

Introduction

6.001 Organisational change and the management of that change continue to be important features of public sector administration. Our interest in the subject stems from considerations such as whether:

- the intended results have been achieved;
- physical assets and other resources have been properly managed; and
- control systems continued to operate.

6.002 We have observed a number of types of organisational change during the course of our 1997-98 audits of government departments, including:

- the disestablishment of an agency, and the creation of a new agency with different management and accountability arrangements;
- the merger of existing agencies to create a new agency;
- the realignment of functions within an agency, and the transfer of functions to other agencies; and
- major strategic reorientation.

6.003 The demands placed on public sector agencies for increased efficiency and effectiveness, and changes in the services that the Government provides and how these are provided, mean that the management of change is likely to continue to be a feature of public sector administration in the future.

Risks

6.004 The risks to financial and service performance most likely to be associated with significant organisational change – such as restructuring or merger – include increased potential for:

- Inability to report accurately on financial and non-financial performance due to a breakdown in information and reporting systems.

- Failure of compliance systems – allowing the possibility of serious legislative breach.
- Unappropriated expenditure.
- Non-delivery or under-delivery of key outputs, or non-fulfilment of statutory obligations – resulting from a loss of staff, reduced staff morale, or lesser commitment to the provision of quality services. We recognise that in times of major restructuring some outputs may not be delivered to the standard anticipated, but the need remains to ensure that core critical work is completed.
- Breakdown in financial control systems, increasing the possibility of fraud or theft going undetected.

Major Organisational Changes in 1997-98

6.005 Illustrative of the major organisational changes that took place in 1997-98 were:

- the merger of the Ministry of Agriculture and the Ministry of Forestry into the Ministry of Agriculture and Forestry, and its subsequent restructuring;
- restructuring in the Department of Conservation; and
- the restructuring of Land Information New Zealand.

Merger and Restructuring of the Ministries of Agriculture and Forestry

6.006 The reorganisation of government departments related to primary industries has been lengthy, involving a series of structural changes – the more recent changes each occurring within a short time.

6.007 In 1994-95, the former Ministry of Agriculture and Fisheries was split into the Ministry of Agriculture and the Ministry of Fisheries (with fisheries research transferred to the National Institute of Water and Atmospheric Research). The new Ministry of Agriculture had thus only recently ‘bedded-in’ when it was merged with the Ministry of Forestry on 1 March 1998, to create the present Ministry of Agriculture and Forestry (the Ministry).

- 6.008 Two other factors had an impact on the merger:
- The restructuring that also took place within the Ministry of Agriculture.
 - The uncertainty that had surrounded the disposition of MAF Quality Management (MQM) for a long time before the merger. The potential to corporatise MQM was recognised in earlier restructuring, and further steps were taken during the course of the merger to prepare for corporatisation. However, the potential impacts of further restructuring MQM were not fully quantifiable.
- 6.009 On 1 March 1998, the meat verification and agricultural quarantine services of MQM were incorporated into the Ministry's Operations Group established from that date. The key surveillance and emergency response capabilities were also transferred back into the Ministry from MQM. After the merger, the decision was taken to corporatise MQM, and on 1 November 1998 its residual functions were transferred to two state-owned enterprises –ASURE New Zealand Limited and Agriquality New Zealand Limited.
- 6.010 Other changes were prepared for during 1997-98. From 1 July 1998 the Animal Health Board became an incorporated society set up under the Biosecurity Act 1993 as a Pest Management Agency. Further structural changes are now being implemented for the delivery of food, biosecurity and forest health services. Several major and minor reviews of structure and function are under way.
- 6.011 A review of border control machinery has been commissioned for 1999, the terms of reference for which require the review to address the viability of a single border control agency.
- 6.012 The Ministry's view is that the scope of changes since the merger has been significantly greater than could have been projected at the time of the merger.
- 6.013 We have been particularly concerned with the effects of time constraints, ongoing change, and loss of human resource capability on:
- the accuracy of the budget; and
 - the ability to address deficiencies in reporting service performance.

Effects of Time Constraints

- 6.014 Time constraints meant that, in some instances, there was insufficient opportunity to consider issues and risks associated with the proposals of the establishment group (Transition Unit). One result was the occurrence of errors affecting the overall budget on an ongoing basis. These errors were:
- the omission of funding for irrigation schemes and biosecurity risk assessment in forestry; and
 - the assumption that some functions were to be funded from Crown revenue when they were supposed to be wholly or partly funded by cost-recovery.
- 6.015 The Ministry informed the Primary Production Committee in the course of its 1997-98 financial review of the Ministry that budget shortfalls of \$2.1 million in 1998-99, \$2.2 million in 1999-2000, and \$2.3 million in 2000-01 and 2001-02 had to be addressed.
- 6.016 These budget shortfalls have had two particular effects:
- delaying set-up work until the situation could be sorted out; and
 - “freezing” positions in, for example, the policy area.
- 6.017 It is still uncertain what efficiency savings – in addition to those already planned – will need to be made to offset these budget errors, and what effect this may have on service performance in 1998-99 and future years.
- 6.018 Time constraints were compounded to some extent by the requirement for neutrality in the merger environment and its inhibiting effect on consultation with the incumbents.

Ongoing Change

- 6.019 Ongoing change has placed pressure on senior management. The chief executive and his new management group have had to concentrate on managing changes in the structure and resources at the expense of addressing some significant policy issues facing the Ministry. Strategic planning was begun in a timely fashion, but its completion has been held back by the pressures of ongoing change.

- 6.020 Another effect of the continual change has been a reduced capability to maintain good management information and control environment systems, or to address identified deficiencies in them. Change issues have taken precedence over the review of existing systems, and a review of the internal control systems is not scheduled for completion until March 1999.
- 6.021 We rated the former Ministry of Agriculture's financial control systems¹ "Satisfactory"² for the period ended 28 February 1998 (final audit). This rating had not improved in the merged Ministry by 30 June 1998. Financial management information systems that had been rated "Good"³ in both of the predecessor Ministries were rated only "Satisfactory" in the merged Ministry.
- 6.022 At the time of our audit of the merged Ministry an estimated 80% of the systems were not Year 2000 compliant. This was confirmed by completion in October 1998 of the inventory and risk assessment phase of the Ministry's Year 2000 project. The position now is that the Ministry expects all of its critical systems to be tested and verified as Year 2000 compliant by the end of September 1999.
- 6.023 We also noted problems with the non-financial (service performance) aspects of the Ministry's information systems. The systems were rated "Just Adequate"⁴ in the former Ministry of Agriculture and since the merger. The statement of service performance was incomplete and untimely, and there was uncertainty in the Ministry over what should be reported against in the four-month period between the merger and the end of the financial year.

Loss of Human Resource Capability

- 6.024 We noted resource pressures in a number of areas during the merger and restructuring – due to either actual staff shortages or larger than anticipated demand for outputs.

1 Financial Control Systems are the individual systems that process financial data. For example, processing payments (expenditure and creditors). They include controls surrounding the processing of these transactions to ensure the completeness and accuracy of data.

2 "Satisfactory" means works well enough, but improvements are desirable.

3 "Good" means works well, with few or minor improvements only needed to rate as excellent.

4 "Just Adequate" means does work, but not well at all.

- 6.025 In connection with its financial review by the Primary Production Committee, the Ministry gave the committee details of staff reductions that totalled 488 between 1996-97 and 1997-98. The Ministry has since acknowledged that the figures provided were incorrect. The correct total is 92.3 full-time-equivalent staff, including 83 redundancies.
- 6.026 The Ministry says that providing incorrect information was symptomatic of the difficulties of bringing together the three different reporting systems of the predecessor organisations. The figures first provided did not differentiate between numbers of people and numbers of full-time-equivalent staff, and were compounded by the omission from the latest count of temporary and seasonal staff.
- 6.027 The Ministry has not indicated the extent to which the staff reductions represent a loss of critical expertise. However, it has acknowledged that its capability in the policy advice area was considerably reduced as a consequence of the merger. Matching the new policy group structure with the merged functions and outputs resulted in a smaller group and an inevitable loss of institutional knowledge.
- 6.028 Effecting the merger part-way through a financial year meant that three sets of financial statements had to be produced in a four-month period. The Ministry told the Primary Production Committee in the course of its financial review that capability problems in the finance area affected debt management, cost recovery, invoicing, and data processing – although not to an extent sufficient for us to issue a modified audit report on the financial statements.
- 6.029 Post-merger functions need to be aligned with new needs, and reviews of functions need to be in step with the change process. For example, we have suggested to the Ministry that (when planning for any future restructuring) the finance function should be reviewed concurrently to ensure that it aligns with future financial service needs. However, because several major and minor reviews are under way, the Ministry has told the Primary Production Committee that it is not possible at this stage to ensure that its financial capability and structure are aligned to business needs.

- 6.030 In the Ministry's own words, *the extent and duration of the capability loss is extended if restructurings follow one on the other with no period of stability to develop and rebuild systems.*⁵
- 6.031 The various papers considered by the Cabinet gave several reasons for the merger and restructuring of the agriculture and forestry sectors. The reasons included:
- Improved biosecurity capability (through operational synergies).
 - Improved consistency in approach to policy advice issues.
 - Improved management of tensions between forestry and farming land use (e.g. ensuring competitive neutrality between sectors).
 - More efficient international trade representation and negotiations.
 - Improved co-ordination and interaction with local government.
 - Efficiencies and economy of scale gains of \$4.6 million annually – with total costs of the merger estimated to be \$8.1 million.
- 6.032 Except for the last of those reasons, no indicators have been given by which to judge their successful achievement. We consider that – as a first step – the purpose of the change and the results sought should be clearly articulated, if Parliament is to be assured that the change is in the public interest, and the effects of change are to be measured. We are concerned that there should at least be milestones against which to measure progress toward the desired outcome(s). The milestones should be established before 2001 when the post-implementation review of the merger is planned to take place. The Ministry has indicated that there is some work to be done to develop the desired measures, and has targeted 1998-99 to achieve this.

5 Response to the Primary Production Committee Financial Review Questionnaire, 1998 Financial Review of Ministry of Agriculture and Forestry, page 2.

Restructuring in the Department of Conservation

- 6.033 The restructuring in the Department of Conservation (the Department) was an internal reorganisation that took place over two years. In 1996-97 the Department established the foundations for a new structure, a stated objective of which was to strengthen accountability within the Department.⁶
- 6.034 The key features of the restructuring were to develop:
- A system for formal monthly operating reviews at all levels.
 - Improved quality management systems.
 - A new general management team – including three Regional General Managers appointed in March 1997. (The new head office divisions and regional offices came into operation on 1 May 1997. Restructuring of conservancies occurred during 1997-98.)
- 6.035 The loss of key personnel and their institutional knowledge during the restructuring had an impact on our assessments of the Department's financial controls. One reason for downgrading our assessments from "Good" to "Just Adequate" was the lack of documented systems and procedures available for new staff to follow. For example, during our audit we noted a general lack of appreciation of the distinction between Crown and departmental activities. Certain assets in the fixed assets register appear to bear little relationship to the expected range of departmental activities.
- 6.036 Our 1997 assessment of "Good" anticipated an improvement in the quality, timeliness, and accuracy of financial information at both conservancy and head office level. This did not occur. The comprehensiveness and quality of financial information at the end of the financial year was not of a good standard, and there was a lack of systems to ensure quality information.

⁶ *Report of the Department of Conservation for the year ended 30 June 1997*, parliamentary paper C.13, 1997, page 8.

- 6.037 The Department is upgrading its present financial management system. The upgrade is being carried out to achieve Year 2000 compliance; but it will also result in training for staff, better documentation, and a separate accounts receivable system for Crown revenue.
- 6.038 The new operating and management structure is now in place. Nevertheless, it is evident that further work is required to fully realise the benefits of the new structure by extending the advances in operational management disciplines to year-end financial reporting.

Restructuring of Land Information New Zealand

- 6.039 The recent creation of Land Information New Zealand (LINZ) involved the merger of functions from two predecessor sources, with the associated management and restructuring of inherited staff and systems. At the same time contestable functions were transferred to other organisations. The merger effectively took place in two steps.
- 6.040 In October 1995, the Land Titles Office (LTO) was transferred from the Department of Justice and attached to the Department of Survey and Land Information (DOSLI), without being functionally integrated. LINZ was created on 1 July 1996, taking over the non-contestable functions of DOSLI and the functions of LTO. The contestable work previously undertaken by DOSLI was taken over at the same time by state-owned enterprise Terralink NZ Limited.
- 6.041 Like the Ministry of Agriculture and Forestry, LINZ started out in circumstances of considerable staff uncertainty and, to some extent, of dysfunctional management information systems. LINZ had the added disadvantage of a large titles backlog to reduce within the first six months. It also had major industrial relations negotiations to conduct.
- 6.042 LINZ has also been undertaking ongoing restructuring, some of which has required changes in staff skills. It has made a major shift to outsourcing of services, requiring new staff skills in contract management.

6.043 During 1996-97 and 1997-98 LINZ concentrated on a fundamental review and restructuring of the functions which it took over. Survey and land title services were integrated, and a major project begun for automating this information. Crown property services were restructured with effect from 1 July 1998. Also on that date the Office of the Valuer-General was established within LINZ, having previously been a function of the Valuation Department.

6.044 There are several points in which the establishment process for LINZ was distinctive:

- ***Achievable time targets.*** LINZ's formation and subsequent major structural shifts have been timed for the start of the financial year. Planning timetables were achievable. Hand-over by the establishment unit to the chief executive occurred three-and-a-half months before the set-up date.
- ***Clarity of objectives.*** The policy framework and the Government's desired outcomes from the new entity were pre-established, by the establishment unit, for the (new) incoming chief executive. There was a clear focus in the post-establishment period on establishing a vision, together with a strategy and rules of operation to support this vision. In 1997-98, the focus was on the development of the Strategic Business Plan, and on confirming and adjusting the plan's links with Government-desired outcomes.
- ***Clarity of internal systems objectives.*** The inherited management information systems were known to be poor, and an independent in-depth study of the systems was carried out before LINZ began operations to identify future needs. The development of adequate internal systems was a specific focus of change management from the establishment date.⁷ This included review and development of risk and information management, and management controls.

For 1996-97, for instance, we assessed financial management information systems as "Satisfactory", and service performance information, and systems and management

⁷ LINZ Annual Report for the year ended 30 June 1997, parliamentary paper C.14, 1997, pages 10-11.

control environment, as “Just Adequate”. For 1997-98, we assessed service performance information and systems as “Satisfactory”, and all other aspects of financial and non-financial management and control systems as “Good”.

- ***Integration of human resource strategy.*** The overall human resource strategy was integrated with the restructuring strategy; in particular:
 - retention and succession planning; and
 - an emphasis on developing human resource policies and procedures *to enable the department to proceed with its proposed business strategies with confidence.*⁸

Conclusions

- 6.045 In our view, the degree of success in maintaining financial and service performance during organisational change within the public sector has been variable. This view is expressed from our perspective as auditor, and is our assessment of the impact that restructuring has had on financial and service performance reporting.
- 6.046 It is not for us to question the purpose or intention behind an organisational change. However, the purpose of the change and the results sought should be clearly articulated. In addition, so that Parliament can be assured that change resulting in significant restructuring and cost is in the public interest, an evaluation should be made at an appropriate time to assess whether the results sought have been achieved.
- 6.047 From our observations we conclude that restructuring arrangements need to:
- Be based on achievable time targets that minimise any adverse impact on the quality of the decisions made and services provided.
 - Take into account at the outset the totality of the anticipated changes – especially in terms of human resource planning – in order to maximise senior management capability and minimise the impact on organisational capability.

8 Ibid, page 17.

- Ensure that key staff have been identified, and that arrangements are in place at the outset to ensure that they are retained wherever possible through the transition phase.
- Ensure that sufficient capability is in place to review and address key management issues within the organisation throughout the restructuring process, so as to –
 - Maintain sound financial and service performance management control environments. Restructuring by its very nature is likely to lead to some deterioration in the control environment. However, control systems should be managed in such a way as to ensure that agencies are able to continue to rely on them to produce financial and non-financial information that is complete, timely and accurate.
 - Minimise disruption to existing information and management systems.
- Ensure that roles and responsibilities in the new structure are clear, and that policies and procedures are put in place as a priority.
- Ensure that any required new skills or processes are developed (e.g. contract management skills, in the case of outsourcing).

6.048 Monitoring, measuring and reporting systems should be in place to ensure that:

- milestones in the restructuring process are met;
- expected efficiencies and other objectives are achieved; and
- a post-implementation review is carried out that will (in part) ensure that feedback occurs in a timely fashion on lessons learned in the implementation process.

6.049 We expect that restructuring of varying scope and nature will continue to be a feature of public sector organisations in the future. As the auditor of these entities we will continue to monitor and report to Parliament on how organisational changes affecting them are being managed.