Proactive release of an independent audit of fees

Licence fees were last set in 1999 and, other than GST adjustments, haven't increased since then. The cost of delivering regulatory activities including the issue of firearms licences has risen greatly since 1999.

A greater contribution is being sought from those who benefit from holding a firearms licence towards the cost of providing regulatory services (licences, endorsements, permits, approvals).

Decisions are yet to be made by Cabinet on any proposed fees.

Police has proactively released documents relating to information on the methodology for determining the proposed fees, costings of firearms licences and dealer's licences, and the relevant Cabinet paper and minute approving the release of the discussion document.

Earlier this year, an independent audit of fees was undertaken by Ernst and Young of Police's Fee Revenue Model and to assess Police's estimated recoverability of costs against the provisions of the Act.

Their scope included a detailed line by line review of the mechanical accuracy of the fees model; and other procedures designed to test the model's logical integrity.

They also assessed the basis of classification of costs between 'recoverable' and 'non-recoverable' and if that is consistent with the Arms Act 1983.

The Review confirms the cost model was sufficiently accurate to not overestimate the fees and may have underestimated them.

Ernst and Young found most of Police's cost recoverability assumptions used in determining the total level of recoverable costs are consistent with the provisions of the Arms Act and are not unreasonable.

Where Ernst and Young disagreed with the way Police have handled some cost assumptions, they believe these differences will not have a material impact on the proposed fees figures recently consulted upon:

"Considering the vast majority of costs relate to recoverable activities, this should not have a material impact." (see page 7 EY Report)

EY have found that the Cost Recovery does not include certain overhead costs currently covered by NZ Police - things like infrastructure costs, and information and communications technology ("ICT") systems.

It is EY's view that these costs may well have been recoverable and therefore total recoverable costs could have been higher than those actually included in the cost model:

"These excluded costs... may be recoverable and therefore total recoverable costs could be higher than those included in the Cost Recovery Model." (see page 7 of EY Report)

The paper attached is Ernst and Young Review.



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### NOTICE

Ernst & Young Limited ("Ernst & Young") was engaged on the instructions of New Zealand Police ("Client") to provide an independent review of the Arms Safety and Control Fee Revenue model and cost recoverability assessment (the "Model Review" and the "Assessment" respectively, in accordance with the CSOs dated 2 February 2023 and 25 January 2023 (together the "Engagement Agreement").

The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the report, are set out in Ernst & Young's report dated 17 March 2023 ("Report"). The Report should be read in its entirety including the transmittal letter, this notice, and the applicable scope of the work and any limitations which are set out in Appendix C, Model review report. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

Ernst & Young has prepared the Report on the instructions and for the benefit of the Client and has considered only the interests of the Client. Ernst & Young has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, Ernst & Young makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.

Our work commenced on 25 January 2023 and was completed on 17 March 2023. Therefore, our Report does not take account of events or circumstances arising after 17 March 2023 and we have no responsibility to update the Report for such events or circumstances as no further work has been undertaken after that date.

No reliance may be placed upon the Report or any of its contents by any party other than the Client ("Third Parties"). Any Third Party receiving a copy of the Report must make and rely on their own enquiries in relation to the issues to which the Report relates, the contents of the Report and all matters arising from or relating to or in any way connected with the Report or its contents.

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In preparing this Report we have considered and relied upon information from a range of sources believed to be reliable and accurate. We have not been informed that any information supplied to us, or obtained from public sources, was false or that any material information has been withheld from us. Neither Ernst & Young nor any member or employee thereof undertakes responsibility in any way whatsoever to any person in respect of errors in this Report arising from incorrect information provided to EY.



We do not imply and it should not be construed that we have verified any of the information provided to us, or that our enquiries could have identified any matter that a more extensive examination might disclose. Further, there will usually be differences between estimated and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. Our model review does not provide any comfort on whether the forecasted or estimated outcomes will be achieved.

Ernst & Young has consented to the Report being published electronically on the Client's website for informational purposes only. This is consented on the basis that only a PDF version of the Model may also be released by the Client to those who specifically request it. Ernst & Young have not consented to distribution or disclosure beyond this. The material contained in the Report, including the Ernst & Young logo, is copyright. The copyright in the material contained in the Report itself, excluding Ernst & Young logo, vests in the Client. The Report, including the Ernst & Young logo, cannot be altered without prior written permission from Ernst & Young.

## **New Zealand Police**

12-7-2

Arms Safety and Control Fee Revenue Model review and cost recoverability assessment

**Reliance Restricted** 

24 March 2023



THE L

Building a better working world



#### **Ernst & Young Limited**

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### **Reliance Restricted**

### New Zealand Police

180 Molesworth St, Wellington, PO BO Box 3017



### 24 March 2023

### Arms Safety and Control Fee Revenue model review and cost recoverability assessment

Dear Sirs

In accordance with your instructions, we have performed the work set out in our CSOs dated 2 February 2023 and 25 January 2023 (together the "Engagement Agreement") in relation to the independent review of the Arms Safety and Control Fee Revenue model and Cost Recoverability Assessment (the "Model Review" and the "Assessment" respectively).

This report contains the following work performed by EY: (i) An assessment of the recoverability of costs set out in Arms Safety and Control Cost Recovery Model (the "Cost Recovery Model") prepared by New Zealand Police and (ii) An independent review of the financial model, "Arms Safety and Control Fee Revenue Model - FINAL v0.4 13 March Updated TEST.xlsx" (the "Model").

- Assessment: The cost recoverability assessment in relation to the Cost Recovery Model considers whether costs assumed by New Zealand Police management ("Management") to be recoverable from customers (including firearms license applicants) appear to be consistent with the Arms Act 1983 ("the Arms Act") and highlights areas of judgement.
- Model review: The Model Review workstream includes a detailed line by line review of the mechanical accuracy of the Model and other procedures designed to test the Model's logical integrity. Our findings are presented on page 11 of this report.

#### Purpose of our report and restrictions on its use

This draft Report was prepared on the specific instructions of New Zealand Police solely for the purposes set out in the Engagement Agreement and should not be used or relied upon for any other purpose.

This draft Report and its contents may not be quoted, referred to or shown to any other parties except as provided in the Engagement Agreement.

We accept no responsibility or liability to any person other than to the New Zealand Police, or to such party to whom we have agreed in writing to accept a duty of care in respect of this draft Report, and accordingly if such other persons choose to rely upon any of the contents of this Report they do so at their own risk.

#### Nature and scope of the services

The nature and scope of the services, including the basis and limitations, are detailed in the Engagement Agreement. We also set out specific limitations with respect to the model review workstream in Appendix C of this report.

Except as otherwise noted, we have not analysed or commented on macroeconomic or geopolitical conditions that could impact the prospective financial information ("PFI"). We have not provided any opinion, conclusion or any type of assurance about specific assumptions or components of the PFI or on the PFI as a whole. There will usually be differences between estimated and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We take no responsibility for the achievement of projected results.

This is a draft Report reflecting the findings of our work from the project commencement on 25 January 2023 up until 24 March 2023. Our draft Report does not take account of events or circumstances arising after 24 March 2023 and we have no responsibility to update the draft Report for such events or circumstances.



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### **Reliance Restricted**

New Zealand Police 180 Molesworth St, Wellington, PO BO Box 3017

We appreciate the opportunity to provide our services to the New Zealand Police. Please do not hesitate to contact us if you have any questions about this engagement or if we may be of any further assistance.

Yours faithfully,

Ernst and Young Limited

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# Summary of Findings

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Basis of Cost Recovery Model preparation and cost recoverability assessment

- We have undertaken a cost recoverability assessment in relation to the Cost Recovery Model. The assessment considers whether costs assumed by New Zealand Police management ("Management") to be recoverable from customers (including firearms license applicants) appear to be consistent with the Arms Act 1983 ("the Arms Act") and highlights areas of judgement. We have assessed the basis of classification of costs between recoverable and non-recoverable, but have not carried out an assessment of the reasonableness of the forecast costs themselves or their underlying assumptions. Further, we make no recommendations as to the level of costs should be recovered or fees charged. We only considered consistency with the allowable cost recovery under the Arms Act. For the avoidance of doubt, we have not advised the client on setting the cost of the Arms Safety and Control function. We also note that our scope did not include consideration of the appropriateness of the accounting policies adopted or whether the cost items are consistent with the policy adopted during the historical period.
- Our cost recoverability assessment was based on the following documents provided by New Zealand Police: (i) "Arms Safety and Control DBC Finance Model v0.13" and (ii) documents outlining the assumptions used in preparation of the Cost Recovery Model ("Arms Regulator - DBC HL Organisation Design Assumptions 0.9 RE", "Arms Regulator - DBC Transition Plan Assumptions 0.8 RE"). We have also held discussions with Management.
- The Cost Recovery Model, originally prepared in 2021 covers an 11 year budget period from FY22 to FY32 and is based on (i) historical financial data, (ii) demand data reflecting change in volumes over the budgeted period, and (iii) mandated general wage increase (GWI) and competency service increment (CSI) rates based on latest collective bargaining agreements. Management has prepared a view of recoverable costs for 10 year period from FY23 to FY32 reflecting 10 year licensing period.
- The key sections of the Arms Act with respect to cost recoverability are s80 Activities that may be subject to recovery, s81 Criteria for cost recovery and s83 Methods of cost recovery. See Appendix A of this report for further details of these sections. In addition, s1A of the Arms Act defines the purposes of the Arms Act as (a) to promote the safe possession and use of firearms and other weapons and (b) to impose controls on the possession and use of firearms and other weapons. This purpose has been considered by Management as part of its cost recoverability assumptions.

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Cost recoverability The Cost Recovery Model includes \$711.5m of total costs to carry out and manage the Arms Safety and Control function over an 11 year period from FY22 to FY32. New Zealand Police have made certain assumptions for each cost type as to whether the cost is recoverable and have determined that \$526.5m of total costs are recoverable over the 10 year licensing period from FY23 to FY32. It is our view that the vast majority of Management's cost recoverability assumptions used in determining the total level of recoverable costs are not unreasonable and appear to be consistent with the provisions of the Arms Act. The Arms Act allows recoverability of both direct and indirect costs, however, these terms are not defined in the Act. Further, the Arms Act recoverability criteria does not consider whether capital expenditure or depreciation on capital items should be captured. We note certain cost categories where Management has applied its own judgements and others where there are some inconsistencies implying recoverability should be further considered. These areas are indicated in our cost recoverability assessment summary on the following page. Forecast costs included in the Cost Recovery Model are broadly split into the following cost types: business as usual ("BAU") opex, transition opex, wage increases, overheads, depreciation, contingencies and capital costs. We note that the Arms Act recoverability criteria per s80-81 reflects the relevance of costs to carrying out the Arms Safety and Control function, classified by type of services provided to the public. The Arms Act does not specify recoverable cost categories by nature. Management has assumed that business as usual costs to run the Arms Safety and Control function (including both direct and indirect costs) are viewed as recoverable costs given these costs have been incurred historically to provide the services set out in the Arms Act. We note that the ongoing overhead and support costs of running the Arms Safety and Control function are assumed to be recoverable on the basis that they are indirect costs supporting the relevant activities. Given there are some activities of the Arms Safety and Control function that could be viewed as non-recoverable, then recoverable overhead costs would be expected to be reflective of the overhead costs allocated across recoverable activities only. Considering the vast majority of costs relate to recoverable activities, this should not have a material impact. Non-recoverable costs include certain transition costs incurred as part of the move to a new operating model, costs outside the 10 year licencing period from FY23 – FY32, funding costs and certain capex costs. **Excluded costs** The Cost Recovery Model total costs of \$711.5m do not include certain overhead costs currently covered by NZ Police (infrastructure. information and communications technology ("ICT") systems and broader police corporate support cost) as it is assumed the Arms Safety and Control function will continue to be hosted by NZ Police. In the event Arms Safety and Control was run as a standalone entity, significant additional overhead costs could be incurred. No allocation of these NZ Police overhead costs is included in the Cost Recovery Model notwithstanding that such costs could be considered indirect costs of undertaking relevant activities. In addition, total forecast costs do not capture the overhead cost, GWI and CSI associated with existing staff at the time of Cost Recovery Model preparation (estimated by Management at \$3.4m for overhead cost and \$7.2m for GWI and CSI) and only include costs in relation to additional assumed FTEs. This is due to the fact that existing FTE costs are based on a separate wage bargaining exercise through the 2022 budget period led by NZ Police and funded by the Crown. Further, fleet costs in relation to vehicles for Arms Vetter roles have been budgeted as a mix of Skoda Kodiag and Skoda Superb vehicles (as detailed on page 17 of this report). However, certain regions have ultimately required 4x4s and all-wheel drive vehicles, and the additional cost of these vehicles has not been included in the Cost Recovery Model. These excluded costs, where directly or indirectly attributable to relevant activities, may be recoverable and therefore total recoverable costs could be higher than those included in the Cost Recovery Model. Please refer to page 10 for more details in regards to costs not

built in to the Cost Recovery Model.

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Cost recoverability assumption appears to

align with the Arms Act provisions

Cost classification needs further consideration

Cost recoverability assumption does not align with the Arms Act provisions

Cost category, NZ\$m	Total forecast costs for 11 year period* FY22 – FY32	Total forecast costs for 10 year period* FY23 –FY32	Assumed recoverable	Assumed recoverable costs* FY23 – FY32	In line with Arms Act 1983	EY Comments
BAU Opex excluding prevention and education (P&E)	451.6	427.9	Yes	427.9		The vast majority of BAU opex costs relate to recoverable activities per s80 of the Arms Act, however a small portion does not appear to align, see line below.
BAU Opex P&E employee cost	6.5	6.5	Yes	6.5		Prevention and education employee costs totaling \$6.5m are not specifically referenced as recoverable in the Arms Act. Management has applied judgement to treat as recoverable on the basis that they are in line with the broader purpose of <i>s1</i> of the Arms Act.
BAU Opex P&E other cost	4.7	4.7	Yes	4.7		Prevention and education other costs are not specifically referenced as recoverable in the Arms Act, however, Management has applied judgement to treat as recoverable on the basis that they are in line with the broader purpose of the Act. A portion of this cost related to training services provided to clubs and ranges potentially aligns with the cost recoverability provisions of the Arms Act, however, a detailed review of the exact activities to which these costs relate should be considered to further assess alignment.
Transition Opex	29.2	22.0	No	-		Assumed to be non-recoverable, costs related to transition to new operating model.
General Wage Increase (GWI)	13.1	12.9	Yes	12.9		BAU cost based on agreed collective bargaining outcomes, appears to align with recoverable activities per s80 of the Arms Act. GWI has been budgeted for the growth in FTE only and does not account for GWI on the existing headcount (248 FTEs).
Competency Service Increment (CSI)	13.1	13.1	Yes	13.1		BAU cost based on agreed collective bargaining outcomes, appears to align with recoverable activities per s80 of the Arms Act. CSI has been budgeted for the growth in FTE only and does not account for CSI on the existing headcount (248 FTEs).
Salary Loading – Annual Leave	1.4	1.3	Yes	1.3		BAU cost for annual leave loading for new FTEs, appears to align with recoverable activities per s80 of the Arms Act
Overhead (Regulator)	22.7	20.8	Yes	20.8		Overheads attributable to the Arms Safety and Control function. Whilst classification as recoverable cost appears to align with the Arms Act, a calculation error has been made. Constabulary overhead rate of \$17.9k has been used for all employees instead of rate of \$13.9k for non-constabulary roles. Management estimated the error as a \$1.6m overstatement. Overhead costs have been budgeted for the growth in FTE only and do not include overhead for the existing headcount (248 FTEs).
Depreciation	37.8	37.8	Yes	37.8		The Cost Recovery Model is built up to forecast depreciation and capital cost as separate lines. We note that FY29-F32F Registry Build depreciation cost (beyond initial 5-year useful life period) reflects an assumption that there is re-investment in the fixed asset base as assets reach the end of their useful lives; however, the forecast does not set out any capital costs reflecting asset re-investment within the capital cost budget line. Depreciable capital cost is forecast at \$20.8m comprising registry build \$20.1m and property fitout \$0.75m. FY29-FY32F depreciation of \$17m is forecast based on assumed asset re-investment. This has no impact on the cost recoverability assumption as detailed on page 18, noting that the Arms Act is not clear whether depreciation or capex costs are recoverable. Considering uncertainty around technology capability available beyond the useful life period, management considered practical to base the estimate of re-investment off the current cost.
Capital Charge	11.0	10.7	No			Capital charge is based on 5% of long term asset value and represents a cost of capital of funding from Treasury. Assumed to be non-recoverable given fee relates to funding.
Agency & Tagged Contingencies	98.3	89.9	No	-	•	Assumed to be non-recoverable as quantitate risk assessment ("QRA") based contingency. Captures risk based adjustment (including risks related to BAU Opex) estimate for costs that would be categorised as recoverable. However, Management assumes the contingency amount will not be recoverable.
Registry Build (ICT Assets)	20.1	14.6	No	-		Assumed to be non-recoverable, capital costs related to the transition to new operating model.
Property	0.8	0.0	Yes	0.8		Office fit-out costs has been included as a recoverable cost as an error in addition to the depreciation component which is also assumed to be recoverable. We consider this cost should have been captured as a capital cost with only the depreciation component of the office fitout costs recoverable as per other capex items. \$0.8m impact does not appear to be material.
Other Capital	0.8	0.8	Yes	0.8		Relates to purchase and set up costs of shipping containers used for arms storage. Classification of this cost as recoverable is not in line with other capital cost assumptions in the Cost Recovery Model, whereby capex costs are reflected in a separate cost category as unrecoverable, with depreciation classified as a recoverable cost. Minimal impact on total recoverable costs due to the fact that this item has not been depreciated within the depreciation line in the Cost Recovery Model (except for 1-year depreciation cost of \$153k captured in FY24).
Total	711.5	663.0		526.5		

\*Note: The schedule presents (i) total costs for 11-year budget period (FY22-FY32) as budgeted as per Cost Recovery Model (for information purpose), (ii) total budgeted costs for 10-year period (FY23-FY32), including recoverable and non-recoverable costs, and (iii) recoverable costs for 10-year period (FY23-FY32). 10-year period represents 10-year licensing period.

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- The Cost Recovery Model forecasts \$711.5m of total costs to carry out and manage the Arms Safety and Control function over an 11 year period from FY22 FY32. The total costs of \$711.5m do not account for the hosting cost by NZ Police; further, these total costs do not capture the overhead cost, GWI and CSI associated with the existing staff at the time of Cost Recovery Model preparation.
- Management has assessed certain costs do not qualify under the recoverability criteria per the Arms Act and, therefore, have excluded from the total recoverable costs, which is estimated at \$526.5m.
- Management assumes the following costs are not recoverable:
  - FY22F costs (\$48.5m): The Cost Recovery Model total costs of \$711.5m have been forecast for the 11 year period from FY22 FY32F whilst recoverable costs of \$526.5m cover the 10-year licensing period from FY23 FY32.
  - FY23-FY32F Transition Opex (\$22m): certain costs have been forecast as part of the transition to a new operating model for arms safety and control, these costs have been captured within transition opex costs. These costs primarily relate to people costs and are expected to be incurred prior to the transition to the new operating model.
  - ► FY23-FY32F Capital Charge (\$10.7m): reflects the charge payable to Treasury for capital funding use. This has been excluded from recoverable costs on the basis it reflects the cost of capital funding.
  - FY23-FY32F Contingencies (\$89.9m): The Cost Recovery Model captures contingency costs based on a quantitative risk assessment as required for detailed business case submissions to the Crown. These contingency costs have been viewed by Management as non-recoverable costs.
  - FY23-FY32F Registry Build (\$14.6m): reflecting capital cost of building up a platform to carry out and manage the Arms Safety and Control function. The capital cost is excluded, however, depreciation of the registry build is captured within recoverable costs as part of depreciation cost.
- ▶ For more details please refer to page "Bridge Total costs to Recoverable costs".



#### Bridge – Total costs to assumed recoverable costs

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Cost uplifts considerations not built-in in the cost recovery model	<ul> <li>The Cost Recovery Model excludes certain potential cost uplifts that may result in actual costs and thus actual recoverable costs being higher than those forecast in the Cost Recovery Model. We understand that certain cost assumptions may be updated in subsequent versions of the forecast model, but include the following items based on the version of the Cost Recovery Model we have assessed.</li> <li>Inflation impact: the Cost Recovery Model is prepared on an inflation-free basis as has been internally agreed by NZ Police. The cost uplift in relation to GWI and CSI rates has been agreed for FY22-FY23F based on the results of a collective bargaining process and negotiations for assumed new FTEs. No further GWI and CSI rates are budgeted for FY24 through FY32 as these will be dictated by the negotiations for the next budgeting cycle.</li> <li>Stand alone costs: the Cost Recovery Model is built on the assumption that the Arms Safety and Control function remains part of NZ Police and therefore has certain administrative functions and related costs covered by NZ Police. The cost recoverability model doesn't consider indirect costs outside of the Arms Safety and Control function which support the function and therefore could be considered recoverable. In the event the Arms Safety and Control function which support the function and therefore could be considered recoverable. In the event the Arms Safety and Control function is subsequently established as a stand alone entity, there could be significant additional operating costs involved.</li> <li>Actual FY22 costs: we have been informed that certain actual FY22 costs have been at a higher level than budgeted and as such will impact the cost base for the forecast period. Identified cost shortfalls include:</li> <li>Learning has been assumed as being fully virtual (and captured within e-learning portal costs in the Cost Recovery Model). However, employee training in relation to firearm handling is to be carried out in person on semi-annual ba</li></ul>
Depreciation and capex	<ul> <li>Re-investment: The Cost Recovery Model includes an initial capital investment of \$21.6m related to the asset base of the new operating model. These assets are assumed to be depreciated using the straight line method over a useful life of five years. The forecast assumes depreciation is charged in the same annual amount for years 5 to 10 of the forecast on the basis there is assumed re-investment in the asset base. However, the Cost Recovery Model does not include any reinvestment capex within capex budget line. Considering uncertainty around technology capability available beyond the useful life period, Management considered it practical to base the estimate of re-investment off the current asset cost.</li> <li>Recoverable capex: we observed that minor capex items have been treated as recoverable costs as detailed further below:</li> <li>Office fitout (\$750k): these costs have been incurred to date (FY22/FY23). Office fitout capital cost has been included as a recoverable cost as an error in addition to the depreciation component which is also assumed to be recoverable. We consider this cost should have been captured as a capital cost with only the depreciation component recoverable as per other capex items.</li> <li>\$0.8m impact does not appear to be material.</li> <li>Container purchase and set up costs (\$764k): these costs relate to setting up regionally based containers to expand armory storage capacity to support arms endorsement and revocation processes. Classification of this cost as recoverable is not in line with other capital cost assumptions in the Cost Recovery Model, whereby capex costs are reflected in a separate cost category as unrecoverable, with depreciation reflected as a recoverable cost. Nil \$ impact on total recoverable costs due to the fact that depreciation on these assets is not currently treated as recoverable.</li> </ul>

### Model review

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#### Overview

- We have performed an independent review of the financial model, Arms Safety and Control Fee Revenue Model - FINAL v0.4 13 March Updated TEST.xlsx, received on 13 March 2023, (the "Model").
- NZ Police prepared the Model with the objective to calculate the estimated fees that will be charged for firearms licences and associated activities.
- ► We have performed the following Model Review procedures on the Model:
  - A detailed line by line review of the mechanical accuracy of the base case Model base.
  - Other procedures designed to test the Model's logical integrity
- ► The full Model Review report can be found in Appendix C including a list of scope exclusions.

#### **Findings**

- Subject to the scope of our review, based upon the work we have performed, nothing has come to our attention to suggest that the Model has not been constructed appropriately, in so far as its arithmetic accuracy is concerned, so as to materially achieve the objective described above under the base case assumptions.
- During the course of our review, we noted the following observations in relation to specific formula used in the calculation of the dealer licence fee:
  - There is a referencing error in the formula for the 'Senior Sergeant FTE' cost which results in the Model understating the dealer fee.
  - There is a formula reference which is inconsistent with the labelling in the formula for 'Senior Sergeant FTE'. NZ Police have confirmed that this is as intended.
  - ► There is a formula error in the calculation of the low end of the 'Variable Import Permit Fee per Item', the variance of 5% is added instead of subtracted. Due to rounding, this has no impact on the dealer fees calculated under the base case assumptions.
- More widely, we have not been able to test the logic which uses the average dealer licence cost and applies some assumptions to reach two options for pricing: 1) an average cost per dealer, and 2) a fixed cost per dealer and a variable fee per employee. NZ Police have confirmed that the logic is as intended. Please refer to Appendix C2 for an explanation of the calculation provided by NZ Police.
- Furthermore, while the Model is small and performs relatively simple calculations, some calculations are not transparent due to the following and may impact the Model's logical integrity:
  - There are a number of hardcoded figures embedded in formulae throughout the Model meaning that a change to one assumption may require several formulae to be updated.
  - There are redundant calculations in the Model and not all calculations are set out with clear labels and units.
  - The model contains external links, care should be taken to ensure that figures sourced externally are not inadvertently changed, resulting in changes to the Model's calculations.
  - A knowledge of the Arms Act is required to understand the calculations.
- We therefore recommend that in its current form, the Model should only be used by an operator who is familiar with the Model structure and calculation approach
- Please note that our findings relate to the base case Model only, reflecting the assumptions contained and selected in the version of the Model that we have reviewed. It is possible that certain combination of assumptions (including extreme values outside the designated limits) could produce unexpected results. We are unaware of any circumstances likely to produce such an error, but the user is advised that, if assumptions or input data are changed, the resulting output should be reviewed to ensure that the results are not materially misstated.



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### Model overview

#### Cost recovery model overview

- New Zealand Police prepared the Cost Recovery Model as part of its business case request for Crown funding for the 10 year period to FY32, capturing the costs associated with carrying out and managing Arms Safety and Control in New Zealand. The Cost Recovery Model also includes Management's analysis and assumptions reflecting its view of recoverable costs.
- The Cost Recovery Model is based on an assumption that the Arms Safety and Control function remains part of NZ Police and thus benefits from certain shared functions which are not included as separate costs in the Cost Recovery Model. In the event the Arms Safety and Control function was required to be a standalone entity, significant additional costs would be incurred.
- The Cost Recovery Model is based on (i) historical financial data, (ii) forecast demand reflecting change in volumes over the forecast period, and (iii) mandated general wage increase (GWI) and competency service increment (CSI) rates.
- The Cost Recovery Model, originally prepared in 2021 includes forecast total costs of \$711.5m for the 11 year budget period from FY22 to FY32F. Management has analysed the total cost base in terms of recoverability of those costs per the terms of Arms Act 1983 resulting in \$526.5m of recoverable costs for the 10 year period from FY23 to FY32, reflecting 10 year licensing period. Total and recoverable cost by cost category are presented in the chart opposite. We discuss Management's assumptions with respect to cost recoverability on the following pages of this report.
- Recoverable costs comprise BAU opex, GWI, CSI, salary loading, overhead and other capital costs for the period FY23-FY32F. The chart below presents split of BAU opex between regulatory costs and supporting services costs.

#### **BAU Opex - Regulatory & Supporting Services**



BAU Opex Regulatory costs
 BAU Opex Services Function costs

Total Cost vs Recoverable Cost



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### Bridge – Total costs to Recoverable costs

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#### **Cost Bridge**



### **Recoverable Costs Bridge**

- The chart opposite bridges total costs per the Cost Recovery Model to Management's view of total recoverable costs over the forecast period.
- 11 year vs 10 year: reflects the variance between total costs based on the FY22 FY32 period as opposed to the FY23 FY32 period for recoverable costs due to alignment with the 10-year arms' licence period. This difference is attributable to FY22 BAU Opex, transition Opex and Registry Build (ICT Assets).
- All bridge items listed below present variances between total costs and recoverable costs for the 10-year FY23-FY32 period, identified by Management as non-recoverable costs.
- Transition opex: includes costs associated with the transition to the new operating model. These costs are deemed unrecoverable due to the fact it is a one off cost not related to ongoing operations and the costs have been incurred prior to the cost recoverability assessment period beginning in FY23.
- Capital charge: represents the cost of capital from Treasury based on 5% of total funding as stipulated by Treasury instruction. It has been excluded from recoverable costs given it represents a funding cost.
- Contingencies: comprises agency and tagged contingencies, including both opex and capex costs. These costs reflect a quantitative risk assessment and have been excluded from recoverable costs given their risk driven nature. Tagged contingency reflects the QRA impact partially included in detailed business case and primarily relates to BAU opex risks, whereas agency contingency reflects the QRA impact included in the detailed business case and captures risks related to transition opex, capex, application volumes, project duration and minor BAU opex.
- Registry build: reflects cost of transition capex in relation to the new operating model and regulator entity establishment. This has been excluded from recoverable costs given the capital nature of costs. The registry build cost has been taken into the initial value of depreciable assets.
- Property: cost relates to the fitout of two offices. The Cost Recovery Model considers this cost to be incurred in FY22. However, this cost has been included in FY23-FY32F recoverable costs. Therefore, this bridge item reflects adding back of \$0.8m to recoverable costs as it was removed during the 11 year vs 10 year adjustment. Office fitout cost has been included as a recoverable cost in error in addition to the depreciation component also assumed to be recoverable. We consider this cost should have been captured as a capital cost with only the depreciation component recoverable as per other capex items.

We set out below a summary of the key cost lines included in the Cost Recovery Model including the basis of Management's recoverability assumptions. The summary includes two schedules, (i) BAU Opex detailed by cost sub-category and (ii) Recoverable cost summary. Our conclusions in regards to cost recoverability assessment are summarised on page 8.

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BAU	Opex				
	Area, NZ\$m	Cost per Cost Recovery Model FY23- FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment
A. BA	U Opex Regulatory Cost	ts:			
A1	Activity Based Services	140.2	140.2	-	Activities include: licence applications, endorsement applications, dealer license applications, permit to possess, permit to import, etc. Cost per each activity is estimated based on (i) forecast FTEs and (ii) forecast cost per FTE. FTEs have been estimated based on volumes by activity and time taken per activity. We see FTE volume fluctuations due to a change from lifetime licenses to 10 year licenses which resulted in a bell-curve for licence application demand. Management assumes that BAU opex is fully recoverable under the Arms Act. BAU opex costs appear to align with recoverable activities per s80 of the Arms Act. However, there are certain areas where Management has applied judgement in the event the cost is not clearly defined in the Arms Act. We highlight these areas below.
A2.1	Executive	39.0	39.0		Executive Director function includes: Directorate, Policy, Governance & Support, Communications, Brand & Media, and Strategy. Management has made judgements with respect to certain Executive costs which are not specifically related to activities defined in the Arms Act.
A2.2	Partnerships	8.7	8.7		Partnerships include: Prevention & Education, Directorate, and Engagement & Partnership. We note that Prevention & Education costs relate to work with communities to promote safe use of arms, and hence are not directly related to revenue fees activities. Prevention and education costs are not specifically referenced as recoverable in the Arms Act and Management has made certain judgements with respect to recoverability. Management has applied judgement to treat as recoverable on the basis that they are in line with the broader purpose of the Act. However, employee costs in relation to Prevention & Education (\$6.5m) do not appear to align with the definition of recoverable costs in the Arms Act.
A2.3	Operations	160.0	160.0	-	Operations include: Service Delivery, Insights & Intel, and Directorate.
A2	Strategic Functions Employee Costs	207.7	207.7	-	Strategic Functions Employee costs are estimated based on cost per FTE and expected FTE requirement.
A3	IT Costs	0.3	0.3	-	IT costs relate to training portal, internal e-learning capability. This cost occurs due to the assumed implementation of e- learning, potentially mix of internal and external, and is assumed to be a capital cost. We consider this cost should have been captured within capex. Noting that depreciation of capitalised assets is treated as a recoverable cost for other assets, the approach taken in the Cost Recovery Model has a nil impact on total recoverable costs.

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	Area, NZ\$m	Cost per Cost Recovery Model FY23-FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment					
A4.1	Executive	11.3	11.3	-	Executive other costs include: directorate other costs (including professional services, Policy – Minister's Arms Advisory Group ("MAAG") Travel & Fees, plus FTE Overheads and Gateway review) and media campaign costs. MAAG costs are included as funding for the ministerial advisory group. MAAG costs include fees for members and travel costs.					
A4.2	Partnerships	6.3	6.3	-	Partnerships other costs primarily relate to prevention and education costs category, particularly, safety training costs (Mountain Safety Council). In addition, other costs include partnerships directorate costs (Advisory Group Meeting Costs and Travel), Engagement Delivery, Conferences and International Travel, Travel and Accom. Safety training is based on contracted rate, while some specific items are based on special endorsement licens: training for certain weapons (e.g. Pistols). A portion of Prevention and Education costs of \$4.7m related to training and testing services, sitting within Partnerships other costs potentially align with descriptions of recoverable activities in the Arms Act. Management has applied judgement to treat as recoverable on the basis that they are in line with the broader purpose of the Act. A portion of this cost related to training services provided to gun clubs potentially aligns with the cost recoverability provisions of the Arms Act, however, a detailed review of the exact activities to which these costs relate should be considered to further assess alignment.					
A4.3	Operations	6.2	6.2		Operations costs include cost of physical licence cards & postage, Crown law fees, file storage and archiving, and other costs. Licence cards cost is budgeted at the rate of \$8.40 per physical license card. Crown law fees reflect legal fees in cases of licence refusal disputes and revocations, with the \$150k based on a historical view of cost. Storage and archiving costs have decreased due to digitalisation but some paper document flow remains.					
A4	Other Costs	23.8	23.8	-	Other costs reflect executive, partnerships and operations other costs as detailed above in A4.1-A4.3					
A	Total BAU Opex Regulatory Costs	372.0	372.0	-	The vast majority of BAU opex costs relate to recoverable activities per s80 of the Arms Act, however a small portion (\$6.5m) does not appear to align, particularly, prevention and education costs are not specifically referenced as recoverable in the Arms Act and Management has made an assumption with respect to recoverability of certain employee costs related to prevention and education roles.					
B. BA	U Opex Services Function C	osts:								
B1	Support Services – People Costs	15.6	15.6	-	People cost relates to Technology & Data, People & Culture, Finance, Legal and Directorate functions.					
B2.1	Total Business Services Director – Technology & Data	27.7	27.7	-	Technology & Data other costs include licences, telephone, analytics, infrastructure production and non- production environments, security testing, C&A Review and contingency costs. The IT licence cost is based on an RFP process and provided by the vendor, while the contingency allows for unknown flex in technology.					
B2.2	Total Business Services Director – People & Culture	-	-	-	Relates to FY22 training cost. This has been incurred although the cost in FY22 was closer to \$900k Management noted there will be on-going training required costing approximately \$300k p.a. that is not currently included in the forecast.					

	Area, NZ\$m	Cost per Cost Recovery Model FY23-FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment
B2.3	Total Business Services Director – Property & Fleet	23.8	23.8	-	Property & Fleet other costs include office lease, property and fleet costs. Office lease cost relates to two locations. Lease cost for 1 Willis Street is in line with lease terms. However, actual lease cost for Rugby House came out higher than what has been budgeted. Further, the cost for existing property footprint across 12 districts and the Service Centre in Kapiti has not been factored in. Fleet cost relates to vehicles provided to Arms Vetters - Skoda Kodiaq and Skoda Superb with annual maintenance cost of \$6.5k and \$11.4k respectively. The ratios used of 0.2/0.8 refer to the fleet mix of 8 Skoda Kodiaq and 2 Skoda Superb. Certain regions have ultimately required 4x4s and all-wheel drive vehicles which are not included in the Cost Recovery Model.
B2	Systems and Other Costs	51.5	51.5	-	
В	Total BAU Opex Services Function costs	67.1	67.1	-	BAU opex services functions costs appear to align with recoverable activities per s80 of the Arms Act.
	Total BAU Opex	439.1	439.1	-	

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Reco	verable Cost Summary				
	Area	Cost per Cost Recovery Model FY23-FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment
Opera	ating Costs:				
A-B	BAU Opex	439.1	439.1	-	Please see BAU Opex schedule above
С	Transition Opex	22.0	0,	22.0	Transition costs are budgeted for four workstreams: Arms operations baseline & improvement, Arms Operations uplift, Regular entity establishment and Common programme capability. These workstreams include people, technology and other costs that have been classified to transition opex and transition capex. This line item represents transition opex, whilst transition capex has been captured within Registry Build costs. Transition opex is the program cost reflecting the change to the new operating model. Transition opex is not recoverable as the transition costs do not relate to the recoverable activities under the Arms Act.
D	General Wage Increase (GWI)	12.9	12.9	-	GWI is the general wage increase attributable to the uplift only of staff in the employee category, and does not account for the existing headcount (248 FTEs). Assumed to be fully recoverable. GWI for transition personnel is budgeted separately within transition cost category. Appears to align with recoverable activities per s80 of the Arms Act.

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	Area, NZ\$m	Cost per Cost Recovery Model	Recoverable cost	Irrecoverable Costs	Recoverable cost assessment comment					
Opera	ating Costs	1123-1132	11231132							
E	Competency Service Increment (CSI)	13.1	13.1	-	CSI is the competency service increment, which is part of the Police Super Scheme NZ. CSI has been budgeted for the growth in FTE only and does not include CSI on the existing headcount (248 FTEs). Assumed to be fully recoverable. CSI for transition personnel is budgeted separately within transition cost category. Appears to align with recoverable activities per s80 of the Arms Act.					
F	Salary Loading – Annual Leave	1.3	1.3	-	Salary Loading - Annual Leave reflects the annual leave accumulated across both constabulary and employee roles in the first year of assumed FTE employment. The amount reflects the number of people needed to perform operational processes, strategic functions, and enabling functions. Asumed to be fully recoverable. Annual leave loading for transition personnel is budgeted separately within transition cost category. Appears to align with recoverable activities per s80 of the Arms Act.					
G	Overhead (Regulator)	20.8	20.8		Overhead regulator cost reflects the total uplift cost per role per annum, and does not include these overheads for the existing headcount (248 FTEs). Overhead regulator captures (i) overhead cost uplift related to FTE increase and (ii) overhead cost related to baseline employees. The uplift overhead costs primarily relate to ICT Costs. Whilst classification to recoverable cost appears to be consistent with Arms Act, a calculation error has been made in the Cost Recovery Model: the constabulary overhead rate of \$17.9k has been used for all employees instead of rate of \$13.9k for non-constabulary roles. Management estimated the error at \$1.6m overstatement of overheads. Management considers this will be fully offset by the overhead cost uplift in relation to the existing headcount that has not been budgeted in the Cost Recovery Model, estimated by management at \$3.2m. Overhead cost related to baseline employees is based on the current year FTEs and "All Staff" overhead rate of \$4,087 per person. Assumed to be fully recoverable. Appears to align with recoverable activities per s80 of the Arms Act.					
Η	Depreciation	37.8	37.8	-	Depreciation is made up of the depreciation cost across the 10 years from FY23-FY32. Depreciation is calculated using straight-line depreciation with the average life assumption on relevant assets being 5 years and the salvage value assumed to be nil. The Cost Recovery Model is built up to forecast depreciation and capital cost as separate lines. We note that depreciation is charged past useful life period of 5 years as Management has made the assumption that assets will be replaced through re-investment. We note that this assumed re-investment is not included in capital costs within the capital cost budget line in the Cost Recovery Model and represents an additional cost. Considering uncertainty around technology capability available beyond the useful life period, Management considered it practical to base the estimate of re-investment off the current cost. The entirety of the amount across the 10 years from FY23-FY32 is assumed to be recoverable. The Arms Act is not clear whether depreciation is recoverable cost. Management has made a judgement that it should be viewed as recoverable which broadly appears to align with recoverable activities per s80 of the Arms Act.					

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	Area, NZ\$m	Cost per Cost Recovery Model FY23-FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment
I	Capital Charge	10.7	-	10.7	Capital charge reflects 5% of capex balance (long terms assets) as per Treasury instructions. These capital costs include Registry Build (ICT Assets), Property, Other Capital, and Contingency Capital. Registry Build (ICT Assets): Is based on if workstreams in relation to transition have aspects directly attributable to capex. Property: Relates to the office fitout of two new offices Other Capital: Relates to the container setup costs and container purchase costs in FY23F. Contingency Capital: Is the sum of Transition contingencies, ICT Implementation Contingencies, and Supplier Contingencies The variance of \$10.7m is because the entire of capital charges is excluded from recoverable costs. Cost of capital from treasury at 5% reflects a transaction fee for securing funds.
J	Agency Contingency	32.5	-	32.5	Contingency reflects results of Quantitative Risk analysis (QRA). All costs have been classified between capex
К	Tagged Contingency	53.5	-	53.5	and opex, further agency vs tagged contingency percentage has been assigned to each category and have been deemed as unrecoverable. Agency and Tagged contingencies have been excluded from recoverable costs as being risk based potential cost. Given opex contingencies relate largely to recoverable activities, to the extent these costs arose they could be treated as recoverable however, they have been excluded on the basis that they are a contingency overlay for the purposes of securing funding rather than a base cost. Classification of this cost category as non-recoverable appears to be in line with the terms of s80 of the Arms Act.
	Total Operating Costs	643.7	525.0	118.7	
Capit	al Costs				
L	Registry Build (ICT Assets)	14.6	OP	14.6	Registry build reflects capex portion of transition cost, including Arms operation uplift costs (under Workstream 2 of Transition costs) and regular entity establishment costs (under Workstream 3 of Transition costs). Arms operation uplift costs of \$13.3m across FY23-FY24 include people, technology and other costs. Regular Entity Establishment costs relate to technology costs of \$1.25m in FY23F. The \$14.6m variance reflects the fact these costs are deemed to be unrecoverable. The Arms Act is not clear whether capex is a non-recoverable cost, noting Management has assumed this should be viewed as non-recoverable with depreciation being recoverable.
М	Property	Q.	0.8	(0.8)	Relates to the office fitout of two new offices in over the two year period FY22 and FY23. This cost has been budgeted for FY22, however, included in FY23-FY32 recoverable costs as being incurred to date. This cost has been included as a recoverable cost in error in addition to the depreciation component also assumed to be recoverable. We consider this cost should have been captured as a capital cost with only the depreciation component recoverable as per other capex items.

	Area, NZ\$m	Cost per Cost Recovery Model FY23-FY32	Recoverable cost FY23-FY32	Irrecoverable Costs	Recoverable cost assessment comment
N	Other Capital	0.8	0.8	-	Other capital relates to container purchase of \$232,500 and setup budget of \$531,960. Classification of this cost as recoverable is not in line with other capital cost assumptions in the Cost Recovery Model, whereby capex costs are reflected in a separate cost category as unrecoverable, with depreciation reflected as a recoverable cost. Nil \$ impact due to the fact that depreciation on this capex is not currently treated as recoverable.
0	Agency Contingency	3.9	-	3.9	Contingency reflects results of Quantitative Risk analysis (QRA). All costs have been classified between capex
Ρ	Tagged Contingency	-	-	-	and opex, further agency vs tagged contingency percentage has been assigned to each category. Agency and Tagged contingencies have been excluded from recoverable costs as being risk based potential cost. Classification of this cost category as non-recoverable does not appear to contradict to the recoverable activities per s80 of the Arms Act.
	Total Capital Costs	19.3	1.5	17.7	
	Total	663.0	526.5	136.5	

24 March 2023

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22 Appendix A. Arms Act 1983 Section 80 – Activities that may be subject to cost ...

23 Appendix A. Arms Act 1983 Section 81 – Criteria for cost recovery

24 Appendix B. Abbreviations

25 Appendix C. Model review report

# Appendix A. Arms Act 1983 Section 80 – Activities that may be subject to cost recovery

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We have provided an excerpt of The Arms Act's 1983 below which outlines activities that may be subject to recovery:

#### 80 Activities that may be subject to recovery

- 1) The Minister of Police may recommend the making of a regulation under section 86 only if satisfied that the fee or charge concerned relates to an activity undertaken by the Police in accordance with this Act in relation to a person, shooting club, or shooting range.
- 2) The activities for which fees or charges may be imposed under section 86
  - a) include
    - i. processing an application for a firearms or dealer's license, including assessing whether the applicant is a fit and proper person
    - ii. providing training and testing services in relation to obtaining a firearms licence:
    - iii. issuing any licence under this Act:
    - iv. processing any application for an endorsement, a permit to possess, or permit to import:
    - v. issuing any endorsement, a permit to possess, or permit to importa
    - vi. undertaking inspections and compliance checks, including checks relating to any licence, endorsement, permit, certification, conditions, or improvement notices:
    - vii. providing testing of samples in relation to firearms, firearm parts, restricted weapons, parts of restricted weapons, magazines, pistol carbine conversion kits, air pistol carbine conversion kits, blank-firing guns, or ammunition:
    - viii. providing testing of samples in relation to firearms, firearm parts, restricted weapons, parts of restricted weapons, magazines, pistol carbine conversion kits, air pistol carbine conversion kits, blank-firing guns, or ammunition:
    - ix. approving the manufacture for sale of arms items:
  - b) do not include
    - i. the response of the Police to calls relating to potential offending; or
    - ii. the conduct of criminal investigations; or
    - iii. the prosecution of criminal offences.

Section 80: inserted, on 25 June 2020, by section 104 of the Arms Legislation Act 2020 (2020 No 23).

# Appendix A. Arms Act 1983 Section 81 – Criteria for cost recovery

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We have provided an excerpt of The Arms Act's 1983 below which outlines the criteria for cost recovery:

#### 81 Criteria for cost recovery

The Minister of Police may recommend that regulations be made under section 86 only If the Minister is satisfied that,

- a) Subject of the provision of section 86, the fee or charge recovers no more than the actual and reasonable costs (including both direct and indirect costs) of the activity to which the fee or charge relates; and
- b) The fee or charge for the activity or class of activities to which the fee or charge relates is generally obtained from the users or beneficiaries of the service or class of services to which the activity relates at a level commensurate, as far as practicable, with their use of the services; and
- c) The costs of the activity to which the fee or charge relates are efficiently incurred; and
- d) The relationships between the costs of the activity to which the fee or charge relates and the nature and duration of the activity is clear

Section 81: inserted, on June 25 2020, by section 104 of the Arms Legislation Act 2020 (2020 No 23).

# Appendix A. Arms Act 1983 Section 83 – Methods of cost recovery

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We have provided an excerpt of The Arms Act's 1983 below which outlines the criteria for cost recovery:

#### 83 Methods of cost recovery

- (1) Regulations for the recovery of costs may provide for the following:
  - (a) fixed fees or charges:
  - (b) fees or charges based on a scale or formula or at a rate determined on an hourly or other unit basis:
  - (c) the recovery by way of a fee or charge of estimated actual and reasonable costs expended in, or associated with, the performance of an activity:
  - (d) fees or charges based on costs incurred from charges by third parties:
  - (e) any combination of the above.
- (2) Without limiting the way in which a fee or charge may be set, a fee or charge may be set at a level or in a way that-
  - (a) is determined by calculations that involve an averaging of costs or potential costs:
  - (b) takes into account costs or potential costs of activities that are not services to be provided directly to the person who pays the fee or charge, but are an indirect or potential cost arising from the undertaking of the activity in question in relation to a class of persons or all persons who use the service or class of services to which the activity relates:
  - (c) takes into account indirect costs, which include the costs and potential costs of support, maintenance, and development associated with provision of the activity.

Section 83: inserted, on 25 June 2020, by section 104 of the Arms Legislation Act 2020 (2020 No 23).

### Appendix B. Abbreviations

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Abbreviations		Abbreviations	
\$	- New Zealand Dollars (unless otherwise stated)	GWI	- General Wage Increase
\$NZm	- Millions of New Zealand dollars	MAAG	- Minister's Arms Advisory Group
BAU	- Business as usual	Mgmt	- Management
Capex	- Capital expenditure	NZ	- New Zealand
CSI	- Competency Service Increment	Opex	- Operating expenditure
FTE	- Full-time equivalent employee	P&E	- Prevention and education
FY	- Financial year	QRA	- Quantitative risk analysis
FYxxF	- Financial year forecast for year ending period 30 Jun 20xx	YoY	- Year on year



## **New Zealand Police**

Review of financial model 24 March 2023





New Zealand Police Attention: Martin Smit 180 Molesworth Street Wellington 6011 24 March 2023

### New Zealand Police - Independent Review of Financial Model

Dear Martin

### Scope of work

In accordance with our CSO (the "Agreement") dated 2 February 2023 addressed to New Zealand Police ("you", or "NZ Police"), we have performed an independent review of the financial model, "Arms Safety and Control Fee Revenue Model – FINAL.xlsx", received on 20 January 2023 (the "Model"). The Model is used to estimate the fees that will be charged for firearms licences and associated activities (the "Project").

Our scope included:

- ► A detailed line by line review of the mechanical accuracy of the Model.
- Other procedures designed to test the Model's logical integrity.
- The scope and limitations to the scope of our work, including our terms of business, are set out in the Agreement.

The following items are excluded from our scope:

- ► Determining the extent and completeness of the assumptions that are included in the Model. More specifically, we have not been required to express any opinion on the validity of the assumptions or commercial risks associated with the Project, and our opinion therefore provides no comfort on these matters. The Model and its assumptions referred to in the preparation of this report reflect the judgement of the NZ Police and its advisers, based on present circumstances, as to both the most likely set of conditions and future courses of action.
- ► We have not had any involvement in setting the fees, advising on the appropriateness of the proposed fees, or the approach applied in calculating the fees.
- Verifying any of the assumptions, judgements, and commercial risks associated with the Project, nor commenting upon the possibility of the financial projections being achieved.
- Considering the cash flows, account balances, and taxation in respect of the Project from the perspective of specific stakeholders, other than to the extent they are explicitly represented in the Model.

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- ► Reviewing any other input configurations other than the base case.
- Reviewing commentary included in cell notes, embedded in the Model, to ensure that is it consistent with the Model.
- Considering the consistency of the Model with externally linked files.

It is usually the case that some events and circumstances do not occur as expected or are not anticipated. Therefore, actual results will almost always differ from the forecasts and such differences may be material. To the extent that our conclusions are based on forecasts, we express no opinion on the achievability of those forecasts. Further, our review does not provide any comfort on the achievability of the forecast produce by the Model.

The above procedures do not constitute an audit in accordance with New Zealand Auditing Standards or a review in accordance with New Zealand Auditing Standards applicable to review engagements. Had we performed additional procedures, or had we performed an audit in accordance with New Zealand Auditing Standards or a review in accordance with New Zealand Auditing Standards applicable to review engagements, other matters might have come to our attention that would have been reported to you.

In performing our review, we have relied upon various explanations provided by yourselves in response to our comments and queries raised during the course of our review.

### The Model

The objective of the Model is to calculate the estimated fees that will be charged for firearms licenses and associated activities, on the basis of your chosen assumptions and input data.

The base case Model is composed of the file:

 "Arms Safety and Control Fee Revenue Model - FINAL v0.4 13 March Updated TEST.xlsx", with a size of 10,289,152 bytes, received on 13 March 2023.

Extracts from the base case Model are attached as Appendix C1, of this report for identification purposes.

### Findings Summary

Subject to the scope of our review, based upon the work we have performed, nothing has come to our attention to suggest that the Model has not been constructed appropriately, in so far as its arithmetic accuracy is concerned, so as to materially achieve the objective described above under the base case assumptions.

During the course of our review, we noted the following observations in relation to specific formula used in the calculation of the dealer licence fee:

- ► There is a referencing error in the formula for the 'Senior Sergeant FTE' cost which results in the Model understating the dealer fee.
- ► There is a formula reference which is inconsistent with the labelling in the formula for 'Senior Sergeant FTE'. NZ Police have confirmed that this is as intended.



► There is a formula error in the calculation of the low end of the 'Variable Import Permit Fee per Item', the variance of 5% is added instead of subtracted. Due to rounding, this has no impact on the dealer fees calculated under the base case assumptions.

More widely, we have not been able to test the logic which uses the average dealer licence cost and applies some assumptions to reach two options for pricing: 1) an average cost per dealer, and 2) a fixed cost per dealer and a variable fee per employee. NZ Police have confirmed that the logic is as intended. Please refer to Appendix C2 for an explanation of the calculation provided by NZ Police.

Furthermore, while the Model is small and performs relatively simple calculations, some calculations are not transparent due to the following and may impact the Model's logical integrity:

- There are a number of hardcoded figures embedded in formulae throughout the Model meaning that a change to one assumption may require several formulae to be updated.
- There are redundant calculations in the Model and not all calculations are set out with clear labels and units.
- The model contains external links, care should be taken to ensure that figures sourced externally are not inadvertently changed, resulting in changes to the Model's calculations.
- A knowledge of the Arms Act is required to understand the calculations.

We therefore recommend that in its current form, the Model should only be used by an operator who is familiar with the Model structure and calculation approach.

### Model Review Findings

A full list of issues identified coded as Category A, B, C or Queries using the following definitions has been provided during the course of the Engagement.

- Category A: Affects the calculations in versions of the Model within the scope of our review.
- Category B: May affect the calculations under assumptions outside the scope of our review.
- Category C: Unclear or bad practice. May affect the user's interpretation of the results, but does not necessarily affect the calculations.
- Queries: Questions asked to increase understanding of the calculations with the express intention of identifying errors.

Category A issues are those which required correction in order to produce results, which are materially reliable under the terms of this review.

Category B and C issues did not have to be corrected for the purpose of this review, but may represent a risk to users of the Model under assumptions other than those we have considered.

Queries raised required a response and were to be corrected if deemed appropriate for the purpose of our review.

These issues and queries have been resolved to our satisfaction notwithstanding the observations noted above.



Please note that our finding relates to the base case Model only, reflecting the assumptions contained and selected in the version of the Model that we have reviewed. It is possible that certain combinations of assumptions (including extreme values outside the designated limits) could produce unexpected results. We are unaware of any circumstances likely to produce such an error, notwithstanding the observations made above, but the user is advised that, if assumptions or input data are changed, the resulting output should be reviewed to ensure that the results are not materially misstated.

### Distribution of this report

Our report is addressed to yourselves. This report has been prepared on your specific instructions solely for the purpose of the project and should not be used or relied upon for any other purpose

We thank you for the opportunity of assisting you in this matter.

Yours faithfully

Ernst and Young Limited



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Appendix C2	NZ Police explanation of dealer licence fee	11





### Appendix C1 Base case model outputs (for identification purposes)

This appendix contains extracts from the base case Model, provided for identification purposes only. These are not intended as a comprehensive presentation of the Model outputs or to indicate particular significance of the data presented, beyond their role in identifying the subject matter of the report.

1	В	с	DE	F G	Н	Ĩ	JKL	М	N	0
1	Option	Discus Fee in	sion Docu Iclusive of	ment GST		Costir Wo Fee inclu	ng Model rkings sive of GST	Reconciliation		
2		Range as per DD	Low	High		Low	High	Low	н	gh
4	Safety training course									
5	Link To Costing Model Tab									
6	Option: Full Cost Recovery			\$88.00			\$88.00		r Y	es
7										
8	Options for firearms licence fee (excluding safety training	course)								
9	Link To Costing Model Tab									
10	Option: A Partial 25% of cost – excludes the safety training course									
11	(5-year)			\$208.55	5		\$208.55		Y	es
12	(10-year)			\$242.50	)		\$242.50		Y	es
13	Option B: Partial 50% of cost – excludes the safety training course									
14	(5-year)			\$417.10	)		\$417.10		Y	es
15	(10-year)			\$485.00	)		\$485.00		Y	es
16	Option C: Partial 75% of cost – excludes the safety training course									
17	(5-year)			\$625.60	)		\$625.65		P	10
18	(10-year)			\$727.50	)		\$727.50		Y	es
19										
20	Dealer Licence (other than Museum Director Curator)									
21	Link To Costing Model Tab									
22	Option A. Averaged across dealers									
23	Averaged across dealers (excluding museum curators)	\$2,330 - \$2,570	\$2,330	_ \$2,570	1	\$2,330	\$2,570	Yes	Y	es
24	Option B. First application for a dealer's licence									
25	First application for a dealer's licence	\$2,330 - \$2,570	\$2,330	_ \$2,570	1	\$2,330	\$2,570	Yes	Y	es
26	Option B. 1 Lower cost for second and subsequent application									
27	Lower fee for second and subsequent application	\$1,760 - \$1,940	\$1,760	\$1,940	1	\$1,760	\$1,940	Yes	Y	es
28	Option B. 2 Fixed plus Variable Fee									
29	Fixed (per dealer)	\$1,000 - \$1,100	\$1,000	\$1,100	1	\$1,000	\$1,110	Yes	N	lo
30	Fee per licenced employee (up to 8)	\$190 - \$210	\$190	_ \$210	1	\$190	\$210	Yes	Y	es
31										

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ilding a rking w	better orld									5	
Dealer on	doreomonto	C	U E	F	G	ні	1	K	L M	N	0
Dealer en	aorsements										
Eived fee ba	ng model Tab	¢110 ¢120	\$110		\$120	F 6110	-	\$120	· ·		Mag
Fixed lee ba	sed on costs	\$110 - \$150	\$110	-	\$130	\$110	-	\$130	Tes		res
Dealer and	valeves endersement (annual)										
Link To Costi	ng Medel Tab										
Δ (i) Eire	t andorsement: and	\$200 - \$220	\$200		\$320	\$ \$200		\$320	· Voc		Vac
A. (I) FIIS	and and subsequent if employed by same dealer	\$290 - \$320	\$290	-	\$320	\$110		\$320	r Ver		Yes
(11) Sec	ond and subsequent if employed by same dealer	\$110 - \$150	\$110	-	\$130	\$110	-	\$130	Tes		res
Liconco	ndercomente										
Licence e	ndoi sements										
Endorcomo	nte soinside with application for renewal of license										
Ontion A	its concide with application for renewal of incence										
Averaging the	e costs across all endorsements	\$1,370 - \$1,510	\$1,370		\$1,510	\$1,390	'	\$1,530	No		No
Option B											
(i)	Pistol (s29(2)(b))	\$1 350 -\$1 490	\$1,350		\$1 490	\$1 350		\$1 490	P Yes		Yes
(ii)	Pest control	\$930 - \$1,020	\$930		\$1.020	\$920		\$1,010	r No		No
(iii)	Memento/heirloom	\$930 - \$1,020	\$930		\$1.020	\$940	-	\$1,010	- No		No
(m)	Wentenconencon	Fixed \$1,230 -	\$350		\$1,020	r	-	\$1,040	-		NO
		\$1,360	\$1,230		\$1,360	\$1,230		\$1,360	Yes		Yes
(iv)	Bona fide collector/(s29(2)(c))	plus									
		Variable per item									
		\$10-\$10			\$10			\$10		1	Yes
(v)	Theatrical	Fixed \$1,230 -	\$1,230		\$1,360	\$1,230		\$1,360	Yes		Yes
endo	reaments (for display and re-enactments)	\$1,300 plus		_							
(\$29(		pius per item									
(320)		\$10-\$10			\$10			\$10			Yes
		\$10-\$10			<b>V</b> 10			<b>V</b> 10			Tes
Additional for	ee if application made in the duration of the licence										
Fee if applica concurrent wi	ation for one or more endorsement is made together but not th the firearms licence application	\$590 – \$650 for one or more endorsements and applied for at the same time	\$590		\$650	\$590		\$650	Yes		Yes



ding a king w	better orld								S	
	в	C D	F I	G	ні	1	K I	м	N	0
Fee if applica	ation for additional endorsement is made not concurrent with the	\$590 - \$650	\$590	\$650	\$590	\$6	350	Yes		Yes
firearms licer	nce and not at the same time as the previous endorsement.	For the additional								
Permit to	Possess									
Link To Costi	ng Model Tab									
Fee for each	permit at full cost	\$40		\$40			40			Ves
		<b>\$</b> 40		+10						Tes
Visitor lic	ences									
Link To Costi	ing Model Tab									
Full cost rec	overv (applicant may need import permit)	\$420 - \$470	\$420	\$470	\$420		170	Vac		Vor
i un cost leci	overy (approant may need import permit)	Q420 Q470		9410	ψ+2.0			165		res
Concent	for additional site (theatrical armourer)									
Link To Cost	ng Model Tab									
Average fee	ner production site	\$2 140 \$2 260	\$2 140	\$2 360	\$2.140		360	Vac		Vac
Average lee	per production site	<i>42</i> ,140 - <i>42</i> ,300	92,140	\$2,300	φ <u>2</u> ,140	- \$2,	300	Tes		Tes
Concert	additional site (gun show or sustion)									
Link Te Certi	adultional site (gun snow or auction)									
Two part for	ng wodel Lab	· · · ·	·							
(i) And in the	5 7 Faa	£1 000 £4 400	¢4.000	64 400			100			
(I) Applicatio	n ree	\$1,020 - \$1,120	\$1,020 -	- \$1,120	\$1,020	- \$1,	120	Yes		Yes
(ii) Della (	ea	C1 100 C1 010	64 400	64.040						
(ii) Daily fee	per Police staff member attendance at show	per Police person	\$1,120 -	- \$1,240	\$1,120	_ \$1,	240	Yes		Yes
		per day								
Recogniti	on as ammunition seller									
Link To Costi	ng Model Tab									
Recognition	as ammunition seller	\$560 - \$620	\$560	\$620	\$560	\$6	320	Yes		Yes
Import for	r arms items: all firearms, firearms parts etc.									
Link To Costi	ing Model Tab									
A: Fixed fee	irrespective of item(s) imported	\$540 - \$590	\$540 -	\$590	\$540	- \$6	300	Yes		No
		Fixed fee			_					
		\$42 - \$46 plus	\$42	\$46	\$38	\$	42	No		No



Bu wo	ilding a better rking world								0	5		
		6	r		6							0
00	В	Eived fee	E	F	6	н		1	N	L M	N	0
90		\$42 - \$46 plus	\$42		\$46		\$39		\$42	No		No
92	B: Fixed fee plus variable fee	Variable fee per item type and major firearms part as defined in the Arms Regulations 1992:							¥12			110
93		\$5 – \$5			\$5.00				\$5.00			Yes
94												
95	Import permit for ammunition			<b>_</b>								
96	Link To Costing Model Tab											
97 98	Fixed fee irrespective of quantity or type of ammunition imported	\$540 - \$590	\$540	-	\$590		\$540	-	\$600	Yes		No
99	Fee for sample import permit and assessment											
100	Link To Costing Model Tab											
101	Fee to assess new arms item or ammunition by sample	\$1,230 - \$1,360	\$1,230		\$1,360		\$1,240	_*	\$1,370	No		No
102												
103	Application for replacement firearms licence/permit											
104	Link To Costing Model Tab											
105	Fee for replacement	\$40			\$40			1	\$40		1	Yes
106												
107	Permission to Carry											
108	Link To Costing Model Tab											
109	Application fee per event	\$1,020 - \$1,100	\$1,020	-	\$1,100		\$1,020	-*	\$1,120	Yes		No
110	plus	plus								-		
111	Attendance on site by one Police person (if required)	\$560 - \$620	\$560	-	\$620		\$560	-	\$620	Yes		Yes
112												
113	Fee for modification/assembly of a firearm											
114	Link To Costing Model Tab											
115	Fee set at full cost to Police of armourer assessment	\$1,230 - \$1,360	\$1,230	-	\$1,360		\$1,240	-	\$1,370	No		No
117												



### Appendix C2 NZ Police explanation of dealer licence fee

The calculation for the per employee dealer fee is used for:

- Option A. Averaged across dealers: A Fixed fee is determined based on (a) the average cost of the permit across 10 years and (b) the average number employees across all dealers (5.3 employees / dealer).
- Option B. Fixed plus Variable Fee: Based on the dealer and employee sample selected, the fee is apportioned to be fixed and variable.

To provide some context, based on the sample of 231 dealers and the average cost of a dealer licence of \$1,203/dealer, the total cost to issue dealer permits is \$277,858. Given an absence of data for the fee per employee, the cost to issue dealer licences is used as a starting point. Based on the employee sample of 980 (1,211 total employees incl. dealers) the average cost is \$284/employee.

- ► For the fixed portion, the dealer licence fee of \$1,203 is reduced by the average cost per employee (\$284/employee) resulting in \$919/dealer.
- ► For the variable portion the total cost to issue dealer permits excl. the cost associated with dealers (231 dealers multiplied by \$284/employee) is divided by the total employees incl. dealers (1,211).

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