objective 2.1 appear satisfactory.</p> <p>Monthly Variance Reports (actual expenditure against annual budget) are prepared LIC submits quarterly reporting to DairyNZ, along with a signed declaration that funds have been used appropriately.</p>
Cost allocation processes	<p>Overall conclusion LIC's cost allocation processes over Objective 2.1 appear satisfactory; however the cost allocation process over the \$100,000 per annum in-kind contribution requires development.</p> <p>Under the subcontract with DairyNZ, LIC are able to claim reimbursement of 50% of the expenditure incurred (up to a maximum each year, as defined in the subcontract) in the pursuit of Objective 2.1.</p> <p>We gained comfort over this allocation by:</p> <ul style="list-style-type: none"> ○ Reviewing the budget for the 2013/14 year (for Objective 2.1), noting the 50/50 split (up to a maximum of \$1.7M available from PGP funding, as per the contract). ○ Verifying the underlying costing of the 31 May 2013 invoice, observing it represented 50% of the expenditure for the period claimed (with the other 50% borne by LIC). <p>We also reviewed LICs costing methodology for overhead allocation and staff time calculation; at a high level the methodology, charge-out rates, and time calculation appeared reasonable.</p> <p>Observation Due to the withdrawal of ViaLactia Biosciences from the co-delivery of Objective 2.1, LIC assumed full responsibility for delivery of the Objective. As a consequence, the contract was varied to reflect that change.</p>

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Process	Conclusions and observations
	<p>The original contract included the provision of \$100,000 per annum of in-kind funding, which was provided by ViaLactia – the responsibility for providing this was transferred to LIC.</p> <p>There appears to be a lack of documentation (within LIC, DairyNZ, and MPI) regarding what this amount includes, and it has not been quantified by LIC (they suggest it covers provision of their Intellectual Property in support of delivering Objective 2.1).</p> <p>RECOMMENDATION FOR DAIRYNZ (recommendation C in main body of report): Review processes for capturing in kind contributions and clarify the nature of LIC's ongoing provision of \$100,000 per annum in-kind contribution to the PGP programme.</p>
Processing of payments	<p>Overall conclusion</p> <p>There are satisfactory processes for making and recording payments and these include:</p> <ul style="list-style-type: none"> ○ Sufficient checking, oversight and approval of payments. ○ Effective separation and segregation of duties between procurers of services and accounts payable processing function and other accounting functions. ○ Controls over access to the accounts payable processing system (not tested). ○ Effective workflow processes embedded within the accounting software system SAP.
Review of documentation and information	<p>Overall conclusion</p> <p>The amounts being claimed by LIC for reimbursement from PGP funding for actual costs are supported by sufficient, relevant and reliable records and the criteria for funding are being met. This is based on:</p> <ul style="list-style-type: none"> ○ Agreeing the invoice submitted for reimbursement (from LIC to DairyNZ) on 31 May 2013 to underlying transactions. ○ Verifying 90% of those transactions (\$1.49M out of \$1.66M) against supporting documentation (invoices, contracts, et cetera). ○ Verifying the transactions tested showed evidence of appropriate levels of oversight and approval (via workflows within SAP). ○ Verifying that only 50% of the total expenditure for the period was claimed for reimbursement from PGP funding (consistent with the contract). ○ Obtaining staff time calculations for April and May 2013, and conducting reasonableness check.

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SECTION 4: ACTION PLAN

No	Recommendations	Action Description	Due Date	Responsibility
A	MPI work with DairyNZ to reach mutual understanding of the PGP Agreement with respect to timing of claims for reimbursement of expenditure from PGP funds.	DairyNZ will meet with MPI to understand practicalities and reach an agreement on timing of reimbursements for expenditure.	30 June 14	DairyNZ / MPI
B	DairyNZ develop and implement a revised reporting approach, for the PSG which allows for greater clarity and transparency. This should include more information on how each Project links to the achievement of Theme Objectives and details of any additional costs being funded by levies DairyNZ for any given project.	The Programme Steering Group is to meet in August to discuss programme reporting alignment. DairyNZ will change its reporting accordingly.	August 14	DairyNZ
C	Review processes for capturing in kind contributions and clarify the nature of LIC's ongoing provision of \$100,000 per annum in-kind contribution to the PGP programme.	DairyNZ will provide a table showing the breakdown of in-kind contribution for DairyNZ, LIC and Synlait at the end of each financial year.	31 July 14	DairyNZ