

NZGM 2054364

New Zealand Racing Board

Audit Report

8 May 2014

**Audit Period 1 February 2012
to 31 July 2013**

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OFFICIAL INFORMATION ACT

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While our audit is carried out in accordance with Department of Internal Affairs' standards, it cannot, and should not, be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency.

The responsibility for public accountability and the implementation and monitoring of internal and management controls rests with the holder of the Class 4 operator's licence.

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ABBREVIATIONS

Act:	Gambling Act 2003
Board:	New Zealand Racing Board
GMP:	Gaming Machine Profit
NPR:	Gambling (Class 4 Net Proceeds) Regulations 2004

1. EXECUTIVE SUMMARY

This is the first audit of the Board since receiving a Class 4 gambling licence.

Overall, the implementation has been good with some areas for further development readily identified by the Department and acknowledged by the Board's management. These were particularly in the grants area with a couple of areas in the expenses worthy of attention. There are some further challenges ahead as the service/compliance contract with The Lion Foundation 2008 ends and the venue support capacity is developed in-house.

The audit found the Board was mostly compliant with the requirements of the Act and associated regulations, game rules and licence conditions with the exception of those matters noted in the Summary of Non-Compliance.

2. INTRODUCTION

2.1. Background

The New Zealand Racing Board (Board) is a statutory body established in August 2003 under the Racing Act 2003 to run the New Zealand TAB, maximise betting profits and promote the racing industry. Since 9 August 2011 the Board has been licensed to operate as a Class 4 society. The head offices are in Petone, Wellington. At the time of audit the Board had 32 TAB venues throughout New Zealand operating nine machines each except for six 18-machine venues.

2.2. Purpose of the audit

The purpose of this audit was to:

- Determine the Board's level of compliance with the Act (and applicable Game Rules & Regulations) and the implementation of the Board's policies and procedures;
- Identify areas of non-compliance;
- Outline required remedial action for areas of non-compliance; and
- Provide best practice recommendation where appropriate.

The scope of the audit covers the following key process areas of the Board's Class 4 gambling operations:

- Governance and management;
- Income;
- Expenses;
- Assets;
- Grants;
- Undistributed net proceeds; and
- Venue compliance.

We have undertaken a venue inspection at eight venues. The report resulting from that inspection has been sent separately and overall comments are included in this report.

3. SUMMARY OF NON-COMPLIANCE

Report Ref.	Regulatory Reference	Subject	Issue
4. Minimising Costs & Maximising Net Proceeds	Section 106(1)	NZRB consultancy fees	Invoiced costs not calculated based on actual costs
		Advertising grants information	Advertising TAB logo
	Section 107	Assets	Failure to recognise non-current assets
5. Grant Distribution Process	Regulation 5 NPR	Grant recipients accountability reporting	Incorrect information provided to net proceeds committee
			Incomplete information maintained

4. MINIMISING COSTS & MAXIMISING NET PROCEEDS

4.1. Expenses - general

The Department reviewed a targeted sample of invoices covering the audit period. On the whole, the Department found the expenses to be actual, reasonable and necessary with the following exceptions.

4.2. NZRB consultancy fees

Invoices relating to the audit period were analysed to ensure that costs were being minimised. As a general statement, the invoices sampled were actual, reasonable and necessary to the conduct of gambling.

An internal charge from the racing operations for support provided to the gaming operation amounted to \$500,004 in the 2012/13 year. This charge was based upon estimates of hours to be spent, the total being reduced by about four per cent to produce an approximately round figure. In some cases those hours were acknowledged to be quite inaccurate. The Department saw no established process to allow for accurate totals to be collated.

Requirement for remedial action

The Board must put in place policies and procedures to ensure that internal charges, as with all other expenses, are able to be justified as actual in all respects.

4.3. The Lion Foundation 2008 consultancy fees

Venue support had been provided by The Lion Foundation 2008 from first issue of a licence in August 2011 and through to 2012/13 year. The contract allowed for a full suite of venue compliance activities to be provided, although not all components were implemented.

Venue costs and associated administration for the 2012/13 year equated to 12.7 per cent of gaming machine profits, well below the 16 per cent cap set by Limit D.

During the 2013/14 year internal capacity to provide these services will be established and the contract with The Lion Foundation 2008 ended. At the time of auditing, a budget for these services was being developed. The Department's expectation that this would be a prudent decision was clearly conveyed. The Board's expectations were that the decision would lead to savings.

4.4. Assets

The Department reviewed assets in the Board's statement of financial position and asset related entries in its statements of financial performance and cash flows. From this the Department had questions around the following:

- Work in progress of \$416,025.00 as a non-current asset;
- Proceeds from sale of assets of \$84,000.00 as income, however a \$0 figure for sale of non-current assets included in the Board's statement of cash flows;
- Tear drop flags at a value of \$11,145.00 claimed in full as an expense in the year of purchase;
- \$76,575.00 claimed on a loss on the sale of assets and
- The rate of depreciation on non-current assets.

The Board provided documents and explanations in answer to the Department's questions from which the following was determined:

- Work in progress of \$416,025.00 was incorrectly coded at the time of book entry. This was in fact for new gaming machines and was corrected when the error was found. Therefore, classification as a non-current asset was correct;
- The \$84,000.00 included as proceeds from the sale of gaming machines refers to trade in values which were given as a discount on new gaming machine purchases. This satisfactorily explains to the Department why the \$84,000.00 amount was not included in the Board's statement of cash flows.
- The Department received an unsatisfactory explanation of the classification of tear drop flags as a cost claimed fully in the year of purchase. Two invoices of \$3,821.08 and \$7,323.72 made up this expense category. Accepted accounting practice would deem any asset or category of assets with an expected useful life of more than 12 months to be treated as a non-current asset and to be depreciated accordingly. The two invoice amounts should meet the *de minimis* threshold of a gaming operation of this size.
- A review of the \$76,575.00 loss claimed on the sale of assets showed that in one instance the depreciation loss on a gaming machine was counted twice, as the gaming machine had inadvertently been included twice in the Board's fixed asset schedule. The error resulted in a net proceeds discrepancy of \$2,678.00 in the 2013 financial year, which had been corrected by the Board with the additional net proceeds having been added back in the 2014 financial year.
- The rate of depreciation adopted for various non-current assets appears to be suitable and in line with accepted accounting practice.

Recommended Action

The Board needs to take additional care when recording assets such as gaming machines in the fixed asset schedule, to ensure that machines have not been recorded twice. This will ensure that the correct amount of depreciation is claimed on assets, and that any losses on the sale of assets are not over stated in the future.

Requirement for remedial action

The Board must establish its policy to align with generally accepted accounting principles for the recognition of non-current assets.

4.5. Advertising grants information

The Board spent \$8,000 on advertising its grants during the 2012/13 year. An advertisement detailing the net proceeds applied and distributed by the Board during the year ended 31 July 2013 was published in the Dominion Post on 31 October 2013. The words "*THE TAB PROUDLY SUPPORTS OUR COMMUNITY*" and the logo of the TAB were features of the advertisement.

While this type of advertising is a requirement of section 110(4) of the Act, which applies to the Board¹, the advertisement was unfortunately spoilt by the sole use of the TAB logo rather than the Board's.

¹ As a society that mainly applies its net proceeds, section 110 does not normally apply to it. However, the special condition in Condition 4 on the operator's licence requires the Board to comply with that section.

The Board advised that the reasons for using the TAB wording and logo was due to brand recognition, and that all net proceeds applied or distributed by the Board were generated from Class 4 gambling that occurred in TAB venues.

As the commercial arm of the Board, the TAB may not directly benefit from advertising expenditure from the gross proceeds of gambling. While the cost of the advertisement would have remained unchanged if the correct logo was used, technically, the expenditure becomes unnecessary to a degree.²

Further, the Department is of the view that the advertisement could have misled the public as to where the net proceeds from Class 4 gambling were generated. While all of the Board's net proceeds were generated in TAB venues, not all TAB venues operate Class 4 gambling machines.

Therefore, it is important that the net proceeds are recognised as proceeds applied or distributed from the Board and not the TAB.

Requirement for remedial actions

The Board must put processes and policies in place to ensure that the Board's logo is the only logo advertised through expenditure of the gross proceeds of Class 4 gambling.

5. GRANT DISTRIBUTION PROCESS

5.1. Grant Processing Systems and Infrastructure

The New Zealand Racing Board's Net Proceeds Committee distributed funds to 79 grant applicants within the sports vein of their authorised purpose statement between 1 February 2012 and 31 July 2013.

Of these 79 grants, 17 were distributed between 1 February 2012 and 31 July 2012 and 62 between 1 August 2012 and 31 July 2013.

Due to inadequate resourcing and a turn-over of staff within the Board's Gaming Unit, efficient systems around the processing of grants were never embedded by the Board's management. Board management concede this was a failing.

The current Grants Administrator has been in the position since May 2013. This is a part-time position. It appears no clear best practice guidelines outlining how grants should be processed were available upon his commencement in the role.

The Grants Administrator, [REDACTED], also received minimal training in the use of the Funds Management Software System, which is used by the Board to record grant requests, applicant information and to manage grant payments. For the most part he is self-taught in the use of this application.

A flow-chart was created by the Grants Administrator which outlines the stages in the grants process. While this is a useful tool, it is by no means a comprehensive best practice document.

Recommended Action

The Department recommends that Board management create a best practice document which includes, but is not limited to:

² Section 106(1).

- A. Detailed procedures/requirements/instructions for each stage of the grant management process.
- B. An outline of which staff members within the Gaming Unit are responsible for each stage of the process.
- C. Timeframes for dealing with each stage.
- D. Copies of template documents (letters of decline, approval, accountability reporting documents etc.).

5.2. Grants

A sample of grants for the audit period was reviewed and a series of issues were identified and are outlined below.

Sports Authorised Purpose

The majority of grants reviewed clearly fit within the Board's sports authorised purpose definition. However, it was noted that several successful grants, though linked to sports-related groups, did not directly fit within the authorised purpose which is outlined below:

To encourage active participation in amateur sports, and to assist bona fide amateur sports teams and clubs competing in recognised amateur leagues and amateur tournaments including (but not limited to) sports equipment, playing uniforms, ground hire, and actual and reasonable travel expenses for groups participating in tournaments with kindred groups.

A bona fide amateur sports team is a sporting activity, organisation or club that is:

- *affiliated or aligned to a national body; and*
- *genuine and real (has standards and rules etc.); and*
- *played on a regular basis as part of a significant competition; and open to public membership*

One such example was a grant distributed to the John Walker Find Your Field of Dreams Foundation (the Foundation).

In April 2013 the Board's Net Proceeds Committee provided the Foundation with a grant of \$30,000 to cover part of the Primary Sport programme which delivers in-school skills training and education in sports to children at 21 schools across South Auckland.

Previously, in April 2012, the Net Proceeds Committee declined an application for \$50,000 from the Foundation for operating costs on the grounds that the Net Proceeds Committee had a preference to deliver funds directly to amateur sporting organisations.

The John Walker Find Your Dreams Foundation is a charitable trust that aims to encourage young people in South Auckland to pursue a more active lifestyle. The Foundation facilitates a number of programmes including Primary and Secondary sports delivered by Counties Manakau Sport, Throw for Gold delivered by Athletics Auckland and Community Swim delivered by Auckland Council and Swimgym.

The Foundation does not directly deliver the programmes but instead facilitates the funding for other service providers and also helps to facilitate the development of new programmes. The Foundation does not appear to be aligned to an amateur sport, nor is it affiliated or aligned to a national body.

The Board has indicated that in its decision to award this grant funding to the Foundation, it made a broad interpretation of "**encourage active participation in amateur sports, and to assist bona fide amateur sports teams and clubs...**" to include charitable organisations or incorporated societies whose role is to facilitate and encourage active participation in amateur sports.

Recommended Actions

- A. The Department recommends the Board takes special care with ensuring the final outcomes derived from grants made to intermediary organisations that do not themselves deliver the goods or services described in the grant application. The stated purposes of all approved grant applications should be specific actions rather than describing types of action. This should involve itemised competitive quotations from suppliers, enabling definitive accountability documentation to be received and matched against the quotes. Further, there should be an acceptable level of confidence provided by the applicant that the supplier of goods or services is trustworthy.
- B. The Department recommends the Board consider broadening their authorised purpose statement to include charitable purposes. This would enable the Board to examine other worthy causes which may not meet the strict definition of amateur sport but are still beneficial to the wider public.

5.3. Application Forms

Regulation 17(4) of the Gambling (Class 4 Net Proceeds) Regulations 2004 (NPR) requires that the amount approved, the date of approval and signatures of persons approving the grant are recorded on the application form. The above information was not routinely recorded on the majority of grant forms sighted during the audit.

The Department acknowledges that whilst regulation 17(4) does not apply to the Board because it is an entity that mainly applies, it does have expectations that grant processes are in accordance with the practices specified in the regulations so to ensure best practice.

Recommended Action

The Department recommends that the Board adopt changes to its grant application forms to accord with the requirements of regulation 17(4) as a matter of best practice.

5.4. Accountability Reporting

Regulation 5 of the NPR outlines that it is a licence holder's duty to keep documents and data. In particular, regulation 5(2)(a) requires that a licence holder must ensure that documents relating to-

- (a) The application of funding to authorised purposes or distribution of funding for authorised purposes, as the case may be, are up to date on a day-to-day basis;

In May 2012, the Board commenced an internal audit of its Class 4 gambling operation. As part of the audit, it identified that the racing codes (Harness Racing, Greyhound Racing, and Thoroughbred Racing) to which the Board applied funding, were not providing satisfactory grant accountability documentation.

This issue was addressed and the Board moved ahead by deciding to cease its funding to the Codes until the matter was rectified. This step was undertaken with the Department's knowledge. The Board then chose to apply this funding (under the racing authorised purpose) to the integrity functions undertaken by the Racing Integrity Unit, The Judicial Control Authority and the New Zealand Racing Laboratory Services.

In mid-2013, Board management also identified that a satisfactory level of accountability reporting was not being supplied by grant recipients. Board management has concluded this oversight occurred during a period when the Board's Gaming Unit was under-resourced and those undertaking the Gaming Unit duties, who should have been ensuring all accountability documents had been received, deemed it not to be a priority.

At the time of the on-site audit (November 2013) there were 14 grant recipients that were yet to provide any accountability report documentation. All 14 had been contacted by Board Management. The longest outstanding recipient related to a grant approved in October 2012.

Also of concern to the Department was the discovery that the Board's Net Proceeds Committee was provided with documentation from the Board's General Manager Gaming advising it that accountability reports had been received by grant recipients when they had not.

In explanation for this, Board management has acknowledged that for a period, the level of resourcing and the quality of output was sub-optimal and the management of the accountability processes was not at an acceptable level.

Management has provided the Department with an assurance that it is now actively addressing the issue with the outstanding accountability documentation and plans to provide the Department with an update of the steps management is taking to correct the issue.

Required Action

The Board must provide the Department with an action plan explaining how it will ensure that accountability documentation is sought and received and ensure the integrity of accountability reporting.

5.5. Frequency of Net Proceeds Committee Meetings

Condition 4 of the Board's licence requires that it applies or distributes net proceeds **regularly** and **frequently** so there is no accumulation of funds.

For the audit period, the Net Proceeds Committee met on 9 occasions.

- March 2012 – Funds applied and funds distributed.
- April 2012 – Funds applied and funds distributed
- May 2012 – **No funds applied**, but funds distributed
- July 2012 – **No funds applied**, but funds distributed
- October 2012 – Funds applied and funds distributed

- February 2013 – Funds applied and funds distributed
- April 2013 – Funds applied and funds distributed
- June 2013 – Funds applied and funds distributed
- July 2013 – Fund applied and funds distributed.

Board management has explained that the inability to meet consistently was because of scheduling issues between the members of the Net Proceeds Committee. As it stands, several of the meetings were held via Teleconference.

Information confirming the dates of upcoming meetings was not readily available on the website. This was inadequate as it did not allow grant applicants the opportunity to plan ahead or provide any certainty around when a grant might be considered. It also meant grants administration staff were unable to work to a clear schedule.

The Net Proceeds Committee will endeavour to meet every two months and its meeting dates for the 2014 calendar year have now been posted on the Board's website.

Recommended Action

The Department recommends that the Net Proceeds Committee adopt a regular schedule of meetings and that this schedule is kept available on the Board's website to meet the requirements for compliance.

6. UNDISTRIBUTED NET PROCEEDS

The Department reviewed the Board's undistributed net proceeds balance of \$1,037,847 held at the end of the 2012 financial year, as a different undistributed net proceeds balance (\$0) was carried forward to the 2013 financial year.

During the 2012 financial year, the Board (with approval from the Department) delayed the application and/or distribution of net proceeds while accountability requirements from grant recipients were improved. \$3,781,668 in net proceeds was applied and/or distributed during the 2012 financial year, with another \$3,037,058 in net proceeds being applied and/or distributed during the first three months of the 2013 financial year. As the \$3,037,058 amount was accrued at year end, the total distributions allocated to the 2012 financial year were \$6,818,726.

However, in the Board's Gaming Machine Account Summary (GMAS) relicensing form provided to the Department for the 2012 financial year, distributions made were calculated at \$5,780,881 with an undistributed net proceeds balance of \$1,037,847 carried forward to the 2013 financial year.

The Board has been unable to provide details of how the distribution and undistributed net proceeds amounts were calculated in the GMAS form provided to the Department for the 2012 financial year. It appears that the discrepancy in amounts arose when the GMAS form was completed as a part of the Board's annual relicensing requirements prior to the Board's annual report and general ledger being finalised. Personnel in key positions had exited the organisation without recording the calculations used to arrive at those figures.

While the difference in amounts did not result in less net proceeds being applied and/or distributed during the 2012 financial year, going forward it is important that the distributions amount included in the Board's annual GMAS form is correct. The distribution amount included in the GMAS form is used to assess the Board's compliance with its minimum return licence condition (requiring at least 37.12% of

GST exclusive gross proceeds to be applied and/or distributed for authorised purposes).

The Board's Class 4 operator's licence also includes a licence condition which requires net proceeds to be applied and/or distributed regularly and frequently so that there is no accumulation of funds in the dedicated gaming account. The Board's current practice of ensuring that all net proceeds generated within a financial year are applied and/or distributed for an authorised purpose within three months of the end of that financial year, means that this licence condition is complied with.

Recommended Action

The Board's annual GMAS form should be completed and submitted to the Department after the Board's annual report and general ledger have been finalised, to ensure that the distributions and undistributed net proceeds amounts included in the GMAS form are correct. This will ensure that the Board's compliance with its minimum return licence condition is assessed correctly.

7. BANKING PROCESS

A sample of banking records selected from within the audit period was reviewed. In each instance it was found that the correct amount was banked and the Board experienced no instances of late banking.

8. VENUE COMPLIANCE

The Department undertook venue inspections at the following NZRB venues that operate Class 4 gaming machines:

- TAB Birkenhead, North Shore;
- TAB Pukekohe, Franklin;
- TAB Flat Bush, Manukau;
- TAB Glen Innes, Auckland;
- TAB Highland Park, Manukau;
- TAB Papakura;
- Porirua TAB; and
- TAB Upper Hutt.

Venue inspections are designed to assess venue compliance with specific parts of the Act, its associated game rules and regulations, and the conditions attached to the Class 4 operator's and venue licences.

This was done by assessing compliance in the following areas:

- Access to and supervision of the gaming area;
- Information displayed;
- Implementation of a harm minimisation/responsible gambling programme;
- Cash float, key security, player dispute requirements; and
- Record keeping.

The Department understands Lion Foundation 2008 was contracted to manage the Board's gaming machine operation until 4 December 2013.

There were some minor issues identified relating to record keeping, the use of Department issued forms, harm minimisation, and access to and supervision of the gaming area.

While these areas of compliance can carry significant weight as to the suitability of an operator's licence and general compliance, the nature of each issue identified on this occasion was assessed not to be so significant as to impact the overall compliance of the gaming machine operation. Further to this, the Board's recently appointed Gaming Operations Manager and venue staff have either rectified these issues or given assurances they will be in the near future, which will be followed up by the Department.

Recommended Action

As the management contract with Lion Foundation 2008 has ceased and the Board is now managing the gaming machine operation in-house, it will be imperative that the Board has robust procedures and policies in place to ensure continual compliance in this area.

8.1. Gaming Machine Analysis

The Board uses Ezi-Balance software to complete Gaming Machine Analysis forms.

The Board is currently in the process of training its venue managers to ensure that they enter the correct 'cash' figures from the actual cancelled credit, hopper refills and cash clearances forms directly into the Ezi-Balance system.

This is a requirement of rule 62 of the Gambling Act (Class 4) Game Rules 2006 and will enable the Board to correctly and accurately analyse the GMA each month.

9. CONCLUSION

The audit has found that in the areas examined the NZRB overall complies with the requirements of the Act, regulations and rules.

However, the Board needs to take remedial action regarding the following areas of concern:

- Implement accounting processes and policies around the reporting of assets, expenditure and distributed/applied net proceeds to the Department.
- Implement risk management accountabilities of Board gaming personnel to ensure issues from any personnel changes is mitigated.
- Implement appropriate and documented processes and policies for grant recipients.
- Ensure satisfactory risk management of venue compliance is established now that this function has been brought in-house.
- Ensure the Net Proceeds Committee regularly meets to consider grant applications.
- Consider whether the Board wants to broaden its authorised purpose.