Note: July 2013 All recommendations have been addressed.

Report on the management of Primary Growth Partnership funding by New Zealand Merino Company Limited for the period 1 July 2011 to 30 June 2012

Ministry for Primary Industries

19 November 2012

ERNST & YOUNG

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1 Overview

Background

We have been engaged by the Ministry to complete an audit (based on the Ministry's requirements and terms of reference) and provide a report for the Ministry and NZ Merino on the management of funding programme. The main objectives of this assignment are to ensure that funding being provided by the Ministry and co-funding being provided by the partner was being used solely and specifically to meet the costs of the programme and in accordance with the PGP agreement between the Ministry and the PGP Partner.

Our work has been designed to provide assurance that NZ Merino has:

- Sufficient, relevant and reliable records of use of the funding and co-funding to adequately support the funding/co-funding claims;
- Financial management systems in place to manage PGP funding and co-funding including:
  - Financial management reporting processes (including financial data to support funding claims);
  - Cost allocation processes; and
  - Payment processes.

Status

We have completed our review of NZ Merino's use of funding being provided by the Ministry. We have performed the audit based on the Ministry's requirements and terms of reference to assess if the funding is used solely and specifically to meet the cost of the programme in accordance with the terms of the Primary Growth Partnership ("PGP") agreement.

Our audit was performed in accordance with the International Standard on Assurance Engagements 3000.

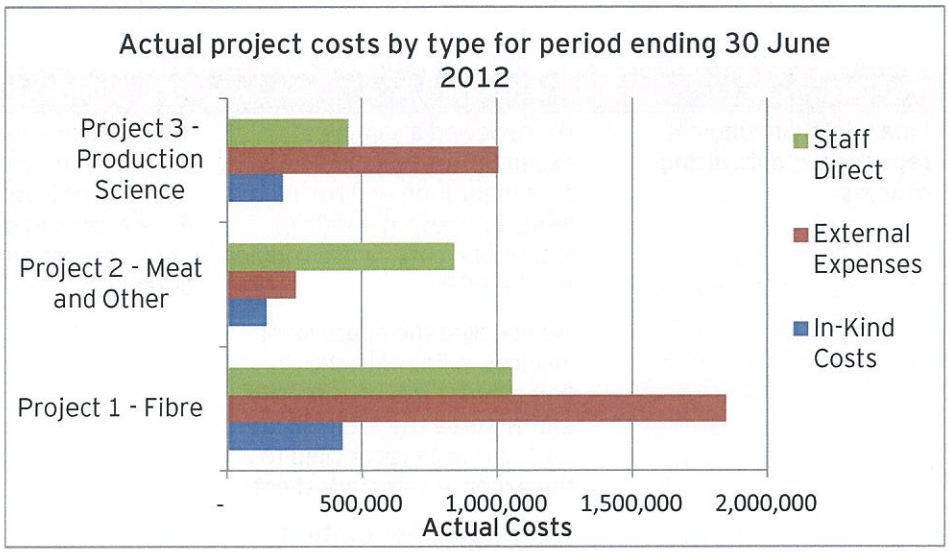
In addition to the terms of reference we also enquired with NZ Merino as to the impact of the Canterbury Earthquakes on the programme. In the aftermath of the earthquakes, NZ Merino has had issues with access to files and records in its former office, staff anxiety and the impact the earthquakes had on other businesses they deal with, which has negatively impacted their productivity. In reviewing the project costs we noted a delay in the completion of several project milestones by approximately one quarter.

Conclusion

Based on the work performed in line with the terms of reference, we noted the following:

- NZ Merino has effective financial reporting processes in place in addition to effective invoicing processes. We noted one exception with regards to the invoicing process, further detail can be found in section 3 of this report;
- Cost allocations and in-kind contributions are performed in line with PGP agreement and through effective processes. We noted one exception in relation to timesheets, further detail can be found in section 3 of this report;
- NZ Merino has sufficient, relevant and reliable records in place to support the funding claims made to the Ministry.

The following details actual expense type by project for the period ending 30 June 2012:



Cost	2011/12 Actual Costs	2011/12 Budget Costs
External Expenses	3,106,136	5,358,000
Staff Direct	2,344,845	1,903,500
In-Kind Costs	779,458	1,398,000
Total Costs	6,230,439	8,659,500

2 Significant areas of audit focus

Area	Work conducted	EY's findings	Conclusion
Financial management reporting and invoicing process	▷ We reviewed a sample of expenditures to supporting documentation and traced the items to relevant general ledger and cost centre coding for the PGP; ▷ We checked the approval of invoices in line with the delegated levels of authority and ensured the total billing for the month reconciled to the expense summary sheet; ▷ We identified key controls relating to the process, these can be found at Appendix A; and ▷ We reviewed expenditure against the milestones of the business plans.	We noted one exception in relation to the approval of invoices. Please refer to section 3 of this report for further detail.	NZ Merino has effective financial reporting processes in place in addition to effective invoicing processes, other than the exception noted.
Cost allocation processes and valuing in-kind contributions	▷ Expense transactions were traced to the relevant ledger and cost centre coding and reviewed for reasonableness against the business plan; ▷ Expense items were traced through to the invoicing processes submitted for payment to the Ministry; ▷ We reviewed timesheets and in-kind costs; and ▷ We performed a detailed walkthrough and held discussions with staff on how these expenses are charged.	We noted one exception with regards to the review of timesheets. Please refer to section 3 of this report for further detail.	Cost allocations and in-kind contributions are performed in line with PGP agreement and through effective processes.

Area	Work conducted	EY's findings	Conclusion
Budgeting, cash flow and forecasting	▸ We performed detailed analytical review of actual expenditure claimed to budget figures; ▸ We sought explanations for variations where actual expenditure did not trend with budget or expectations; ▸ We identified the key controls relating to the processes. These can be found at Appendix A; and ▸ We reviewed quarterly steering group minutes and reports.	None noted.	Budgeting, cash flow and forecasting processes are effectively performed and incorporated into the plan by NZ Merino.
Allocated staff charge out rates	▸ We reviewed a sample of staff and in-kind expenses to supporting documentation and time invoiced as part of the PGP; ▸ We reviewed charge out rates to ensure they were in line with the agreed rates and the relevant staff roles.	None noted.	Allocated staff charge out rates is in accordance with the rates set by the Investment Advisory Panel of the PGP.

3 Control environment

Two issues were identified during our testing. These are detailed below. Both were classified as low risk.

The definition of Low Risk is as follows:

Corrective action is required, generally within 6 to 12 months. A weakness which does not seriously detract from the system of internal control and/or operational effectiveness/efficiency but which should nevertheless be addressed by management.

Issues identified are only those found within the course of the audit for the period 01 July 2011 to 30 June 2012. Recommendation issues are intended solely for the use of the Ministry and NZ Merino's management. We disclaim any assumption of responsibility for any reliance on this report, to any other person than the Ministry or NZ Merino or for any other purpose that that for which it was prepared.

Issue: Review of timesheets	
Observation	Through our review of direct staff and in-kind costs incurred as part of the PGP programme, we noted there was no formal review of timesheets. It is understood that a review does occur but it is not documented or undertaken in a consistent manner.
Implication	Without a regular formal review process, there is an increased risk that staff time charged may be calculated or coded incorrectly and incorrect amounts charged to the PGP programme.
Recommendation	We recommend that a check is evidenced on the summary timesheets for all staff time on a monthly basis to review that the time charged to each of the projects in the PGP programme is in line with project progress and expectations.
Management Response	We concur with the recommendation. While review of monthly time sheets is a normal part of our monthly process, we have not been physically signing the file to evidence that the review has taken place. We have now amended our procedures to do this.

Issue: Approval of invoices	
Observation	During our review of a sample of expenses we noted one instance where an invoice had been processed and claimed as part of the PGP programme without being approved by the delegated authority.
Implication	If expenditure items are not appropriately approved for payment there is an increased risk that incorrect or inappropriate payments are made and claimed through the PGP programme.
Recommendation	We recommend that a sample check is conducted on a weekly or monthly basis to review that the authorisations are made and are also in line with the delegated authority.
Management Response	We have strong processes in place to check invoices are signed off according to delegated levels of authority. The instance referred to here related to an item that slipped through as it was a direct debit rather than a normal invoice. Given the processes we have around invoices and direct debits we consider this to be a one-off instance. Accounts staff have been reminded of requirements around this.

Appendix A: Summary of audit work performed

PGP Expenditure and billing process

In understanding the expenditure and billing process NZ Merino have put in place for the PGP programme, we identified the following key controls:

- Control 1: Manager signs and approves invoice in line with NZ Merinos delegated levels of authority
- Control 2: Accounts Payable reconciliation is performed monthly between actual expenditure and budgeted expenditure
- Control 3: Independent person enters online banking information
- Control 4: Two authorisers required to process online banking
- Control 5: Invoice raised to MPI is reconciled to the expense summary sheet

Budgeting, cash flow and forecasting processes

In understanding the budgeting, cash flow and forecasting processes NZ Merino have put in place for the PGP programme, we identified the following controls:

- Control 1: Budget is based on the business plan agreed upon between NZ Merino and MPI.
- Control 2: Detailed time analysis is performed by the relevant manager for each of the projects to determine the percentage of time budgeted for each of the projects.
- Control 3: Hourly staff rates are set as determined by the business plan agreed with MPI.
- Control 4: Budget is reassessed and re-projections are submitted to the steering group committee for review and approval each quarter.
- Control 5: Actual against budget expenditure variance analysis performed and presented to the steering groups quarterly meetings.

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