

NZGM 2060287

***First Light Community
Foundation Ltd***

**Audit Report
April 2014**

**Audit Period 22 May 2012
to 31 March 2013**

DISCLAIMER

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

The responsibility for public accountability and the implementation and monitoring of internal and management controls rests with the society.

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ABBREVIATIONS

Act:	Gambling Act 2003
BR:	Gambling (Class 4 Banking) Regulations 2006
DJTR:	Daily Jackpot Turnover Report
EMS:	Electronic Monitoring System
GAA:	Gambling Amendment Act 2005
GMA:	Gaming Machine Analysis
GMP:	Gaming Machine Profit
GR:	Class 4 Game Rules 2006
HMR:	Gambling (Harm Prevention & Minimisation) Regulations 2004
MS:	Minimum Standards
NPR:	Gambling (Class 4 Net Proceeds) Regulations 2004
WGMPPR:	Weekly Gaming Machine Profit Report
WJSR:	Weekly Jackpot Summary Report

1. EXECUTIVE SUMMARY

The First Light Community Foundation (**the Foundation**) is a relatively new organisation set up with the express purpose of conducting Class 4 gambling.

This audit looks at the Foundation's processes and procedures, current venue practices, and reviews the first set of audited accounts.

The audit identified breaches with some of the approved grants by the Foundation. There was non-compliance with aspects of the Gambling (Class 4 Net Proceeds) Regulations 2004 (NPR) resulting in a number of grants being deemed in breach of the NPR.

One of the underlying values for any Class 4 operator is how it minimises costs to ensure a greater return to the community. There were areas noted in this audit that question whether financial decisions are measured against that value.

An example of this would be the installation of two jackpot displays at the Class 4 venue Zabeels. The requirements of displaying jackpot information are achieved through player screen displays on each gaming machine. The Department questions the necessity for two additional displays.

Now that the Foundation has been operating for a reasonable time, it is expected that a complete review will be undertaken to ensure that costs associated with the Foundation's Class 4 operation are actual, reasonable and necessary.

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2. INTRODUCTION

2.1. BACKGROUND

First Light Community Foundation Limited (**the Foundation**) is a limited liability company first registered with the Companies Office on 4 November 2011.

Key persons associated with the Foundation and still present today are:

- Lloyd Robert SINGLETON
- Gordon Albert TRIPP
- Dennis John OWEN

The Foundation's operation is managed by Tracy Ann McKAY.

In April 2012 the Foundation applied to the Department of Internal Affairs (**the Department**) for a Class 4 Operator's licence which was approved on 22 May 2012.

The application indicated one Class 4 venue would be associated with the Foundation, that venue was Zabeels (GMV679).

The Foundation's authorised purpose statement read as follows:

- (a) Any charitable purpose*
- (b) Any non-commercial purpose that is beneficial to the whole or a section of the community; and*
- (c) Promoting, controlling and conducting race meetings under the racing act 2003, but excluding the payment of racing stakes.*

In addition to the authorised purpose statement, the application also outlined examples of what would, and would not, meet the Foundation's authorised purpose.

The Foundation's statement specifically excludes the following grant types:

- *groups or individuals standing for an election to public office;*
- *lobby groups or action/pressure groups (e.g. greenpeace, or sensible sentencing trust);*
- *social events, e.g. school balls, family reunions, entertainment in pubs or clubs, sporting trips for supporters or spectators or after match functions for sporting groups;*
- *personal or commercial gain;*
- *professional sport;*
- *non-affiliated "social" sports clubs (such as corporate leagues); or*
- *racing stakes.*

The Foundation's operation initially was run from the manager's residential home, and then moved to commercial offices situated at 209 Karamu Road Hastings in March 2013.

The office accommodation is a shared tenancy arrangement between Sowman Associates, who holds the head lease, and the Foundation.

In September 2012 the Foundation added the Class 4 venue The Story Bar (GMV714), followed by the Kaiti TAB (GMV1064), in October 2012.

At the time this audit was carried out the Foundation operated 41 gaming machines at three Class 4 venues.

2.2. PURPOSE OF THE AUDIT

The purpose of this audit was to:

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

The scope of the audit covered the following key process areas of the Society's class 4 gambling operations:

1. Society costs;
 - venue payments;
 - service provider costs e.g. management companies (where relevant);
 - society operational costs;
2. Grant distribution process;
 - conflict of interest issues concerning grants by key persons.
 - inappropriate grants e.g. outside the Society's authorised purposes;
 - potential grant recipient fraud.
3. Venue Compliance;
 - assessing venue compliance;
 - assessing staff competency;
4. Society Governance;
 - establishing responsibilities;
 - assessing procedures and policies are correctly applied;

The scope of the audit process was also sent to the Foundation's Chairperson, Lloyd Singleton, on 21 November 2013.

A team of three inspectors were involved in carrying out this audit of the Foundation.

3. VENUE COMPLIANCE

Two of the three Class 4 venues licensed with the Foundation were inspected as part of this audit.

The questions put to the venue staff during these visits can be seen in the venue report for Zabeels carried out on 11 September 2013.

3.1. ZABEELS (GMV679) – 115 KING STREET, HASTINGS

The venue inspection was carried out on 11 September 2013 by Gambling Inspectors [REDACTED]. The Venue Manager was spoken to.

Concerns raised in this inspection relate to the non-use of Department standard forms, supervision and access, and discrepancies in the float level.

3.2. THE STORTY BAR (GMV714 – 1014 HERETAUNGA STREET HASTINGS

The venue inspection was carried out on 11 September 2013 by Gambling Inspectors [REDACTED]. The Venue Manager was spoken to.

No concerns were raised at the time of the visit. However, since the visit the Department became aware that a system recently installed at the venue had changed the way staff carried out some Class 4 activities. Those changes removed the need for the staff to use the Departmental forms. This change resulted in the venue using a process which breach the game rules.

The Department advised the Foundation of the outcomes of both venue inspections in a letter dated 30 September 2013, and this report notes that the Foundation addressed the matter after being notified.

BEST PRACTICE RECOMMENDATION

Where the Foundation makes significant changes to a venue operation, such as the installation of automated systems, a review should by be undertaken to assess how those changes impact on the Foundation's ability to comply with the legislation. Part of that assessment should include informing the Department to ensure there are no concerns from the regulator.

4. EXPENSE REVIEW

Under the Act a corporate society may incur costs that are actual, reasonable and necessary in conducting class 4 gambling and costs that are actual, reasonable and necessary in complying with the relevant statutory and licensing requirements. Any expense that is not ARN must not be met from the society's net proceeds, as defined in section 4 of the Act. Net Proceeds must only be applied or distributed to the society's authorised purposes.

Overall it was found that the Foundation's expenditure was reasonable and necessary to the gaming machine operations.

4.1. CAPITAL EXPENDITURE POLICY

During the 2013 financial year, the Foundation purchased gaming machine equipment for three of its venues at a cost of \$457,556. This amount included \$16,500 spent on purchasing downloadable jackpots to replace the non-downloadable jackpots operating at the three venues during January and February 2013.

The total cost of \$457,556 also included the purchase of the operating systems and cabling associated with the new downloadable jackpots, (\$160,224 across the three venues). The purchase of the downloadable jackpots ensures that all of the Foundation's current venues have downloadable jackpots in place, well ahead of the required deadline of 1 December 2015.

In March 2013, after the purchase of the downloadable jackpots, the Foundation implemented a capital expenditure policy which requires:

- Foundation Board members and staff to obtain approval from the Board of Directors for any purchase over \$500 (excluding GST);
- All assets purchased over \$500 (excluding GST) are to be recorded in the asset register under the applicable asset category and depreciated at the level approved by Inland Revenue or the Foundation's accountants;
- All proposals for asset purchases over \$100,000 (excluding GST) must contain at least two quotes for the same or equivalent products.

BEST PRACTICE RECOMMENDATION

The Foundation should ensure that any future capital asset purchases follow the procedures outlined in the Foundation's March 2013 capital expenditure policy.

4.2. EXPENSES POLICY

In March 2013, the Foundation implemented an expenses policy to ensure that outgoings are minimised, and to ensure that sufficient resources are available to meet all operational and compliance requirements.

Included in the expenses policy is a dedicated section on "professional services". Professional services are engaged as necessary and include accounting, auditing, legal and consultancy services. The policy states that

“consultants are to be engaged where there is a specific requirement that cannot be managed within the organisation or where independent advice is required.

The Foundation has a legal services agreement with Harkness Henry for advice and to complete all legal obligations for \$500 per month plus GST.

BEST PRACTICE RECOMMENDATION

The Department does not consider agreements such as these meet the actual, reasonable and necessary test as they are not necessarily for work that has been undertaken at the time it is paid i.e. not actual. It is noted that the agreement states that Harkness Henry is to issue a credit notice if the work in those 12 months was less than the annual amount of \$6,900.00. Even so, payments are made on a monthly basis for work that at that time has not necessarily been performed. This also temporarily reduces the amount available for authorised purposes on a monthly basis.

The Foundation have provided comment to the Department that it had undertaken a cost analysis on which it was found to be very cost effective.

The Foundation acknowledged that there was a need to have a more robust policy in this area, hence a policy review in March 2013.

4.3. FACIAL RECOGNITION TECHNOLOGY

During the 2013 financial year, the Foundation claimed expenditure of \$2,789, as a 10% deposit on a facial recognition based player exclusion system, which was to be trialed in two phases. Provided the trials proved successful, the total cost of the facial recognition based exclusion system to the Foundation was expected to be \$32,068.90 inclusive of GST.

While this matter has already been addressed in previous correspondence with the Foundation, the audit confirmed that the refund of the \$2,789 deposit received from Positive Outlook has been included as proceeds to be distributed during the Foundation's 2014 financial year.

BEST PRACTICE RECOMMENDATION

The Foundation must ensure that all costs incurred are necessary and reasonable for the gaming operation. As previously advised in a letter to all class 4 societies on 24 April 2013; as the regulator, the Department does not currently support or endorse the use of third-party facial recognition systems.

If it is believed that there is a significant problem with the harm minimisation system currently being employed at any of the Foundation's venues, then the Foundation should first identify the nature and size of the problem, and then establish whether the problem can be solved using current resources.

5. GRANT DISTRIBUTION

This audit involved a review of the Foundation's grant distribution process. The efficient and effective distribution of funds to the community is the underpinning principle of any class 4 gambling operation and a Foundation's performance in this area is important for the purpose of an audit.

5.1. OVERVIEW OF THE FOUNDATION'S PERFORMANCE

During the audit period from 22 May 2012 to 31 March 2013 the Foundation considered 215 grant applications declining 59 and approving 156. A total of \$744,235.00 was distributed to the Foundation's authorised purpose (AP).

This represents a return to the community of 44.05% which satisfies the requirements of the Gambling (Class 4 Net Proceeds) Regulations 2004 (NPR) 10(1) of a minimum distribution to AP of 37.12% of GST exclusive gross proceeds.

A particular feature of the Foundation's method of distribution is the manner in which funds are distributed almost exclusively in Hawkes Bay or to national bodies that are based in Hawkes Bay.

It is noted the Foundation met its requirements to publish the results of its distribution on its website.

5.2. REVIEW OF INDIVIDUAL GRANTS

A sampling of approved and declined grants were reviewed to ensure that they complied with the Foundation's internal processes and the following requirements:

- The Act section 106. That funds were distributed only to an authorised purpose specified on the Society's licence;
- NPR 8. The establishment of a net proceeds committee (NPC);
- NPR 16(1)(b). That grant applications conformed to the requirements of NPR 17;
- NPR 16(1)(c). That grant applications were supported by competitive quotes or other evidence that the amount of money being sought was appropriate;
- NPR 16(1)(e). That grants were not retrospective;
- NPR 16(1)(g). That grants were not promissory;
- NPR 16(1)(h). That grants were used specifically for the purpose for which they were applied;
- NPR 16(1)(i). That grants were made directly to the applicant.

The grants reviewed were generally compliant with the requirements of the Act and NPR.

This audit notes that the records maintained by the Foundation around its NPC decisions and meetings are compliant to meet the minimum standard of its regulatory requirements.

The Department also has an expectation that if requested at any point in

time, a society should be able to clearly justify any questions asked around their decision making process when approving or declining grants.

5.3. NET PROCEEDS COMMITTEE

Net Proceeds Regulation 8(3) requires that a NPC **must** comprise at least three natural persons who are key persons in relation to the class 4 operator's licence.

The Foundation's NPC currently consists of the three directors Singleton, Owen, and Tripp, who all have links with groups that regularly apply to the Foundation for funding.

The Foundation's constitution provides a process which will be followed when a director or senior staff member registers an interest in any transactions the Foundation has with third party providers or grant applicants.

Where a director or senior staff member signal an interest the Foundation's minutes will record the conflict of interest, and the director or senior staff member will be excluded from all discussions and voting relating to that matter.

The problem for the Foundation is, once a director signals an interest, thereby removing themselves from the discussion and voting process, the remaining 2 directors no longer meet the requirement of NPR 8(3).

In discussion with the Foundation representatives, it was agreed that the best remedy for this breach, was to add another key person's so that any future NPC meetings remain compliant with NPR 8(3).

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6. SOCIETY GOVERNANCE

The audit team interviewed Foundation key persons, (Lloyd Singleton, Dennis Owen and Tracy McKay), about the decision making processes applied by the Foundation.

The scenarios put to Foundation related to various activities that a Class 4 society would be required to manage, such as the purchasing of assets, tendering processes, and the distribution of net proceeds to name a few.

The approach applied by the Foundation was considered to be sound business practices. There were some decisions made by the Foundation that the audit team believed was inconsistent with the principle of reducing expenses to maximise the return to the community.

6.1. INDEPENDENT LEGAL ADVICE

This audit notes that during the first two years of operation the Foundation has sought professional advice on a number of matters ranging from the initial set-up to base operating procedures and administration systems.

The Department accepts there will be instances where the Foundation will need to seek independent legal advice, but also believes that societies should, over a period of time, gather sufficient industry knowledge that their reliance on these professional services should lessen over time.

There is also the option for the Foundation to contact a Department liaison officer on compliance and licensing matters.

6.2. ASSET PURCHASING

Previously mentioned in this report was the purchase of jackpot equipment and other venue ancillary equipment installed at the three Class 4 venues aligned with the Foundation.

In respect of the jackpot equipment it was noted at one venue, Zabeels, that the venue had 2 jackpot displays present. One in the defined gambling area, the other on a wall in the main bar area.

The *Minimum Technical Requirements for Linked Jackpot Systems Version 2* outlines standards for jackpot devices and displays. Requirement 14.1 of those standards states:

A meter display, displaying jackpot details (e.g. current value and indication of a jackpot win), should be readily visible to all players playing a gaming machine connected to the jackpot equipment without the player having to move significantly from the normal position of playing a gaming machine (e.g. the player should not have to turn 180 degrees to their rear to view a display).

The requirement of 14.1 means that any person playing a gaming machine linked to a jackpot must be able to sight the jackpot information without difficulty. To this end, jackpot information displayed on a player's display screen would meet this requirement.

Because the jackpot information is displayed on all players display screens, it could be argued that having a separate jackpot display inside the gambling area is an unnecessary cost.

The secondary jackpot display at Zabeels positioned on the wall of the

main bar area would, in the Department's opinion, be deemed an unnecessary expense.

6.3. APPOINTMENT OF DIRECTORS

Given the issue the Foundation found itself in with needing to expand the current board. The audit team inquired as to how the current board approached its succession planning. This discussion and a review of the Foundation's constitution outlined that the power to appoint solely rests with the current directors as they saw fit.

The Department sees that the role governance plays in a Class 4 society as having changed considerably. The workload, level of responsibility and skill required has risen in conjunction with increased compliance obligations and public accountability.

The Department would expect that Class 4 societies consider the composition of their boards and whether they reflect the actual requirements of the community, sector and regulator.

Any process to appoint a new director should always be approached through the lens of demonstrated competence but also be cognisant of the need to stand public scrutiny in terms of transparency.

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7. BANKING PROCESS

A review of the bank deposits by each venue into the Foundations dedicated account was carried out to ensure compliance with section 104 of the Act, and the time frames outlined under the Banking Regulations.

The period covered was 27 May 2013 to 30 September 2013, which included 19 deposits. All the deposits were made within the 5 working days, with 5 deposits differing from the calculated Gaming Machine Profits (GMP) figure. In all instances the amount was greater than the calculated GMP figure.

8. CONCLUSION

The audit has found that that the practices applied by the Foundation are overall, compliant and consistent with what the Department would consider best practice.

The areas identified in this report as requiring correction are minor in nature and stem from a genuine misunderstanding of requirements.

This audit notes that the Foundation have breached the following areas:

- Game Rule 17(2) – Security and Issue of keys
- Net Proceeds Regulation 8(3) – Establishment of Net Proceeds Committee.

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