EECA TE TARI TIAKI PŪNGAO
ENERGY EFFICIENCY & CONSERVATION AUTHORITY

[redacted]

11 May 2023

Dear [redacted]

Re: Official Information Act Request: 2015 Board Paper

Thank you for your email on Tuesday 9 May in which you requested a Board paper that you had written whilst you were employed at EECA. Your request was clarified on Thursday 11 May. You have requested:

A December 2015 Board report about Capital Adequacy. This includes an appendix: Capital adequacy Review paper – provided to the Risk and Audit Committee meeting in February 2014.

Please find EECA's response to your request attached. This document has been released in full.

You have the right to seek an investigation and review by the Ombudsman of this decision. Information about how to make a complaint is available at www.ombudsman.parliament.nz or freephone 0800 802 602.

Please note that it is our policy to proactively release our responses to official information requests where possible. Our response to your request will be published shortly at https://www.eeca.govt.nz/about/news-and-corporate/official-information/ with your personal information removed.

Yours sincerely

Murray Bell
Group Manager of Strategy, Insights and Regulations

Board Report

Meeting date	8 December 2015
Subject	Capital Adequacy

Purpose

1. To present EECA's forecast of the capital adequacy position as at 30 June 2016.

Background

2. A capital adequacy review paper was provided at the February 2014 Risk and Audit Meeting, a copy of which is included as an Appendix.
3. The Board has requested an update and a forecast of the capital adequacy position as at the end of this financial year.

Commentary

4. We have reviewed the paper presented at the February 2014 Risk and Audit Meeting (Agenda item 7) and are of the opinion that both the methodology used and the conclusions reached have not changed and are still relevant.
5. The retained earnings position as at 30 June 2016 is the result of the balance as at 1 July 2015 as adjusted for the forecast deficit for the current year.
6. The forecast deficit for the year ended 30 June 2016 is $857,000 as presented in the Financial Performance paper, of the 8 December 2015 Board Meeting.
7. The following table sets out the actual and forecast retained earnings as at 30 June 2015 and 30 June 2016 respectively:

	30/6/2015	30/6/2016
	$000	$000
Total Retained Earnings	15,060	14,203
Made up as follows:		
Financial & industry support commitments	8,708	8,511
Working capital	1,500	1,500
Carbon Funding	2,512	609
Balance available for new/existing programs or returning to Crown	2,340	3,583
	15,060	14,203

8. As shown in the table above, $3.6 million is available for new/existing programs or to return to the Crown.

Recommendations

9. It is recommended that the Board

   a. **note** the forecast of retained earnings at 30 June 2016 as set out in para 7.

   b. **note** the availability of $3.6 million for new/existing programs or to return to the Crown.

MANAGER FINANCE & IT

David Roberts

pp Ian Horne
GENERAL MANAGER CORPORATE

Mike Underhill
CHIEF EXECUTIVE

Appendix

Capital Adequacy Review Paper – provided to Risk and Audit Committee meeting in February 2014 – Agenda Item 7

This paper should be read in conjunction with the Capital Adequacy Board Report submitted in December 2015

Introduction

1. As requested by the Board at its August 2013 meeting, we have completed a review of the appropriate level of cash reserves for EECA. This paper outlines our advice in relation to this review. Throughout this paper references to "cash" also include short-term deposits and other short-term investments held by EECA.

Conclusion

2. The appropriate level of cash reserves that need to be maintained by EECA should reflect:
    - the cash requirements of EECA's existing operations;
    - future capital expenditure requirements of EECA;
    - prudent levels of cash reserves to allow continuity of operations in the event of abnormal or significant unbudgeted expenditure;
    - the secure nature of funding via appropriation for EECA;
    - future international consultancy opportunities; and
    - the funding requirements to transition the organisation from its current state to the future state as described in its Organisational Development Plan (ODP).
3. While EECA's cost structure has a high proportion of fixed costs its revenues have a degree of certainty, as they are primarily derived from appropriations from the Government. These funding flows have a high degree of certainty during the financial year however are subject to annual review as part of the Governments annual budget process. The Four Year Budgets plans introduced in 2011 provide a higher degree of higher on four year funding streams than was available in the past.
4. Based on the analysis we have undertaken, and recognising the cash requirements of EECA over the remainder of the period 2013 to 2016 (as set out in the 2013/14 to 2015/16 Statement of Intent), we are of the view that EECA's current cash reserves exceed those required for EECA's current level of operations. This view takes into account the forecast FY14 loss which results in EECA having an estimated $5.5 million taxpayers funds as at 30 June 2014. We have also formed this view on the basis that EECA is able to successfully deliver on its ODP and achieve a break-even position from FY15 onwards.
5. EECA's forecast June 2014 cash reserves of $5.5 million represents between two and three months' operating expenses for EECA. Given the security of cash flows based on appropriated funding and the ability to draw down funding in advance EECA's current level of cash reserves appears excessive. Total taxpayer funds (excluding provisions for financial and industry support commitments) of circa $1.5 million are considered sufficient for EECA's needs.
6. If this level of taxpayer funds is agreed as appropriate it would free up circa $4 million for investment in new programmes or, if deemed a better use of the funds, returned to the Crown.

Background

7. EECA is the organisation set up by the New Zealand Government to encourage, support and promote energy efficiency, energy conservation, and the use of renewable sources of energy. EECA receives 99% revenue from the Crown and the annual agreed cash flows are secure and available to be drawn down in advance if necessary.
8. If a Budget decision was made to substantially reduce EECA's funding, that decision process would also ensure sufficient cash was available to accommodate those changes.

9. EECA does not require the same cash reserves as a buffer for adverse trading conditions and events that are the norm for Crown Entities that rely heavily on non-government funding.

Methodology

10. Determining the appropriate level of cash reserves for EECA involves balancing a number of competing factors:

- the need for cash to meet typical operating cash requirements;
- prudent levels of cash reserves to act as a buffer for the impacts of implementing EECA's ODP;
- the certainty of payment for services that goes with funding via appropriation; and
- future capital expenditure requirements.

11. In undertaking our analysis, we have also taken into consideration the following risk-factors:

- the risk of EECA funding cuts over and above those determined as part of Budget 2013;
- the high fixed proportion of EECA's costs; offset
- by the requirement on the part of Government to ensure that EECA can continue to meet its legal obligations in the face of any future cuts to government funding.

12. The approach we adopted to review EECA's level of cash reserves included reviewing:

- EECA's forecasts of future cash requirements as contained in EECA's 2013/14 to 2015/16 Statement of Intent;
- high-level research as to any recommended cash reserve positions from authoritative sources; and
- the level of cash that would be required to disestablish EECA in the unlikely event that it had to cease to trade.

13. In undertaking our analysis we have:

- not included additional government funding that may be provided as a result of future Government budgets ;
- assumed that EECA will continue to be exempt from income tax; and
- assumed that the capital and cash requirements for any growth in international consulting opportunities will be funded from the retained profits of that activity as it grows.

14. EECA's 2013/14 forecast provides for a loss of approximately $4.0 million, which will result in a negative cash of a like amount. $2.5 million of this will be from a specific provision and the balance will reduce closing Taxpayers funds as at 30 June 2013 from $6.35 million to circa $5 million as at 30 June 2014.

Cash Levels

15. EECA is almost entirely funded by Crown Appropriations and has a reasonable amount of flexibility as to the cash draw down profile for the year. For example, if actual expenses for say, WUNZ: HH are higher than budgeted then the cash profile can be revised in consultation with MBIE so that funds are available to meet the reforecast expense profile.

16. EECA does not have any material debtors. The $5.13 million debtor at 30 June 2013 related to the balance of appropriations due for 2012/13 (Mainly the WUNZ: HS Multi Year Appropriation [MYA] drawn down early). This debtor has now been settled and the cash received.

17. Note that Crown Loan Debtors and Creditors can be ignored in our analysis as these are contra entries that only impact balance sheet presentation.

18. EECAs creditors are predominantly all short term relating to trade creditors payable within the next month.

19. Given point 15 above, the level of cash held at any one time is effectively the value of Taxpayers funds plus trade creditors less capital assets (plant & equipment and intangible assets).

20. As the level of trade creditors will vary from month to month and will be funded from appropriations then the real question becomes 'what level of Taxpayers funds is appropriate?'

Taxpayers funds

21. Taxpayers funds have 2 components:

- funding received in previous years for 'financial and industry support' that has been contractually committed in previous years but will be expensed in the current and future years
- 'normal' Taxpayers funds that are the net sum of previous year's surpluses and deficits.

22. Taxpayers funds relating to financial and industry support commitments are a temporary timing difference that will reverse to zero over time. These funds are committed and not available for funding any other EECA activity in the future.

23. The 'normal' Taxpayers funds are represented by cash and the value of capital assets that have yet to be charged to the statement of comprehensive income (P & L Account) as depreciation (plant and equipment) or amortisation (software).

Required future minimum level of 'normal' Taxpayers funds

24. Future normal Taxpayers funds could potentially be required to cover the following:

- the current capital assets balance of $1.35 million plus planned capital expenditure (net of depreciation/amortisation expense);
- any restructure costs, resulting from the ODP currently in progress, not already forecast and covered as part of the annual operational budget;
- costs of EECA being disestablished or amalgamated with another Crown entity;
- provision to meet any unforeseen events; and
- working capital to fund day to day operational expenses.

Capital assets

25. The majority of our IT equipment is either expensed as incurred (desktops /laptops) or expensed under a server hosting and maintenance agreement.

26. The capitalised software is essentially the GEM system and it is forecast that the current net book value of assets will not increase over the next 4 to 5 years, as additional capital expenditure will be covered by the reduction in the existing net book value as a result of depreciation and amortisation.

27. Holding Taxpayers funds of $1.5m for this purpose should be adequate.

Restructure costs

28. The current plan is that all costs will be met from the annual operational budget.

Disestablishment/amalgamation costs

29. Our view is that his would be a government decision and any shortfall in funding would need to be met by the Crown.

Provision to meet any unforeseen circumstances

30. Given para 13 and to a limited extent para 19, EECA has sufficient capacity to manage most surprises in the short to medium term whilst it explores options available to resolve these challenges on a permanent basis.

Working capital

31. EECA receives cash in advance via appropriations so day to day working capital is not an issue (refer para 13). One of the key deliverables of the ODP is a plan that will ensure there is not a need to fund operational expenses in out years from Taxpayers funds.

Comparable Organisations

32. We have endeavoured to identify organisations with similar characteristics to EECA in order to analyse and compare the levels of cash reserves held by those organisations. The purpose being

determine if they provide any relevant guidance on the appropriate level of cash reserves for EECA.

33. The only organisation we have identified as comparable for such a in this analysis is the Electricity Authority (EA). It has comparable revenue streams and expense flows. In essence the EA has Taxpayers funds sufficient to cover its fixed asset funding requirements. This paper suggests the same for EECA.

Authoritative Guidance

34. We carried out high-level research as to any recommended cash reserve positions from authoritative sources. There does not appear to be any relevant guidance published in New Zealand.

35. We have been provided, on an "In Confidence" basis a copy of a report recommending an appropriate level of cash reserves for Standards New Zealand as prepared by PricewaterhouseCoopers. This paper uses the same approach and principles adopted by PricewaterhouseCoopers.

Disestablishment Requirements

36. The most conservative approach to estimating the required level of cash reserves is to estimate the amount required upon disestablishment of the organisation. Given EECA is owned and funded by the Crown management believe holding cash reserves for such an event is not a prudent use of capital.

Concluding Comments

37. Based on the analysis we have undertaken, and recognising the cash requirements of EECA over the remainder of the 2013/14 financial year (as set out in the recent Statement of Intent), we are of the view that EECA's current cash reserves are excessive for EECA's current level of operations and that circa $4 million of Taxpayers funds should be made available for investment in new programmes or, if deemed a better use of the funds, returned to the Crown.

38. This view assumes that EECA is able to achieve a break-even position from FY14 onwards but also takes into account the forecast FY713 cash loss which results in EECA having an estimated $5.5 million of cash reserves as at the end of the 2013/14 financial year.

Recommendations:

39. It is recommended that the Board:

   a. **agree** to recommend to the Minister that circa $4 million of Taxpayers funds should be made available for investment in new programmes or, if deemed a better use of the funds, returned to the Crown.

End of paper provided in February 2014