



cutting through complexity

New Zealand Racing Board

Performance and Efficiency Audit

April 2014

Kpmg.com/nz





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7 April 2014

The Board
New Zealand Racing Board
106 – 110 Jackson Street
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Dear Board members

Performance and Efficiency Audit of the New Zealand Racing Board

I am pleased to present KPMG's report on the recent Performance and Efficiency Audit, required under section 14 of the Racing Act 2003.

We conducted this audit between October and December 2013 in accordance with the Terms of Reference approved by the Minister for Racing.

Yours faithfully

Souella Cumming
Partner

Inherent Limitations

This report has been prepared in accordance with the Terms of Reference approved by the Minister of Racing and our Proposal dated 16 August 2013. The services provided ("Services") have not been undertaken in accordance with any auditing, review or assurance standards. The term "Audit" or "Review" used in this report does not relate to an Audit or Review as defined under professional assurance standards.

The information presented in this report is based on that made available to us in the course of our work by the New Zealand Racing Board ("NZRB") and racing code personnel, and publicly available information. We have indicated within this report the sources of the information provided. Unless otherwise stated in this report, we have relied upon the truth, accuracy and completeness of any information provided or made available to us in connection with the Services without independently verifying it.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, the NZRB and racing code personnel consulted as part of the process.

In relation to any forecasts or projections included in the report, we do not make any statement as to whether any forecasts or projections will be achieved, or whether the underlying assumptions and data are accurate, complete or reasonable. We do not warrant or guarantee the achievement of any such forecasts or projections. There will usually be differences between forecast or projected and actual results, because events and circumstances frequently do not occur as expected or predicted, and those differences may be material.

KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

Third Party Reliance

Other than our responsibility to the NZRB, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party's sole responsibility.

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Executive summary

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Background and recent historical context

The New Zealand Racing Industry

- Racing is a significant industry with 52,000 people directly participating and 17,000 full time equivalent positions, generating around \$1.6 billion in economic value added or 0.9% of GDP. Over 80% of the industry's funding comes from the gross betting profits earned by the New Zealand Racing Board ("NZRB").
- The betting market is becoming increasingly challenging, with loss of customers, migration of customers to lower margin products (i.e., from racing totalisator to racing and sports fixed odds) and increasing competition from other betting products. It is clear that current legislation limits the ability of the industry, via the NZRB, to respond to all of these changing customer preferences.
- The business of racing (as opposed to betting) is dispersed in a large number of clubs with a range of governance and constitutional arrangements, with many reliant on volunteers to occupy governance roles. These bodies appoint the members of the code governance bodies following representation principles. In our view, representation models of governance can make it more difficult for governing bodies to take a long range approach in the best interests of an industry as a whole. It is also more difficult with representational models to create a balanced board with a range of relevant skills and experience.
- Stakeholder objectives are not fully aligned throughout the industry, which is a major challenge for the NZRB's statutory function to develop policies that are conducive to the overall economic development of the racing industry. The non-alignment of objectives may be due in part to the representational models of governance, as well as past low levels of confidence in the NZRB. We noted during our meetings with code bodies that communication from the current Board and management is more open, receptive and visible, and that confidence in the NZRB is increasing as a result.

Board and management changes

- The New Zealand Racing Board ("NZRB") has had a complete change in the members of its Board since August 2012 and the most senior management leadership team includes six out of seven members who are new to the industry. There were also two changes of Chief Executive Officer ("CEO") in the three years leading up to the appointment of the current CEO.

The NZRB's organisational capability

- When the current CEO started in August 2012 he found that the core bookmaking activities operated well and had been supported by ongoing investment in capability and tools. This core aspect of the business had been a priority for many years. By contrast the more general non-core functions had not kept up with growth of the organisation and in many areas were not in line with expectations for a complex business with \$1.9 billion in annual turnover. In our view, the support functions and infrastructure inherited by the current management team were not adequate to sustain the NZRB's business.
- Management has taken a number of steps to address these gaps, including:
 - Establishing a new strategy function and carrying out in-depth internal research and external market research to inform the development of a new strategy.
 - Investing in increased people capability in corporate support functions. This is largely complete, and the related disciplines are developing.
 - Investing in a more flexible and up-to-date IT architecture which is progressing.
- The NZRB has invested significantly in increased people capability across the organisation since August 2012 – including executive leadership, core operations, and the corporate support functions noted above. Overall these investments in people capability have increased the on-going staff cost base by approximately \$2m annually.

NZRB Strategy

Strategy process

- The NZRB's process to develop its strategy has produced very good strategic clarity as the basis for shared understanding between the NZRB and the racing codes. The process used extensive new internal and external research. The resulting key initiatives and priorities seem reasonable.
- Investment in capability and infrastructure underpins the strategy and may enable long-term structural issues affecting costs to be addressed.

Financial impact of strategic initiatives

- The strategic goals include a significant increase in net profit for distribution, based on new sources of revenue, and a significant reduction in the cost to income ratio. The SOI states that these goals are aspirational, and in our view they are indeed very challenging. They depend on more customers spending more (possibly the single greatest strategic challenge), and on identifying and quantifying specific cost structure initiatives (also a major challenge).
- There are high level calculations of certain identified actions to support the strategic initiatives, with work still under way to identify and quantify further specific opportunities. The value and timing of benefits has proven to be ambitious - subsequent estimates include reduced and/or delayed timing for some estimated benefits, as well as some increased implementation costs.

Executing the priority key initiatives

- A total of 20 key strategic initiatives have emerged from the strategy process. Of these, seven are prioritised for the 2013-14 financial year. Responsibility and accountability for these seven are clearly assigned, and there is effective monitoring and reporting. Business case and project management disciplines are being strengthened, and business planning capability is being developed. The new incentive scheme supports a performance culture, although it targets current year profit rather than strategy.

Governance framework and management mechanisms

- The new Board is balanced and, together with the CEO and leadership team, well engaged with the industry and focused on the NZRB strategy. The industry has increasing confidence in the new Board and management.
- The management mechanisms are in varying stages of development – and are being developed in appropriate sequence.
- The policy and procedures framework needs more structure. While a comprehensive range of internal policies exist there is no framework to ensure they have a current “owner” internally, are kept fit for purpose (i.e., effectively address identified risks, and periodically reviewed), or that those who must comply know about the policy. The policy framework would also identify those policies that need to be reviewed by the Board. It follows logically after the enterprise risk framework, currently under development. Meanwhile, the biggest known risks are being addressed with the highest priority.

Statutory functions

- The NZRB complies with the requirements of all of its statutory functions. There are major opportunities to perform some of them more effectively for the benefit of the industry, and these opportunities have been appropriately prioritised by the NZRB.
- The NZRB demonstrates a commitment to natural justice and social responsibility across its various functions.

Financial performance

- The NZRB has maintained its profit performance over the past five years in a more challenging environment, and has enhanced this performance by becoming an operator of class 4 gaming machines.
- Management is still working on identifying the specific actions (for the 13 key initiatives that were not prioritised for 2013-14) that will deliver the strategic goals set out in its latest SOI.

Following our review we have made a number of recommendations to address our key observations. The observations and recommendations are set out in the following two pages. The recommendations have been discussed and agreed with the Board and management and we understand a work plan to address the recommendations will be developed.

Observations	Recommendations	Page Ref.
<p>Recent historical context</p> <p>The investment in people capability has increased the staff costs by \$2m (4%) and it is appropriate to ask the question “how much capability is optimal?”</p>	<p>1. That NZRB formally assesses, over the next two to three years, the return attributable to its investment in increased capability.</p>	<p>17</p>
<p>NZRB Strategy</p> <p>The strategic financial goals are very challenging and the early initiatives are facing economic and regulatory headwinds, together with some higher than expected costs to implement.</p> <p>The new performance incentive scheme is based solely on the NZRB achieving its budgeted current year profit. This may discourage investments with a longer-term payoff.</p>	<p>2. That management continue to update the Board periodically on progress towards identifying and quantifying specific actions that will deliver the strategic goals under the future strategic initiatives. This information could also be shared with the codes. There is already good dashboard reporting on the current priority initiatives.</p> <p>3. That management consider the timeframe for introducing a longer-term element to the performance incentive framework.</p>	<p>18 – 21</p> <p>21</p>
<p>Governance and management mechanisms</p> <p>The Board agenda is structured around the strategy, industry matters, organisational governance, financial performance, compliance and significant risks. There is no standing agenda mechanism for the Board to review its statutory functions.</p> <p>There is no central reference source on all employee positions, titles, and reporting lines. This means that the scope of accountability of staff and management positions is not clear, which makes it difficult to fully assess and manage people’s performance.</p> <p>The internal audit activity is on hold on the basis that there is limited value in independent assessments during a period of change. It would be usual to retain internal audit in a \$1.9 billion organisation, including (and especially) during times of change.</p> <p>A wide range of policies exist, but there is no consistent approach to developing and maintaining policies, or monitoring compliance. Many have passed their “review by” date and the identified “owner” is no longer with the NZRB. It is not clear which policies require Board approval and how often.</p>	<p>4. That a review of the performance of the NZRB’s statutory functions be included as part of the compliance function’s programme and reported on in management’s Continuous Disclosure Confirmation paper for the Board.</p> <p>5. That management develop and maintain a comprehensive organisation chart, which is an important part of any organisation’s control framework. It would also improve the NZRB’s ability to develop internal and external benchmarking.</p> <p>6. That management reassess the timeframe for re-establishing its internal audit function, with a medium-term emphasis on independent assurance over change and investment processes, and gaps in control that can arise during periods of change.</p> <p>7. That management set a definite timeframe for establishing its organisational policy framework.</p>	<p>22</p> <p>22</p> <p>22 - 23</p> <p>24</p>

Observations	Recommendations	Page Ref.
<p>Statutory functions</p> <p>Industry development</p> <p>Stakeholder objectives are not aligned throughout the industry, which may be due in part to the dispersed structure of the industry and the range of governance and constitutional arrangements across the clubs and other industry bodies.</p> <p>Conduct race and sports betting</p> <p>The NZRB estimates New Zealand punters lose \$35m annually to overseas operators, with legislative limits on the NZRB's protection from unauthorised betting on New Zealand racing and/or its ability to offer competing products. If this estimate is correct it represents a major potential opportunity for the industry.</p> <p>Distribute funds to racing codes</p> <p>The NZRB and codes agree that a new distribution model is needed. Profitability is related to the number of races, together with field size and quality, but the optimum numbers may differ between the NZRB (betting perspective) and codes/clubs (operational and stakes perspectives).</p> <p>Use resources for the benefit of racing</p> <p>The strategic goal of a cost to income ratio below 30% is very challenging. It was set without any external assessment of the NZRB's internal efficiency and the specific initiatives to reduce the cost structure have yet to be identified. The current Statement of Intent estimates the ratio at 36.7% in 2015-16 (down from 38.2 % in 2012-13).</p>	<p>8. That the Board initiate, with the codes, a review of the governance structures of the racing industry with a view to supporting the long-term interests of each racing code and the industry as a whole, including industry efficiency.</p> <p>9. That the NZRB identifies and quantifies the impact of different forms of leakage to overseas gambling providers and, if appropriate once the results of this work are known, use this to support a case for legislative remedies with the Government.</p> <p>10. That the NZRB initiate a discussion, with codes, about racing club incentives contained in the code distribution models to help ensure full industry alignment. Incentives should enable optimum profitability for the industry as a whole, as well as lowest cost betting channels.</p> <p>11. That management establish internal and external efficiency metrics, and begin tracking trends and setting targets. This will be an important part of the framework for managing towards the strategic goal of a cost to income ratio below 30%.</p>	<p>28</p> <p>12,33</p> <p>35 – 36</p> <p>43</p>

The full report

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Unless otherwise stated, information in this section is taken from the New Zealand Racing Board (“NZRB”) Statement of Intent for 2013-16 (“SOI”).

Overview

The SOI provides an overview of the racing industry in New Zealand, including:

- The sport of racing is carried out by 115 clubs that, between them, operate 65 venues (i.e. racecourses) and hold over 1,000 race meetings, with over 10,000 races, every year. The clubs and venues vary in size and frequency of meetings, and the clubs depend on a mix of employed staff and volunteers. Each club belongs to one of three racing codes, and there is an incorporated society representing each code: New Zealand Thoroughbred Racing Incorporated, Harness Racing New Zealand Incorporated, and Greyhound Racing Association. (The term “code” is used throughout this report to refer to these incorporated societies.) The codes are responsible, under the Racing Act 2003 (“the Act”), for setting the rules of racing and the basis for distributing funds from net betting proceeds to the clubs.

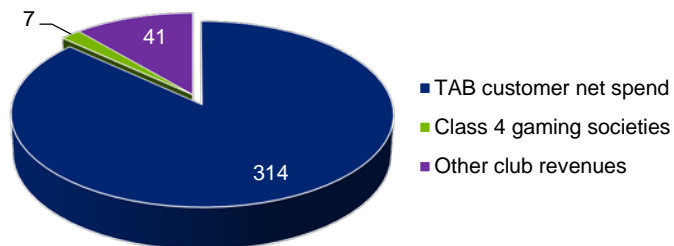
Table 1 – Summary of racing activity by code

	Total	Thoroughbred	Harness	Greyhounds
Race meetings each year	1,049	369	265	415
Individual races	10,928	3,079	2,873	4,976
Targeted average no. of runners per race		10.8	11.5	7.9

Source: NZRB

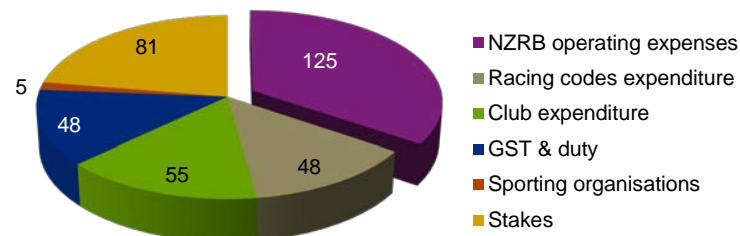
- Racing is a significant industry with 52,000 people directly participating and 17,000 full time equivalent positions, generating around \$1.6 billion in economic value added or 0.9% of GDP. Owners of racing animals fund the incomes of trainers, jockeys/drivers, veterinarians, etc., and these costs are partly offset by stakes paid to race winners and place getters. On average, stakes paid cover approximately 26% of the costs of owning racing animals (costs exclude the initial purchase price).
- Stakes paid to owners by clubs are ultimately funded mainly from betting profits earned by the New Zealand Racing Board (“NZRB”) under the trading name TAB. The NZRB has control, within New Zealand, over betting on New Zealand racing and sport under the Act, which also limits the range of activities on which the NZRB can offer betting products. The non-stakes operating costs of racing clubs (which total \$55m) are approximately equal overall to their income from other sources (admission, events, hospitality, nomination fees, community trust grants, etc.)
- Net spending each year by punters (bets placed minus dividends paid) is approximately \$314m. Approximately \$48m is paid to the Government as GST or duty, and \$4m to national sporting bodies as sports betting levies. Expenses of the NZRB total \$125m (covering TAB running costs and industry leadership) and of the codes \$48m (covering racing integrity, broadcasting, advertising, on course totalisator, community race days, community trust grants, etc). After NZRB retentions, this leaves approximately \$88m available for clubs (of which \$81m is paid out as stakes).

Figure 1 – Where the money comes from (\$m)



Source: Indicative figures from SOI page 8

Figure 2 – Where the money goes (\$m)



Source: Indicative figures from SOI page 8

Industry governance

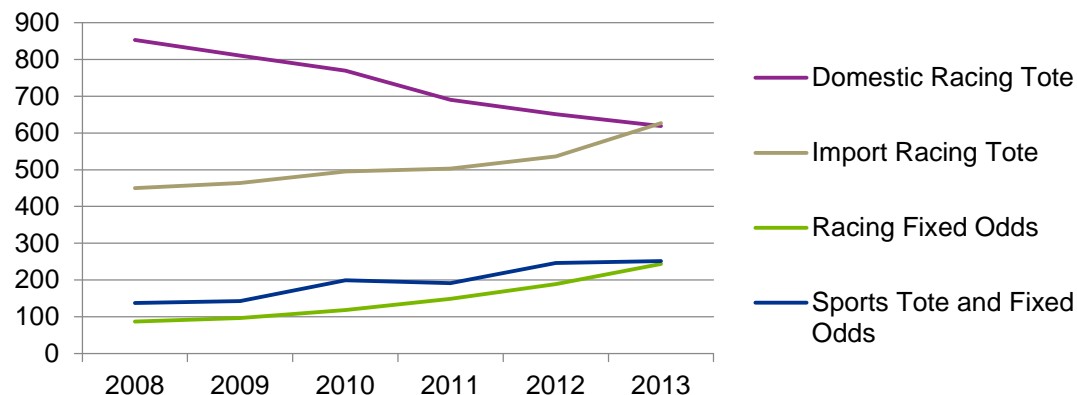
The business of racing (as opposed to betting) is dispersed in a large number of clubs with a range of governance and constitutional arrangements, with many reliant on volunteers to occupy governance roles. These bodies appoint the members of the code governance bodies and the codes are each represented on the NZRB Board (three of the seven Board members are code nominees). The Act requires that the Chair of the NZRB be an independent Board member.

The three codes and the NZRB keep each other informed through the quarterly Combined Racing Industry Group (“CRIG”) which is made up of the Chair and CEO from the NZRB and each code. There is also a monthly meeting of the four CEOs or their nominees referred to as the Chief Executives’ Forum.

Challenges

In line with overseas trends, totalisator betting in New Zealand as a business is declining. Although on-course attendance is estimated at around one million attendances across more than 1,000 race meetings, the NZRB considers that racing is steadily losing relevance with the New Zealand population. Participation in horse or dog betting fell from 25% of the adult population in 1985 to 14% by 2005. Off course betting (the majority of betting turnover) has been steadily shifting from totalisator to fixed odds, which overall has a lower margin. However, the growth of sports betting has offset this decline and, together with the introduction of Class 4 gaming machines to NZRB venues, helped NZRB profits to keep up with inflation.

Figure 3 – Trend in tote and fixed odds turnover (\$m)



Source: NZRB internal data

There have been huge increases in the alternatives for individual discretionary leisure spending, and increasing competition in terms of gaming options. Many New Zealanders use overseas internet gambling services that provide products which, under New Zealand law, can not be provided in New Zealand. The NZRB estimates that New Zealand customers lose \$35m annually to such overseas providers, who make no contribution to New Zealand racing or sport and pay no GST or duty.

These challenges have seen a small but steady decline in the real returns to owners, especially Thoroughbreds, as costs of ownership continue to increase. Probably as a consequence, the number of Thoroughbreds in racing is also declining slowly.

NZRB Strategy

The NZRB's strategy, as set out in the SOI, aims to increase the NZRB's turnover and profitability to increase the real and sustainable returns to owners of racing animals. It aims to broaden the customer base, modernise service delivery, optimise NZRB costs, and promote industry conversations to improve profitability for owners. The paradigm for this strategy is the current industry structure, roles, and scope of business set out in the Act. Within this paradigm the goal to broaden the TAB's customer base (and thereby increase turnover) is critical. Its failure would force more fundamental strategic questions to address the cost side of the NZRB and the industry.

Racing enjoys a standing in New Zealand society that gives it control, for its own benefit, over racing and sports betting in New Zealand. This standing acknowledges the place racing has in New Zealand's history, the large number of people who derive their livelihoods from this sector, and the high cost to owners of participating in the sport of racing.

The NZRB was established under the Act, which brought together the former Totalisator Agency Board and Racing Industry Board, recognising the overlapping interests and operational factors of betting and racing.

The objectives of the NZRB under the Act (section 8) are to:

- a) Promote the racing industry; and
- b) Facilitate and promote racing betting and sports betting; and
- c) Maximise its profits for the long-term benefit of New Zealand racing.

The functions of the NZRB under the Act (section 9) are to:

- a) Develop policies that are conducive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing.
- b) Determine the racing calendar each year, and issue betting licenses.
- c) Conduct racing betting and sports betting, and make rules relating to betting.
- d) Distribute funds obtained from betting to the racing codes.
- e) Administer the racing judicial system.
- f) Develop or implement programmes (or arrange for such) for the purposes of reducing problem gambling and minimising the effects of that gambling.
- g) Undertake (or arrange for) research, development, and education for the benefit of New Zealand racing.
- h) Use its resources for purposes that will directly or indirectly benefit New Zealand racing.
- i) Keep under review all aspects of racing and to advise the Minister of Racing of those aspects.
- j) Other functions given by or under the Act or any other Act.

In carrying out its functions, the NZRB must:

- a) Comply with the principles of natural justice; and
- b) Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

The Act requires the NZRB to arrange, at least once every five years, for an audit in relation to its performance and efficiency. Specific requirements for the audit are set out in Schedule 2 to the Act. The previous such audit was carried out in 2008.

KPMG conducted this audit in accordance with Terms of Reference, approved by the Minister for Racing, which are taken unmodified from Schedule 2 of the Act (refer Appendix 2 to this report). KPMG's objective in carrying out this audit was to form an independent view in line with the Terms of Reference. We met with selected senior managers and Board members from the NZRB, and the Chief Executives of each of the codes. We also reviewed a number of public and internal documents and Board papers. We considered a range of issues raised in the meetings or from our document review and independently assessed these issues to arrive at our view.

Under the Act, all decisions relating to the business or affairs of the NZRB must be made in accordance with its most recent SOI that has been presented to the House of Representatives. The most recent SOI covers the period 2013-16 and was presented to the House on 22 August 2013.

In KPMG's view, the current SOI is no mere roll-over of previous such documents. It is based on significant new detailed research and analysis and includes a major programme of change designed to:

- a) invest in up to date infrastructure, new products/services/channels to meet current consumer expectations, and an organisational culture of performance and customer service, and
- b) lead the racing industry into a different future from the past it has emerged from.

Although the focus of this audit is the present, some discussion of the recent past is essential to understanding current priorities and performance. We have presented this recent historical context early in the report.

Beyond presenting the context of the recent past we focused mainly on:

- The current NZRB strategy, reflected in the SOI, and the process used by the NZRB to develop its strategy and priorities.
- The existence and nature of plans and targets that support its key priorities under the current strategy, and the assignment of responsibility for these priorities.
- The relationship of strategies and plans to each of the ten statutory functions, as well as the "business as usual" objectives, risks, roles, delegations, policies and procedures supporting each function.
- Stakeholder engagement mechanisms and the managing of inherent tensions across the industry.
- Opportunities to improve efficiency.

The SOI articulates very well the strategic context, issues and priorities for the NZRB, based on the understanding we gained during our work. It would provide any reader of this report with more detailed background about the NZRB's strategic context, priorities and financial performance. Refer <http://www.nzracingboard.co.nz/other/>.

The new Board and CEO have found a need to invest in the basic organisational culture and infrastructure, to bring them in line with expectations for a \$1.9 billion business.

There is a new leadership team with six out of seven members recruited from outside the racing industry, beginning with the Chief Executive Officer (“CEO”) in August 2012, and the most recent appointment in August 2013. There is also a new Board. From 1 August 2012 five new members were appointed to the seven member board. The appointment of one of the two remaining members to the Chairmanship was subsequently overturned by the High Court, requiring a sixth new member who was appointed Chair in August 2013. A further new member has been appointed following the recent retirement of the last remaining member of the previous board.

Leading up to this time there had been two previous changes of CEO in three years, accompanied by periods of uncertainty for the staff. The operational financial delegation by the former Board to its CEO was relatively low (\$500k, compared to the current delegation of \$1m).

When the current CEO started in August 2012 he found the following, which we have verified by discussion, observation or examination:

- In general, the core bookmaking activities operated well and had been supported by ongoing investment in capability and tools. This core aspect of the business had been a priority for many years.
- By contrast the more general non-core functions had not kept up with growth of the organisation and in many areas were not in line with expectations for a complex business with \$1.9 billion in annual turnover, for example:
 - No strategy function, which would normally give rigour to the strategy and business planning process.
 - An aging and inflexible IT architecture with major inherent vulnerabilities and single points of failure.
 - No comprehensive risk framework or reporting, in spite of major inherent operational risks and an increasing betting risk profile.
 - A finance function with ten staff members, only one a qualified accountant. The internal financial information for management and the Board was inadequate for an organisation of the scale and complexity of the NZRB.
 - No clear profit retention policy to cover maintenance or future investment.
 - Inconsistent approaches to project management and insufficient rigour in preparing business cases.
 - A number of freehold properties and over 80 leases around New Zealand, but no facilities strategy. Property management was treated as an administrative function, and there had been little capital expenditure on the retail network.
- No real sales or performance culture that could support any plan to broaden the customer appeal of TAB, build customer experience and upsell to manage profitability actively. A typical TAB retail outlet has staff members stationed behind counters processing customers’ bets, as has been the case for the past several decades.
- No leadership training for many years.
- Relatively low staff engagement.
- Strategically significant contracts with clauses unfavourable to the NZRB.
- The three racing codes did not have full confidence in the Board or management and this was a barrier to a more coordinated industry.

A number of significant initiatives are under way to establish the platform for the NZRB's new strategy.

The new CEO has made it a priority to invest in increased capability, which the Board has supported. The investment in the new Racing Board Leadership Team ("RBLT") and people capability is the platform for addressing the historical issues. The following two tables set out these actions for, firstly, the industry and business issues and, secondly on the following page, the support services issues.

Table 2 – actions taken to address Industry and business issues

Issue	Actions taken
No real sales or performance culture	Leadership bonus scheme has been introduced to create, for the first time, widespread awareness of the NZRB's key financial target. We note that the scheme is based on current year NZRB profit rather than specific performance goals or longer-term strategy targets.
No leadership training	Implemented a leadership behaviours programme and regular meetings with the senior leaders across the NZRB to promote common culture and working across silos.
Low staff engagement	In the past year engagement surveys have shown a significant trend upwards from 66% to 79%, during a period of significant change.
Strategically significant contracts with unfavourable clauses	The renegotiation of international agreements is led by a member of the RBLT and there are clearly agreed internal negotiation parameters.
The three racing codes did not have full confidence in the Board or management	The NZRB has engaged proactively and constructively with industry bodies on the strategy and in the regular industry forums (CRIG and the monthly Chief Executives' Forum). The codes confirmed to us that the new RBLT and Board have the confidence of the industry and that the codes support the direction of the new strategy. Regular stakeholder surveys carried out by Nielsen commenced in April 2013 with the aim of monitoring perceptions of the NZRB performance by codes and other racing bodies. The NZRB is also working towards a periodic performance report to the industry, which will increase NZRB's accountability.

Source: KPMG review of NZRB documents, information gained during meetings with people from NZRB and codes.

Table 3 – actions taken to address support services issues

Issue	Actions taken
Lack of a strategy function	New strategy function created, which has led the strategy and SOI processes to achieve very good strategic clarity and a shared understanding about goals and priorities. The process used extensive internal analysis and external market research. The function continues to do in depth research to assess a range of potential strategic options.
Aging and inflexible IT architecture with major inherent vulnerabilities and single points of failure	A new IT architecture strategy, based on an “Enterprise Service Bus” and decoupling of the core totalisator from other functions, is being developed. This should make future product enhancements easier and less risky, and enable more opportunities to share infrastructure with strategic partners.
Finance function	New finance structure with more qualified staff members, strengthening the financial reporting and management accounting functions and adding treasury and tax functions.
No clear profit retention policy	The Board reviewed the balance sheet in detail in June 2013 with an intention to develop balance sheet and retention strategies.
Operational and betting risk management	Management commissioned a review of fixed odds betting risk management and has begun planning and recruiting for a more automated fixed odds environment, which will increase capacity and control.
Inconsistent approaches to project management and insufficient rigour in preparing business cases	A programme management office is now established to help ensure consistent approaches to project management, including stage gate disciplines and rigorous assessment of business cases. Finance is moving towards adding financial benefits promised in business cases to the owners’ budgets. There are no major “all or nothing” IT projects planned. Rather, changes will be in smaller chunks.
Facilities strategy	A Property Council is established and it will develop, for the first time of which we are aware, a facilities strategy.

Source: NZRB meetings and information verified by KPMG.

Investment in capability

NZRB has invested significantly in increased people and technological capability across the organisation since August 2012. This investment has increased the on-going staff cost base by approximately \$2m. Some of the codes are concerned about the size of this investment, given the estimated timeframe for benefits arising from the key initiatives (see the discussion about the financial impact of strategic initiatives on page 19), although the codes agree that some investment in capability has been necessary. It is reasonable to question “how much capability is optimal?” In April 2013 the Board reviewed the new positions and their bandings in detail under the heading of “Talent and Role Update and Return on Investment”. The NZRB should consider assessing the return on this investment as a whole, once the timeframe for benefits realisation is further advanced. The assessment could include the actual results of its strategic initiatives and any changes in NZRB’s risk profile attributable to the investment.

Recommendation:

1. That NZRB formally assesses, over the next two to three years, the return attributable to its investment in increased capability.

NZRB has invested significantly in increased people capability, which has increased the ongoing staff cost base.

In our view, the NZRB's process to develop its strategy has produced very good strategic clarity as the basis for shared understanding with the NZRB and with the codes. The process included significant new in-depth research.

The resulting key initiative areas and priorities seem reasonable. The specific initiatives that will bring them about have yet to be fully identified and quantified.

Overview of the process

In November 2012 the newly formed Strategy Group began facilitating a new strategy for the NZRB. The starting point was based on observations that the new CEO had made during his first three months, which were further developed into a list of possible initiatives during senior leadership planning discussions. The Strategy Group continued to develop the options and build a fact base – including:

- Internal business performance review including business unit in-depth analysis of betting, broadcasting, sales/distribution and information technology; and analysing long-term performance trends.
- Domestic economic, gambling and betting market performance and prospects.
- NZRB customer base analysis including the commissioning of what we understand from NZRB management is the largest research ever done in this market. This market research gives detailed insights into the behaviours and preferences of existing and potential customers across the spectrum of New Zealand society. (Note there is a significant proportion of people who will never be TAB customers.)
- Review of the New Zealand racing industry historical performance and evaluation of numerous industry reports.
- Assessment of international markets and peer companies globally.

The RBLT generated a first draft at a planning session in February 2013, based on the research and deep dives.

High level financial analysis was done for the key initiatives, including estimates of additional revenue and expenditure over the upcoming five years, in March and April 2013 ahead of a Board strategy day in May 2013. Management informed us that the Board clarified its risk/uncertainty appetite during the strategy day, and that this also helped fine tune the initiatives and prioritisation criteria. We reviewed the presentation to the Board and it shows clearly the basis for the NZRB's strategic imperatives and its key initiatives. The strategy process generated 20 key initiatives, of which seven were made a priority for 2013-14. The criteria for deciding these seven were (a) ability to execute – able to implement based on resources and capacity for change, (b) benefit realisation – to the industry taking into account uncertainty and risk, and (c) customer impact – extent to which it will increase the number of customers, and the duration and level of their spending.

Refer page 20 for a further discussion of the seven 2013-14 priority key initiatives.

The strategy and a draft of the SOI were discussed with the three codes as part of the CRIG process and feedback was sought from the codes, which led to further changes to the SOI. We understand from our discussions with the codes that there is general support for the broad direction of the strategy and the key initiatives – any disagreement is about the relative prioritisation of some specific initiatives.

The final version of the SOI was presented to the Minister for Racing for approval and subsequently to the House of Representatives in August 2013. The SOI reflects the same level of clarity that is evident from the Board presentation.

Without exception the matters raised by us in discussions had already been identified and, to some extent, assessed or pursued by the relevant leadership team member.

In our view the process for developing the current strategy has been comprehensive. The specific actions related to 13 key initiatives not prioritised for 2013-14, that will bring about the strategic initiatives, have yet to be fully identified and quantified.

The Board and leadership team are united behind the strategy, which also has broad support from the codes.

The strategic goals are very challenging. The strategy depends crucially on more customers spending more, in our view the single greatest strategic challenge.

The priority initiatives may enable long-term structural issues affecting costs to be addressed – IT architecture, digital strategy, review of channels and managing the balance sheet. However, the cost structure will be another major strategic challenge.

Support for strategy and process

It is clear from our discussions and review of documents that the Board and leadership team are united behind this strategy and that the NZRB is strategy-driven. The strategy is not sitting in a bottom drawer somewhere. Everyone we met with has a shared understanding of the key initiatives, why each is important, and what each entails.

The process is not yet aligned with the codes' strategy process, although there was a closer relationship in this round with the New Zealand Thoroughbred Racing process. This matter was raised in August/September 2013 as part of the Code Business Plan review process, and we understand NZRB and code CEOs continue to discuss a coordinated strategic planning process.

Achieving the strategic goals

The CEOs commentary in the SOI acknowledges that the strategic goals are aspirational and are not expected to be realised within the three years covered by that document. Subsequent to the SOI process, significant work is under way to identify and quantify further specific income and cost-saving opportunities with the intention that, within the 2017-18 financial year, the NZRB will achieve its strategic financial goals, namely:

- Net profit increase to \$160 to \$180m.
- 30% of income from new products and markets.
- Cost to income ratio below 30%.

These goals are very challenging. An increase in the number and spending of customers is clearly crucial to the strategy and, in our view, the single greatest strategic challenge. It means a significant demographic that currently does not bet will need to become regular bettors. The initiatives that may enable the NZRB to address long-term cost structures are: re-architecting the IT infrastructure (which opens the door to a wider range of options for future development and/or collaboration), digital strategy, review of sales channels, and more deliberately managing the balance sheet. However the cost structure will remain a major challenge.

Financial impact of the 20 key initiatives

There are high-level estimates of the financial impacts (both revenue and expenditure/investment) for each key initiative.

Some of the codes were understandably concerned about the size and timeframe for benefits arising from the key initiatives, especially in light of the investments already made and/or planned in NZRB's capability and infrastructure. In fact the original targets are proving to have been ambitious, with some targets subsequently revised downwards based on actual results and the emergence of regulatory and economic headwinds. We also understand that detailed modelling for business cases shows that, overall, some projects will cost more and the related benefits will be smaller and later than the high-level estimates in the SOI.

The NZRB has determined it will not expose the industry to a "big hit", which means it aims to maintain its current level of profitability in real terms. This requires a steady investment in any operating expenditure. We understand from NZRB management that there is probably significant capacity for investment on the existing balance sheet (total assets of \$125m, including \$66m of current assets, no term debt and equity of \$70m). However, given the commitment to maintaining profitability, any capital expenditure would need to be assessed in terms of the timing of depreciation versus benefits arising.

The key initiatives have a well structured system of assigned responsibility, accountability, monitoring and reporting.

Business case and project management disciplines are being strengthened.
Business planning capability is being developed.

The seven key initiatives given priority for 2013-14 are:

- Re-architect IT, to enable more flexible and efficient future development of customer channels.
- Introduce new betting products to broaden the customer appeal base.
- Attract more high value customers.
- Develop new digital channels, to make it easier for customers to do business and further broaden the customer base.
- Deliver a broadcasting strategy to position the NZRB in an international context and bring technology up to date.
- Strengthen the legislative review function to address leakage of income from New Zealand.
- Realign Board Venue locations to improve the gaming and betting footprint.

The framework for executing these initiatives is as follows:

- There has been a major investment to increase capability. Staff costs will increase significantly over the three years of the SOI period, and the Board and CEO expect the return on this investment will come from the successful execution of key initiatives.
- NZRB Board meetings and RBLT meetings include reviews of progress on key initiatives, which we note from our review of Board papers and minutes, the monthly CEO report to the Board, and from our discussions with members of the Board and RBLT.
- A monthly one page dashboard report summarises the progress and status of each of the seven key initiatives.
- Each initiative has a RBLT sponsor and there is also clear allocation of responsibility to the “owner(s)”.
- The programme management office is implementing a Project Review Board methodology that applies to all key initiatives.
- The business case framework is being strengthened and there is to be closer scrutiny of the estimation of costs and forecast benefits. The medium-term plan is that net benefits forecast will be added to the responsible manager’s budget, which would give managers a healthy tension between advocating for a project and being held to account for delivering its benefits.
- The business planning framework has been developed in the Strategy Group and is well developed in the Strategy and Transformation Division. This model is being used to roll out business planning, which is being done in a way that builds planning capability across the organisation. There is not yet a widespread business planning capability in the NZRB.

The leadership performance incentive scheme targets current year profit, rather than strategy. This could undermine longer-term objectives.

There is not yet a consistent approach to key initiatives in individual performance agreements. A new performance incentive scheme for the senior leadership group is based on the NZRB achieving its budget surplus for 2013-14. While we agree that this innovation is very helpful to develop a stronger performance culture, it lacks a long-term dimension. It may create a personal incentive for management to avoid any investment with a delayed payoff. We acknowledge that a long-term dimension is more difficult without a share price. The scheme was accepted by the Board's Compensation and Development Committee.

Recommendations:

- 2. That management continue to update the Board periodically on progress towards identifying and quantifying specific actions that will deliver the strategic goals under the future strategic initiatives. This information could also be shared with the codes. There is already good dashboard reporting on the current priority initiatives.***
- 3. That management consider the timeframe for introducing a longer-term element to the performance incentive framework.***

An effective and balanced Board together with the CEO and the RBLT are well engaged with the industry and focused on the NZRB strategy.

The organisational governance mechanisms are in varying stages of development – and are being developed in an appropriate sequence.

The previous section of this report dealt with the strategy process and the resulting strategic objectives and key initiatives. Our discussion now turns to the broader governance and management frameworks of the NZRB as an introduction to the following sections on each of the ten statutory functions, and efficiency.

Balanced independent Board: In our view, based on our discussions and review of Board minutes, the Board has a good mix of members and all members act in the interests of the NZRB as a whole. The Board has a balance of members with a mix of political, stakeholder, commercial, entrepreneurial, and financial skills and experience. There is also a balance between concern for the “big picture” and attention to detail. Members of the Board make an effort to be visible throughout the industry and this includes nominees of codes attending events relating to other codes. The Board has an established process of registering interests and managing conflicts of interest as they arise. The current Board composition and dynamic is a strength in the NZRB’s governance framework. The Board plans to perform its first self assessment in 2014 and we agree with this timing given the recent changes in the Board membership.

To support the Board’s governance role it has four committees, the Dates Committee, the Audit and Risk Committee, the Compensation and Development Committee, and the Net Proceeds Committee. Each committee has a terms of reference and calendar, and there are appropriate secretarial arrangements to enable effective support to the Board. The Board is currently in the process of establishing a Projects Committee.

Led by statute and strategy: The Board has acknowledged that the Racing Act serves as the Board’s charter and meetings are structured around the Act and the new strategy. There has not yet been any formal review of the performance of NZRB’s statutory functions and this should be reviewed as part of the compliance function’s programme and reported on in Management’s ‘Continuous Disclosure Confirmation’ paper to the Board.

Engagement with codes: In addition to informal commitment to visibility of both Board and senior management, the formal processes of CRIG and CEOs’ forum appear to be effective in helping to ensure the industry moves forward in a more coordinated way.

Delegations to CEO: The financial delegations increased from \$500k to \$1m. The CEO’s sub-delegations have similarly been updated. The delegated financial authorities policy is clear that if the delegations are silent on a matter then it should be brought to the Board for decision.

Clear assignment of responsibility: In relation to the statutory functions we found the responsibility for each function was clearly and consistently understood, although position descriptions did not necessarily spell out specific sections of the Act.

No organisation chart: There is no central reference source on all employee positions, titles, and reporting lines. This means that the scope of accountability of staff and management positions is not clear, which makes it difficult to fully assess and manage people’s performance.

Enterprise risk framework has begun: With changes in staff and the focus of the CEO on building a new leadership team and developing a new strategy, the enterprise risk framework has not been fully implemented. A manager has recently been appointed to develop and operate the enterprise-wide risk and assurance function. In October the RBLT held the first combined Finance and Risk meeting and identified NZRB’s most significant risks, with future discussions held in January to agree the NZRB’s risk appetite and consequence table. The internal audit function has been on hold since early in the CEO’s tenure, on the basis that while an organisation-wide improvement is under way there is limited value in carrying out independent assessments. All expenditure is subject to prioritisation in order to deliver the current year surplus target. We note that it would be usual for a \$1.9 billion turnover organisation undergoing change to continue to invest in proactive risk management frameworks, policies and processes including its internal audit function.

The biggest known risks are being addressed with the highest priority.

Meanwhile, the biggest risks are being addressed: The most significant of the identified risks are being addressed as a priority. The SOI process addresses strategic risks. The biggest operational and betting risks are being addressed with the highest priority, as described in the following table.

Table 4 – key known operational and betting risks

Issue	Actions taken	Further planned priorities
Inadequate business continuity planning with several single points of failure (systems and people dependencies) at Petone.	The re-architecture of IT infrastructure will enable much stronger business continuity and disaster recovery.	A gradual spreading of functions across the Petone and Parnell sites will, together with the IT re-architecture, strengthen organisational resilience and remove many single points of failure.
Health and safety framework outdated (NZRB issues relate mainly to on-course and broadcasting staff).	A manager has been appointed recently.	Development of a health and safety framework.
Fixed odds betting risk management.	Independent review of fixed odds controls. Planning and recruitment have begun for more automation.	Implement additional controls over fixed odds betting risks per the independent review. Implement automated environment.
Lack of focus on revenue and margins.	Development of strategies to drive margin growth, e.g. higher margin totalisator products. Senior leaders' incentive scheme.	Build sales management processes.
Equine influenza.		Planned agreement with the Government for management of disease incursion, with the intention to limit the possibility of an equine influenza outbreak.
Poor asset management.	Property Council established.	Development of a property strategy.

Source: KPMG analysis based on discussions and reviews of documents.

The policy and procedures framework needs more structure. It follows logically after the enterprise risk framework, which is still under development.

The policy framework will follow: Management intends that once the risk framework is more established a policy framework will follow, which is reasonable in our view. At present there are numerous policies, many of which are past their “review by” date. There is no consistent approach to identifying the risks a particular policy is intended to manage or the formal procedures needed to support the policy. There is no single place on the NZRB intranet that contains all policies and it was a manual process for NZRB staff to identify all the policies for this review. As already noted, management has employed a person with responsibility for the policy and procedures framework.

Recommendations:

4. *That a formal review of the performance of NZRB’s statutory functions be included as part of the compliance function’s programme and reported on in Management’s ‘Continuous Disclosure Confirmation’ paper for the Board.*
5. *That management develops and maintains a comprehensive organisation chart, which is an important part of any organisation’s control framework. It would also improve NZRB’s ability to develop internal and external benchmarking.*
6. *That management reassesses the timeframe for re-establishing its internal audit function, with a medium-term emphasis on independent assurance over change and investment processes, and gaps in control that can arise during periods of change.*
7. *That management sets a definite timeframe for establishing its organisational policy framework.*



The statutory functions



A high priority of NZRB is to build effective working relationships across the industry. This is the necessary foundation for working together to develop the industry for maximum overall benefit.

The supply of racing animals contributes directly to the size and quality of race fields, and better fields are more profitable for the TAB. There is evidence that this supply is related to returns to owners.

Statutory function (a) *“Develop policies that are conducive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing”.*

This function is primarily the responsibility of one RBLT member, with significant leadership from the CEO and Board.

Racing is both a sport and a business and people who participate in racing view it through a variety of lenses. Some people see racing as purely an entertainment business, some as a livestock business, some as purely a sport, and others as some combination of these. This is fertile ground for conversations at cross purposes, and for conflict. The Act describes racing as an “industry” and emphasises economic well-being of people who derive their livelihoods from racing. For the purposes of our audit we regard racing as a business with an ultimate purpose to maximise long-term distributions to owners of racing animals.

The new Board and CEO have made it a priority to be visible throughout the industry and to communicate openly. During our meetings with codes we received some favourable feedback about the NZRB’s open communication and the clarity of its information, for example the economic outlook for industry presented to code conferences.

The NZRB’s major areas of focus in terms of industry development are:

1. Increasing turnover and profits from betting and gaming, which are central objectives of the NZRB strategy. This is inevitably associated with public policy and legislation (discussed further on pages 30 to 34).
2. Increasing cooperation between the codes in a way that maximises the total returns to the industry for the benefit of all codes. The NZRB and the three codes will begin in early 2014 on a coordinated SOI process for 2014-17. The NZRB also has a focus on improving the current distribution model based on section 16 of the Act (discussed further on pages 35 to 36), and on optimising or “monetising” the racing calendar (discussed further on page 29).
3. The dispersed racing infrastructure which, if rationalised, may offer significant potential cost reductions for the benefit of distributions to owners. The CEO has introduced this conversation with the attention-grabbing label “the missing hundred million” – the total costs of operating codes, clubs and race meetings is about \$100 million annually – and the NZRB has analysed the costs in detail using publicly available financial information from every racing club. While the \$100m is clearly not “missing” the industry should be open to exploring this question, assuming the objective of maximising returns to owners. This total cost (including \$14m of recharges from the NZRB for broadcasting and totalisator services) equates to non-stakes expenditure of, for Thoroughbred, \$65k per meeting and \$7.5k per race; for Harness, \$50k per meeting and \$5k per race; and for Greyhounds, \$14k per meeting and \$1.1k per race.

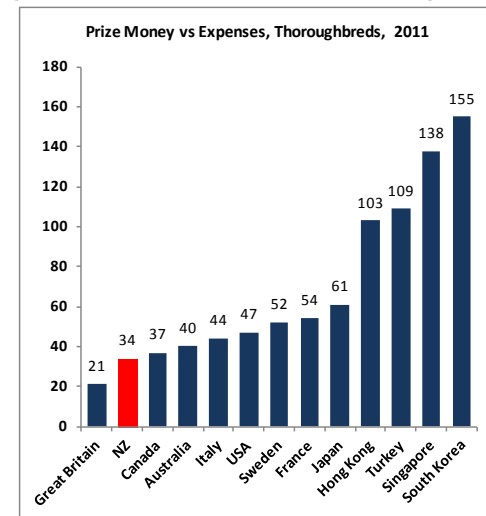
In our view the new Board, CEO and RBLT have made significant progress on building a better foundation of industry relationships, and the prioritisation of the matters it has raised seems reasonable.

There are big differences between New Zealand's industry and those overseas with the best returns to owners. The NZRB is focusing on the potential opportunities presented by these differences.

In developing its industry development priorities the NZRB has used data published by the International Federation of Horseracing Authorities ("IFHA"), that ranks New Zealand near the bottom of the world in terms of returns to owners of Thoroughbreds (Prize Money vs. Expenses, 2011).

According to the data there are only four countries in which returns to owners exceed the cost of ownership – South Korea, Singapore, Turkey and Hong Kong. We understand from the CEO that these countries all have a number of characteristics in common. The following table sets out those characteristics alongside a description of the New Zealand industry.

Figure 4 – returns to owners of thoroughbreds (%)



Source: IFHA

Table 5 – Characteristics of high-returning racing industries

Characteristic	Description	New Zealand
Vertical integration	A single body, with an emphasis on maximising distributions to owners, carries out all functions from operating race courses and meetings, organising the industry and controlling betting.	Three code bodies, each representing a large number of clubs.
Few race courses	The highest ratio in these four countries is South Korea, three race courses (population of 16.5 million per course), the lowest is Hong Kong, two race courses (population of 3.6m per course)	52 courses (population 0.09m per course).
Monopoly protection	Prohibitions on locals using overseas betting services, backed up by race fields legislation (preventing overseas providers from using race field information) and extending to blocking IP addresses.	The NZRB monopoly on taking bets on New Zealand races, not backed by race fields legislation or blocking of IP address.

Source: NZRB plus KPMG analysis.

The business of racing is dispersed in a large number of clubs with a range of governance and constitutional arrangements.

Our review of industry development would be incomplete without the following observation on the industry's governance structures. The business of racing (as opposed to betting) is dispersed in a large number of clubs with a range of governance and constitutional arrangements, with many reliant on volunteers to occupy governance roles. These bodies appoint the members of the code governance bodies following primarily representation principles. In our view, representation models of governance make it more difficult for governing bodies to take a long range view in the best interests of an industry as a whole.

Recommendation:

- 8. That the Board initiate, with the codes, a review of the governance structures of the racing industry with a view to supporting the long-term interests of each racing code and the industry as a whole, including industry efficiency.***

The NZRB runs a solid consultation process to confirm the calendar each year, in line with the principles of the Act.

There is general agreement in the industry that the calendar does not optimise profitability. It is a strategic priority for the NZRB to improve the industry profitability of the calendar, while being mindful of possible adverse effects on clubs and communities.

Statutory function (b): *“to determine the racing calendar each year, and issue betting licenses, under Part 5”.*

The Act also specifies that there will be a “Dates Committee” with members from the NZRB and each code.

There is clear assignment of responsibility within the NZRB for administering this function and we understand from our discussions that it is done well and to the satisfaction of the NZRB and the codes.

The codes each have their own industry dates committees that do significant work leading up to the first meeting of the Board’s Dates Committee (which includes nominees of the three codes). The Board Dates Committee agrees the first cut, considering each week of the draft calendar. The second meeting of the committee considers a calendar amended by NZRB staff and that takes into account code feedback, logistics (e.g. broadcasting) and the assessed capacity of punters to bet (e.g., Saturdays are big betting days and there is a degree of “punter fatigue” evident by Sunday). The Dates Committee aims to confirm the calendar by 30 April for the season beginning the following 1 August.

Day to day race scheduling is coordinated by NZRB staff in conjunction with Tabcorp, which coordinates the racing calendar in some states of Australia. Tabcorp also broadcasts New Zealand races in Australia and supplies Australian races for broadcast in New Zealand. The aim of this daily schedule is to maximise the overall profitability of betting (given that broadcasting attracts bets), balancing this against the desire for clubs to have their races broadcast in New Zealand.

The current process is based mainly on the existing historical calendar and ensuring a logical programme of racing, given logistical and other factors, building to priority meetings. It is generally agreed across the industry that this basis does not optimise NZRB or industry profitability.

The racing calendar is a balancing act between the historical scheduling of particular meetings, the desire of the codes and clubs to each maximise broadcast coverage of their races, and for the codes to each maximise their share of domestic betting turnover (due partly to the incentives contained in the distribution model, discussed on pages 35 to 36). The racing calendar is also a significant aspect of the NZRB’s strategy because, in theory, there is an optimum calendar and schedule of meetings and races that maximises total profits from New Zealand racing (derived from both domestic and export customers) for the benefit of all codes. In theory there is also an optimum broadcast schedule that maximises NZRB betting profits, that could at times favour Australian races over domestic.

We note that NZRB management has done some initial modelling of an optimised calendar, and that this could produce significant additional profit. Some of the codes have also done extensive analysis on the overall profitability of races and meetings compared to the current incentives. The RBLT expects to make significant progress in this direction for the 2015-16 calendar, though it wants to do more thorough modelling of the benefits and any proposals would need to consider the potential benefits against any detrimental effect on clubs, owners, trainers, and communities.

Statutory function (c): “to conduct race betting and sports betting, and make rules relating to betting, under Part 6”.

Race and sports betting is carried out by the “TAB” part of the NZRB, under the leadership of the Executive GM, TAB and a TAB Leadership Team.

There are three main product types:

Table 6 – TAB product areas

Product	Financial characteristics for TAB	Betting infrastructure
Racing totalisator	<p>“Risk free” rate of return in that a set percentage is deducted from each bet type (per the Betting Rules) before striking the dividend rates after the race results are declared. This is the TAB’s highest margin product type, although it is steadily losing share compared to other product types.</p> <p>For many races the pools are “commingled” with Tabcorp in Australia, thus providing a larger pool that may attract bets to the totalisator. The odds are the same for both TAB and Tabcorp customers, although the details of the commingling agreement currently produces some non-parallel financial outcomes between the two betting agencies.</p>	<p>The totalisator – core of the Jetbet betting engine computer system. It calculates and displays updated odds for every betting option from the time betting opens through to closing. It needs to be available throughout the race day to publish up to date odds and take bets, most of which are placed within the last few minutes before a race closes.</p> <p>The totalisator needs to replicate continuously with Tabcorp’s totalisator for all commingled races.</p>
Racing fixed odds	<p>Each bet placed is given a fixed price for the outcome, thus exposing the TAB to a “liability” for that outcome. A race is profitable if the total non-paying bets exceed the amount paid out on paying bets – the higher this difference, the higher the margin. Overall margins are considerably lower than totalisator, but turnover is growing.</p>	<p>A team of bookmakers sets the initial odds in their fixed odds system, which interfaces with the core Jetbet system. Odds need to be manually updated while betting is open to manage the TAB’s financial exposure to each possible outcome.</p>
Sports fixed odds	<p>Similar to racing fixed odds, although growing at a faster rate.</p>	<p>All the characteristics of racing fixed odds plus, with sporting events being of longer duration than races, a number of bet types remain open during the event thus requiring continuous updating of odds.</p>

Source: SOI and discussions with NZRB management.

There is also some minor turnover from sports totalisator products – sports pools for rugby, league and football.

The provision of these products involves a considerable distribution and broadcasting infrastructure, as set out in the following table.

Table 7 – distribution infrastructure

Channel/support	Description	Financial characteristics
Branches	The NZRB leases the premises, pays for the fitout, and employs the staff. There are staff-operated terminals and self-service kiosks. Some branches have the NZRB-operated gaming machines.	Mostly fixed costs.
Agencies	An agent pays costs such as power, phone and staff. Premises are provided by NZRB together with marketing and brand support .	Mix of fixed costs plus a variable component based on turnover. The incentive on agents is to generate turnover (to secure commission). There is no incentive to maximise profitability of bets.
Pubs and clubs	TAB facilities are provided within a pub or club and may contain either or both of staff-operated terminals or self-service kiosks.	Variable cost based on turnover. The incentives are to make the facilities available.
Regional management	There are regional offices in Auckland, Hamilton, Palmerston North, Petone, Christchurch and Dunedin. These offices house the regional managers and provide leadership for branch and agency staff and manage the distribution contracts.	Fixed costs.
Internet	Interactive website that publishes odds and takes bets, interfaces real-time with Jetbet. A mobile version of the site is about to be superseded by a mobile application. Filebet is used by very high value customers and it interfaces with their own systems.	Fixed costs, relatively low – mostly depreciation of up front capital investment.
Touchtone	Customers interact with Jetbet directly via their telephones.	Fixed costs, relatively low – mostly depreciation of up front capital investment.
Phone betting	Two call centres – Petone and Christchurch.	Mostly fixed costs (relatively high) with a variable component achieved through rostering on peak periods. Minimum bets have been set for this channel to help keep it economic.
On-course betting	TAB provides totalisator terminals and recovers the costs from the clubs and the clubs employ staff to operate the totalisator terminals.	Variable cost (high) based on cash turnover.

Source: Discussions with NZRB management.

Getting more customers, keeping them longer, and increasing their average spend are critical to the whole NZRB strategy.

A significant “catch up” investment in infrastructure and capability is needed, in addition to the new innovations in channels, products and customer experience.

There has been a progressive net migration of customers (through customer preference) from higher cost phone betting to lower cost internet channels. There remains a strong level of customer support for retail channels (branches, agencies, pubs/clubs). The retail strategy will aim for a stronger emphasis on profitability (in addition to turnover) in its retail channels and for an optimum mix of fixed and variable costs.

Broadcasting is critical to the conduct of race betting as there is a direct correlation between the broadcasting of a race and the betting turnover on that race. The NZRB broadcasts races on two television channels and a radio channel, which involves a considerable investment in outside broadcasting (“OB”) staff and equipment. Six OB trucks and crews provide coverage across New Zealand for broadcasting of significant live content. Broadcast of overseas races is provided via Tabcorp under a broadcasting agreement.

Strategies and plans

The NZRB’s objectives under the Act include to facilitate and promote racing betting and sports betting and to maximise its profits for the long-term benefit of New Zealand racing. This is a clear mandate to broaden the appeal of betting, not just to maintain services for those who are already inclined to bet. Our remaining discussion is based on this assumption.

In the NZRB’s own view it has, for the past several years, not kept up with the changing business environment and has made incremental improvements to its product offerings and channels that have met some of the evolving needs of its existing (and ageing) customer base. We note that there have been new products such as Final Field Place and the high margin tote bet type Place 6. Furthermore, management realises there is a need to attract the “Lotto” type of customer to the totalisator. However, research indicates that the TAB brand is a major barrier to most “Lotto” type customers and new totalisator products.

As previously noted, the SOI sets out numerous threats to NZRB’s business. These include changing consumer preferences within New Zealand, increasing competition for punters from overseas race and sports betting providers and on-line gaming providers, and threats to overseas coverage of New Zealand races. Customer preferences are moving away from the most profitable and least risky part of the business (totalisator race betting) and towards lower margin and riskier fixed odds betting on sports and racing. These changes mean that the NZRB needs to improve its turnover and/or product innovation significantly over the medium-term just to preserve its current levels of financial performance.

In fact, the NZRB’s longer-term strategy is to increase both its financial performance and the sustainability of that performance. The NZRB needs to “catch up” and invest to bring both organisational capability and infrastructure up to date. This view is well supported by the codes, although there are a range of views about how much investment is appropriate.

Case study – fixed odds betting controls

The trend towards fixed odds is slowly increasing the betting risk profile of the NZRB. Management reviewed the processes and controls over fixed odds betting in early 2013. This review concluded that the control framework is immature compared to equivalent overseas businesses, though similar to those overseas businesses at their equivalent stage of maturity. A number of remedial actions are under way and a priority for the TAB is to move towards a more mature and automated environment. Part of this plan is to recruit a key person with experience in such environments. The TAB management considers the fixed odds function is already at its full capacity in terms of customer betting options and that the move to automation will significantly increase this capacity.

There is much work to be done but some important first steps have been taken.

Beyond this “catch up” investment the key strategic initiatives are aimed at getting more customers, keeping more of them longer, and increasing their average spend on profitable products. These outcomes are critical to the NZRB’s strategy. The key initiatives each have clear responsibilities and resourcing, financial targets and direct governance oversight.

The following table sets out the key initiatives that relate to the conduct of race and sports betting. In summary there is much work to be done but some important first steps have been taken.

Table 8 – key initiatives that aim to increase TAB profits

Key initiative	Progress so far
Attract and retain new high value customers.	Responsibility has been assigned and targets have been set.
Product innovation, aimed at broadening and increasing the customer base.	One new high margin product (Triple Trio) has been released, though it has yet to broaden the customer base significantly.
Digital channel enhancement – mobile application and live streaming.	Live streaming is in place and the mobile application is well through development and nearing readiness for release.
Retail strategy, will aim to optimise the cost structure (variable versus fixed) and the incentives for operators to maximise turnover and profitability.	Retail conferences have been established in the past year and these include agencies.
Retail strategy, firstly addressing customer interactions, to be followed by the physical presentation of venues.	Recruitment and engagement of advisers is under way.
Racing calendar monetisation.	Topic of regular industry-wide discussions, with an expectation that significant progress will be made for the 2015-16 season.
Broadcasting strategy, recognising that turnover depends on TV coverage in New Zealand and overseas.	One experienced TAB senior manager has been assigned clear responsibility for three projects under this work stream.
Focus on international partnerships to maximise export earnings through bets placed overseas on New Zealand races.	Responsibility has been assigned and targets have been set.
Develop policies to address legislative issues affecting loss of business from New Zealanders and unauthorised use of New Zealand race field information.	Government relations position has been created and an appointment made.

Source: KPMG discussions with NZRB managers.

Updates to the Betting Rules follow a suitable process.

Compliance

The Betting Rules (that are issued pursuant to the Act, and have the standing of regulations for certain purposes) include the dividend percentage for every totalisator product. Any changes to the rules of betting are approved by the Board once management has provided a high level overview of rule changes including the potential impact on customer behaviour or satisfaction. We understand from discussions with management that some account is taken of the impact on profitability of any change to dividend rates (i.e. customer demand elasticity). The changes are then gazetted and made available to the public. We confirmed this process by the review of Board minutes.

We understand from management that all retail sites have a set of operating procedures that are periodically audited by the Business Development Team for compliance. We have not verified this programme.

Recommendation:

- 9. That the NZRB identifies and quantifies the impact of different forms of leakage to overseas gambling providers, and, if appropriate once the results of this work are known, use this to support a case for legislative remedies with the Government.***

The industry has agreed on the distribution model for the past three years. It also agrees that this model is at odds with maximising industry profitability. The NZRB has a priority to move towards a better model from 2015/16.

Statutory function (d): *“to distribute funds obtained from betting to the racing codes in accordance with sections 16 and 17”.*

The distribution model is among the most difficult to solve of the NZRB’s industry issues. It is a source of conflict, and also a significant potential opportunity.

The share of distribution to each code:

Section 16 of the Act enables the NZRB and the codes to agree on a basis for distribution (i.e. the way the NZRB surpluses are divided between the three codes), and provides a default formula in the absence of any such agreement. The default formula is that surplus is distributed to codes in proportion to the domestic racing turnover attributable to each code. The current industry agreement provides for a definite dollar amount for the year, based on share of turnover prior years with some adjustments. It also contains penalty clauses aimed at regulating the number of race meetings and races, and the size of fields (i.e., number of starters).

This model is at odds with maximising TAB profits. Domestic racing contributes a diminishing share of TAB profitability, which is also (and increasingly) based on imported races and sports betting. For example, the TAB may need to favour some imported races over domestic in the broadcast schedule (which will affect betting turnover), in order to increase its profitability, but this would directly impact on each code’s share of that increased profitability. The impact is even more obvious if the TAB needs to favour one domestic race over another from a different code to maximise its profitability.

The model is also at odds with maximising industry profits because of the penalties and incentives framework built into the model. These incentives are designed to optimise for the TAB the number of races and field sizes. Larger more even fields attract more bets to the totalisator (which earns higher margins than fixed odds) and, because they have a lower proportion of winning favourites, also gives a higher margin on fixed odds turnover. Some codes have assessed that the industry would be more profitable with fewer meetings and races.

The NZRB and the codes agree that the current distribution model does not support maximum profitability for the industry or even the TAB. They also agree that a better distribution model is needed, but that it will be very difficult for them all to agree on one – while all codes want to see the total size of the surplus increased (to the benefit of all codes) none would like to see any other code receive an inequitable share. There is general support to try for a significantly improved model for the 2015-16 season, which means it needs to be resolved by about April 2015 when the racing calendar for that season is confirmed.

The codes recognise they need each other. Greyhounds has much lower industry costs than the equine codes and is therefore more “profitable”, but Greyhounds could not support the TAB infrastructure on its own. Harness carries a share of the industry costs and night racing helps extend the domestic timetable. All codes need a viable Thoroughbred racing industry because, at 55% of TAB domestic racing turnover, it underpins the NZRB’s financial performance and provides much of the economic legitimacy for Government support of racing.

Distributions to clubs:

We understand from our discussion with NZRB and code management that the distribution from codes to clubs contains an incentive for clubs to maximise on course betting, even though industry costs would be lower if punters use interactive channels (e.g., their mobile phones).

The Board has reviewed the balance sheet in detail and is working towards a retentions strategy.

Retentions policy:

Historically, the NZRB has distributed roughly all of its accounting profits, with some exceptions for known short-term capital requirements. Ongoing capital expenditure has been funded from the depreciation charge on existing assets. The lack of a retentions policy may mask the longer-term economic burden of maintaining the NZRB infrastructure. The “racing services” charge to clubs for using totalisator equipment currently has no capital component for any equipment that has been fully depreciated. The Board reviewed the balance sheet in detail in June 2013. It noted that, in the absence of an identified need to retain earnings, it is unclear why NZRB would not maintain a 100% distribution policy. NZRB intends to build on this detailed review towards a full balance sheet strategy, which will include its retentions strategy. We note that the SOI includes retentions of \$3m in the 2013-14 year increasing to \$5m for the two years following.

New model:

The main factors that need to be addressed and/or overcome in developing a new model, and of which NZRB management are well aware, are:

- The distribution calculation should be economically sustainable so that the ongoing cost of maintaining the NZRB's capital infrastructure is reflected in the distributions/retentions. This would mean that factors beyond accounting profit should be included.
- The incentives and distributions should target maximum total industry profitability, without reducing any individual code's industry profitability.
- Consensus about the share of industry profitability that does accrue to each code will be difficult.
- The two equine codes' target average field sizes currently fall significantly below the calculated optimum for TAB profitability and there is a gradual decline in the number of racing horses in both equine codes.
- There is currently no incentive related to the overall quality of fields (for which the percentage of winning favourites may serve as a proxy).
- There are constraining factors such as calendar commitments, and the interests of owners (e.g. the number of racing animals available in particular areas).
- The returns to owners are lowest for Thoroughbred because they have the highest cost of ownership, meaning the industry profitability and sustainability issue is most acute for Thoroughbred.

Recommendations:

10. *That the NZRB initiate a discussion, with codes, about racing club incentives contained in the code distribution models to help ensure full industry alignment. Incentives should enable optimum profitability for the industry as a whole, as well as lowest cost betting channels.*

The judicial system has strengthened in independence with the creation of the Racing Integrity Unit in 2011.

Statutory function (e): *“to administer the racing judicial system in accordance with sections 36 to 41”*.

Based on our discussions there is widespread understanding in the NZRB that the viability of the racing industry depends on public confidence in the integrity of (1) racing, and (2) betting. The racing judicial system relates to the first aspect.

Racing Integrity Unit

The NZRB and the codes agreed to establish the Racing Integrity Unit (“RIU”) (25% ownership each between the NZRB and the three codes) that commenced operations in 2011 to carry out race day monitoring and investigation and collect samples for independent laboratory testing for banned substances. The Stipendiary Steward at each meeting observes race day activities and the races themselves to identify, follow up on and investigate possible breaches of the relevant code’s Rules of Racing. RIU also analyses betting data to help identify matters for investigation. An investigation may lead to a complaint being laid with the Judicial Control Authority (“JCA”), see below. The Stipendiary Stewards used to be employed by racing codes so the RIU brought the Stipendiary Stewards/Race Investigators for all codes under one body. This enables operational efficiency and sharing of good practices, and the separation of the investigation function from codes (the rule making bodies) should also increase public confidence in the integrity of the racing system.

The Board of the NZRB approves the budget of the RIU, which is \$5.7m, and also funds the laboratory services contract (approximately \$1.1m).

According to the RIU website, it employs a total of 34 staff members in offices in Auckland, Hamilton, Wellington and Christchurch, as well as regionally throughout New Zealand. The RIU also employs approximately 85 casual swabbing officials and race day typists.

Judicial Control Authority

The Act constitutes the Judicial Control Authority (“JCA”), an independent statutory authority that provides one-member or two-member committees (from a panel for each code) at every race meeting to decide on complaints under the respective codes’ Rules of Racing, as well as a non-race day decisions process and an appeals tribunal. The NZRB’s role is to approve the budget of JCA, which in practice it does in consultation with codes by re-assessing JCA plans and processes.

The annual budget is approximately \$1.3m, covering committee member fees, governance and administration.

The following table contains information about JCA activity levels.

Table 9 – JCA statistics 2011-12 racing season

Activities – all codes	No.
Charges	573
Protests	170
Rulings	28
Minor infringement notices	381
Non race day hearings	58
Appeal Tribunal hearings	14

Source: JCA Annual Report 2011-12.

A minor infringements process was introduced in 2011 to reduce the number of rulings and improve the efficiency of the process for all participants.

In summary, the integrity system's race day resources consist of one RIU staff member and a one-member or two-member JCA committee, plus the independent laboratory testing. There needs to be at least one RIU person on course, and the race day JCA committee structure does help to maintain confidence in the integrity of racing. We understand from our discussions with NZRB management that the two-member committee structure is long-established and the trial of one-member committees has been underway for certain race meetings for the past year.

Review of the system

In early 2013 the NZRB, in conjunction with the codes, engaged an independent reviewer to examine the RIU processes and this led to a number of changes to strengthen capability and effectiveness. The recommendations from that review included a review of the roles between JCA and RIU.

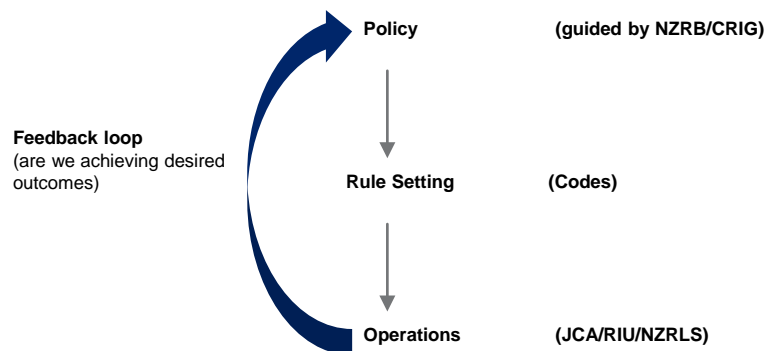
Following this recommendation, the NZRB recently arranged a facilitated workshop, involving the NZRB, the codes, JCA and RIU, to discuss the best future model for the New Zealand judicial system. The principles underpinning this workshop were agreed as:

- maintain the utmost integrity in racing
- provide a cost-effective service to the industry.

The NZRB facilitated an industry review of the system, with agreement to consider aligning penalties with Australia. This would increase the deterrent effect.

The workshop confirmed the following understanding of the racing integrity system:

Figure 5 – roles within the racing integrity system



Source: NZRB – output from a 2013 joint industry workshop.

A number of significant matters for consideration came out of the workshop aimed at improving effectiveness and efficiency, with a view to reporting back on these to the March 2014 CRIG meeting. One of these matters is aligning to the Australian penalties regimes for serious misconduct, animal welfare, and prohibited substance charges. This would increase penalties and therefore, it is hoped, give a greater deterrent. This direction seems reasonable.

The NZRB aims to be “best in class” in terms of its problem gambling procedures.

Statutory function (f): “to develop or implement, or arrange for the development or implementation of, programmes for the purposes of reducing problem gambling and minimising the effects of that gambling”.

This function relates to race and sports betting as well as the gaming machines subject to the rules for Class 4 activities under the Gambling Act 2003. The NZRB-operated gaming machines are all located in NZRB venues.

The NZRB’s stated aim is to be “best in class” in terms of its problem gambling procedures for betting and operating Class 4 gaming machines. The results of our review indicate that its activities are consistent with this aim.

The problem gambling and harm minimisation function is the clear responsibility of the General Manager Gaming and there are documented problem gambling policies and procedures. The NZRB’s procedures aim to reduce the likelihood of problem gambling by its customers, or to detect any problem gambling early. The problem gambling levy is NZRB’s contribution to minimising the harm from problem gambling that does occur.

Table 10 – TAB procedures problem gambling procedures

Procedure	Prevention	Early detection
An ongoing training programme delivered throughout the NZRB network in conjunction with Problem Gambling Foundation (“PGF”), with refreshers required every two years.	✓	✓
In addition, for Class 4 venues, further on site discussions with PGF trainers more personalised to the site and individual.	✓	✓
On-line training for staff, developed in conjunction with PGF and Clubs NZ, including an assessment and pass certificate at the end.	✓	✓
Information and advice about problem gambling on the TAB website and options for customers to voluntarily exclude themselves from venues and/or limit their betting.	✓	
Data analysis exception reporting on account activity to identify behaviour patterns or changes for follow up.		✓
NZRB venues do not serve alcohol and have shorter opening hours than many other Class 4 operators. The latest closing time is 10pm on a Friday night.	✓	

Source: Review of documents and discussion with NZRB management.

As a statutory Board, we understand from management that the NZRB seeks to interpret rules conservatively and not push boundaries. We are not aware of any instances of the NZRB pushing boundaries in the interpretation of any rules. The Department of Internal Affairs reviews the NZRB’s Class 4 activities and we understand management is not aware of any significant issues.

The NZRB arranges a number of investments on behalf of the industry, based on mutual agreement about funding levels and priorities. The governing body monitors the quality of research and outputs.

Statutory function (g): *“arrange for the undertaking of, research, development and education for the benefit of New Zealand racing”.*

The NZRB arranges a number of investments on behalf of the industry. The amounts budgeted each year are agreed with the industry because they are funded from the distributions of the NZRB profits to each of the codes. The current arrangements are:

- A \$250k research budget can be assigned to Greyhound or Equine research, and can fund equine projects recommended by either the Equine Trust (Massey Partnership for Excellence) or NZ Equine Research Foundation. The NZRB and the racing codes are well represented on the governing bodies, which monitor the quality of research and outputs.
- Agriculture ITO, which covers the training of racing and equestrian sector staff, \$160k annually based on historical funding levels.

The Act does not prescribe an amount of funding and the amount has been arrived at by mutual industry agreement. We are not aware of any concerns that the level of funding is either excessive or inadequate.



A number of initiatives are underway to increase the NZRB's efficiency, although it has not yet developed internal metrics and benchmarks to assess its efficiency.

Statutory function (h): "to use its resources, including financial, technical, physical, and human resources, for purposes that, in the opinion of the Board, will directly or indirectly benefit New Zealand racing".

In line with our comments elsewhere in this report, the NZRB complies with all of its statutory functions as specified in the Act (although it plans to comply at a higher level of performance in some cases) and the focus of its strategy is on improving the amount and sustainability of economic returns to the racing industry.

We consider that this statutory function includes an expectation that the NZRB will operate efficiently. We have already discussed that the strategy process gives early priority to activities that will have greatest financial impact for the level of effort required, and the attention given to industry costs. A number of measures taken or planned are aimed at increasing efficiency of the NZRB's operations:

- Rebuilding the IT architecture that will enable more flexible and less risky development of new product and also opens opportunities for sharing resources with strategic partners.
- The planned TAB retail and channel strategies.
- A new broadcasting strategy that includes a new partnership with Sky Network Television Limited, which will enhance content offerings, whilst reducing the cost burden of providing free to air coverage of Trackside.
- A plan for a strategic property function and the recent establishment of the NZRB Property Council, which will begin work on a facilities strategy. There are over 80 tenancies covering TAB branches, head offices and regional offices. Property management has previously been treated as an administrative function.
- A new procurement function that is intended to take a more active and strategic view.
- The NZRB has recently begun rationalising the property portfolio by closing the Ellerslie call centre and concentrating Phonebet in Petone and Christchurch. This change happened before the property strategy because there was general agreement that any strategy would include this change. These cost savings are offset in part by the establishment of the Parnell office, but this new office supports a strategy for greater resilience (by reducing dependence on Petone) and broadens the talent pool to support the investment in capability.

Using resources to benefit racing (continued)

The NZRB has yet to develop internal metrics and benchmarks for assessing and managing its efficiency. These should be developed in the near future to enable external and internal benchmarks trends and targets, and to more positively demonstrate efficiency. These should include:

- Salary costs as a ratio of a suitable market index (correlation score between job size and index mid point).
- Occupancy costs per square metre.
- FTEs per square metre of occupancy.
- Channel costs per transaction.

Our financial analysis section includes some work on comparing the overall financial performance of the 2008 and 2013 financial years by normalising the 2008 performance for 2013 conditions (e.g. GST rates and average betting margin), refer page 47.

Recommendation:

- 11. That management establish internal and external efficiency metrics, and begin tracking trends and setting targets. This will be an important part of the framework for managing towards the strategic goal of a cost to income ratio below 30%.***

There is a structured process to communications, which has increased visibility across the NZRB. The appointment to a new Government Relations Manager position has strengthened the function.

Statutory function (i): *“to keep under review all aspects of racing and to advise the Minister of those aspects, either on its own initiative or at the request of the Minister”.*

There is currently a well structured process for developing, discussing and approving formal communications (such as quarterly reporting to the Minister) and there is increasing visibility of the Board and management team. This process has become more structured under the current Board and CEO and we understand from discussions that there is greater visibility of the Board members and leadership team members.

The strategy process has identified that changes to legislation will be needed if the NZRB is to achieve its full business growth potential. Changes will be needed to protect New Zealand from uneven competition from overseas and possibly to allow the product offering to expand in line with current consumer preferences. Accordingly, higher priority is being given to the government relations function and a new manager has been appointed to help drive it.

The NZRB has responded when significant issues develop, such as in 2013 when the NZRB worked with the codes to make a joint submission on the Gambling (Gambling Harm Reduction) Amendment Bill.



Statutory function (j): *“Any other functions that it is given by or under this Act or any other Act”.*

The NZRB is a Class 4 operator under the Gambling Act 2003, and subject to oversight by the Department of Internal Affairs, and we are not aware of any significant related compliance issues. We are not aware of any other significant statutory functions.

The Act states that in carrying out its functions, the NZRB must also:

- Comply with the principles of natural justice.
- Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

We are not aware of any instances in which the NZRB acts contrary to these requirements.

Natural justice

Natural justice means freedom from bias, actual or perceived, and procedural fairness that keeps affected parties adequately informed on a timely basis with opportunity to comment. The most significant examples of the NZRB complying with this principle are:

- The structure of the integrity and judicial system separates the investigation and decision making functions.
- The current Board and CEO aim to have open relationships with the codes, and matters of significance are discussed with codes and industry and there are suitable consultation processes.
- The Act requires any model for distributing surpluses must have the agreement of at least two codes. In fact the current three-year model has the agreement of all three codes.

Social responsibility

The NZRB takes an active approach to social responsibility. For example:

- The “5 C’s” of the NZRB strategy include one called “community”, which involves building a more positive reputation through being connected to stakeholders and communities.
- Commitment to being “best in class” in terms of problem gambling harm minimisation.
- Industry development discussions include an awareness of the importance of the racing infrastructure to communities throughout New Zealand.
- The NZRB and codes are working towards joint oversight of animal welfare in racing.

Financial analysis



Normalised financial performance comparison 2013 to 2008

In comparing the overall financial performance with 2008, the date of the previous Performance and Efficiency Audit, it is appropriate to make allowances for significant changes in the environment. The following comparison includes normalising adjustments for the October 2010 increase in the GST rate (which reduces gross betting profit) and the shift in the market from higher margin totalisator products to lower margin fixed odds products.

Table 11 – normalised profit comparison 2013 to 2008 (\$m)

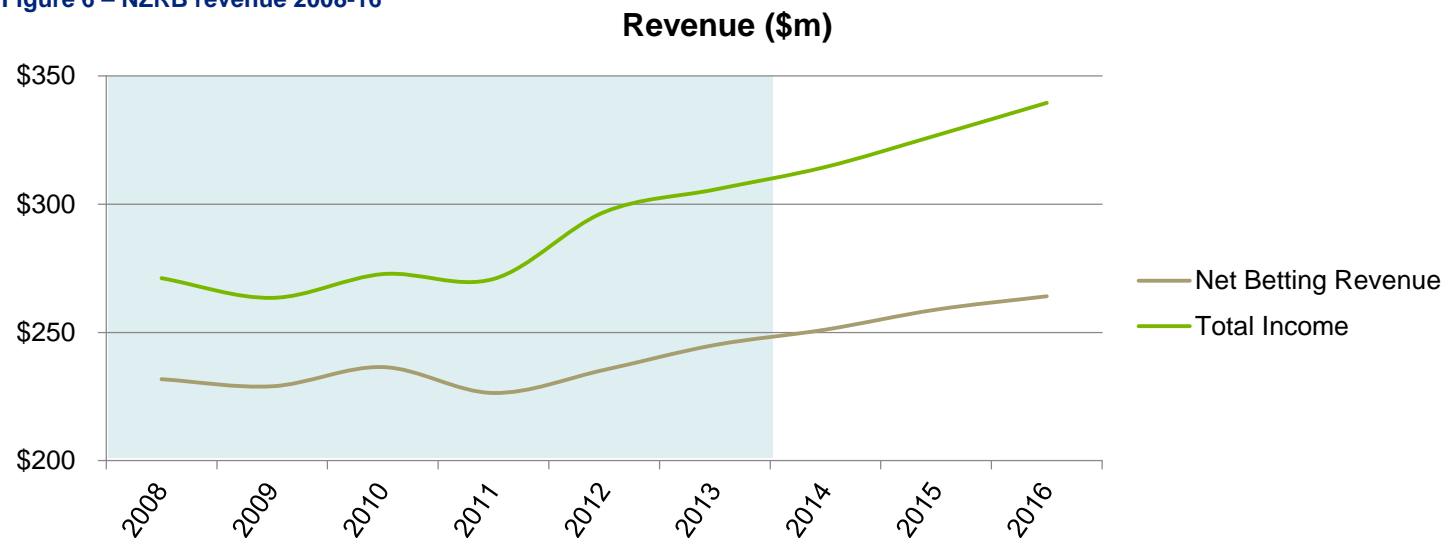
	2008	2008 @ 2013 GST rates and average dividend %	Adjust for CPI	2013	Variance
Total betting turnover	1,527.7	1,527.7	1,690.1	1,741.7	51.6
Dividends	(1,257.8)	(1,286.1)	(1,422.8)	(1,454.5)	(31.7)
Duty	(10.7)	(10.7)	(11.8)	(11.6)	0.2
GST	(29.6)	(35.5)	(39.3)	(37.8)	1.5
Other betting income and expenses	2.1	2.1	2.4	7.3	4.9
Net betting revenue (excl. gaming)	231.8	197.6	218.6	231.2	12.6
Net betting revenue (incl. gaming)	231.8	197.6	218.6	245.2	26.6
Net profit (excl. gaming)	130.9	96.7	107.0	135.0	28.0
Net profit (incl. gaming)	130.9	96.7	107.0	142.5	35.5

Source: NZRB analysis plus KPMG CPI analysis.

The table shows that, after allowing for a more challenging environment in terms of GST and betting margin, the NZRB's overall financial performance improved by \$28m in real terms over the period, excluding gaming. The total of the normalisation adjustments, which are favourable to this comparison, is \$34.2m. On a non-normalised basis and excluding gaming revenue, the NZRB has managed to hold its financial performance steady in real terms.

This and the next three pages summarise the financial performance of the NZRB since the previous Performance and Efficiency Audit in 2008, together with the related forecast information from the SOI.

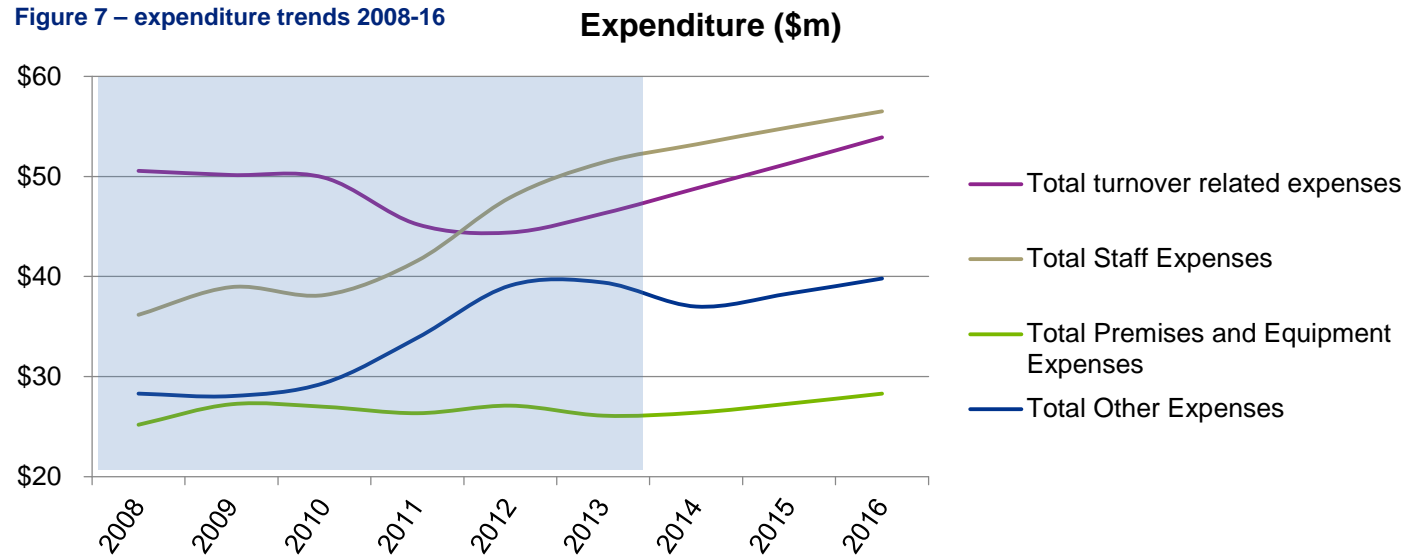
Figure 6 – NZRB revenue 2008-16



Source: NZRB financial models, aligned to the SOI.

- The trend from 2008 to 2011 was static, reflecting the decline in traditional customer base, offset by growth in sports betting. The decline 2010-11 includes the increase in GST, which comes off the net betting margin.
- Net betting revenue recovered in 2011-12 due to the Rugby World Cup and increased business from the NZRB's high value customers.
- The forecast growth in net betting revenue reflects expectations about new products and channels, and the growth in total income includes this growth as well as gaming and overseas.
- Total Income includes approximately \$14m annually of cost recoveries from the industry for broadcasting and totalisator services, as well as gaming and overseas betting on New Zealand racing. This is projected to grow in 2016 in line with investment in new broadcasting technology. The jump in 2011-12 and much of the projected growth relates to the introduction of gaming.

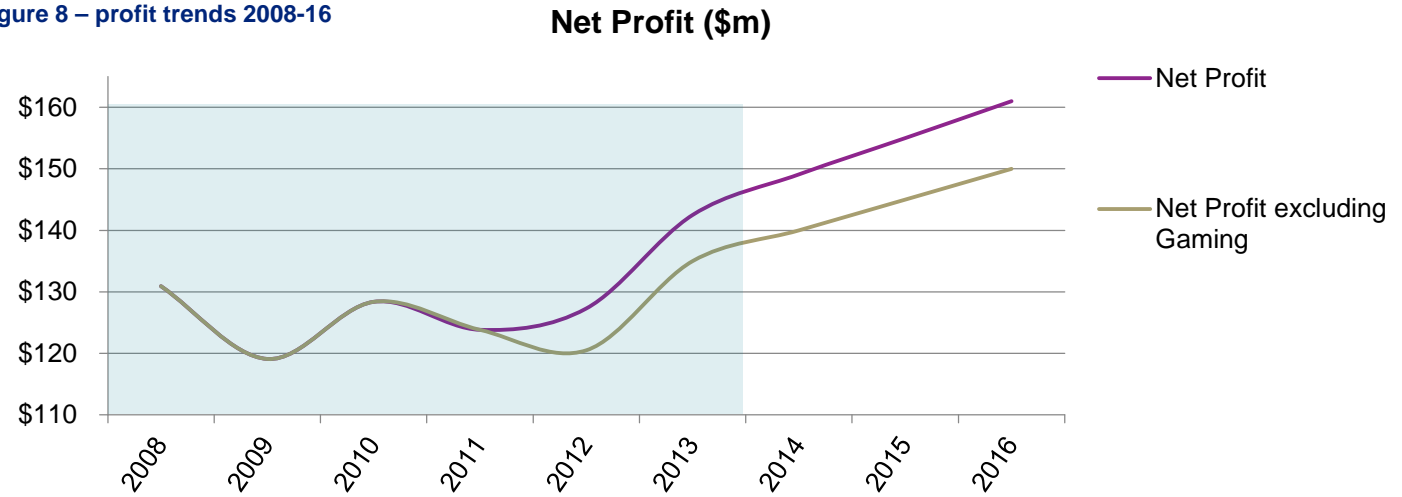
Figure 7 – expenditure trends 2008-16



Source: NZRB financial models, aligned to the SOI.

- Total Turnover Related Expenses fell in 2010-11 due to a significant net migration of customers from cash to account, reducing agency fees. The forecast reflects planned increases in turnover.
- Total staff expenses jumped in 2011-12 and 2012-13 reflecting the investment in capability and the related one-off restructuring costs. The investment in capability gives a higher on-going cost base.
- Total Premises and Equipment has been relatively static over the five years. The SOI figures include some growth related to IT infrastructure and retail premises.
- Other expenses include gaming expenses, which in the 2012 period account for \$4.8m, and in the 2016 period will account for \$9.6m. The dip in 2014 reflects management's plan to manage "discretionary" costs to offset increases in the other areas. The remainder of the growth 2013 – 2016 is mainly investment in new broadcasting technology and advertising to attract new customers.

Figure 8 – profit trends 2008-16



Source: NZRB financial models, aligned to the SOI.

- These projections show that gaming is essential to achieving the strategic goal range of net profit (\$160 to \$180m) within the 2015-16 year. Expected growth in international revenue is also important.
- The full return on investments in terms of profit is not expected until after the SOI planning horizon.

Appendices



Appendix 1 – Follow up on the 2008 Performance and Efficiency Audit

The report of the previous performance and efficiency audit report in 2008 contained a statement in its opening section that the NZRB's articulation of its strategic intent and strategic direction requires further development. In our view this was a key observation of that audit and the matter has been addressed very well through the most recent strategy process. The 2008 report made a further key observation about ongoing dialogue with stakeholders, which we consider is well on the way to being developed.

There were 14 formal recommendations in the report. In our view all of these recommendations have been satisfactorily implemented, with one exception - the Board has yet to schedule a performance self assessment (although it is a new Board and we understand from the Chair that it intends to carry out an assessment in the next twelve months).

Appendix 2 – Terms of Reference

Background

The New Zealand Racing Board was established by the Racing Act in 2003. The Act requires that, at least once every 5 years, the Board must arrange for an audit to be conducted in relation to how effectively and efficiently the Board is performing its statutory functions.

These functions are defined as follows:

- a) To develop policies that are conducive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing.
- b) To determine the racing calendar each year, and issue betting licenses, under Part 5.
- c) To conduct racing betting and sports betting, and make rules relating to betting, under Part 6.
- d) To distribute funds obtained from betting to the racing codes in accordance with sections 16 and 17.
- e) To administer the racing judicial system in accordance with sections 36 to 41 and Schedule 3.
- f) To develop or implement, or arrange for the development or implementation of, programmes for the purposes of reducing problem gambling and minimising the effects of that gambling.
- g) To undertake, or arrange for the undertaking of, research, development, and education for the benefit of New Zealand racing.
- h) To use its resources, including financial, technical, physical, and human resources, for purposes that, in the opinion of the Board, will directly or indirectly benefit New Zealand racing.
- i) To keep under review all aspects of racing and to advise the Minister of those aspects, either on its own initiative or at the request of the Minister.
- j) Any other functions that it is given by or under this Act or any other Act.

In carrying out these functions, the Board must also:

Comply with the principles of natural justice.

Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

Conduct of audit

Scope

In determining the Board's performance and efficiency, the person appointed to conduct the audit must take into account:

- the extent to which the Board has established objectives for the performance of its functions;
- the nature of those objectives;
- the progress the Board is making towards the achievement of those objectives;

Appendix 2 – Terms of Reference (continued)

- the extent to which the Board has put in place policies and strategies to use its resources effectively and efficiently for the purpose of achieving those objectives;
- the nature of those policies and strategies, and the manner in which they were put in place; and
- any other matters determined by the Board.

While the Act states that the audit must relate to the Board's performance on the particular day on which the audit is conducted, and its prospective future performance, the person conducting the audit may also have regard to the Board's performance during the five years before that day.

The audit will examine, verify, and if appropriate, validate the steps the Board has taken to date and recommend any further steps the Board should take to ensure that it is well positioned and capable of discharging its functions.

Consultation

The Board is required to consult with applicable industry organisations in the preparation of these Terms of Reference.

Appointment of auditor

To conduct the audit the Board is required to appoint a suitably qualified and experienced person who may not be a member, former member, or employee of the Board. The Board envisages that such a person would have relevant experience in the corporate governance of statutory and similar entities and, in particular, in the evaluation of the performance of governing boards.

Reporting

The person who conducts the audit must, after conducting it:-

- prepare a written report on the conclusions reached as a result of the audit; and
- provide copies of the report to the Minister, the Board, and the recognised industry organisations.

Fees and expenses

The Board will pay the reasonable costs of the audit to the person who conducts it in terms of fees and the reimbursement of expenses. The Board will ensure that the person appointed will be supported in the conduct of the audit by way of access to information and personnel and the provision of administrative support when requested.

The following policies were provided to us:

- Corporate Governance - Harm Prevention & Minimisation Policy
- Corporate Governance – Information Asset Protection Policy
- Corporate Governance - Physical Security Policy
- Corporate Governance - Delegated Financial Authorities Policy
- Corporate Services - Credit Card Policy
- Corporate Services - Asset Management Policy
- Corporate Services - Contracts Policy
- Finance - Cash Expenses & Allowance Policy
- Finance – Petty Cash
- Finance – Purchasing Policy
- Finance - Treasury Policy
- HR Policy - Code of Conduct
- HR Policy - Departures & Exit Policy
- HR Policy - Dress Code
- HR Policy - Education Support Programme
- HR Policy - Health and Safety Policy for Employees, Contractors and Visitors
- HR Policy - Harassment Prevention Policy
- HR Policy - Travel Policy
- HR Policy - Leave Policy
- HR Policy - Long Service Recognition Policy
- HR Policy - Phonebet House Rules
- HR Policy - Recruitment and Selection

Appendix 3 – Policies (continued)

- HR Policy - Smoke Free Environment
- HR Policy - Social Clubs and Associated Events
- HR Policy - Succession Planning
- Legal Compliance Guide - Racing Act 2003
- Legal Compliance Guide - Employment Relations Act 2000
- Legal Compliance Guide - Financial Transactions Reporting Act 1996
- Legal Compliance Guide - GST Act 1985
- Legal Compliance Guide - Health and Safety in Employment Act 1992
- Legal Compliance Guide - Privacy Act 1993
- Operational Risk Management Framework
- Operational Policy - Wagering Policy for Employees and Contractors
- Operational Policy - Sports and Racing Fixed Odds Betting Policy
- Technology Policy - Secure Computing Environment.

NZRB Board members

Glenda Hughes, Chair

Alistair Ryan, Board Member

Racing Board Leadership Team

Chris Bayliss, Chief Executive Officer

Monique Cairns, Executive General Manager, Strategy and Transformation

Stewart McRobie, Chief Financial Officer

Glenn Patrick, Executive General Manager, TAB

Colin Philp, Chief Information Officer

Martin Saunders, Chief Operating Officer

Emma Scott, Chief Talent Officer

NZRB management

Martin Burns, Head of Industry Liaison

Michael Dore, Head of Betting

Zoe Goodall, Head of Risk, Audit and Investigations

Megan Kloppenburg, Head of Financial Reporting

Sam Moncur, Head of Business Support and Management Information

Shameel Sahib, Head of Strategy

Michael Wemyss, General Manager Gaming

Code management

Jim Leach, Chief Executive, and Stuart Cashen, Racing Manager, New Zealand Greyhound Racing Association

Greg Purcell, Chief Executive, New Zealand Thoroughbred Racing Incorporated

Edward Rennell, Chief Executive, Harness Racing New Zealand Incorporated



cutting through complexity

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