

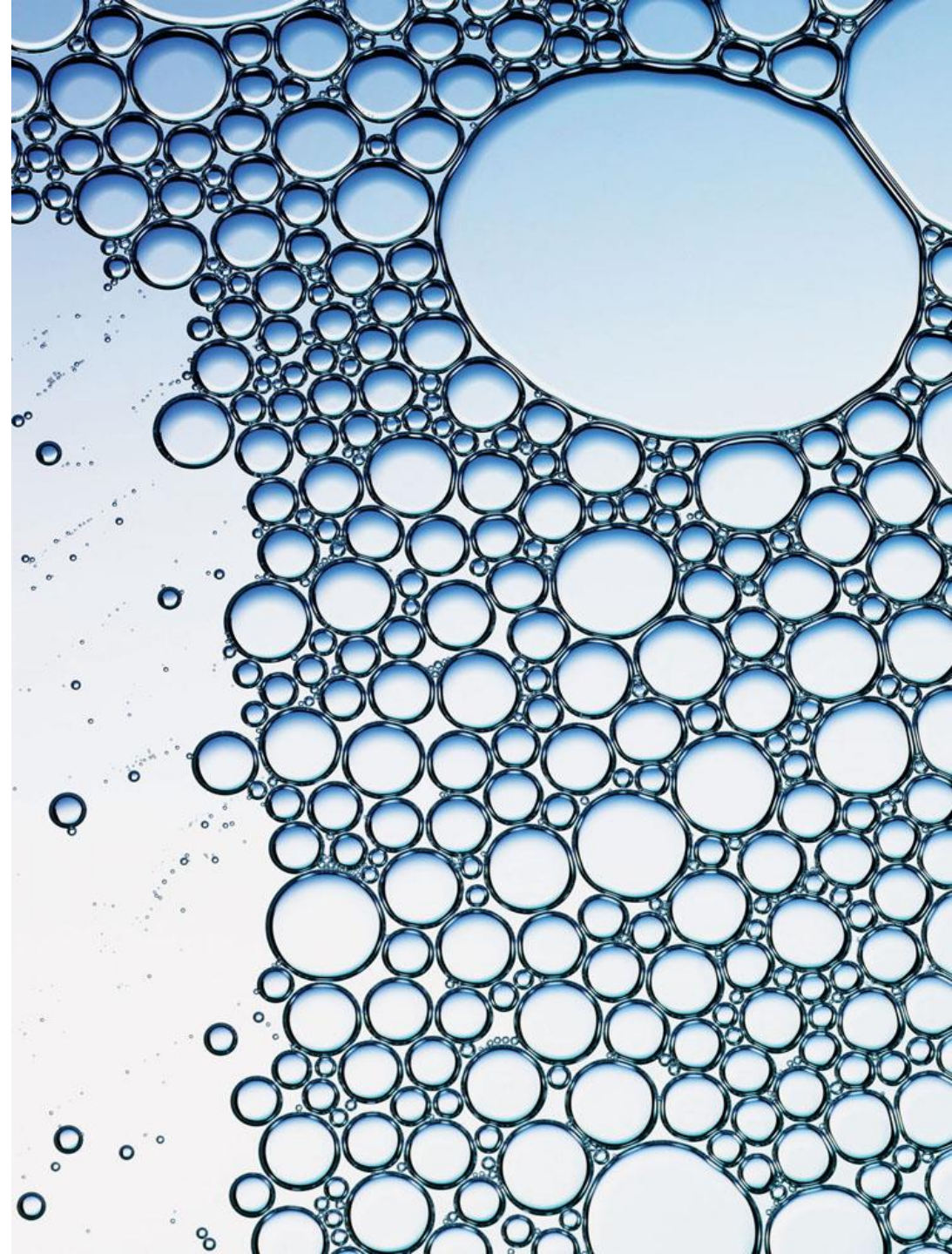


Corporate Finance

Environmental Protection
Authority
Fiscal Review

19 December 2014

Strictly private and confidential



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In this Report capitalised terms have the meaning given to them as defined below:

\$	New Zealand dollars	ICT	Information and Communication Technology
BASS	Better Administrative and Support Services	m	Million
BAU	Business as usual	Maori Advisory Committee	Ngā Kaihautū Tikanga Taiao
BOI	Board of Inquiry	MED	Ministry of Economic Development
CCR Act	The Climate Change Response Act 2002	MfE	Ministry for the Environment
Deloitte	Deloitte Touche Tohmatsu	MPI	Ministry for Primary Industries
EEZ	Exclusive economic zone	NSP	Nationally significant proposal
EEZ Act	The Exclusive Economic Zone and Continental Shelf Act 2012	NZEUR	New Zealand Emission Unit Register
ELT	Executive Leadership Team	PP&E	Property, plant and equipment
EPA	Environmental Protection Authority	Resource Management Act	The Resource Management Act 1991
ERMA	Environmental Risk Management Authority	SPE	Statement of Performance Expectations 2014-15
ETS	Emissions Trading Scheme		
FYXX	Financial year ended 30 June 20XX		
HSNO	Hazardous substances and new organisms		
HSNO Act	The Hazardous Substances and New Organisms Act 1996		

Executive Summary

Overall Conclusion

- The level of funding required by an organisation to effectively deliver on its strategic objectives depends on two primary factors:
 - The outputs mandated to be delivered hence the resources, systems and tools required to produce the services – for example, some of these may be stipulated in legislation, while others may be more discretionary in nature to deliver on policy decisions.
 - The operating model chosen and implemented and the level of efficiency that is able to be achieved in delivering the outputs.
- As the EPA is primarily a regulatory authority, there is a relatively limited degree of discretion that can be applied with regard to outputs. From our discussions with EPA senior management there would appear to be some discretion in relation only to:
 - The timeliness of delivery of outputs where this is not mandated by legislation (e.g. reassessment of hazardous substance rulings).
 - The level of investment the EPA puts into development of self-assessment capabilities and hence into a process of continuous improvement to fully deliver on the government's vision for the EPA as a key environmental protection agency.
- Beyond these semi-discretionary activities, EPA's choices are largely limited to those relating to its operating model (organisation structure, team sizes and skillsets, systems and tools, suppliers).
- Based on our enquiries we have concluded that the EPA appears to have the necessary funding to deliver its non-discretionary legislated activities.
- However we note one important caveat to this conclusion which relates to those activities which are wholly or primarily funded through fees charged to third party applicants on a cost-recovery basis. In the case of these activities – most notably Exclusive Economic Zone (EEZ) and Nationally Significant Project (NSP) applications – we consider that some changes are necessary to the funding framework to smooth out the funding profile. This is discussed further below.
- In relation to the semi-discretionary activities described above, we consider that there may be a business case for some additional funding to enable investment in enhanced long term planning and strategic thinking.

Cost Recovered Activities

- The EPA is able to cost recover time directly recorded against certain activities, based on time recorded in timesheets (or charged to the EPA by contractors) multiplied by hourly rates, plus disbursements. We understand that the hourly rates were calculated to include a level of overhead allocation as well as direct staff costs however we observe the following:
 - The activities for which costs are recovered all relate to application processes – in other words the initial activities triggered or consequential upon an application. There is no provision for recovery of the whole of life spectrum of costs surrounding applications including for example costs preceding receipt of applications or costs arising after a decision has been reached.
 - We have not been able to accurately assess the extent to which the current fees are recovering the full costs relating to the activities which are notionally cost-recovered, however we consider it likely that the full overhead costs – such as investment in systems – are not being fully recovered through the rates charged.
 - Because there is no mechanism to smooth funding, when levels of activity are low permanent employees must be redeployed. This structural weakness in the cost-recovery model deployed needs to be addressed or it will ultimately undermine both the long run financial sustainability of the EPA, or its performance due to high rates of staff turnover.
 - Possible responses to this problem include charging fees for a wider range of services, increasing the hourly rates charged to recover a greater proportion of true overheads (potentially in conjunction with a memorandum account to enable investment in systems), or increased levels of Crown funding.
- In particular we note that the EPA initially absorbed the cost of EEZ within the baseline by agreeing with MfE to run a deficit position at the end of FY14 during the implementation phase. In FY15 a one-off appropriation has been given to the EPA to cover EEZ activity.
- Further work needs to be undertaken to determine what level of costs are currently being recovered and how best to gain a better match between revenues and costs. This could include adaptations to the operating model to ensure that when staff are not engaged in application processing, they can be redeployed onto activities which best utilise their expertise.

Executive Summary

Capacity for Long Term Planning and Reinvestment

- In our view the EPA is not currently investing sufficiently in important long term planning and strategic thinking, such as the ability to invest time in learning from past experiences, the strategic outlook plan, and forward financial planning. We have not assessed if the EPA has existing capability in this space or if new resources are required.
- It is not within our mandate to consider in any detail the efficiency or effectiveness of the EPA's current operating model, however we recommend that the EPA:
 - Invests in strategic thinking to take the organisation to the next level.
 - Considers investing in additional people in policy and legal with a strategic outlook and focus.
 - Explore the opportunity to use staff across NSP, EEZ and other service but retain the right staff and skill mix.
 - Dedicates time and resource to consult with industry to determine the pipeline of work within all operational arms of the entity.
 - Considers the complexity in budgeting within EEZ and NSP while giving these teams the opportunity to reflect and apply "lessons learned". The EPA should consider whether the cost recovery approach for team budgets is still the most appropriate method.
 - Revisits the prosecution and appeals fund for EEZ taking a longer term view and the ability for the funds to be used is appropriately aligned with the service need. The funds should have appropriate governance, set by the EPA Board.
 - Builds on the recommendations from the self review undertaken in September 2014 which has an emphasis on planning to get the recommendations underway/completed.
 - Benchmark their activities against other entities that undertake comparable services (such as Commission of Inquiry and Royal Commission of Enquiry for NSPs).

Financial Management

- We strongly recommend prioritisation of the successful implementation of the new FMIS and consider additional person/capability in the finance team with a focus on finance strategy to inform executive team decision-making.
- The EPA needs to maintain a sufficient level of working capital. We understand that the EPA partly uses balance sheet funding for capital projects. The EPA must take care to maintain cash reserves to cover business as usual activities and set an expectation of this level of cash.
- The EPA should revisit fees and rates that are able to be charged periodically to test that the appropriate costs of the EPA are being recovered. This is particularly important following investment in new systems and processes or organisational change.
- The EPA should revisit the hourly rates applied to the Maori Advisory Committee against the SSC guidelines and see if the rates are still applicable given the expanded services and changing role of this board over the past three years. We were specifically requested by the EPA to review the Maori Advisory Committee fees as these were considered low.
- Upon revisiting the fees for activities, the EPA should consider taking a holistic approach and consider an approach to recover the whole of system costs for activity, not just the application component.
- The pricing tool created by the EPA finance team should be used and continually developed to determine the expected budget and effort required at different stage of the NSP process. As more decisions are made, a similar process should be undertaken for EEZ hearings.

Introduction

Purpose of Report

- In accordance with the Statement of Work dated September 2014, we have been requested by the Ministry for the Environment (MfE) to prepare a report on the fiscal sustainability of the Environmental Protection Authority (EPA), including a high-level assessment of its operational efficiency and the impact of such efficiency on funding needs.
- Our Report will be prepared for this purpose and no other. The scope and basis of our work was limited to the matters set out in Appendix 1 of this report. We make no comment as to the adequacy of the scope.

Limitations of Scope

- In undertaking our assessment, we have relied upon and assumed without independent verification, the accuracy and completeness of all information that is available from public sources and all information that was provided to us by the EPA, including unaudited information. We have not corroborated the information received and, to that extent, the information may not be reliable. We accept no responsibility for matters not covered by the Report or omitted due to the limited nature of our review. We have evaluated the information provided through analysis, enquiry and examination for the purposes of forming our assessment. However, we have not verified the accuracy or completeness of any such information nor conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of the EPA. We do not warrant that our enquiries have identified or revealed any matter which an audit, due diligence review or extensive examination might disclose.
- The key findings, set out in the section titled 'Executive Summary', highlight the most significant matters arising out of our Report. They are not meant to be exhaustive and need to be read in conjunction with the rest of the Report. The Report may also include some suggestions as to how the MfE or the EPA may want to mitigate or respond to a risk associated with a finding from our assessment. Our suggestion as to how the MfE or the EPA may want to respond to these risks is provided as general information only. Where we have made a suggestion about how to mitigate a risk we are not responsible for whether, or the way in which, that suggestion is implemented.

Report Use

- The findings from the procedures that we have conducted on your behalf were initially reported to you solely for the purpose of identifying potential issues that may be of interest to MfE. However we have granted permission to MfE to publish the findings of our assessment on MfE's website. However we accept or assume no duty, responsibility or liability to any party, other than you, in connection with the reports or this engagement, including without limitation, liability for negligence in relation to the factual findings expressed or implied in the reports.

Report Conventions

- Financial years (FY) represented in this report represent the twelve months ended 30 June.
- Figures presented in this report are in New Zealand dollars (\$) unless otherwise stated. Amounts may be expressed in terms of millions of dollars (m), while figures below one million dollars (\$1.0) are rounded to the nearest thousand. Tables have not been adjusted to correct minor rounding errors.

Disclaimer

- This report has been prepared with care and diligence and the statements and conclusions in this report are given in good faith and in the belief, on reasonable grounds, that such statements and conclusions are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of the EPA will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of the EPA and its management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.
- We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of this assessment to the extent that such errors or omissions result from the reasonable reliance on information provided by others or assumptions disclosed in this report or assumptions reasonably taken as implicit.

Description of Information Provided

- We have been supplied with the following documents:
 - EPA Annual Report for the year ended 30 June 2012, 2013, 2014 (draft)
 - EPA Statement of Performance Expectations 2014-15
 - EPA Statement of Intent for 2012-17, 2013-17 and 2014-18
 - Self-review of the EPA 2014
 - EPA Benchmarking Report 2013 and 2014
 - Cost Recovery Policy for NSP and EEZ
 - Cost Recovery Provisions in Legislation EPA Administers
 - EPA Output Agreement for 1 July 2012 to 30 June 2013 and 1 July 2013 to 30 June 2014
 - Allocation of Costs to Outputs
 - EPA Cost Recovery Workshop notes for EEZ, ETS, HSNO, NSP, Ozone Imports and Exports
 - Finance reports to 31 May; 30 June; 31 July and 31 August 2014
 - EPA Information from the MfE 4 Year Plan
 - EPA Cost Allocation Presentation
 - EPA organisational chart
 - EPA Information and Communication Technology (ICT) Strategic Plan 2013 -2016
 - Assessment of Costs to Applicants of the Board of Inquiry Process: Selected NZ Transport Agency Projects

- We have been supplied with the following workbooks:
 - Proposed cost recovery rates for NSP and EEZ
 - HSNO Applications Modelling
 - NSP Applications Model
 - TRS Pivot
 - Activity Pivot

- In addition, we requested but were not supplied with the following documents:
 - Detailed forecast profit and loss statements for FY16 and beyond and the associated breakdown of revenue and expenditure into output classes
 - Detailed breakdown of forecast fees revenue and Crown funding for FY16 and beyond
 - Forecast application volumes for each function
 - Forecast FTE numbers

Approach

- In accordance with the Statement of Work agreed to with MfE, we have carried out the following tasks building on conversations held with key stakeholders:
 - Completed a financial review of the actual results from FY12, FY13, FY14 and budgeted results for FY15 and normalised each financial year for any anomalies;
 - Understood the key drivers of historic and forecast performance including changes to: the nature of the EPA's activities, including policy driven changes to output categories; operating funding streams; key cost categories and the drivers of these costs; balance sheet and cashflow changes and management policies; and any other significant issues that arose from the stakeholder interviews;
 - Analysed the financial model(s) that support financial forecasts and discussed key areas of judgement within forecast figures and the basis for assumptions made with respect to these areas;
 - To the extent possible, assessed costs at an output category level to better assess the EPA's performance efficiency;
 - Understood the nature and extent of operational efficiency and continuous improvement initiatives underway and planned;
 - Assessed alignment of financial forecasts with articulated future service performance including project costs and potential changes in organisational scope;
 - Identified any areas of concern and discussed these; and
 - Considered the findings of the parallel work stream for the cost recovery practices.
- Note we have assumed that we will not undertake any detailed financial modelling of future revenues during the financial review section. We have assumed that the EPA will provide us with forecast information of future revenue and we will review outputs but not undertake the modelling.

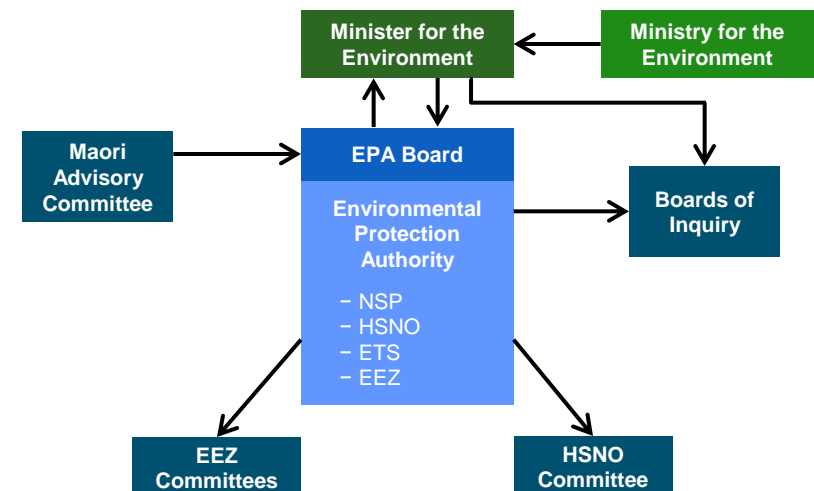
Organisation Information

History & Background

- The EPA was established as a Crown Agent on July 1 2011 under the EPA Act 2011 and incorporated functions from the former Environmental Risk Management Authority (ERMA), MfE and the Ministry of Economic Development (MED). The EPA have legislated responsibilities including:
 - Managing applications for nationally significant proposals (NSP) under the Resource Management Act 1991 (the Resource Management Act);
 - Regulation of hazardous substances and new organisms (HSNO) under the Hazardous Substances and New Organisms Act 1996 (the HSNO Act);
 - Managing applications for ozone-depleting substances and hazardous waste under the Ozone Layer Protection Act 1996 and the Imports and Exports Act 1988;
 - Administration of the New Zealand Emissions Trading Scheme (ETS) under the Climate Change Response Act 2002 (the CCR Act); and
 - Promoting the sustainable management of the natural resources of the exclusive economic zone (EEZ) and continental shelf under the Exclusive Economic Zone and Continental Shelf Act 2012 (the EEZ Act).
- The EPA began operations in FY12 as the single national-level environmental regulator. Prior to the formation of the EPA, the management of applications for NSPs was the responsibility of MfE; the regulation of HSNO was the responsibility of ERMA; and the administration of the ETS was shared between the Ministry for Primary Industries (MPI), MED and MfE. The EEZ function is a new service which was implemented in FY14.
- An organisational chart is shown overleaf which summarises the EPA's various work functions and the allocation of staff to each function. Note that the certain activities within the Compliance and Enforcement team were transferred to WorkSafe on 1 September 2014, including Crown funding. This included responsibilities for the management of the test certification regime, promoting industry awareness of compliance obligations, and setting controls on the use of substances in the workplace. The transfer of these activities will be offset by new enforcement activity which includes the enforcement of obligations on importers and manufacturers as well as enforcement of prohibitions relating to persistent organic pollutants.

Governance

- The EPA is governed by the EPA Board which has between six and eight members and is appointed by the Minister for the Environment. The EPA Board is responsible for the governance of the organisation including setting strategic direction and monitoring performance and is currently chaired by Kerry Prendergast.
- The EPA is supported and advised by Ngā Kaihautū Tikanga Taiao (the Maori Advisory Committee) who are responsible for helping to incorporate Maori perspectives and Treaty of Waitangi principles in its decision making. The Maori Advisory Committee has up to eight members who are appointed by the EPA Board.
- In addition, the EPA appoints and is supported by decision-making committees for specific functions such as the HSNO Decision-making Committee and the EEZ Decision-making Committees. An independent Board of Inquiry (BOI) is appointed by the Minister for the Environment to make decisions on NSPs.
- The diagram below summarises the structure of the EPA.



Historic Financial Analysis

EPA Historical Financial Performance

\$000	FY12A	FY13A	FY14A
Revenue			
Revenue from the Crown	18,947	22,137	22,492
Fees revenue	<u>4,771</u>	<u>5,744</u>	<u>11,947</u>
Total revenue	23,718	27,881	34,439
Operating expenditure			
Personnel costs	(11,316)	(12,577)	(15,315)
Board remuneration	(195)	(195)	(201)
Nga Kaihautu Tikanga Taiao remuneration	(71)	(87)	(116)
HSNO Committee remuneration	(65)	(115)	(81)
EEZ Decision-making Committee remuneration	-	-	(389)
Boards of Inquiry remuneration	(834)	(1,031)	(2,312)
EEZ Decision-making Committee expenses	-	-	(1,292)
Boards of Inquiry expenses	-	(2,483)	(3,844)
Other expenses	<u>(9,071)</u>	<u>(8,927)</u>	<u>(10,789)</u>
Total operating expenditure	(21,552)	(25,415)	(34,339)
EBITDA	2,166	2,466	100
Depreciation and amortisation expense	<u>(1,165)</u>	<u>(1,516)</u>	<u>(1,546)</u>
EBIT	1,001	950	(1,446)
Interest income	<u>182</u>	<u>356</u>	<u>329</u>
Net surplus / (deficit)	<u>1,183</u>	<u>1,306</u>	<u>(1,117)</u>

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- The table above summarises the profit and loss statements of the EPA for FY12, FY13 and FY14. The FY14 figures have been sourced from the EPA's draft FY14 annual report and are subject to audit (due to be completed in October 2014).

- The EPA receives revenue in the form of Crown funding, fees revenue, and interest income.
 - The EPA is primarily funded through revenue received from the Crown, which increased year-on-year from \$18.9m in FY12 to \$22.5m in FY14. Crown revenue was used to fund the majority of the EPA's expenditure, which increased across each function by output class over the historical period as discussed on page 25.
 - The EPA did not receive additional Crown funding in relation to responsibilities it was given under the EEZ Act in FY14 as it was thought the majority of the function could be cost recovered.
 - Fees revenue includes application and cost recovery fees related to EPA's services delivered under the HSNO Act, the Resource Management Act, and the EEZ Act. Noticeably, fees revenue doubled from FY13 to FY14 following the implementation of EEZ assessments and its associated recovery fees, as well as an increase in fees recovered from NSPs.
 - Interest income was a minor source of funding in each year of the review and increased from \$182,000 in FY12 to \$329,000 in FY14.
- Total operating expenditure increased year-on-year from \$21.6m in FY12 to \$34.3m in FY14 reflecting increases in most expense lines.
 - The rise in salaries and wages was broadly in line with the increase in FTEs, which rose from 145.5 FTE in FY12 to 179.5 FTE in FY14. The additional FTE are discussed on page 14. The EPA's predecessor ERMA had salaries and rates that were lower than industry average and have been increased over the past three years to remain competitive.
 - Total board remuneration remained relatively steady from FY12 to FY14 and includes remuneration for the EPA Board, the Maori Advisory Committee and the HSNO Committee. A decision making committee for EEZ related matters was established in FY14 which resulted in remuneration costs of \$389,000. We understand the rates for the board have not been reset since the EPA's inception.
- Note that revenue and expenditure relating to the ETS function was only with the EPA for seven months during FY12.

Historic Financial Analysis (cont)

EPA Historical Financial Performance

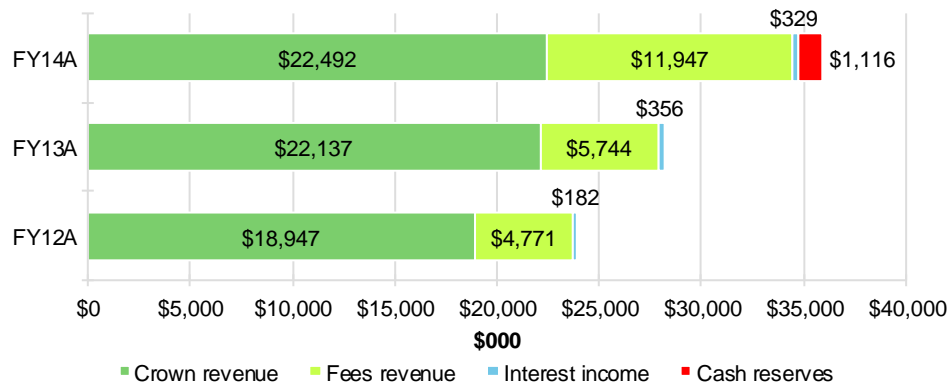
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Net surplus / (deficit)	<u>1,183</u>	<u>1,306</u>	<u>(1,117)</u>

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- The BOI remuneration doubled from \$1.0m in FY13 to \$2.3m in FY14 reflecting increased NSP activity over the period. This reflected the Basin Bridge and the Ruataniwha Water Storage proposals during FY14 which resulted in extended hearing times and eventually cost more than anticipated. The BOI members are paid by the EPA but are then fully on-charged to the applicant.
- Other expenses included staff travel, operating lease, consultancy, and BOI and EEZ Decision-making Committee expenses. BOI expenses were \$3.8m in FY14 having increased in line with NSP activity while consultancy expenses were \$4.7m in FY14 following a dip in FY13.
- The EPA produced a net surplus of \$1.2m in FY12 and \$1.3m in FY13, and returned \$1.0m to the Crown in FY13. The implementation of the EEZ function in FY14 was a major contributor to the deficit of \$1.1m incurred in that period, as well as the upgrade of the New Zealand Emission Unit Register (NZEUR). A deficit of approximately \$2m was budgeted for in FY14 and agreed to with MfE.

Funding Analysis

EPA Funding Streams



Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- The chart above summarises the composition and change in funding received by the EPA from FY12 to FY14 from the Crown and from fees collected from industry.

EPA Breakdown of Fees Revenue

\$000	FY12A	FY13A	FY14A
Hazardous Substances application fees	594	499	426
New Organisms application fees	89	95	76
NSP cost recovery fees	3,919	5,132	8,611
EEZ cost recovery fees	-	-	2,741
Other fees and revenue	169	18	93
Total fees revenue	4,771	5,744	11,947

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- The EPA is heavily reliant on Crown revenue which contributed a total of \$63.6m of funding from FY12 to FY14. Although the level of Crown funding increased year-on-year, the proportion of Crown funding to total revenue fell from an average of 79% in FY12 and FY13 to 65% in FY14 due to an increased proportion of fees revenue. Cash reserves of \$1.1m were used to fund the net deficit in FY14.
- The EPA charges fees as specified by each of the relevant Acts. It is worth noting that there is no consistent over-riding fees framework, with some fees set in legislation while others are set by the EPA. Nonetheless a consistent principal is that activities which provide a clearly defined private benefit will be cost recovered, while benefits accruing to the public will be funded through Crown revenue. Activities with mixed public/private benefit are split by set ratios between the private and public sector (e.g. 80% private and 20% public in EEZ).
- EPA fees are charged solely to recover the cost of specific activities, namely applications-related activities. No cost recovery is applied to other activities which are nonetheless critical to the integrity of the legislation regulated by the EPA such as reassessments, compliance functions and policy development.
- The table opposite summarises the breakdown of fees revenue from FY12 to FY14. Application fees from hazardous substances and new organisms progressively declined in line with the fall in application volumes as a result of an increase in the emphasis on using group standards. The approval of the four Vet Med group standards resulted in the reduction in the number of rapid assessment and non-notified applications. It is of note that HSNO fees were last set in October 2010.
- Cost recovery fees from NSPs were a significant driver of total fees revenue, having increased by \$4.7m from FY12 to FY14 as a result of increased NSP activity, in particular the Basin Bridge proposal and the Ruataniwha Water Storage proposal which cost more than anticipated and were long projects.
- Furthermore, the implementation of the EEZ function resulted in additional cost recovery fees of \$2.7m in FY14 which included the Chatham Rock Phosphate and Trans Tasman Resources projects.

Personnel Analysis

FTE Analysis

	FY12A	FY13A	FY14A
Function			
NSP	31.6	26.5	20.2
Hazardous Substances	23.7	21.7	25.0
New Organisms	8.0	9.0	6.0
ETS	16.3	23.0	23.7
EEZ	-	-	14.0
Compliance	10.3	14.4	17.5
Corporate	24.6	24.6	28.4
Policy and Legal	20.0	20.0	31.7
Senior Management	11.0	11.0	13.0
Total FTE	145.5	150.2	179.5
Personnel costs (\$000)			
Salaries	10,510	11,680	14,251
Other personnel costs	806	897	1,064
Total personnel costs (\$000)	11,316	12,577	15,315
Average salary per FTE (\$000)	72.2	77.8	79.4
Average personnel costs per FTE (\$000)	77.8	83.7	85.3

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), management information

- The table above summarises the number of FTE in each EPA function from FY12 to FY14, as well as an analysis of average personnel costs per FTE. Note that the table opposite reflects the hours allocated through the EPA time recording system and is not specifically related to the group structure within the EPA.

- The EPA staff are responsible for supporting the EPA board in carrying out its statutory functions and are responsible for delegated decision making in a number of areas. The total number of FTEs has grown from 145.5 in FY12 to 179.5 in FY14 as the organisation has expanded in scope.
- The number of FTEs sitting in operational functions such as NSP, Hazardous Substances, New Organisms, ETS, EEZ and Compliance represent approximately 60% of the total FTEs from FY12 to FY14. The remaining FTEs are employed in various organisational support functions such as Corporate, Policy and Legal and Senior Management. The Benchmarking Administrative and Support Services (BASS) Report for the Financial Year 2012/13 indicated an average of 8.3% of total FTE were employed in HR, Finance, ICT, Procurement or Communications. The BASS report covers 27 public sector agencies.
- The NSP, Hazardous Substance and ETS functions are the largest drivers of FTEs in terms of the operational functions. FTEs employed in the NSP function declined from 31.6 FTE in FY12 to 20.2 FTE in FY14 due to a lower number of hearings. However, the cost of these hearings increased substantially due to longer hearing times for two of the projects in FY14. Once staff are assigned to a NSP, they continue with that project until completion. During the hearing process, staff may work very long hours to get the job done.
- The establishment size of the ETS group was 24 when it was formed in 2011 and although some team roles have changed, the establishment size has not. In the first year of the EPA's operations there was a conversion of temporary workers and contractors to permanent staff. Subsequent to that there have been fixed term appointments to ensure BAU can be undertaken while the NZEUR redevelopment project is underway.
- The Compliance team's role is expanding to include enforcement of HSNO and EEZ. However, a portion of the compliance team activity was transferred to WorkSafe on 1 September 2014. This included responsibilities for the management of the test certification regime, promoting industry awareness of compliance obligations, and setting controls on the use of substances in the workplace. The overall size of the team is envisaged to reach around 17-18 FTE, mostly Crown funded.

Personnel Analysis (cont)

FTE Analysis

	FY12A	FY13A	FY14A
Function			
NSP	31.6	26.5	20.2
Hazardous Substances	23.7	21.7	25.0
New Organisms	8.0	9.0	6.0
ETS	16.3	23.0	23.7
EEZ	-	-	14.0
Compliance	10.3	14.4	17.5
Corporate	24.6	24.6	28.4
Policy and Legal	20.0	20.0	31.7
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Total personnel costs (\$000)	11,316	12,577	15,315
Average salary per FTE (\$000)	72.2	77.8	79.4
Average personnel costs per FTE (\$000)	77.8	83.7	85.3

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), management information

- The number of FTEs employed in Corporate, Policy and Legal and Senior Management were constant over FY12 and FY13, but all increased in FY14. In particular, Policy and Legal grew by 11.7 FTE due to the implementation of the EEZ function. The transfer of certain hazardous substance regulatory responsibilities to WorkSafe New Zealand occurs in FY15 but will be offset by new enforcement activity such as enforcement of obligations on importers and manufacturers as well as enforcement of prohibitions relating to persistent organic pollutants.
- The Policy and Legal team is an internally focused team that has been undergoing a rolling restructure with the team growing to 31.7 FTE. The team undertakes the policy and legal function of the EPA, which comprises the following:
 - Regulatory legal, a decision making team with a compliance outlook of ~9 FTE (activity is demand driven). The team is funded mostly from the appropriation offering stability, some cost (~30%) is fixed term (pipeline driven) and consultants (specialist skills, short term activity).
 - Regulatory policy, a team that undertakes the policy cycle work, offering feedback and technical support to MfE. The team provides operational policy input.
 - Strategy and risk, a team that develops and implements internal and external organisation strategies and frameworks. This team has been in place since October 2013. As noted elsewhere EPA currently has limited capacity and capability to develop the strategies that will enable it to operate as a learning organisation focused on delivering the government's aspirations for environmental protection. EPA considers that an additional 2 FTE are required to support the organisation develop this capability.
 - Since 1 September 2014 the Regulatory Information and Communications team has been fully in place. This team focuses on implementing corporate communications across the EPA and the provision of regulatory information to the public and industry.
 - This team is assisting with the transition of hazardous substances activities to WorksafeNZ

Personnel Analysis (cont)

Employee Remuneration

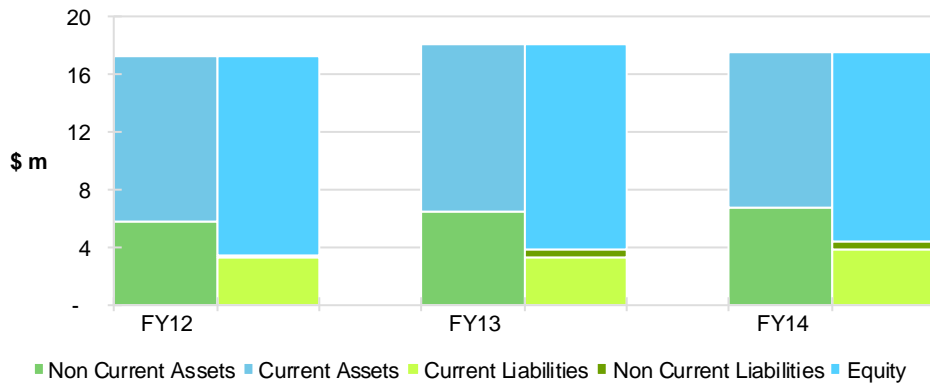
\$000	Number of employees		
	FY12A	FY13A	FY14A
100-109	11	7	9
110-119	7	12	7
120-129	-	-	3
130-139	-	1	4
140-149	1	1	-
150-159	3	1	-
160-169	1	2	1
170-179	-	1	1
180-189	1	2	3
190-199	-	-	1
270-279	1	-	-
310-319	1	1	-
320-329	-	-	1
Total	26	28	30

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- Personnel costs represent the largest single operating expense for the EPA and are largely made up of salaries and wages. Other personnel costs are comprised of employer contributions to defined-contribution plans, employee entitlements and other staff-related costs. The average salary per FTE was \$72,200 in FY12, which increased to \$79,400 in FY14 which reflected a growing number of employees with total remuneration above \$100,000.
- The table opposite summarises the number of employees in each salary band over \$100,000 from FY12 to FY14.
- The number of employees earning over \$100,000 has increased from 26 in FY12 to 30 in FY14.
- There has been a general change in the mix of seniority of employees as the number of employees with remuneration above \$160,000 has increased from 4 in FY12 to 7 in FY14 due to changes in organisational structure.
- A significant portion of personnel costs are covered by the revenue received from fees. While the costs of staff are recoverable from third party revenue when working on projects, the time incurred when the staff are not busy is not able to be recovered. We understand that the fee rates charged do not account for this staff “down” time.
- To partly manage the lumpy nature of NSP and EEZ processes, the EPA is able to draw upon fixed term contractors. These contractors need to be affordable within the rate cards for NSP and EEZ.
- The need to hold in-house a certain base level of expertise to support operational excellence creates a tension with the cost recovery model which assumes close to full cost-recovery for certain functions which directly support management of NSP and EEZ applications. This is because these staff are unable to be fully utilised on cost-recovered activities all of the time.
- While these resources could be effectively redeployed during down-time, this still requires funding from another source. Some Crown funding can be made available when there are vacancies in other parts of the organisation however reliance on this form of funding is risky over the longer term.

Balance Sheet Analysis

Structure of EPA Balance Sheet



Source: Audited financial statements (FY 12-FY 13), unaudited draft financial statements (FY 14)

- The chart opposite presents a breakdown of the structure of the EPA's balance sheet from FY12 to FY14. The structure of the EPA's balance sheet remained relatively stable with total assets increasing slightly overall from \$17.3m in FY12 to \$17.5m in FY14.
- The majority of the EPA's total assets were comprised of current assets which consisted of cash, receivables, investments, and prepayments.
- Cash and cash equivalents decreased from \$6.5m in FY12 to \$2.1m in FY14. This reflected a reallocation of funds into term deposits, balance sheet funding into the development of the ETS register, and funding the net deficit reported in FY14. Investments represent term deposits which fluctuated from \$4.0m in FY12 to \$6.5m in FY13 before decreasing to \$4.4m in FY14.
- Non-current assets were comprised of property, plant and equipment (PP&E) and intangible assets. PP&E comprised of computer hardware, furniture and fittings, office equipment and leasehold improvements and remained relatively stable averaging \$2.5m from FY12 to FY14. Intangible assets relate to acquired software pertaining to the ETS Register, which increased from \$3.5m in FY12 to \$4.3m in FY14 as development in the register progressed. The register will be fully developed and operational in FY15.
- Non-interest bearing creditors and other payables represented the largest liability on the balance sheet and increased from \$1.9m in FY12 to \$2.6m in FY14 as a result of an increase in accrued expenses at year end.
- Equity comprises of general funds which includes capital contributions from the Crown (\$3.8m), assets transferred from MED (\$5.8m) and assets transferred from ERMA (\$3.1m). Total equity increased from \$13.9m in FY12 to \$14.2m in FY13 following a reported net surplus of \$1.3m and a capital repayment of \$1.0m to the Crown in FY13. Total equity then decreased to \$13.1m in FY14 as a result of the net deficit of \$1.1m reported in FY14.
- The EPA does not have any debt and did not enter into any borrowing or financial lease arrangements from FY12 to FY14. Furthermore, the EPA were not aware of any contingent liabilities as at balance date FY14.

Actual v Budget Analysis

EPA Actual vs. Budget Analysis

\$000	FY12A	FY12B	Var	FY13A	FY13B	Var	FY14A	FY14B	Var
Revenue									
Revenue from the Crown	18,947	20,047	(1,100)	22,137	23,637	(1,500)	22,492	22,492	-
Fees revenue	4,771	24,620	(19,849)	5,744	7,492	(1,748)	11,947	9,602	2,345
Total revenue	23,718	44,667	(20,949)	27,881	31,129	(3,248)	34,439	32,094	2,345
Operating expenditure									
Personnel costs	(11,316)	(12,709)	1,393	(12,577)	(12,713)	136	(15,315)	(14,607)	(708)
Board remuneration	(331)	(369)	38	(397)	(371)	(26)	(398)	(392)	(6)
EEZ Decision-making Committee remuneration	-	-	-	-	-	-	(389)	(1,128)	739
Boards of Inquiry remuneration	(834)	(6,905)	6,071	(1,031)	(3,134)	2,103	(2,312)	(1,969)	(343)
Other expenses	(9,071)	(23,292)	14,221	(11,410)	(13,232)	1,822	(15,924)	(14,401)	(1,523)
Total operating expenditure	(21,552)	(43,275)	21,723	(25,415)	(29,450)	4,035	(34,338)	(32,497)	(1,841)
EBITDA	2,166	1,392	774	2,466	1,679	787	101	(403)	504
Depreciation and amortisation expense	(1,165)	(1,476)	311	(1,516)	(1,753)	237	(1,546)	(1,753)	207
EBIT	1,001	(84)	1,085	950	(74)	1,024	(1,445)	(2,156)	711
Interest income	182	84	98	356	74	282	329	140	189
Net surplus / (deficit)	1,183	-	1,183	1,306	-	1,306	(1,116)	(2,016)	900

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14)

- The table above provides a comparison of the actual (A) and budgeted (B) figures for FY12 to FY14.
- Var represents the dollar figure variance between the actual and budgeted results, and is defined as actual less budget figures. A positive variance represents additional income or a cost saving, whereas a negative variance denotes an income deficit or additional cost.

Actual v Budget Analysis

Summary

- The EPA's performance against budget has been mixed from FY12 to FY14. The EPA's financial performance is heavily demand-driven, particularly from the number of NSP applications received. In FY12, a total of 4 NSP applications were lodged with the EPA, while 5 were lodged in FY13. These were lower than what the EPA expected and budgeted for, explaining the majority of variances in the actual versus budgeted results. In FY14, although there was only 1 new application lodged with the EPA, the remaining applications in progress meant that NSP-related activity had increased.
- The large variances in FY12 also reflect uncertainties in budgeting as FY12 was the inaugural year of the EPA's operations. Although the FY13 and FY14 results better matched budgeted performance, significant variances arose throughout the historical period as the EPA moved through a transitional state which included the redevelopment of the ETS register and the implementation of the EEZ.
- Note that the EPA was budgeted to have a net surplus of nil in FY12 and FY13, and a budgeted net deficit of \$2.0m in FY14 due to the implementation of the EEZ.

Operating Revenue

- Total revenue varied significantly from budget in FY12, reflecting the initial year of transition and the uncertainty of financial performance in the EPA's first year of operation. Fees revenue was \$19.8m under budget as the EPA received less activity in the NSP applications. Revenue from the Crown was \$1.1m less than budgeted in FY12 as this funding was transferred to FY13.
- Total revenue was \$3.2m less than budget in FY13 due to lower than anticipated NSP applications. In FY14, the EPA received the EEZ function which had revenue from the TTR decision. In FY14, the EPA exceeded budgeted total revenue by \$2.3m due to greater revenue received from NSP applications.

Operating Expenditure

- Personnel costs were \$1.4m less than budgeted in FY12 due to staff vacancies from the initial transition period and cost reduction measures. This variance decreased in FY13, although staff vacancies meant that actual personnel costs were still \$136,000 below budget. Personnel costs exceeded budget by \$708,000 in FY14 owing to the employment of more temporary staff to work on NSPs and the employment of staff for the EEZ function.
- Board member remuneration varied slightly against budget being \$38,000 under budget in FY12, and \$26,000 and \$6,000 above budget in FY13 and FY14. The variance in FY13 reflects additional time spent on decision-making activities by the HSNO Committee, while variance in FY14 reflects more time spent on activities by the Maori Advisory Committee.
- BOI remuneration was \$6.1m and \$2.1m under budget in FY12 and FY13 respectively due to the lower number of NSP applications. In FY14, BOI remuneration exceeded budget by \$343,000 owing to more hearing days for NSP applications.
- The establishment of the EEZ Decision-making Committee in FY14 incurred remuneration expenses which fell below budget by \$739,000 reflecting a lower number of EEZ applications received.
- Other expenses included audit fees, staff travel, operating lease expense, EEZ Decision-making Committee expenses, BOI expenses and consultancy. Other expenses were \$14.2m below budget in FY12 and \$1.8m below budget in FY13 due to lower than expected activity, less consultant expenses, domestic travel and publication expenses. The reduction in these expenses followed the lower number of NSP applications received than anticipated. Other expenses exceeded budget by \$1.5m in FY14 due to increased consultancy, travel and publication expenses following the increased hearing days for NSPs.

Depreciation and Amortisation

- Depreciation and amortisation expense came in under budget for each of the periods analysed. This was largely attributed to the delays in the new premises project as well as the delay in the redevelopment of the ETS Registry and HSNO databases.

Forecast Financial Analysis

EPA Historical and Budgeted Financial Performance

\$000	FY12A	FY13A	FY14A	FY15B
Revenue				
Revenue from the Crown	18,947	22,137	22,492	24,977
Fees revenue	<u>4,771</u>	<u>5,744</u>	<u>11,947</u>	<u>11,274</u>
Total revenue	23,718	27,881	34,439	36,251
Operating expenditure				
Personnel costs	(11,316)	(12,577)	(15,315)	(16,752)
Other expenses	<u>(10,236)</u>	<u>(12,838)</u>	<u>(19,023)</u>	<u>(18,059)</u>
Total operating expenditure	(21,552)	(25,415)	(34,338)	(34,811)
EBITDA	2,166	2,466	101	1,440
Depreciation and amortisation expense	<u>(1,165)</u>	<u>(1,516)</u>	<u>(1,546)</u>	<u>(1,540)</u>
EBIT	1,001	950	(1,445)	(100)
Interest income	<u>182</u>	<u>356</u>	<u>329</u>	<u>100</u>
Net surplus / (deficit)	1,183	1,306	(1,116)	-

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), Statement of Performance Expectations 2014-15

- The table above summarises the EPA's historical financial performance for FY12 to FY14 and the budgeted performance for FY15B. The FY15B figures are sourced from the EPA Statement of Performance Expectations 2014-15 (SPE) which provide only a high level view of budgeted financial performance. We note that there is no further financial planning beyond one financial year.
- Crown contributions are budgeted to increase by \$2.5m overall from FY14 to FY15B across the decision making and compliance activities of the EPA. From an original baseline of \$21.0m, an additional \$2.6m was budgeted for HSNO enforcement and simplification and an additional \$2.8m budgeted for EEZ, while \$1.8m of funding was transferred to WorkSafe. We understand that the Crown revenue uplift has only been approved for one year to support EEZ decision making and compliance functions.

- Given the deficit in FY13, and the discussion above regarding tensions around the ability to fully recover costs, it seems likely that this increased level of Crown funding will need to be sustained – unless EEZ fee rates can be increased to fully cover the whole of system costs. The NZEUR upgrade is budgeted and will be funded using existing funding and some of the EPA's cash reserves. Additional funding is not specifically required for this.
- The \$25.0m Crown appropriation covers expenditure in the six output classes:
 - \$6.4m to fund ETS and the NZEUR decision making and compliance;
 - \$5.9m to fund HSNO, ozone-depleting substance and hazardous waste *decision making*, and \$4.8m to fund *compliance*.
 - \$3.1 m budgeted to fund resource management decision making (NSP).
 - \$2.5 m for EEZ decision making, and \$2.2 million compliance
- We note that the \$3.1m budget for resource management decision making includes the Mt Victoria Tunnel project which has been terminated following the Basin Bridge decision, and two unknown NSP. The EPA expects the two NSPs to begin in March 2015 which will mean the majority of the associated direct costs and corresponding revenue from applicants will be incurred in FY16. This highlights the unpredictable nature of the EPA's pipeline.
- Fees revenue is expected to be \$11.3 million in FY15B.
- The EEZ decision making output class is budgeted to recover \$6.6m in fees revenue, an expected cost recovery of 72.3%. EEZ compliance is budgeted to recover 11.8% of costs through receipt of \$300,000 in compliance fees.
- The NSP decision making output class is budgeted to recover \$3.9m or 54.9% of total costs. As mentioned above, this revenue is likely to be reduced due to the removal of the Mt Victoria Tunnel project from the pipeline and delayed starts for the next two major projects.
- The HSNO decision making output class is budgeted to recover \$532,000 fees or 8.2% of total costs within the output class. No fees are received for HSNO compliance.

Forecast Financial Analysis

EPA Historical and Budgeted Financial Performance

\$000	FY12A	FY13A	FY14A	FY15B
Revenue				
Revenue from the Crown	18,947	22,137	22,492	24,977
Fees revenue	<u>4,771</u>	<u>5,744</u>	<u>11,947</u>	<u>11,274</u>
Total revenue	23,718	27,881	34,439	36,251
Operating expenditure				
Personnel costs	(11,316)	(12,577)	(15,315)	(16,752)
Other expenses	<u>(10,236)</u>	<u>(12,838)</u>	<u>(19,023)</u>	<u>(18,059)</u>
Total operating expenditure	(21,552)	(25,415)	(34,338)	(34,811)
EBITDA	2,166	2,466	101	1,440
Depreciation and amortisation expense	<u>(1,165)</u>	<u>(1,516)</u>	<u>(1,546)</u>	<u>(1,540)</u>
EBIT	1,001	950	(1,445)	(100)
Interest income	<u>182</u>	<u>356</u>	<u>329</u>	<u>100</u>
Net surplus / (deficit)	1,183	1,306	(1,116)	-

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), Statement of Performance Expectations 2014-15

- Personnel costs are based upon 170 FTE with an increase for performance related payments. Plus an additional 15 fixed term FTE for activities during the year. The hiring of the additional FTE may not occur given the significant change in pipeline for NSP.
- We note there is inherent uncertainty regarding the pipeline of future applications, even with detailed forecasting and close contact with potential applicants.

Consultation with Staff & Stakeholders

Key Topics & Stakeholders

Deloitte arranged and met with recommended staff and stakeholders to discuss the EPA's fiscal sustainability. Key topics included:

- The nature of the work undertaken by the EPA teams and how this is evolving over time
- Understanding the key trends and drivers of the historical performance since FY12, including key differences between business as usual and exceptional activities in any period.
- Upcoming review of legislation and regulations in 2015 and the implications for the EPA
- The roles of staff and the nature of the work completed

The following is a list of key people who we met and discussed topics relevant to their respective roles.

- Andrea Gray, General Manager, Emissions Trading Scheme, EPA
- Andrea Eng, General Manger, Enforcement & Compliance, EPA
- Phil Parkes, General Manager Policy & Legal, EPA
- Sarah Gardener, General Manager, Applications & Assessment, EPA
- Aaron Crookston, Acting CFO, MfE
- Nic Hill, Senior Policy Analyst, MfE
- Jacqui Yeates, Senior Analyst, MfE
- EPA Finance Team (Joon Too - CFO, Diana Miller, Jeff Shum)
- Owen Cox, Senior Policy Analyst, Policy & Legal, EPA
- Tracey Crowther, Finance MfE
- Sue Suckling, PIF Reviewer
- Linda Faulkner, General Manager, Kaupapa Kura Taiao
- *Agreed not to meet with the Minister – Hon. Nick Smith*

General Themes from Consultation

- Lumpy workflow that is often unpredictable for the decision making teams of the EPA, such as NSP and EEZ activity..
- A lot of the EPA's cost is fixed, regardless of work activity. The big projects (i.e. NSP and EEZ decisions) have the ability to recover costs of some the EPA staff time. However, to maintain organisational knowledge and consistency, these employees may not be able to be fully utilised given the lumpiness of activity.
- There is some flexibility between service offerings at the EPA where staff have been seconded from teams that are experiencing lighter workflow through to other teams. Some secondees are working outside of the organisation. This offers good opportunities for the EPA staff to understand the wider business and extend their skill base. However, the counter risk is that staff become generalist in their skills rather than growing specific skills relevant to their initial area, do not return from their secondments, or become dis-satisfied and leave. Further, some fixed costs for each service offering still remain even when the staff member is on secondment.
- The EPA are able to draw upon contracted employees to expand and contract the personnel base given the requirement to scale up or down the baseline staff levels to respond to workflow. Extensive use of contracted staff on a workflow basis has a risk of organisational knowledge leaving the EPA.
- There have been significant changes in activities undertaken by the EPA with the introduction of EEZ, the introduction of enforcement activities, the exit of services that will now be undertaken by WorkSafe, the development of the new NZEUR, and structural reorganisation.
- The EPA has many processes that are not systemised. We understand there is current investment in systems (such as the FMIS) and this will be beneficial for the EPA and assist to reduce financial and budgeting risk.
- The potential for prosecution and appeals of decisions made on the EPA projects is unknown from an effort and financial sense. This fund currently sits at \$500k.

Consultation with Staff & Stakeholders

General Themes from Consultation (cont)

- The EPA has limited resource to invest in strategic thinking such as:
 - the development and implementation of internal and external organisational strategies and frameworks
 - working with the executive leadership team (ELT) to develop the EPA Strategy,
 - leading EPA business planning and reporting,
 - thought leadership on regulatory practices and their relevance to the EPA and risk management
 - Monitoring and evaluation, including coordinating international monitoring and reporting obligations
 - Coordinating corporate accountability documents and ministerial services.
- The EPA has limited ability to dedicate resources to implementing lessons learned from past experiences and activities. The value of this resource is to improve efficiency, and best practice from experience, such as the NSP processes and put processes in place that mean future project benefit from this knowledge. We understand that there is some self reflection activity completed at times when operational activity is quiet, however this time is not able to be cost recovered and will consequently be difficult to prioritise. There would be benefit across all EPA activities to incorporate lessons learned (e.g. parallels between NSP and EEZ processes).
- There are variable cost recovery expectations that are set for each activity within the EPA. MfE have undertaken a review of the EPA's cost recovery practices in a parallel workstream to this Fiscal Review.
- Particular pressure falls into the EEZ and NSP space where FTE employed for assistance with BOI or Decision Making Committee processes are assumed to be cost recoverable. When there is low decision making activity the EPA still incurs the costs for these employees. This time is used usefully by EPA staff (reflection on past projects, internal or external secondments) but is ultimately not recoverable from an external revenue source.
- Overhead costs that are allocated to each of the EPA's operational arms are not able to be re-allocated if the forecast activities do not get underway putting budget pressure into these teams.
- A risk exists with the existing cost forecasting tools that are used to support cost recovery processes as these are mostly spreadsheets. This risk will be assisted with the introduction of the EPA's new FMIS system in 2015.

EPA Activity Rates

Charge-out Rates

- The table below sets out the current charge-out rates (excluding GST) for EPA staff time in relation to NSPs and EEZ assessments.
- The current rates for NSPs were set in June 2011 and are based on the average salary for each category of employees, plus overhead costs comprising of personnel costs for additional support staff plus corporate overhead costs apportioned across all non-support staff, divided by an average of 1,352 working hours per staff member per annum.
- The current rates for EEZ assessments were set in legislation in June 2013 and are calculated in a similar manner to the charge-out rates for NSPs, with the exception that overhead costs are divided by an average of 1,365 working hours per staff member per annum.

Charge-out Rates

Category of Staff	NSP	EEZ
	Current Hourly Rate (\$)	Current Hourly Rate (\$)
Project administrator	90.96	97.43
EPA advisor	96.85	103.75
EPA senior advisor	108.43	116.12
Project leader	131.43	140.80
Principal technical advisor	N/A	290.00

Source: NSP Cost Recovery Policy, EEZ Cost Recovery Policy, Management information

- The EPA have also calculated new proposed hourly rates for NSPs and EEZ assessments which are calculated in a similar manner to the current hourly rates. The suggested rates are based on updated FTE and salary information. We have not tested the assumptions or inputs of these calculations.

- When the opportunity to re-set the rates for NSP or EEZ arises, the EPA should consider the whole of life activities undertaken through the application process. The current rates are set with a short term focus to cover the up front activities.
- To date we understand that the EPA has not been able to prioritise time to understand if the NSP or EEZ rates are at a level that actually covers the true cost to serve or the whole of life costs of the activities.
- Further discussion of the current level of cost recovery can be found on page 26.

Maori Advisory Committee

- The Maori Advisory Committee are responsible for advising the EPA Board and helping the EPA incorporate Maori perspectives and Treaty of Waitangi principles in its decision making.
- The Maori Advisory Committee has up to eight members who are appointed by the EPA Board. The charge out rate for the Maori Advisory Committee board members is \$51.88 per hour and \$81.88 per hour for the Chair. The rates were set according to SSC guidelines. The Maori Advisory Committee remuneration is funded through the EPA baseline.

EPA Activity Rates (cont)

HSNO Application Fees

- HSNO application fees and charges were set in October 2010 by ERMA and are intended to:
 - Keep the costs of applications as low as possible;
 - Be seen as fair and reasonable to the applicants;
 - Reflect actual costs and not discourage applications;
 - Ensure predictability for applicants;
 - Recognise public benefits; and
 - Not be a barrier to growth and innovation.
- The application fees vary depending on the complexity of the application and the length of time it takes to process. Some fees are negotiable due the unique nature of each application. A detailed table of the HSNO fees schedule is included in Appendix 2.
- A review of the HSNO application fees and charges was carried out in April 2012 although no changes were made.
- When the opportunity to re-set the rates for HSNO arises, similar to the other activities mentioned above, the EPA should consider the whole of life activities undertaken through the application process. The current rates are set with a short term focus to cover the up front activities.
- The low level of recovery for HSNO activity is the result of an explicit Cabinet decision made in 2003. This decision was reviewed and confirmed by Cabinet in 2006.

Output Class Analysis

EPA Performance by Output Class

\$000		FY12A	FY13A	FY14A
Revenue				
Output 1	HSNO, ozone-depleting substance and hazardous waste decision making		6,992	6,053
Output 2	Resource management decision making		6,189	10,910
Output 3	HSNO, ozone-depleting substance and hazardous waste compliance		2,115	3,694
Output 4	Promoting awareness and compliance		504	891
Output 5	Government policy, legislation and international activities		1,813	1,845
Output 6	Resource management advice and support		1,257	604
Output 7	EEZ applications, assessments and compliance		1,339	4,318
Output 8	Climate change response administration		8,028	6,453
Total revenue		23,900	28,237	34,768
Expenditure				
Output 1	HSNO, ozone-depleting substance and hazardous waste decision making	(5,613)	(6,100)	(4,639)
Output 2	Resource management decision making	(4,828)	(5,706)	(8,904)
Output 3	HSNO, ozone-depleting substance and hazardous waste compliance	(1,894)	(3,168)	(3,916)
Output 4	Promoting awareness and compliance	(663)	(869)	(1,289)
Output 5	Government policy, legislation and international activities	(1,994)	(2,188)	(3,328)
Output 6	Resource management advice and support	(1,821)	(1,329)	(1,401)
Output 7	EEZ applications, assessments and compliance	-	(994)	(6,054)
Output 8	Climate change response administration	(3,969)	(6,577)	(6,354)
NA	EPA Transition	(1,935)	-	-
Total expenditure		(22,717)	(26,931)	(35,885)
Net surplus / (deficit)		1,183	1,306	(1,117)

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), Statement of Performance Expectations 2014-15

- The EPA summarises and measures performance by output classes which are broad groupings of similar and related activities. The classification of output classes has undergone continuous reorganisation as certain output classes are replaced or merged into another output. The output classes as at balance date FY14 and the associated breakdown by revenue and expenditure is presented in the table opposite. Note that a breakdown of FY12 revenue by output class was not possible due to insufficient granularity of data.
- Our assessment of the cost recovery was limited by the level of data available to us and is therefore very high level.

Cost Recovery Assessment

- In order to assess the cost recovery of each function, we are interested in comparing the fees recovered from each function to the total cost of carrying out that function. Our methodology in assessing cost recovery is explained below and was limited by the quality and level of data provided to us. Therefore, it reflects only a high level assessment of cost recovery.
- The total revenue figures presented opposite include Crown appropriation, fees revenue and interest revenue. As we were not able to be provided with a breakdown of each revenue stream by output, we have used the application and cost recovery fees as per the annual reports to assess cost recovery for each function.
- We have assigned each output class to a function to allow us to approximate the total costs of carrying out each function. Note that this method provides only an indication of total function costs as each output class is generally broader in scope than each function. The classification of output classes to each function is:
 - **HSNO:** Outputs 1 and 3
 - **NSP:** Output 2 and 6
 - **EEZ:** Output 7
 - **ETS:** Output 8
 - **Other:** Output 4 and 5

Cost Recovery of Activities

EPA Cost Recovery

\$000	FY12A	FY13A	FY14A
HSNO Cost Recovery			
Hazardous Substances application fees	594	499	426
New Organisms application fees	89	95	76
Total HSNO costs recovered	683	594	502
Total implied HSNO costs	(7,507)	(9,268)	(8,555)
Implied cost recovery	9.1%	6.4%	5.9%

NSP Cost Recovery

Total NSP costs recovered	3,919	5,132	8,611
Total implied NSP costs	(6,649)	(7,035)	(10,305)
Implied cost recovery	58.9%	72.9%	83.6%

EEZ Cost Recovery

Total EEZ costs recovered	-	-	2,741
Total implied EEZ costs	-	(994)	(6,054)
Implied cost recovery	0.0%	0.0%	45.3%

ETS Cost Recovery

Total ETS costs recovered	-	-	-
Total implied ETS costs	(3,969)	(6,577)	(6,354)
Implied cost recovery	0.0%	0.0%	0.0%

Other Cost Recovery

Other fees and revenue recovered	169	18	93
Total other costs	(2,657)	(3,057)	(4,617)

Source: Audited financial statements (FY12-FY13), unaudited draft financial statements (FY14), Deloitte analysis

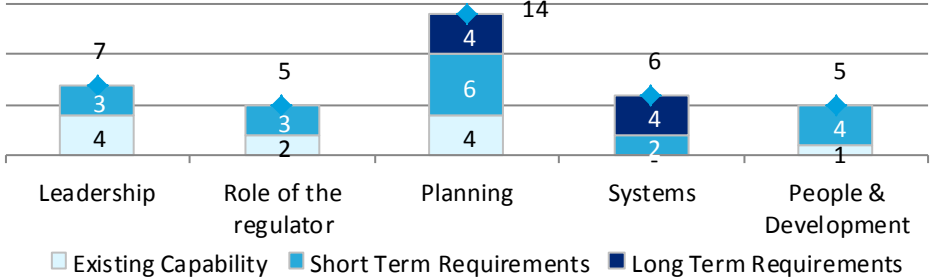
- The table opposite presents a summary of our cost recovery assessment from FY12 to FY14.
- Cost recovery fees for HSNO were received in the form of hazardous substance and new organism application fees. These decreased over time in line with the general decrease in application volumes. HSNO fees are set with the purpose of keeping the cost of applications as low as possible so as to not discourage applications. Total HSNO costs included decision making and compliance elements and expenditure for ozone-depleting substances and hazardous waste. Therefore, the cost recovery rates for HSNO shown opposite are lower than expected due to the inclusion of non-HSNO costs.
- Cost recovery fees for NSP applications increased from \$3.9m in FY12 to \$8.6m in FY14 more than the increase in NSP activity. Total NSP costs included decision making and advice and support. The implied cost recovery was the highest of all the functions and increased from 58.9% in FY12 to 83.6% in FY14. Hourly rates for NSPs are set through the EPA rather than by regulation, which supports a fairer and more accurate system of cost recovery for the applicant. The higher implied cost recovery rates for NSPs reflect the EPA's greater ability to recover costs relative to the other functions.
- The EEZ was implemented in FY14, although \$994,000 of costs were incurred in FY13. A total of \$2.7m of EEZ cost recovery fees were received in FY14 resulting in an implied cost recovery rate of 45.3%. Under the EEZ Act, all costs associated with making rulings, preparing, processing and deciding marine consents will be cost recovered. On the other hand, domestic marine research, submarine cabling and the majority of enforcement costs will be funded by the Crown. This contributed to lowering the overall cost recovery rate for EEZ.
- There is currently no cost recovery of the ETS function, which incurred expenditure of \$4.0m in FY12 and \$6.4m in FY14.
- Total other costs include promoting awareness and compliance, and Government policy, legislation and international activities.

EPA Self Review Findings

Findings of the Self Review

- The EPA undertook a self review that was completed in September 2014. The review highlights strengths and areas for improvement within the EPA.
- Strengths** include the attitude and contribution the EPA staff, empowered and cohesive leadership.
- Areas for improvement** include strategic planning and looking to the future, clarifying the organisations role in the regulatory space, developing systems (process and IT), and taking a whole of business approach.
- The review provided the EPA with 23 recommendations that are mapped into five activity areas including leadership, role of the regulator, planning, systems and people & development. The mapping of the recommendations sees a focus on planning being required by the EPA with 14 of the recommendations requiring some planning activity. An area that is currently under resourced.
- We have attempted to classify the activities required for the recommendations into:
 - Existing capability:** done by existing employees within current roles. (Recommendations 1, 2 , 4 – 6, 9, 11, 19)
 - Short term requirements:** recommendations will require a burst of activity above BAU. (Recommendations 2, 3, 7, 8, 10, 12, 13, 18, 20 – 23)
 - Long term requirements:** recommendations will require up front thinking and sustained activity to achieve. The four recommendations categorised into this definition are recommendations 14 to 17 from page seven of the self review document. These recommendations reflect investment in infrastructure, systems, risk and organisation fit. (Recommendations 14 – 17)

Self Review Recommendations Mapped to Activity Areas



Fiscal Impact

Deloitte has identified relevant areas of the self-review and considered the supporting evidence behind the statements. We note the following observations:

- The limited reference in the documentation given as evidence behind the findings that considers the dollar implications of the comments and recommendations.
- There is emphasis placed on the development of systems and processes. Historically, the EPA have funded such development from reserves and depreciation funding. This approach has been appropriate for activity to date but we have not seen evidence about the sustainability of this approach going forward.
- There is no mention of how the activity required to achieve the recommendations will be funded. Each of the recommendations will require varying degrees of effort for different skills sets. Some of these skills exist within the EPA (defined as existing capability recommendation above). Other recommendations are likely to require ongoing funding streams. Further work will be required to understand the fiscal implications. We discuss further in the recommendations section on page 36.

EPA Benchmarking Review

Administrative Support Services

- The EPA has benchmarked the organisation's administrative support services performance for the past two years. The EPA showed a steady improvement in performance from 2012 to 2013.
- While there are only two years of information, making the results difficult to observe a trend, there are steady improvements between the two years analysed. No concerning points were identified.
- The EPA uses the BASS programme that measures and compares Government agencies Administrative Support Services. The EPA sits around the median metrics of comparable small cohort government entities and all agencies for most metrics including Finance, property costs per FTE, ICT. The EPA is a small entity and may struggle to compete with median metrics where economies of scale are not achievable.
- The report identifies the need for improved understanding about directly allocated costs compared to genuine overheads. The inability to define true corporate costs may be influencing metrics reported. For example other agencies are increasingly direct coding overhead unit costs to operational outputs and outcomes where appropriate, to identify the true overheads of the organisation.
- The EPA is identified at the lower end of capability maturity, indicating potential for improvements in functional processes
- Upgrading the finance system in the 2014-15 year will assist the finance function to perform at a higher grading overall, but this is dependent upon the system being implemented appropriately and all users having adequate training to make full use of the improvements

EEZ Benchmarking

- The EEZ activities are in early days and the potential for prosecution will give variability in costs. However, over time the costs of a Decision Making Committee for the EEZ could be comparable to NSP decision making.

ETS

- The ETS does not currently have the opportunity to charge registry users. Over time the costs of operation could be compared to other New Zealand registry operations. At the present time, overseas cost comparisons are unlikely given different legislative environments.

NSP Benchmarking

- The EPA has identified that there is room for improvement in operational benchmarking. Consequently, the finance team has developed a model that will assist the organisation to estimate costs of future NSP processes. This model is yet to be fully tested against a new project.
- The EPA has completed limited benchmarking of the NSP decision making process. However, the EPA have identified that NSP could be compared to the DIA Commissions of Inquiry and Royal Commissions of Inquiry going forward.
- The EPA commissioned a report by Covec to provide an *“Assessment of Costs to Applicants of the Board of Inquiry Process: Selected NZ Transport Agency Projects “*

EPA Benchmarking Review (cont)

Covec Report – NSP process comparison

- The Covec Report looked at the direct and indirect costs of obtaining resource consent for NSPs, in particular via the BOI process. NZTA projects were used for analysis. The report seeks to provide information on the costs of the BOI process to help the EPA assess whether, and in what circumstances, a BOI is likely to reduce costs for applicants in comparison to the Local Authority or Direct Referral processes (potential alternatives to the BOI that are not time bound).
- For time sensitive projects the BOI process can generate material benefits for applicants to the extent that it is quicker than either the Local Authority or Direct Referral consent processes. An example of this is the Waterview Connection which had a high cost associated with project delays.
- Covec analysis suggests that both the direct and indirect costs of different consent processes can vary massively depending on the specific characteristics of the proposal in question.

HSNO

- The EPA (and its predecessor ERMA) has assessed the average cost of HSNO applications and time frames for many years. Overall there is a downward trend in cost per application
- During FY15 a review is being undertaken to look at the system, simplify and make the processes more efficient.
- New technology is anticipated for the HSNO team in the short to medium term and we understand that funding has been made available for the project. Scoping work is underway as at October 2014.
- The total number of working days per application for Hazardous Substances has declined (influenced largely by a 2010 change in the HSNO Act for s28) and given the large staff time component of the cost, the average cost per application has decreased accordingly –p38. Applications made under s28a has remained almost static in terms of cost since FY08.
- Over the past six years, there have been on average 36 applications for new organisms which can use one of seven different application processes (where applicable). The low volumes and variable complexity of applications make benchmarking difficult. The EPA report that New Organism application costs are generally trending down.
- The EPA have identified that benchmarking against DIA and Maritime NZ would be a valuable addition to benchmarking work in the future.

High \$\$\$	Med \$\$	Low \$
Certain	Potential	Uncertain

Risk Analysis

Risk	Discussion	Mitigation & Opportunities	Potential Size of Fiscal Impact	Overall Financial Impact
<p>The EPA has limited understanding the pipeline of NSPs applications, hearings and decisions</p>	<ul style="list-style-type: none"> The sporadic nature of NSPs create lumpy workflow for the EPA staff and a difficult budgeting environment. While the costs of staff are recoverable from applicants when they are working on NSP hearings, the time spent waiting for the next project is not able to be recovered. The recovery rates are not set at a rate to cover time spent by staff not involved in the NSP process directly. Therefore it is difficult for staff to prioritise work that that enables investment to be made into the wider processes or NSP development and the EPA must cover the non-chargeable time from baseline appropriations. The EPA currently keeps the core staff occupied during quiet times by offering secondments internally and externally. This creates a risk that knowledge of core staff moves away from the NSP applications team and staff may become more generalist in skills. The EPA is able to hire contractors during the peak times and bring in specialised skills. However, these contractors need to be affordable within the set rates for NSP. The EPA needs to be able to be responsive and have the right skill mix within their teams. At present, there is limited scope within the NSP baseline to allow forward thinking and investment by staff into the processes. The EPA should maintain interesting and challenging work for employees, pay competitive salaries to employees, manage staff turnover, the lost intellectual property of old staff and recruitment costs for new staff. 	<ul style="list-style-type: none"> Undertake a consultation programme with industry to determine the project pipeline Development of a forecasting tool to assist with financial planning and staff resourcing Explore the opportunity to use staff across NSP, EEZ and other services of the EPA but retain the right staff and skill mix Use and continue to develop the pricing tool created by the EPA Finance team to determine the expected budget and effort required at different stages of the NSP process Increase baseline funding to allow the team to build upon knowledge and enhance processes going forward. Create a sustainable and efficient operating model. Invest and develop what will make the future processes successful 	<p>\$\$\$</p>	<p>\$\$</p>

High \$\$\$	Med \$\$	Low \$
Certain	Potential	Uncertain

Risk Analysis

Risk	Discussion	Mitigation & Opportunities	Potential Size of Fiscal Impact	Overall Financial Impact
The EPA has limited understanding the pipeline of EEZ decisions	<ul style="list-style-type: none"> EEZ is a relatively new service for the EPA, and the team has been growing to meet the current demand for projects. The process for EEZ has parallels with NSP in terms of limited knowledge of the pipeline of activity. While the team is busy and expanding at the moment, this may not continue forever. The team will need to reflect on lessons learned and continue to streamline this process, improving efficiency over time. EEZ hearings will create lumpy workflow for the EPA employed staff and will likely have similar budgeting complexity as NSP 	<ul style="list-style-type: none"> Similar opportunities exist for EPA in the EEZ space as with the NSP. Consultation could be undertaken with Industry to determine the project pipeline Explore the opportunity to use staff across NSP, EEZ and other services of the EPA Develop a forecasting tool to assist with financial planning and staff resourcing once there are precedents of EEZ processes Increase baseline funding to allow the team to build upon knowledge and enhance processes going forward. Seek opportunities to reflect on lessons learned from the process 	\$\$\$	\$\$
Prosecutions and Appeals for the EEZ are yet to be tested or fully funded.	<ul style="list-style-type: none"> The EEZ environment could be litigious and the EPA needs to be in a position to respond and set precedents and expectations to industry. The prosecution and appeals process under the EEZ is yet to be tested. There is currently \$500k ring-fenced which has strict criteria of use. Litigation can be unpredictable in regard to both occurrence and size, and therefore may extend beyond the resources of the EPA's normal year-to-year resourcing. 	<ul style="list-style-type: none"> Consider increasing the existing fund and allowing the EPA an appropriate mechanism to access these funds to provide legal and administrative support. This fund should remain ring-fenced from the EPA's baseline and only drawn upon under certain circumstances set in governing rules The EPA should look at how other government entities manage reserve funds for legal risk. Entities that operate either legal or emergency response funds (or similar structures) are Pharmac, MPI, Commerce Commission, Maritime NZ, Civil Aviation Authority and Worksafe. Pharmac's legal risk fund was \$6.7m as at 30 June 2013. 	\$\$\$	\$\$\$

High \$\$\$	Med \$\$	Low \$
Certain	Potential	Uncertain

Risk Analysis

Risk	Discussion	Mitigation & Opportunities	Potential Size of Fiscal Impact	Overall Financial Impact
Financial Management Information System (FMIS) is not successfully implemented and does not meet expectations	<ul style="list-style-type: none"> We understand that the EPA will introduce a new financial management system (FMIS) in 2015. There are high expectations that this system will assist the EPA to assess and interpret the financial results more effectively and to implement better cost recovery forecasts for applicants. Many EPA staff members expressed high hopes of improved financial information being available. The EPA does not look further out than one financial year in respect of any budgeting exercise. The introduction of the system should encourage the finance team to investigate better forward planning. 	<ul style="list-style-type: none"> Prioritise a successful roll out for the new FMIS and manage staff's expectations and requirements. It would be prudent and less reactionary if the organisation developed a forecast model that projected three future years at a time. This will help link the strategic direction of the organisation with the financial performance and the potential financial impact of strategic decisions to be identified. 	\$	\$
The financial planning of capital projects is not transparent	<ul style="list-style-type: none"> The EPA puts together the Information and Commination Technology (ICT) Strategic Plan annually which includes a three year work programme. We understand that the capital programme for investment in systems is funded through a mix of depreciation funding and use of balance sheet capital. There does not appear to be alignment of the projects, timeframes, value and phasing of payment between the ICT Strategic Plan and the financing of the projects. If the organisation develops a forecast financial model, the ICT Strategic Plan should be included. 	<ul style="list-style-type: none"> Develop a forecasting tool to assist with financial planning of capital projects. Align forecast costs of capital projects with appropriate funding streams. 	\$	\$

High \$\$\$	Med \$\$	Low \$
Certain	Potential	Uncertain

Risk Analysis

Risk	Discussion	Mitigation & Opportunities	Potential Size of Fiscal Impact	Overall Financial Impact
Unsustainable levels of working capital	<ul style="list-style-type: none"> As mentioned above, the EPA uses balance sheet funding to assist with investment in processes and systems. Ultimately, using up cash reserves may be a high risk if the organisation gets into a position of where working capital is insufficient to allow bills to be paid as they fall due – particularly where debtor recovery is delayed by applicants contesting costs. If reserves get too low, the alternatives for funding involve finding budget from other areas of the baseline, MfE or a request to Cabinet. 	<ul style="list-style-type: none"> The EPA should determine an appropriate level of working capital to maintain on its balance sheet and prioritise investment accordingly. 	\$\$	\$\$
Rates for EPA activities may not match the costs of activities undertaken creating further baseline funding pressure	<ul style="list-style-type: none"> The rates for EEZ activities are set in legislation from June 2013. This means the EPA has limited flexibility in changing the rates charged. The EPA has more flexibility to set the NSP rates as these are not set in legislation. Naturally there will always be pressure from applicants to minimise the total cost of the process. The rates for the Maori Advisory Committee were historically set according to the SSC guidelines and are low. The activities of the Maori Advisory Committee have increased since the inception of the committee. The specialist skills required, combined with the low rates may result in difficulty finding appropriate people to fill the roles of the Committee. The application fees for HSNO were set in 2010 and have not been tested against actual activities undertaken. 	<ul style="list-style-type: none"> The EPA should review all rates periodically to test that the rates are still aligned with the actual cost to serve and cost recoverability expectations (see below). The rates for the Maori Advisory Committee should be tested if the rates are at the appropriate level. 	\$\$	\$\$

High \$\$\$	Med \$\$	Low \$
Certain	Potential	Uncertain

Risk Analysis

Risk	Discussion	Mitigation & Opportunities	Potential Size of Fiscal Impact	Overall Financial Impact
There is little transparency between the rates charged for EPA activities and the costs incurred to complete them	<ul style="list-style-type: none"> A challenge we identified within this fiscal review was sourcing information around cost recovery. The finance team stated they had been unable to prioritise time to understand if the NSP or EEZ rates were set at a level that actually covered the true cost to serve by the EPA. 	<ul style="list-style-type: none"> We suggest undertaking an exercise to determine whether the overhead component of the rates set for EPA activities actually cover effort completed The rates should be updated depending on the outcome of the above. 	\$	\$\$
There is limited capacity to reach strategic organisational goals	<ul style="list-style-type: none"> The EPA currently has limited capacity to reflect on lessons learned from core processes and limited strategic focus on the future outlook, particularly from a financial perspective. The EPA needs to continue to work towards creating a sustainable and efficient organisation Without prioritising the above activity, the EPA may not reach its organisational goals. 	<ul style="list-style-type: none"> We recommend an increase in FTE in Strategy and Planning team, possibly in the order of 1-2 FTE. This would be further supported with the finance team investing in a forecast model. We have not assessed whether there is existing capability within the finance team to deliver this strategic modelling. 	\$	\$
The EEZ functions do not have long term funding	<ul style="list-style-type: none"> We understand there was no formal increase in the EPA's appropriation for the EEZ function and all EEZ activity was assumed to be cost recovered. This is unlikely to be sustainable in the long term given the administrative support and policy . 	<ul style="list-style-type: none"> The EEZ function should receive an ongoing appropriation for services that are not able to be cost recovered. 	\$\$	\$\$

Recommendations, Evaluation & Summary

Recommendations

We recommend that the EPA invests in strategy:

- The EPA invests in strategic thinking to take the organisation to the next level. What does 'a successful EPA' look like?
- The EPA should consider investing in additional people in policy and legal with a strategic outlook and focus.
- The EPA builds on the recommendations from the self review undertaken in September 2014 which has an emphasis on planning to get the recommendations underway/completed.
- The finance and strategy team work together to create a three year strategic model that includes financial forecasting and maps the capital investment programme against ICT projects and other business processes.

We recommend that the EPA continues to develop their financial knowledge and analytics of their business activities

- The EPA needs to maintain a sufficient level of working capital. We understand that the EPA partly uses balance sheet funding of capital projects. While this approach is not inappropriate, the EPA must maintain cash reserves to cover business as usual activities and set an expectation of this level of cash.
- The EPA gains awareness if the rates charged for BOI and EEZ decision making are set high enough to actually capture the overhead component of time and cost.
- The EPA revisit fees and rates that are able to be charged periodically to test that the appropriate costs of the EPA are being recovered. This is particularly important following investment in new systems and processes or organisational change.
- The EPA should revisit the hourly rates applied to the Maori Advisory Committee against the SSC guidelines and see if the rates are still applicable given the expanded services and changing role of this board over the past three years.

- Upon revisiting the fees for activities, the EPA should consider taking a holistic approach and consider an approach to recover the whole of system costs for activity, not just the application component
- The pricing tool created by the EPA finance team should be used and continually developed to determine the expected budget and effort required at different stage of the NSP process. As more decisions are made, a similar process should be undertaken for EEZ hearings.
- Prioritise a successful introduction of the new FMIS and consider additional person/capability in the finance team

We recommend that the EPA looks at their operational model

- The EPA should explore the opportunity to use staff across NSP, EEZ and other service but retain the right staff and skill mix
- Consider the complexity in budgeting within EEZ and NSP while giving these teams the opportunity to reflect and apply "lessons learned". The EPA should consider whether the cost recovery approach for team budgets is still the most appropriate method
- The EPA dedicates time and resource to consult with industry to determine the pipeline of work within all operational arms of the entity.
- A prosecution and appeals fund for EEZ is increased to a longer term level and the ability for the funds to be used is appropriately aligned with the service need. The funds should have appropriate governance, set by the EPA Board.
- The EPA should benchmark their activities against other entities that undertake comparable services (such as Commission of Inquiry and Royal Commission of Enquiry for NSPs)

Recommendations, Evaluation & Summary

Evaluation of Fiscal Sustainability

- The EPA appears to have the resources to complete the entity's legislated activities.
- However, there is some important long term planning and strategic thinking that appears to be missing (such as the ability to invest time in learning from past experiences, the strategic outlook plan, forward financial planning). We have not assessed if the EPA has existing capability in this space or if new resources are required.
- The operational activities of the EPA are able to cost recover time directly recorded against activities. We have no reason to believe that there is misuse or over/under recovery of time recorded in timesheets. Work needs to be undertaken to determine if the costs are being fully recovered and more transparency is required to understand what the costs that are not able to be recovered before any additional funding should be given.
- Other government organisations are able to take a longer term view and operate a memorandum account to smooth the highs and lows of third party revenue.
- The EEZ activities were not given any additional funding when the EPA took on the role in FY14. The EEZ legislation allows the EPA to recover:
 - 100% of costs regarded as having 'private benefit',
 - 80% of costs regarding as having 'mixed' benefit between the private and public sectors, and
 - 'Public benefit' activities that cannot be recovered.
- We note that the EPA have absorbed the cost of EEZ within the baseline by agreeing with MfE to run a deficit position at the end of FY14 during the implementation phase. In FY15 a one-off appropriation has been given to the EPA to cover EEZ activity. However, we believe the EEZ function requires additional funding to be sustainable, particularly given the public good component and to recognise the reality that EEZ staff will never be able to be fully utilised on cost-recovered activities.

Evaluation of Fiscal Sustainability (cont)

- The EPA will require additional funding in the EEZ prosecution fund aligned with the approach of other government entities that operate in litigious markets.
- The EPA undertook a self review which produced some useful and insightful recommendations. The EPA will need to consider the cost of implementing some of these recommendations.
- The EPA needs to take care and have appropriate reporting and financial controls in place when using the reserves from the balance sheet to fund capital projects. Care should be taken to ensure that working capital does not get too low.

Gap Funding Opportunities

- The EPA should gain an understanding about the true cost recovery of the operational activities the entity undertakes.
- Rates should be reviewed periodically to make sure they are current for escalation and are reflective of the cost drivers
 - for example if there is significant investment in systems or a step change in activities the rates should be reviewed and updated where possible
- The EPA should also consider opportunities to recover further of the whole of life costs of activities undertaken through the application process. This could be achieved through higher up front fees, levies, ongoing renewals.
- Increase in the ring-fenced prosecution fund but making sure the fund has appropriate governance and controls to ensure the fund are used for its correct purpose.
- We recommend increasing baseline funding for EEZ to support the functions that are not recoverable from applications and other activities.

Recommendations, Evaluation & Summary

Summary of Findings

Financial Trends & Analysis

- The EPA is primarily funded through Crown revenue which increased year-on-year from \$18.9m in FY12 to \$22.5m in FY14. Revenue is also received in the form of application and cost recovery fees which more than doubled from \$4.8m in FY12 to \$11.9m in FY14. NSP cost recovery fees were the largest driver of fees revenue historically with EEZ cost recovery fees also making a significant contribution after its implemented in FY14. Application fees were also received for HSNO applications.
- The EPA reported net surpluses in FY12 and FY13 and subsequently returned \$1.0m to the Crown in FY13. A net deficit was budgeted for in FY14 and agreed to with MfE in recognising the costs of implementing the EEZ function.
- Personnel costs were the largest expense line and increased from \$11.3m in FY12 to \$15.3m in FY14 in line with the increase in FTE, which increased from 145.5 in FY12 to 179.5 in FY14. The number of FTEs sitting in operational functions represented approximately 60% of the total FTEs historically while the remaining FTEs were employed in various organisational support functions.
- The majority of the EPA's total assets were comprised of cash and term deposit investments. The cash balance decreased from \$6.5m in FY12 to \$2.1m in FY14 reflecting a reallocation of funds into term deposits, investment into the development of the ETS register, and funding the net deficit reported in FY14. The EPA did not hold any debt from FY12 to FY14.
- The EPA's performance against budget has been mixed from FY12 to FY14. The EPA's financial performance is heavily demand-driven, particularly from the number of NSP applications received. The large variances in FY12 arose due in part to the EPA receiving fewer NSP applications than anticipated. The variances also reflected uncertainties in budgeting as FY12 was the inaugural year of the EPA's operations. Although the FY13 and FY14 results better matched budgeted performance, significant variances arose throughout the historical period as the EPA moved through a transitional state which included the redevelopment of the ETS register and the implementation of the EEZ function in FY14.

Activity Rates

- The current hourly rates for NSPs were set in June 2011, while the rates for EEZ were set in June 2013. The rates, which exclude GST, are based on the average salary for each category of employees, plus overhead costs comprising of personnel costs for additional support staff, divided by average working hours per staff member per annum. The EPA has provided a schedule of new proposed hourly rates based on updated FTE and salary information. Hourly rates for NSPs are set through the EPA, while rates for EEZ are set through legislation.
- The charge out rate for the Maori Advisory Committee board members is \$51.88 per hour and \$81.88 per hour for the Chair. This remuneration is funded through the EPA baseline and is only recovered through the EEZ function.
- HSNO application fees and charges were last set in October 2010 and vary depending on the complexity of the application and the length of time it takes to process. A detailed table of the HSNO fees schedule is included in Appendix 2.

Cost Recovery Assessment

- Our assessment of cost recovery was limited by the quality and level of data provided to us. As certain simplifying assumptions have been made, our analysis reflects only a high level assessment of cost recovery.
- Cost recovery fees for HSNO decreased over time in line with the general decrease in application volumes. The implied cost recovery decreased from 9.1% in FY12 to 5.9% in FY14.
- Cost recovery fees for NSP applications increased over the historical period resulting in an implied cost recovery which was the highest of all the functions, increasing from 58.9% in FY12 to 83.6% in FY14.
- The EEZ was implemented in FY14, although preparation costs were also incurred in FY13. The implied cost recovery for the EEZ function in FY14 was 45.3%.

Recommendations, Evaluation & Summary

Self-Review

- The strengths of the EPA were identified as the attitude and contribution of the EPA staff, empowered and cohesive leadership teams
- Areas of improvement include strategic planning and looking to the future, clarifying the organisations role in the regulatory space, developing systems (processes and IT), and taking a whole of business approach.
- Potential fiscal impacts that were identified out of the self review were that while there is mention of significant activity, some of which will be long term there is no mention of how this activity will be funded. Further work will be required to understand the fiscal implications

Benchmarking Results

- **Administrative Support Services** were benchmarked against other government entities for the second year. The EPA compared well against the comparative cohort of entities and against wider government. As a small entity there will always be challenges to capture economies of scale efficiency. The EPA is identified at the lower end of capability maturity, indicating potential for improvements in functional processes.
- **EEZ** was a new activity for the EPA in FY14. There are limited decision opportunities for thorough benchmarking to take place. The EPA considered costs under the equivalent Australian legislation, but there is limited similarity between New Zealand and Australian schemes.
- **ETS** does not have any opportunity to recover any service costs. As activity increases on the register, this could potentially be explored. The legislative environment of other jurisdictions offers limited opportunity for comparison.
- **NSP** costs have been included within a budgeting model developed by the EPA finance team. This model is yet to be fully tested against a new project. The EPA has completed limited benchmarking of the NSP decision making process but have identified comparators within the Commission of Inquiry and Royal Commissions of Inquiry.
- The EPA commissioned the Covec Report to compare NSP decision making process with the alternatives under the RMA (Direct Referral or Local Authority decisions)

Benchmarking Results (cont)

- HSNO has seen an overall downward trend in cost per application. A review will be undertaken in FY15 to look at the system, simplify and make the processes more efficient. The EPA identified that benchmarking against DIA and Maritime NZ would be a valuable addition to benchmarking work in the future.

Risks identified during the course of this review were

- Understanding the pipeline of NSP applications, hearings and decisions
- Understanding the pipeline of EEZ applications, hearings and decisions
- Prosecution and Appeals – EEZ
- Financial Information
- Capital Projects
- Use of balance sheet funding
- Rates for activities and recoverability
- Legislative change
- What does a successful EPA look like?

APPENDIX I - MASTER TERMS OF BUSINESS FOR CONSULTATIVE SERVICES

These Master Terms of Business (“the Terms”) together with any engagement letter (“Engagement Letter”) and any fee estimate sent to the Client form the contract (the “Contract”) between the Deloitte entity specified in the Engagement Letter (“Deloitte”) and the party specified in the Engagement Letter as the Client (“the Client”). In the event of conflict between the Terms and the Engagement Letter, the Engagement Letter will prevail. Any reference to “DTT Parties” will be a reference to all entities (including Deloitte) that are members of the Deloitte Touche Tohmatsu worldwide network (“DTT”) and each of their subsidiaries, predecessors, successors, assignees and subcontractors, and all partners, principals, members, owners, directors, employees and agents of all such entities.

- 1. Contracting Parties.** The Contract is between the Client and Deloitte. The Client agrees that its relationship is solely with Deloitte as the entity contracting with the Client to provide the Services. The Client acknowledges that certain Services under the Contract may be performed by DTT Parties other than Deloitte in which case Deloitte will be responsible for such DTT Parties and will be liable to the Client for all actions or omissions of such other DTT Parties. The Client agrees that it will not bring any claim or proceedings of any nature (whether in contract, tort, breach of statutory duty or otherwise and including, but not limited to, a claim for negligence) against any of the DTT Parties (except Deloitte) in relation to or in connection with this Contract.
- 2. Services.** Deloitte will provide the services specified in any initial Engagement Letter or, as may be subsequently agreed, in any replacement or supplementary Engagement Letter (“the Services”). The Services may include advice and recommendations, but it is understood and agreed that the implementation of such advice and recommendations shall be the responsibility of, and undertaken by, the Client. Unless such implementation is specified as being part of the Services in the Engagement Letter, Deloitte shall not be liable in any way for the implementation of the advice or recommendations. Either Deloitte or the Client may request changes to the Services. Each agrees to work together to enable each party to assess the impact of any requested changes on the cost, timing or any other aspect of the Services. Any material change will be documented in a replacement or supplementary Engagement Letter. Unless otherwise agreed in writing, any other services subsequently performed by Deloitte which are not the subject of a further Engagement Letter will be provided by Deloitte on the basis of the Terms.
- 3. Information.** The Client will provide in a timely fashion all information and documents reasonably required to enable Deloitte to provide the Services. Unless otherwise required pursuant to the engagement, Deloitte will not independently verify the accuracy of such information and documents. The Client will also provide Deloitte personnel working at the Client’s workplace such access to its IT network and systems as may reasonably be required to enable such personnel to operate effectively and efficiently. Deloitte will not be liable for any loss or damage arising (whether in contract, tort or otherwise) from any inaccuracy, incompleteness or other defect in any information or documents supplied by the Client or from the use of the Client’s network and systems by Deloitte personnel.
- 4. Workpapers.** The workpapers produced by any DTT Party (including Deloitte) in the course of its work in providing the Services are the property of that DTT Party and that DTT Party shall be entitled to retain its documents and copies of any documents provided to it in the course of performing its Services.
- 5. Health and Safety.** The Health and Safety in Employment Act 1992 obliges Deloitte to take all practical steps to ensure the health and safety of its staff engaged on any assignment. Deloitte and the Client will be jointly responsible to ensure the safety of Deloitte staff and to see no harm is caused to them in the Client’s workplace. The Client shall ensure that such Act is fully complied with when Deloitte staff visit Client sites and, if necessary, will provide a safety briefing at the beginning of the engagement to those Deloitte staff involved regarding work hazards to which Deloitte staff may be exposed on the Client site provision of any appropriate equipment, and the Client’s procedures for hazard management, accident reporting and emergencies.

APPENDIX I - MASTER TERMS OF BUSINESS FOR CONSULTATIVE SERVICES

6. Non-exclusivity. Nothing in this Contract will prevent or restrict any DTT Party from providing services to other persons (including services which are the same or similar to the Services) or using or sharing for any purpose any knowledge, experience and skills used in, gained or arising from performing the Services subject to the obligations of confidentiality set out in clause 8 even if those other persons' interests are in competition with those of the Client. The Client agrees that, to the extent that a DTT Party possesses the confidential information of another client or other third party, that DTT Party will not be obliged to disclose it to the Client or make use of it for the Client's benefit, however relevant it may be to the Services.

7. Fees and Payment. Unless agreed otherwise the fees charged by Deloitte will be based on the time spent by professional staff at charge out rates appropriate to their levels of skill, experience and responsibility having regard to the Services Deloitte is required to perform. The Client will pay all disbursements reasonably incurred by Deloitte in performing the Services. Fees and disbursements will be billed monthly unless otherwise agreed, and will be payable within 20 days of the billing date. Failure to pay fees on time may, at Deloitte's discretion, lead to suspension of the Services, or termination of the Contract. All reasonable fees charged up to suspension or termination shall be and remain payable, notwithstanding the suspension or termination.

8. Confidentiality. Deloitte will not disclose to third parties any confidential information provided to it by the Client in the course of providing the Services unless Deloitte is authorised to do so by the Client, or Deloitte is compelled by any legal, professional or regulatory requirement or such information is in the public domain.

9. Liability. Deloitte shall use reasonable skill and care in the provision of the Services to the Client. To the extent permitted by law, any liability of Deloitte for costs, damages or other legally payable amounts for losses arising from the provision of the Services by Deloitte or any other DTT Party (whether in contract, tort or otherwise) shall be limited to and not exceed the amount of the fees paid in aggregate in respect of the Services provided under this Contract, except to the extent that such legally payable amounts are finally judicially determined to have resulted primarily from the fraud of Deloitte. Deloitte will not be liable for any loss of profits, indirect, consequential or exemplary losses suffered or incurred by the Client. The Client must bring any claim or proceedings of any nature (whether in contract, tort or otherwise and including, but not limited to, a claim for negligence) against Deloitte relating directly or indirectly to the provision of the Services within 12 months of the earlier of the date that Deloitte completes the provision of the Services under this Contract or the date this Contract terminates. No claim may be made against Deloitte outside of this time limit. All claims must be made in writing to Deloitte.

10. Third Party Claims. In the event a third party brings any claim (including actual or threatened litigation of whatever form) involving any DTT Party in relation to the Services, or any Government agency, tribunal, select committee or other regulatory body undertakes an investigation involving any DTT Party in relation to the Services, the Client agrees, to the extent permitted by law, to indemnify such DTT Party in all respects for costs, damages or other losses incurred by that DTT Party (including all reasonable legal and other professional costs and disbursements and time incurred by its Partners and staff involved in defending or responding to any such claim or investigation), except to the extent that such amounts are finally judicially determined to have resulted primarily from the fraud of such DTT Party. Deloitte will (and will procure any DTT Party to) use its best endeavours to agree the quantum of any such costs recognising the need to respond to such claim or investigation on a prompt and reasonable basis.

11. Reliance. Except where Deloitte has previously agreed in writing, no advice or information provided to the Client is to be made available, directly or indirectly, to be used or relied upon by any third party. No DTT Party will be liable to any third party in respect of such advice or information. The Client indemnifies all DTT Parties against any third party claim arising from its release of any such Deloitte advice or information.

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12. E-mail and Voice Communication. Unless otherwise agreed, Deloitte will at times communicate with the Client by electronic means. These communications can be subject to interference or interception or contain viruses or other defects (“corruption”). Deloitte does not accept responsibility and will not be liable for any damage or loss caused in connection with the corruption of an electronic communication. All oral, electronic or voicemail communications with the Client and any copies of draft report(s), opinions, advice and any other Deloitte deliverables provided to the Client (together “Communications”) may not be relied upon by the Client and Deloitte has no liability in respect of such Communications, unless and until the content of such Communications is confirmed by a partner or director of Deloitte as being the formal and final advice (“Advice”). Where Advice is made available to the Client in draft or in electronic as well as paper copy format, and multiple copies and versions of the Advice exist in different media, in the case of any discrepancy, the signed paper copy of the Advice is definitive.

13. Intellectual Property. All intellectual property rights (including ownership, licence, usage and other rights) (“Rights”) in any methodology, process, checklist, approach or related document (“Materials”) provided by Deloitte to the Client or developed by Deloitte shall remain with Deloitte and Deloitte grants the Client a non-exclusive, non-transferable license to use such Rights for the Client’s own internal uses. All Rights in Materials provided by the Client to Deloitte or developed by the Client shall remain with the Client and the Client grants Deloitte a non-exclusive, non-transferable license to use such Rights for the purposes of the Services. Rights in Materials which are jointly developed by Deloitte and the Client shall be jointly owned and each party grants the other an irrevocable, non-transferable, non-exclusive and royalty-free licence to use such Rights.

14. Term and Termination. The Contract will continue until all the Services have been provided unless terminated by agreement earlier or as set out below. Either party may terminate the Contract by written notice with immediate effect if in the opinion of that party it is professionally proper to do so in the circumstances or in the event a party fails to remedy a material breach of the Contract within 30 days of the date on which it receives written notification of that breach from the other party. Termination will not affect the Client’s obligations to pay Deloitte’s fees for all Services performed up to termination. Any provisions of the Contract which either expressly, or by their nature, extend beyond the expiry or termination of this Contract shall survive such expiration or termination of this Contract and shall include, but not be limited to, clauses 1, 3, 4, 6 and 8 to 14 (inclusive), 16, 17 and 20.

15. Force Majeure. Deloitte shall not be liable for any delays resulting from circumstances or causes beyond its reasonable control, including, without limitation, fire or other casualty, act of God, strike or labour dispute, war or other violence, or any law, order or requirement of any governmental agency or authority.

16. Relationship. The Client acknowledges and agrees that Deloitte will perform all Services in connection with the Contract as an independent contractor. Nothing in the Contract shall create, constitute or evidence any partnership, joint venture, agency, trust or employer/employee relationship between Deloitte and the Client, and Deloitte shall not have the authority to act for, or to incur any obligation on behalf of, the Client, except as expressly provided for in the Engagement Letter.

17. Invalidity. If any provision of this Contract is or becomes illegal, invalid or unenforceable for any reason, the relevant term is considered to be modified to the extent necessary to remedy the invalidity, illegality or enforceability. If this is not possible, the provision is to be severed from the Contract, without affecting the validity, legality or enforceability of any other provision of this Contract.

18. No Assignment or Benefit. Neither the Client nor Deloitte may assign or otherwise transfer the benefit of this Contract to any other person without the prior express written consent of the other, save that Deloitte may assign the benefit of this Contract to any DTT Party. The provisions of this Contract are intended to create a benefit in favour of and be enforceable by the DTT Parties pursuant to the Contracts (Privity) Act 1982 and no other person is intended to have such enforceable benefit in relation to this Contract.

APPENDIX I - MASTER TERMS OF BUSINESS FOR CONSULTATIVE SERVICES

19. Entire Agreement. The Contract, subject to any qualifications, conditions, assumptions and reservations set out in any report, forms the entire agreement between Deloitte and the Client. No previous discussions, proposals, correspondence, understandings or other communications, whether written or oral, shall have contractual effect subsequent to the Engagement Letter unless expressly agreed to in writing by Deloitte as a written variation of the Contract.

20. Governing Law. Deloitte and the Client agree that this Contract and their relationship will be governed by the applicable laws of New Zealand and submit to the exclusive jurisdiction of the New Zealand Courts.

Appendix 2 – HSNO Fees Schedule

Hazardous Substances Application Fees Schedule

Hazardous Substances in Containment	Fee (\$, incl. GST)
Import or manufacture in containment	
Import into containment (field trial)	575.00
Import or manufacture in containment (export only)	575.00
Import or manufacture in containment (persistent organic pollutants)	575.00
Import or manufacture in containment (other purposes)	575.00
Tranship a hazardous substance through New Zealand	287.50
Hazardous Substances for Release	Fee (\$, incl. GST)
Import or manufacture for release	
Notified (Category A)*	3,450.00
Notified (Category A - meets reduced risk criteria)*	575.00
Notified (Category B)*	5,750.00
Notified (Category B - meets reduced risk criteria)*	2,012.50
Notified (Category C)*	17,250.00
Notified (Category C - meets reduced risk criteria)*	5,750.00
Major Issue (likely to be more complex than Category C)*	Negotiated
Group Standards applications	Negotiated
Import or manufacture for release in an emergency*	8,265.00
Import or manufacture for release in a special emergency	No Charge
Rapid assessment for import or manufacture	
Least degree of hazard	575.00
Similar composition and hazardous properties	575.00
Reduced hazard	575.00

Source: www.epa.govt.nz

Other Hazardous Substance Applications	Fee (\$, incl. GST)
Reassessments and amendments	
Determine grounds for a reassessment	575.00
Externally generated reassessment	Negotiated
Modified reassessment	Negotiated
Amendments requiring significant input	575.00
Correction of minor errors	115.00
Amendment to a Group Standards	3,450.00
Statutory determination and non-statutory advice	
Determine whether a substance is hazardous	1,150.00
Status of Substance	115.00
Labelling of substance containers	115.00

Appendix 2 – HSNO Fees Schedule

New Organisms Application Fees Schedule

New Organisms (non-GM) Fee (\$, incl. GST)

Import, ferment, regenerate, or field test in containment

Publicly notified	11,500.00 + disbursements
Non-notified	2,300.00

Release into the environment

Release with controls	Negotiated
Release without controls	17,250.00 + disbursements
Release with controls by rapid assessment	575.00
Release without controls by rapid assessment	575.00

Genetically Modified Organisms Fee (\$, incl. GST)

Import into containment

Publicly notified	11,500.00 + disbursements
Non-notified	1,150.00
Import by rapid assessment	575.00

Develop, regenerate, ferment and field test in containment

Publicly notified	11,500.00 + disbursements
Non-notified	2,300.00
Develop by rapid assessment	575.00
Field test and outdoor developments	Negotiated

Release into the environment

Release with controls	Negotiated
Release without controls	Negotiated

Source: www.epa.govt.nz

Other GM and non-GM Applications Fee (\$, incl. GST)

Determine if organism is new or not

Determine if an organism is a new organism	1,150.00
Non-statutory advice of organism status	No charge

Amend or reassess an existing approval

Make a minor amendment to an approval	575.00
Make a minor amendment to a rapid assessment approval	115.00
Determine grounds for reassessment of an approval	575.00
Reassessment of an approval	Negotiated

Other release and containment approvals

Release in an emergency	11,500.00
Release in a special emergency	No charge
Release a medicine that is or contains a new or GM organism	575.00
Tranship a new or GM organism through New Zealand	1,150.00

Holders of Delegated Authority (IBSCs) Fee (\$, incl. GST)

Application for a delegation	575.00
Amendment for a delegation	115.00
Renewal of a delegation for the same scope and terms	57.50
Renewal of a delegation with significant changes	575.00
Audit of implementation of a delegation (maximum fee)	4,600.00

Deloitte.

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