



Sector Report: Audit of Management Service Providers

April 2018

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 Management Service Provider.

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Executive Summary

This report provides an overview of identified themes and recommendations from 14 targeted audits of Management Service Provider (MSP) arrangements operating in the class 4 sector conducted by the Department of Internal Affairs (the Department).

The focus of the audits was to analyse the MSP contracts and to measure the cost and delivery of these services to the societies. The Department also sought to identify and encourage good practice, and offered recommendations if required in the individual audit reports.

The principles of accountability, integrity and transparency have driven the recommendations outlined in this report with the aim of encouraging improved practice of the services MSPs provide to Societies and their class 4 sector operations.

The Department found that overall MSPs operate well and have good working relationships with their societies, venues and the Department. MSPs are very diverse and undertake a wide range of duties for societies. This ranges from undertaking a specific role, such as a society venue representative, to much larger MSPs who provide all the duties and services to a society. This makes it very difficult to compare the different MSPs and their relative contracts with the various societies.

The audits found that the services provided to the societies by MSPs were generally of a good quality and play an important role in the day-to-day operations of the societies. The MSPs demonstrated that:

- all but one of the MSPs had contracts with societies that were comprehensive and robust;
- societies with MSPs have a similar rate of return to Authorised Purposes and a cost per electronic gaming machine (EGM) to societies that undertake their day-to-day operation in-house; and
- no unlawful payments to venue operators or third parties were identified during the audits.

The audits did identify matters that need to be resolved to ensure the arrangement between the societies and the MSPs adheres to the principles of transparency, integrity and accountability. These included:

- minor amendments to the MSP contracts to wording, legislative requirements, clear categorisation of costs and duties, and end dates;
- better managing and reporting on potential conflicts of interest;
- a number of societies did not undertake a transparent tender process when they appointed an MSP; and
- several MSPs were not completing all duties or reporting accurately as per their contract with the society.

The MSPs demonstrated potential non-compliance in the following areas:

- two MSP contracts contained costs for which the Department queried the justification. The society has now resolved this matter; and
- one society did not have a written contract in place with its MSP. The society is rectifying this matter.

Introduction

Why we carried out the audits

MSPs provide ongoing services to societies that directly relate to the conduct of class 4 gambling. These services are conducted by way of a contract if a society chooses not to perform these functions itself.

The Gambling Amendment Act (No 2) 2015 captured MSPs within the scope of the regulatory framework and required MSPs to become key persons to a society that is holder of a class 4 operator's licence.

This legislative change recognised the risks that existed in having individuals operating in the class 4 sector who were not subject to the licencing process and other regulatory functions. The previous omission of MSPs from the legislation reduced transparency for the arrangements that existed in the sector, and it created the following potential risks:

- The existence of conflicts of interest that were not visible and/or being properly managed.
- MSPs having undue influence with societies or class 4 venues that extended beyond the provision of MSP services.
- MSPs being used as a vehicle by societies to illegally acquire class 4 venues by making unlawful payments to venue operators or third parties (given the financial arrangements and the services being provided by MSPs were unable to be thoroughly examined before the legislation change).
- Ineffectual services being provided by MSPs that would not help a society to realise its goals.
- Limited financial value/benefit to the community from the use of MSPs.

What we looked at

With the role that MSPs play in assisting societies with class 4 gambling now captured within the regulatory framework, the Department undertook targeted audits to understand the operational dynamics and determine the performance of MSPs in relation to their contractual arrangements with societies. The objectives were to:

- provide a level of assurance to the Department over the integrity of the arrangement between MSPs and the societies;
- identify the levels of performance of MSPs against key focus areas and how this would compare to other MSPs;
- examine payments to MSPs in relation to the services provided; and
- assess that the operations of MSPs are in accordance with the Act.

The audits assessed performance against three key focus areas:

1. contractual relationships and obligations between the MSP and the society;
2. service offerings provided by the MSP, including operational provisions provided by the MSP to the society and its venue operators; and
3. a cost comparison versus service offerings of the MSP to the society.

A list of the MSPs audited and the societies involved is contained in Appendix A.

Key Findings

Focus Area One: Assessment of the contractual relations and obligations between MSPs and societies

The Department expects societies to have thorough written contractual agreements with MSPs to ensure the relationship and obligations are transparent, including clarifying who the key parties are so they are held accountable. A quality contract should also inform how the society and the MSP defines and manages conflicts of interest to ensure integrity is emphasised.

The Department's assessment of focus area one is summarised below:

- Thirteen of the fourteen MSP arrangements had formal written contracts.
- One MSP arrangement did not have a formal written contract. However, the society had a long standing arrangement that was covered by a comprehensive list of duties. Following the audit a contract was being drawn up.
- Ten contracts either met all the requirements and had no issues, or required minor clarification of wording, duties performed, clearer categorisation of costs, and updated legislative requirements.
- Three contracts had no end dates.
- Two MSPs were not providing all the monthly reporting services and the hours worked to the society as per the contract.

Focus Area Two: Assessment of the service offering provided by the MSPs

In order to be an effective regulator, it is important for the Department to have a good understanding of the value MSPs bring to the class 4 sector. Better visibility for the functions undertaken by MSPs allows the Department to identify the level of influence these key persons have in the sector. This information allows the Department to be better equipped to work with these parties towards achieving sector outcomes, such as lifting harm minimisation and grant accountability practices.

It is also important for the Department, the wider class 4 sector, and the community, to have visibility of services offered by MSPs so that there is an assurance that agreed services are being delivered by all parties involved. Both the MSPs and societies are accountable to ensure they fulfil their obligations, and to ensure action is taken when they are not.

The Department's assessment of focus area two indicated that 14 of the MSP arrangements were considered to either meet all the requirements and had no issues, or only required minor clarification of wording, duties performed, clearer categorisation of costs, and updated legislative requirements.

Focus Area Three: Cost comparison and service offerings of the MSP

It is integral for the purposes of sustainability that the benefits of the class 4 sector are maximised whilst the harms are minimised. One way societies can maximise benefit is to minimise the cost of its operations in order to increase the return of funds to the community. For societies to do this, they need to ensure contracts they hold with external parties are cost effective for the services that are provided.

The existence of MSPs has created some concern in the sector in regards to whether contracts with MSPs can fit the definition of actual, reasonable and necessary (ARN). Cost comparison between MSPs that offer similar services allows the Department to identify how MSPs are contributing to the

need for societies to maximise benefits, although it is recognised that a number of intangible benefits will exist within arrangements.

The costing arrangements in place can also help to determine whether the decision-making and governance processes at a society level are robust and align with a strategic desire to maximise return to the community.

The Department's assessment of focus area three is summarised below:

- Six contracts had no issues.
- Seven contracts did not go through a tender process. It is noted that in some cases societies and the MSPs had reasons for doing so. These ranged from having long-standing relationships, being the only provider in the region, having a specific set of skills that were required and the ability to speak other languages e.g. mandarin.
- Five contracts required amending so the charges clearly align with service offerings.
- Two contracts had staff costs that were not considered ARN when compared with societies who employ staff. The society has now resolved this matter.

Other Findings

There was significant variation between the eight MSPs in both size and levels of complexity. Some of the 14 MSP arrangements were discovered to be little more than individual employment contracts, with many of the services that are carried out by those MSPs identical to those that are conducted by employees of societies that do not use MSPs. Other MSPs were established firms that provided specialised services to multiple societies. There were also MSPs that had a separate core business or businesses, so their involvement in class 4 gambling was only a minor component of their overall operation.

As part of audit the Department identified issues that were not part of the scope of the audit and summarised below:

- Potential conflicts of interest were identified in four MSP audits. These reports outlined solutions so they could be correctly managed.
- There were no confirmed instances of the MSPs having undue influences over the societies or venues.
- No unlawful payments were found to venue operator or third parties.
- All MSP arrangements except one were covered by comprehensive contracts and the Department found in general the services provided performed to the same standards of other societies in the class 4 sector.

Financial analysis of Management Service Providers' performance

Limited analysis was able to be undertaken on the performance of MSPs. The Department was able to look at the rates of return to Authorised Purposes and costs per Electronic Gaming Machine (EGM) for societies at relicensing time over the 2016 financial year. A summary is set out in the following table:

Societies	Return to Authorised Purpose	Cost per EGM
Societies with an MSP	42.94 per cent	\$27,982
Societies without an MSP	42.22 per cent	\$28,145

The limited amount of data available makes it difficult to draw any conclusive findings. Nevertheless, we found that societies that use MSPs have a similar return to Authorised Purpose and a cost per EGM comparable with those societies who perform their duties in-house.

Conclusion

Overall, the Department found that the majority of MSPs operated well and had good working relationships with their societies, venues and the Department.

Given the variations that exist amongst MSPs, the making of direct comparisons and providing a level of benchmarking is problematic. However, it is interesting to note, there is very little difference between the return to Authorised Purpose and the cost per EGM for societies that operated with MSPs and those who perform those duties in-house.

Most of the MSP contracts were comprehensive and robust. The Department recommended minor improvements to wording, legislative requirements, and clearer categorisation of costs and duties. However, one society did not have a written contract with its MSP. Several societies and MSPs did not have end dates to their contracts and two other MSPs were not reporting to the society as per their contract. It is pleasing that societies have agreed with the Department's recommendation and have or are in the process of rectifying these matters.

While some societies put forward sound business cases as to why they did not undertake a tender process, it is concerning that the other societies did not go through a tender process to appoint an MSP. The Department considers it important that a robust tender process is undertaken so societies can ensure the contracts are cost effective and identify and manage potential conflicts of interest. It is worth noting that societies have acknowledged that tendering for future MSP services will be considered when their current MSP contracts come up for review in the future.

The audits identified two MSP contracts that contained costs which the Department has queried the justification and its pleasing that the society has resolved this matter.

No unusual transaction or issues were identified to venue operators during the MSP audits. However, the Department identified several potential conflicts of interest. These were either currently being managed by societies or recommendations were made to the societies on how to best manage these potential conflicts of interest.

The Department considers it important for MSPs and societies to confirm policies and procedures are applied correctly and consistently. It is equally important for MSP staff to clearly understand the policies and procedures, and the expectations placed on them. In several instances the Department encouraged MSPs to make improvements to their policies and procedures.

Most of the audited MSP and societies readily accepted the Department's recommendations. These MSPs, societies and the Department worked together to not only meet their legal obligations, but implemented processes considered to be good practice.

It is also acknowledged a better framework is required to compare individual audit reports against one another while taking into account the size and structure of the different MSPs and societies. Information from the targeted audits will help the Department form a set of criteria and standards in the future. The Department will also work towards providing better guidance around good practices, specifically around what documents could satisfy verification processes, and guidance on identifying fraud risk indicators.

Appendix A

The MSPs audited and the societies involved as part of this review were:

MSP	Society
Maxserve Ltd	Trillian Trust
	Grassroots Trust Ltd
	Milestone Foundation Ltd
	CERT Your Local Gaming Trust Ltd
Marco Management Ltd	Blue Waters Community Trust
	Manukau Counties Community Facilities Charitable Trust
Dawn Management Ltd	Constellation Communities Trust Ltd
	Dragon Community Trust Ltd
	Bluesky Community Trust Ltd
Jade Pacific Consultancy Ltd	First Sovereign Trust Ltd
MACHV Consultancy Ltd	
RTP Ltd	
WK Advisors & Accountants Ltd	Redwood Trust
DLA Management Ltd	Oxford Sports Trust