MNP

Merger Follow-Up Interim Report

Presented To: **Manitoba Liquor and Lotteries Corporation**

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1.0 EXECUTIVE SUMMARY

Since the announcement in 2012, Manitoba Liquor and Lotteries (MBLL) has been working steadily to realize the anticipated benefits of the merger between the Manitoba Liquor Control Commission and Manitoba Lotteries Corporation. MBLL has been actively tracking the resulting changes and engaged MNP to conduct an objective review of its internal analysis.

MBLL has reported very satisfactory progress on implementing merger related initiatives. Over 90% of the original recommendations made to support merger integration are either substantially complete or are continuing as work in progress. The process of examining these opportunities has also stimulated a significant number of additional recommendations from staff that have also achieved significant benefits.

Review of MBLL documentation indicates combined savings from salaries, operating and contract improvements of $9.6million to March 31, 2014. Including an estimated $26.5 million pension adjustment, forecast savings to the end of March 2015 total $40.3 million. After merger related costs of approximately $3.6 million, projected net savings to the end of March 2015 are $36.6 million.

MBLL has achieved significant staffing efficiencies as part of the merger initiative, reporting a total of 38 positions that have been identified as redundant and will be removed from the staffing complement of the organization. As of March 31, 2014, 22 of these positions were removed, including nine Executive and senior management positions recommended by MNP as part of the restructuring to form an integrated executive team. Staff impacted by the merger have been or will be offered alternate opportunities. This has resulted in a total of $3.2 million in recurring annual salary savings to date, anticipated to reach $3.8 million over the next two years. Savings were also achieved by reducing from two Boards of Directors to one.

Further savings are anticipated as a result of the Head Office Consolidation and Corporate System Selection Projects. Confirmation of anticipated savings as a result of these projects is expected by not later than March 31, 2015, and will be documented in a final follow up report.

2.0 INTRODUCTION / PURPOSE

In Budget 2012, the Government of Manitoba announced plans to merge the Manitoba Liquor Control Commission and Manitoba Lotteries Corporation to modernize the organizations, reduce costs, and streamline operations. The Minister Responsible for Gaming announced the new Board of Directors and President on May 5, 2012. Following a period of intense work to plan for merger integration, the new organizational structure to support the merged organization was announced on October 4, 2012. The Manitoba Liquor and Lotteries Corporation (MBLL) was officially formed with passage of legislation, effective April 1, 2014.

During the course of work to support integration of the two corporations, Joint Transition Teams formed from both organizations and MNP identified a number of savings that could reasonably be anticipated as a result of the merger. These savings were identified in the broad categories of executive and senior management, general operating costs, and contract services and were documented in the merger report dated October 2012. The organizations have since been working steadily to merge and integrate common functions and realize the anticipated benefits of the merger. MBLL has been actively tracking the changes as a result of the merger and has provided an estimate to government of $6.1 million in to the end of March 2014. In March 2014, MBLL engaged MNP to conduct an objective review of its internal analysis.

3.0 APPROACH

MNP reviewed savings estimates and gathered documentation from the Vice President of Integration, Business Support Manager, Corporate Governance and Business Development, Executive Director, Financial Planning & Analysis, and Executive Director, Corporate Procurement. This included tracking information for merger related salary savings, operating cost and contract savings, and merger related costs.

Detailed support documentation was subsequently gathered to support the tracked information, including:

- Position specific salary information and effective dates for positions that were reduced as a result of the merger
- HRIS reports
- Internal emails confirming the amounts budgeted and status of positions that were adjusted or not filled as a result of the merger
- Detailed invoices and contracts providing evidence of changes in pricing or contractor terms for work completed internally
- Contract approval recommendations documenting historic and bid contract values.
- Detailed information regarding hours of work performed by internal resources that were previously contracted
- Excerpts from corporate budgets identifying expenditures planned prior to the merger that were no longer required and removed from the budget as a result of the merger
- Actuarial report regarding pension alignment.

MNP also referenced original documentation gathered as part of the work to identify merger integration opportunities conducted from May to August 2012.

4.0 FINDINGS

4.1 Executive and Senior Management Integration

The re-structuring to form an integrated executive team took place as planned, effective October 2012. The streamlined executive structure resulted in a reduction of nine executive and senior management positions, all of which were concluded by December 2012. Three of these positions were vacant prior to October 2012. Incumbents in two of these positions were retained for a transition period to support merger integration. The cost for this transition assistance has been identified as a merger related cost. The transition services provided by one individual concluded within 8 months; services from the second individual will conclude when the merger is finalized.

Evidence provided by the corporation regarding total savings as a result of the executive restructuring, and by reducing governance requirements from two Boards of Directors to one, confirms annual recurring savings of approximately $1.8 million. The salary and benefit amounts for the nine positions were determined as of the date the position concluded. Recurring amounts do not include cost of living or other merit increases that would have been gained over time. Approximately 64% of these savings were realized in 2012/13, with the full amount of recurring savings achieved effective 2013/14, for combined savings of approximately $3.0 million to March 31, 2014.

In the October 2012 merger report MNP had estimated savings or avoidance of approximately $1.5 million from executive and senior management positions.

4.2 Management and Staffing Efficiencies

Two additional management positions and three staff positions were removed from the staff complement as a result of the merger. Effective dates for conclusion of employment in these positions occurred over the course of 2012 and 2013, with the last two positions concluded effective May 2013. Three additional positions that were planned and approved prior to the merger were found to be unnecessary with the consolidated resources, for a total of nine positions. The salary and benefit amounts for the above positions were determined as of the date employment concluded, or in the case of planned positions, the amount included in previously approved budgets. Cost of living or other merit increases that would have been gained over time have not been included in recurring savings. The associated salary and benefits for these eight positions provides recurring annual savings of approximately $719,000. Approximately 63% of these savings were realized in 2012/13; 98% in 2013/14. Additional, time limited savings were achieved through not filling, on a term basis, positions of staff on leave or placed in other term positions for one time savings of approximately $53,000. All of the above results in total salary savings to the end of March 2014 of approximately $1.2 million.

MBLL also deliberately delayed filling positions across the corporation from 2012 - 2014 resulting in additional vacancy savings of approximately three months in each position, for estimated savings in excess of $4 million. While it appears reasonable that additional savings would be achieved in this manner, MNP did not conduct detailed analysis to validate this estimate, and as such it is not included in the summary calculations in this report.

A staffing efficiencies initiative was undertaken in the fall of 2013, which found 108 positions from the merged organization were no longer required. MBLL has reported these staffing related savings will total $6.1 MM in salaries and benefits over the next two years. MBLL considers 20 of these positions and approximately $1.3 million of these savings to be related to the merger. Four of these positions were vacated as of March 31, 2014; nine as of August 2014. Full year recurring savings for these nine positions are $712,100. These known amounts have been included in the summary analysis of recurring and 2014/15 forecast savings.

4.3 Operating Cost Savings

Operating cost savings have been tracked in each department of the merged organization. Savings have been identified as a result of reduced duplication (for example licenses, subscriptions, presence at career fairs), use of existing internal resources for previously contracted services (AV, HVAC, etc.), acquiring services at the lower of the two previous rates, and leveraging previous investments of one corporation for the benefit of the other (e.g. records management system, excess inventory). Some previously budgeted costs were also avoided (new software, professional services).

A total of approximately $1.7 million in savings was identified to the end of March 2014. Of this amount, approximately $600,000 is recurring annual savings (e.g. removal of a cost that was previously incurred on an annual basis). A further $930,000 in savings is forecast for 2014/15. MBLL anticipates further operating and staffing savings will be achieved with the Corporate System Selection Project and Corporate Head Office Consolidation project.

In the October 2012 Merger report, MNP estimated savings or avoidance of approximately $1 million in general expenses, which included staffing efficiencies identified in section 4.2 above.

4.4 Contract Savings

In addition to the operating cost savings discussed above, the corporation has reduced the cost of goods and services acquired through the procurement process. Some of these savings have been achieved by extending and applying best practices from one organization to the other, such as applying more rigorous processes for securing competitive bids or re-tendering longstanding services, some by seeking the lower of two previously contracted rates for the two corporations, and some by gaining volume discounts. In the case of more rigorous procurement practices, the previous contract or previously approved requisition value was used as the baseline from which to calculate savings.

Contract savings achieved for fiscal years 2012/13 and 2013/14 totalled approximately $3.6 million, most occurring over the terms of the contracts, varying from two to five years (not including option years). A further $90,000 in savings has arisen from contracts established to date in fiscal 2014/15.

4.5 Pension Alignment

Both legacy Manitoba Lotteries (MLC) and the Manitoba Liquor Control Commission (MLCC) employees participate in defined benefit pension plans administered by the Civil Service Superannuation Board. Historically these pensions were funded under different models. The MLC had been a fully funded matching employer; the MLCC had been a pay-as-you-go employer. For MLCC, this meant carrying a significant liability in its financial records, which changed annually according to investment market conditions. This created significant volatility in net income.

As part of the merger review, it was the intention of the Corporation to streamline, simplify and align the pension funding such that the new Manitoba Liquor & Lotteries would be a fully funded matching employer. Based on actuarially determined balances of the pension asset and liability recorded in MLCC records, and the actuary's calculation to settle the historic pension liability of the MLCC, a gain in settlement of the pension liability of approximately $25 to 27 million will be recognized in 2014-15 (estimated at $26.5 million for the purpose of this report). This will increase the allocation to the Province by a corresponding amount and eliminate the risk of market fluctuations and any associated negative annual impacts to allocations to the Province going forward. From 2010 to 2013, these combined negative impacts have reduced net income, and thus the allocation to the province, by a total of $23.6 million.

4.6 Merger Costs

MBLL has incurred costs specifically associated with the merger. These costs include expenses such as legal costs associated with new legislation, branding and marketing materials for the new corporation, costs associated with co-locating functions, consulting services to support merger integration and information system selection, additional software licenses, etc.

Total operating costs associated with the merger incurred to the end of March 2014 have been identified at approximately $2.0 million. Approximately $700,000 in additional costs are forecast for 2014/15.

MBLL also incurred capital costs for co-location of departmental functions, including VOIP and telephones, furnishings and renovations. Analysis is currently underway to enable decision-making on system options, which will have future associated capital costs. Capital costs incurred to date are approximately $970,000, and will be amortized over a period of five years, for an annual cost of $220,344.

The October 2012 Merger Integration report identified a number of anticipated transition costs associated with the merger. Costs that could be estimated totalled approximately $1.7 million.

5.0 SUMMARY ANALYSIS

Merger Savings	One Time or Recurring Time Limited (Contract) Savings	Recurring Annual Savings[1]	Actual to March 31, 2014[2]	Forecast 2014/15	Total to March 30, 2015
Executive and Senior Management Salaries & Benefits		$1,801,700	$2,951,200	$1,801,700	$4,752,900
Management and Staff Salaries & Benefits	53,500	1,430,800	1,395,100	1,355,500	2,750,600
Operating Cost Savings	1,082,500	607,000	1,689,600	930,000	2,619,600
Contract Savings	3,642,200		3,553,100	89,100	3,642,200
Sub-Total Merger Savings	**$4,778,200**	**$3,839,500**	**$9,589,000**	**$4,176,300**	**$13,765,300**
Pension Alignment				26,500,000[3]	26,500,000
Total Merger Benefits	**$4,778,200**	**$3,839,500**	**$9,589,000**	**$30,676,300**	**$40,265,300**

1. Reflects full year wages and benefits for removed positions.
2. Reflects partial years of recurring wage and benefits savings from April 2012 to March 2014 from the actual date employment in the position ended, and actual operating cost savings realized during this period. Includes savings over the term of multi-year contracts established in this period.
3. Amount to be adjusted with contributions and market changes subsequent to March 31, 2014 up to the date of settlement.

Merger Costs	Actual to March 31, 2014	Forecast 2014/15	Total
Operating Costs	1,983,000	694,200	2,677,200
Capital Costs	966,000		966,000
Total Merger Costs	**$2,949,000**	**$694,200**	**$3,643,200**

Net Merger Benefit	Actual to March 31, 2014	Forecast 2014/15	Total
Merger Benefits	9,589,000	30,676,300	40,265,300
Less Merger Costs	-2,949,000	-694,200	-3,643,200
Net Merger Benefit	**$6,639,940**	**$29,982,138**	**$36,622,078**

6.0 CONCLUSIONS

1. Detailed documentation indicates actual savings associated with the merger to the end of March 2014 were approximately $9.6 million. After merger related operating and capital costs, net savings were approximately $6.6 million to the end of March 2014, and exceed MBLL's estimate by approximately $500,000.
2. With the addition of forecast savings for 2014/15, including $26.5 million as a result of pension alignment, the total forecast benefits of the merger are approximately $40.3 million.
3. One-time merger costs estimated at approximately $2.9 million to the end of March 2014 have been fully recovered. Approximately $700,000 in further related costs is forecast to the end of 2014/15.
4. Total merger savings less merger costs known to date and forecast to the end of March 2015 provide net merger benefits of approximately $36.6 million.
5. MBLL anticipates the Corporate Head Office Consolidation Project will achieve further future real estate and staffing savings that have not been included in the above. Similarly once the Corporate System Selection project has been finalized, MBLL anticipates future operating and staffing savings net of implementation cost will be achieved. These projects will be included in a final merger savings report to be prepared for March 31, 2015.
6. MBLL has carefully tracked merger-specific savings and costs, and incurred ongoing staff time across all merged departments to do so for approximately 2 years prior to the formal legal merger effective April 1, 2014. It is reasonable to anticipate further savings and costs to occur in 2014/15 as it is the first full year of the legally merged corporation, and to expend the effort to monitor these savings and costs over this period. Over time, however, it becomes less clear whether a particular savings is as a result of the merger, or just an evolution of business practices that may otherwise have occurred. MNP recommends that the ongoing evaluation of merger savings and costs be considered complete as of the end of fiscal 2014/15.

ABOUT MNP

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