

Assurance and Evaluation  
Strategy, Performance and Engagement

Ministry for Primary Industries  
Manatū Ahu Matua



**PRIMARY GROWTH PARTNERSHIP  
FINANCIAL MANAGEMENT**

**ASSURANCE ON USE OF PGP FUNDING:  
SHEEP – HORIZON THREE**

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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 Spring Sheep Dairy NZ Limited Partnership for the Sheep - Horizon Three 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 Sheep - Horizon Three is a partnership between MPI and Spring Sheep Dairy NZ Limited Partnership (Spring Sheep Dairy). Spring Sheep Dairy is jointly owned by Landcorp Farming Limited (Landcorp), a state-owned enterprise and SLC Ventures Limited, a partnership of private New Zealand investors.
7. The vision of the Sheep - Horizon Three programme is to create a market driven, end-to-end value chain for sheep milk that can be used as a platform to expand into a significant industry for New Zealand while retaining the value for New Zealand.
8. The programme was contracted to begin 10 July 2016 and run until 30 June 2022. It officially began in December 2016, with some work streams beginning in July 2016 under a 'go-early status'. A 'go-early' funding of \$542K was approved and paid to Spring Sheep Dairy in January 2017 to cover programme costs from 11 July 2016 to 30 November 2016.
9. The agreed total maximum funding for the Sheep - Horizon Three is \$31.392 million: \$12.56 million (40%) from government and \$18.83 million (60%) from Spring Sheep Dairy as co-investor. The cost is allocated in the following areas over the 6-year life of the programme:
  - **Genetic Development (\$2.96 million)** – to create a high performance New Zealand dairy sheep flock using imported world leading genetics;

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- **Transformative Farming System (\$19.677 million)** – to develop/build a fit-for-purpose New Zealand sheep milk farming system which is suited to new imported genetics, commercially viable, environmentally sustainable and replicable in New Zealand;
  - **Market Insights and Development: (\$4.176 million)** – to investigate and undertake market research to determine which market segments have the greatest potential for profit and how to access those markets successfully;
  - **High Value Product Development (\$3.035 million)** – to create high value sheep milk products from NZ by investigating potential high value products from sheep cream/fat stream source (e.g. butter or cream products) and development of advanced nutritional powders/supplements; and
  - **Project Management (\$1.544 million)** – to put in place an effective programme management through effective resourcing (i.e. financial management, reporting, and governance) and strategic management.
10. During the 2016/17 financial year, a total of \$3.050 million was spent on the programme against a budget of \$4.016 million. Spending for 2016/17 was \$966K (32%) under budget.
11. During the 2017/18 financial year, \$6.063 million was spent on the programme. There was overspend of \$265K (4.6%) over the annual budget of \$5.798 million.
12. Appendix One provides a breakdown of costs relating to the programme for the last two financial years that the programme has been running.
13. In the 2016/17 financial year, spending (\$1.48 million) in the Farming System work stream made up the largest portion (49%) of the total programme costs (\$3.050 million) and related largely to the construction of farm prototype housing for research (refer Table 1 of Appendix One).
14. As shown in Table 2 of Appendix One, the Farming System work stream made up the largest part of the programme costs (69%) for 2017/18. Most of the spending was capital expenditure relating to the building of pilot farms during the financial year. This was in line with the financial projections and the annual plan.
15. As at 30 June 2018, the cumulative programme spend of \$9.11 million is well under the \$12.38 million programme costs originally budgeted for in the business case. MPI has contributed a total of \$3.64 million (40% of \$9.11 million) of the total programme costs as at 30 June 2018.

## OBJECTIVE OF WORK

16. The key objectives of this review work were to provide assurance:

- That the key elements of Spring Sheep Dairy financial management systems relating to the PGP programme are suitably robust and effective. Elements of the system assessed include:
  - Financial monitoring and reporting to MPI and the Programme Steering Group (PSG)
  - Budgeting, cash flow and forecasting processes
  - Processes for completion of claims for funding
  - Payments processes
  - Cost allocation processes
- That Spring Sheep Dairy has sufficient, relevant and reliable records supporting use of the funding and co-funding that adequately support their funding/ co-funding claims.

## WHAT WE DID AND HOW WE DID IT

17. The approach that we took to this work included:
- talking to the persons in the Ministry and at Spring Sheep 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 processes used for making monthly claims to MPI, developing budgets, doing forecasts and re-projections; and
  - for a sample of thirty external expenses and staff time costs incurred, checking documentation which supports the amounts being claimed for payment by Spring Sheep Dairy for the period 2016/17 and 2017/18.

## OVERALL CONCLUSIONS

**Key elements of Spring Sheep Dairy's financial management systems for financial reporting, budgeting and monitoring are robust and effective**

18. Spring Sheep Dairy has systems in place for the financial management of the programme that are robust and effective.
19. Spring Sheep Dairy has systems in place for developing quarterly financial reports for the PSG and MPI, developing annual plan budgets, carrying out regular budget review, forecasting and monthly monitoring of spending.
20. At present, it is not standard practice for MPI to request the supporting/underlying information (i.e. work stream budget spreadsheets) relating to the annual budget approved by the PSG. Having this information available would help inform the review of the annual budget and would be useful in the ongoing monitoring by MPI of programme spending against budget.

**Spring Sheep Dairy has systems in place to collect and collate the information it needs to support its monthly claims for funding from MPI**

21. Spring Sheep Dairy has effective processes in place for completing the monthly invoices it submits to MPI to recover MPI's share of the actual programme costs. Spring Sheep Dairy uses a reputable accounting software system and a number of supporting spreadsheets to capture and summarise the financial information and data it needs to complete these monthly invoices.

22. Spring Sheep Dairy has a robust record management process in place that allows the amounts claimed each month to be linked back to supporting records and cost allocation calculations. There is a satisfactory audit trail to support the expenses incurred for the PGP programme.

**Spring Sheep Dairy has a process in place for identifying costs for the PGP programme**

23. Spring Sheep Dairy uses a reputable accounting software to capture and maintain financial information and data. Up until June 2018, Spring Sheep Dairy used Landcorp's accounting system (Microsoft NAV) to record their accounting transactions. Spring Sheep had its own general ledger set up in Landcorp's accounting system.

24. Beginning 1 July 2018, Spring Sheep Dairy has brought the accounting function in-house and now uses the Xero accounting system. The accounting processes seem to be well managed by the Financial Controller on a day-to-day basis.

25. The programme costs are segregated and identified in the accounting system by using programme specific codes. This facilitates the extraction of financial information relating to PGP activities for financial reporting and claiming back programme costs from MPI.

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

26. MPI management can take reasonable assurance that there is sufficient evidence to support Spring Sheep Dairy spending to date on expenses related to the PGP programme.

27. As part of our work, we reviewed a total of thirty items of expenses and general ledger items (including staff costs allocation, travel costs) for 2016/17 and 2017/18 financial years. Based on this review, we can confirm that these expense items are appropriately supported by invoices and relevant documentation (e.g. rental contracts) and cost allocation calculations.

28. The Farming System work stream, which incurred the most significant costs of the Programme, has a robust system for monitoring costs. The farm team has access to appropriate financial information and reports to monitor spending on a regular basis.

29. Staff costs of \$1.003 million represent 17% of the 2017/18 programme costs. There is a process in place for calculating and allocating staff costs to the programme.

30. Allocation of international travel costs, for work in international market access development, are adequately supported by invoices and documented calculations.

31. In our view, the external and allocated costs claimed from MPI related to PGP activities proposed in the Sheep - Horizon Three Annual Plan. This is in line with the financial projections and the annual plan.
32. MPI has adequate internal processes in place for reviewing monthly invoices and associated financial reports received from Spring Sheep Dairy.

## **RECOMMENDATIONS**

33. There are no specific actions or recommendations arising from this work for Spring Sheep Dairy.
34. There is one recommendation for MPI to consider:
- Consider requesting the supporting/underlying information supporting the annual budget. We believe there is benefit in seeking additional information to understand the underlying numbers in the budget (e.g. big project milestones, budgeted staff costs of employees working on the programme). This will provide baseline information and can help inform MPI's review of the budget as well as the analysis of financial summaries accompanying the monthly invoices submitted to MPI.
35. Appendix Two 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.



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**APPENDIX ONE - BREAKDOWN OF COSTS**

**Table 1 –Analysis of 2016/17 Spend across Work Streams**

<b>Area of Spend</b>	<b>Actual (% of total) \$</b>	<b>Budget (% of total) \$</b>	<b>Variance \$</b>
Project Management	229,977 (8%)	257,300 (6%)	27,323
Genetic Dev	603,927 (20%)	789,501 (20%)	185,574
Farming Systems	1,483,158 (49%)	1,430,500 (36%)	(52,658)
Market Insights & Dev	545,429 (18%)	854,207 (21%)	308,779
Product Dev	187,724 (6%)	684,643 (17%)	496,919
<b>Total</b>	<b>3,050,215</b>	<b>\$4,016,152</b>	<b>965,937</b>

**Table 2 –Analysis of 2017/18 Spend across Work Streams**

<b>Area of Spend</b>	<b>Actual (% of total) \$</b>	<b>Budget (% of total) \$</b>	<b>Variance \$</b>
Project Management	224,412 (4%)	257,300 (4%)	32,888
Genetic Dev	500,954 (8%)	631,591 (11%)	130,638
Farming Systems	4,179,806 (69%)	3,899,075 (67%)	(280,731)
Market Insights & Dev	697,176 (11%)	662,332 (11%)	(34,844)
Product Dev	460,268 (8%)	347,623 (5%)	(112,645)
<b>Total</b>	<b>6,062,616</b>	<b>5,797,921</b>	<b>(264,694)</b>



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**APPENDIX TWO: OVERALL ASSESSMENT OF PGP FINANCIAL MANAGEMENT PROCESSES: SHEEP - HORIZON THREE**

Process	Key conclusions and observations
<p><b>OVERALL ASSESSMENT OF FINANCIAL MANAGEMENT SYSTEMS</b></p>	
<p><b>The overall framework of financial management processes is satisfactory</b></p> <ul style="list-style-type: none"> <li>• The financial management processes and systems that Spring Sheep Dairy has in place relating to the Sheep - Horizon Three PGP programme appear to be working effectively. The day-to-day financial management practices for payment processing, bookkeeping etc. have operated throughout the life of the programme. The processes and systems in place for budgeting, forecasting, monitoring and reporting also appear to be operating effectively.</li> <li>• It is our view that Spring Sheep Dairy has sufficient, relevant and reliable records that adequately support programme spending and funding claims from MPI.</li> </ul>	
<p><b>Processes for creating funding claims and financial reports</b></p>	<p><b>Reporting processes are satisfactory</b></p> <ul style="list-style-type: none"> <li>○ The process for creating the funding claims and quarterly financial reports appears to be well established in Spring Sheep Dairy practices.</li> <li>○ The systems in place for accounting and financial record keeping seem to be well managed by the Spring Sheep Dairy Financial Controller on a day to day basis.</li> <li>○ There is effective segregation of duties and oversight of financial management appropriate for the size of the organisation.</li> </ul>
<p><b>Processing of payments</b></p>	<p><b>Payment processing practices are satisfactory</b></p> <ul style="list-style-type: none"> <li>○ The systems for making payments and processing creditors look to be consistent with the expectations that we would have of any organisation of a similar size and complexity.</li> <li>○ There are clear financial delegations in place for approving spending.</li> </ul>
<p><b>Processes for PGP cost allocation (e.g. staff time based costs, travel costs)</b></p>	<p><b>Processes for allocating costs to the programme are satisfactory</b></p> <ul style="list-style-type: none"> <li>○ The organisation has adequate processes to ensure accurate recording and allocation of costs to the programme.</li> <li>○ There is appropriate documentation that provides an audit trail to support all charges made against the programme.</li> </ul>

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<b>Process</b>	<b>Key conclusions and observations</b>
<b>Budgeting</b>	<p><b>Budgeting processes are satisfactory</b></p> <ul style="list-style-type: none"> <li>○ There is a process in place for developing the annual plan budget, with the right level of engagement of the right people (i.e. Programme Manager and work stream leads) tasked in managing the various programme streams.</li> <li>○ The budgeting tools being used are appropriate to the size and value of the funds being managed.</li> <li>○ There is appropriate oversight, monitoring and reporting on how the programme is tracking against the budget and annual plan.</li> </ul>
<b>Forecasting</b>	<p><b>Forecasting systems are satisfactory</b></p> <ul style="list-style-type: none"> <li>○ The work stream managers and Programme Manager have responsibility for the process. The process Spring Sheep Dairy have in place is consistent with expectations that we would have of any organisation of a similar size and complexity.</li> <li>○ There are various points during the year where budgets are re-assessed against actual spending. There is an appropriate review process in place. There are three reforecasts during the year which provide sufficient opportunity to reassess progress and spending.</li> <li>○ There is also monthly variance analysis of actual and budget which provides a detailed assessment of variances.</li> </ul>
<b>Evidence to support partners funding claims</b>	<p><b>There is satisfactory evidence to support funding claims made by Spring Sheep Dairy to MPI</b></p> <ul style="list-style-type: none"> <li>○ The amounts being reported as actual cash costs are supported by adequate, complete and reliable documentation and records.</li> <li>○ The costs that are being claimed back by Spring Sheep Dairy from MPI are reasonable and relevant to the activities undertaken and as part of the programme.</li> </ul>