

REPORT ON
GOVERNANCE ISSUES
IN
CROWN ENTITIES

November 1996



REPORT OF
THE CONTROLLER AND
AUDITOR-GENERAL
ON
GOVERNANCE ISSUES IN
CROWN ENTITIES

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PREFACE

Crown Entities use significant public resources and represent a major area of taxpayer investment. They are responsible for the effective use of the public funds under their control, and for the proper management of the assets under their stewardship.

Crown Entities have increasingly been used to give effect to Government policy, and many of the newer Crown Entities have been key components of the recent reforms of the state sector, particularly in the transfer of service-delivery functions to entities outside the core governmental sector. These public bodies therefore play a key part in the way the Government carries out its business, and the performance of Crown Entities has a significant impact on the quality of government administration.

Crown Entities exist as separate bodies independent of the Crown, normally under the direct control of a board, and with their own enabling legislation. The special characteristics of Crown Entities produce a number of complex governance issues which are addressed in this report.

We undertook the audit on which this report is based for the purpose of stimulating further debate on whether existing governance arrangements for Crown Entities are appropriate to the entities' functions, duties and powers. The response of those agencies consulted in the preparation of this report was very positive, pointing to a keen interest in the issues raised.

The findings and conclusions arising from the audit are based on our review of six Crown Entities. The report points to specific areas where governance arrangements can be improved, and offers practical guidance, drawing where possible on observations of good practice. In framing our recommendations we are conscious that Crown Entities form a loose grouping of organisations, large and small, with some very different characteristics. Although based on findings drawn from a subset of this grouping, we are confident that the report's recommendations will be relevant to a much wider range of corporate bodies owned by the Crown.

I would like to thank the Crown Entities, Ministers, officials and others who willingly participated in this audit. I hope that they and others with an interest in governance issues in the wider public sector will find the report stimulating and of practical use.

A handwritten signature in black ink, appearing to read 'D J D Macdonald', with a long horizontal flourish extending to the right.

D J D Macdonald
Controller and Auditor-General

25 November 1996

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INTRODUCTION

What Is a Crown Entity?

- 101 A "Crown Entity" is identified by being named in the Fourth Schedule to the Public Finance Act 1989, either directly or by description. Every Crown Entity is thereby subject to the reporting requirements of Part V of that Act.
- 102 The Crown Entity concept has its origins in the 1991 report of the Finance and Expenditure Committee on the *Inquiry into Reporting by the Crown and its Sub-entities to the House of Representatives*¹. The Committee recommended five alternative criteria by which to determine whether an entity (other than a State-owned Enterprise) should be a Crown Entity:
- ◆ The Crown owns a majority of the voting shares in the entity.
 - ◆ The Crown has the power to dismiss a majority of the members of the governing body of the entity or, where no such body exists, has the power to dismiss the chief executive, and replace the governing body or the chief executive with a governing body which or chief executive who is primarily responsible to the Crown.
 - ◆ The Crown has the right to more than 50% of the net assets of the entity on its disestablishment.
 - ◆ The Crown would be expected to assume any residual liabilities of the entity other than pursuant to a guarantee.
 - ◆ Parliament considers the entity to be owned by the Crown and deems it to be a Crown Entity.
- 103 The Crown Entities listed in the Fourth Schedule to the Public Finance Act 1989 take different organisational forms, have different powers and responsibilities, perform different functions, and operate with differing degrees of independence from the Government. The entities include advisory bodies, trusts, school boards, regulatory authorities, quasi-judicial bodies, and service delivery agencies and companies. Some deliver services or disburse grants on behalf of the Government, others carry out trading or other commercial activities.
- 104 The different characteristics of individual Crown Entities, or classes of entities, mean that governance issues have to be considered in light of the particular circumstances of each entity.

1

Parliamentary paper I.4A, 1991.

Why Are Crown Entities Important?

- 105 Many Crown Entities receive all or part of their annual revenue from the Crown, totalling more than \$9,000 million. Crown Entities also control over \$17,000 million in assets. They therefore use significant public resources and represent a major area of taxpayer investment. Appendix A (page 58) shows the value of assets held by Crown Entities, and the Crown's equity in each entity or group of entities. Crown Entities are responsible for the effective use of the public funds under their control and for the proper management of the assets under their stewardship.
- 106 The Crown has important long-term interests in Crown Entities which go beyond the delivery of outputs in a given year. These interests are concerned with organisational capability, responsiveness to the objectives and priorities of the Crown, corporate integrity, and the quality of management.
- 107 Crown Entities have increasingly been used to give effect to Government policy. The entities' performance therefore has a significant impact on the quality of government administration.
- 108 Many of the newer Crown Entities are key components of the recent reforms of the state sector, particularly in the transfer of service-delivery functions to entities outside the core central government sector. However, the practical implications of the new regime for the machinery of government and for parliamentary accountability have received relatively little attention from policy-makers.

The Crown's Relationships with Crown Entities

- 109 In 1994 the Office reported to Parliament on the management of payments on behalf of the Crown². That report focused on the roles of the Crown as purchaser and Crown Entities as providers of services, and raised concerns about arrangements for monitoring Crown Entity performance. This report examines in greater depth the relationships between the Crown and Crown Entities, drawing on observations from six case studies.
- 110 Government departments are instruments of the Crown and are responsible to Ministers. Many Crown Entities, too, have a close association with the Crown — some acting as vehicles for the implementation of Government policy. Unlike departments, however, Crown Entities are stand-alone legal entities — existing independent of the Crown, normally under the direct control of a board. The special characteristics of Crown Entities produce a number of complex governance issues which are addressed in this report.

What We Mean by "Governance"

- 111 The term "governance" is being used frequently nowadays but it has no single definition that is universally accepted. Nevertheless, it is generally understood to encompass

² *Fifth Report for 1994*, parliamentary paper B.29[94e], pages 35-63.

authority, stewardship, leadership, direction and control. For the purposes of our audit we have taken “governance” to refer to the processes by which organisations are directed, controlled and held to account.

112 The principal parties involved in the governance of a Crown Entity are Parliament, the Responsible Minister, and the governing body. The nature of their involvement is discussed in Chapters 2 to 4 and is illustrated in Figure 1 on page 12.

113 The prerequisites for effective governance of a Crown Entity include:

- ◆ A role for each of the parties which is clearly understood by the other parties;
- ◆ Constructive relationships based on those roles;
- ◆ An effective governing body; and
- ◆ A regime for monitoring entity performance which reflects a balance between the interests of Parliament, Crown oversight, and the autonomy of the governing body.

114 The influences on the way a Crown Entity is governed can be one or more of:

- ◆ An Act of Parliament, trust deed, charter, or constitution.
- ◆ A statement of (corporate) intent.
- ◆ A ministerial directive.
- ◆ Creditors holding securities.
- ◆ Constituents, customers, and other members of the public.

The Entities We Chose for the Audit

115 Our audit examined the quality of the governance relationships between the boards of six selected Crown Entities (referred to from here on as “the six Crown Entities”), their respective Responsible Ministers, and the Ministers’ advisers. We examined the relationships against our expectations about the requirements for good governance, including effective accountability by each entity to the Minister and to Parliament.

116 We did not assess the performance of individual Crown Entities. Nor did we examine the governance relationship between the boards and their executive managers.

117 All of the six Crown Entities operate under the control of a governing board, and (because they are named or described in the Sixth Schedule to the Public Finance Act 1989) must produce an annual Statement of Intent. These characteristics distinguish this group of Crown Entities from those which may have no governing board, or whose objectives and performance targets are set by means other than those in Part V of the Public Finance Act 1989. The latter include some regulatory and appeal authorities which are required to act judicially or otherwise independently of the Government.

- 118 None of the six Crown Entities are companies, which all operate within the statutory framework of the Companies Acts under the oversight of the Crown Company Monitoring Advisory Unit. Crown Entities that are trusts, school boards of trustees, and other groups of entities to which special governance arrangements apply, were also excluded from our sample.

The Purpose of the Audit

- 119 We undertook this audit for the purpose of stimulating further debate on whether existing governance arrangements for Crown Entities are appropriate to the entities' functions, duties and powers. We aimed to stimulate debate by:
- ◆ Making audited data available to policy-makers.
 - ◆ Raising governance issues relevant to the interests of Parliament.
 - ◆ Providing guidance to boards, Responsible Ministers and their advisers.
- 120 Based on the results of the audit we comment on aspects of the governance arrangements for the six Crown Entities and make recommendations designed to improve the effectiveness of relationships between Crown Entity boards, Responsible Ministers, central agencies and administering departments³.
- 121 The Treasury and the State Services Commission have been reviewing frameworks and structures within the Crown Entity sector. The findings from this audit, and the recommendations based on those findings, are designed to make a useful contribution to their consideration of these matters.

The Audit Approach

- 122 The audit was conducted by means of a review of selected documentation and interviews. The details are given in Appendix B (page 59).

Applying the Findings and Recommendations

- 123 The findings of the audit are based on our review of the six Crown Entities. We believe that these findings and the conclusions we have drawn are broadly relevant to all Crown Entities — modified as required for those entities subject to statutory provisions different to those applying to the six Crown Entities and those entities which have a fundamentally different relationship with the Crown.
- 124 The recommendations are intended to provide specific guidance based on those same audit findings and conclusions and to secure improvements in current practice. Individual Crown Entities, Responsible Ministers and their advisers should consider and apply the recommendations to their own businesses as appropriate.

3 By "administering department" we mean the government department charged with providing support and advice to the particular Responsible Minister.

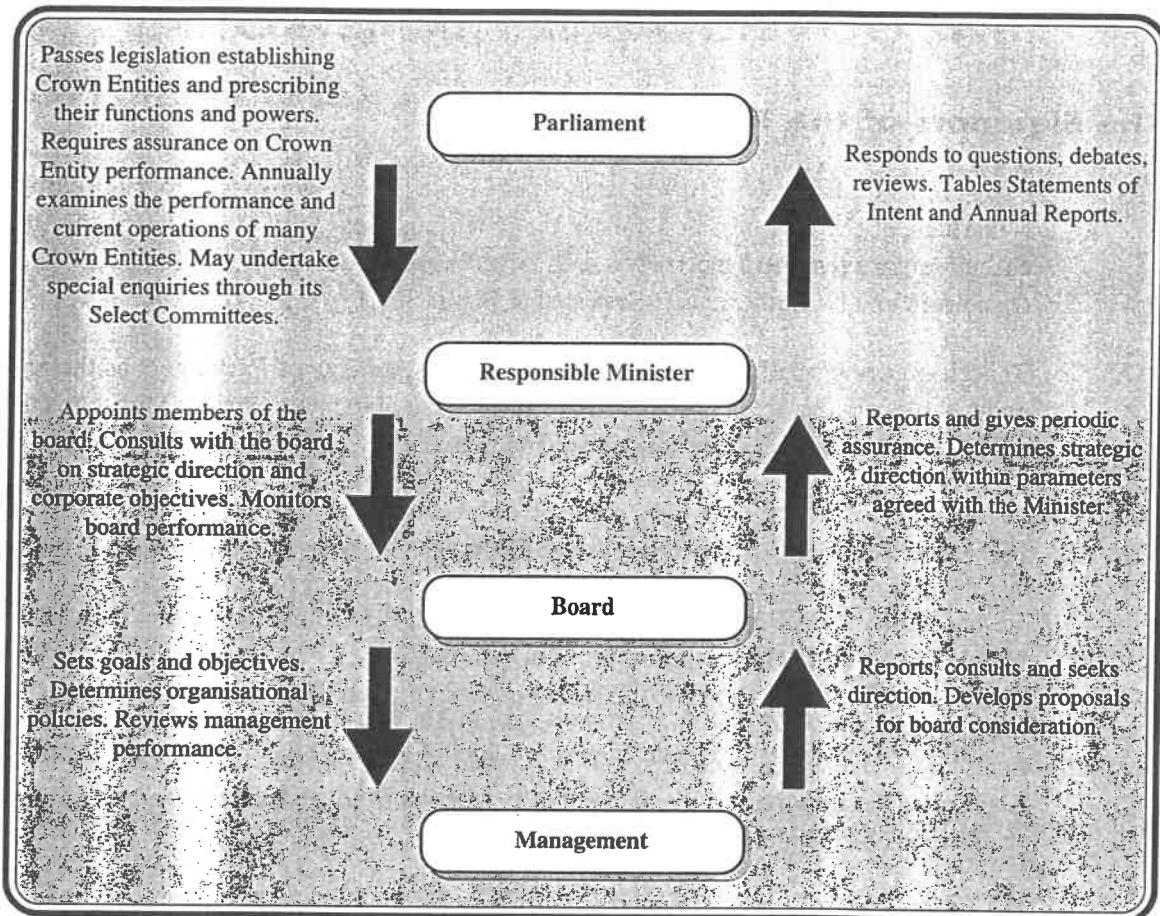
THE GOVERNANCE FRAMEWORK

The Elements of the Framework

- 201 The governance framework for the majority of Crown Entities consists of four key parties — Parliament, the Responsible Minister, the governing body (most often a board), and the executive management of the entity — and the different relationships between them⁴. This framework and its elements are illustrated in Figure 1.
- 202 This chapter principally addresses the role and requirements of Parliament as the pre-eminent party in the governance framework. The role of the Responsible Minister is the subject of Chapter 3 and the role of the board as the governing body is the subject of Chapter 4.
- 203 Parliament has established boards to oversee the management of many Crown Entities.
- 204 Responsibility for setting corporate objectives and achieving those objectives lies with the board. The board is also responsible for developing policies governing the day-to-day operations of the entity, and for overseeing implementation of those policies through the chief executive.
- 205 The Crown has important rights in relation to a Crown Entity, which it exercises through the Responsible Minister:
- ◆ To exercise control over the entity and to determine its direction, using the provisions of legislation;
 - ◆ To appoint and dismiss members of the board;
 - ◆ To approve the size, shape and scope of the entity's operations; and
 - ◆ To exercise other rights as contained in the legislation.
- 206 The board is immediately accountable to the Responsible Minister for the performance of the entity. The Minister is responsible for ensuring that the Crown Entity is managed in accordance with the Crown's interests, and so plays a key part in the governance framework for the entity.

4 Some Crown Entities, such as the Road Safety Trust, have no enabling legislation. Other Crown Entities have a special corporate form in which the “governing body” and the “executive management” are combined, in some cases in a single person. Examples of the latter are the Commerce Commission and the Privacy Commissioner respectively.

Figure 1
The Governance Framework for Crown Entities



The Statutory Basis of the Framework

207 In most cases two statutes define the framework within which each Crown Entity operates: the Public Finance Act 1989, and the enabling legislation specific to the entity concerned. The Public Finance Act specifies the reporting obligations of Crown Entities. The enabling legislation charges the entity with certain functions and gives the board, as governing body, the necessary powers to carry out those functions.

208 The governance framework for Crown Entities should be:

- ◆ Relevant to the entity concerned, i.e. appropriate to its powers, functions and activities;
- ◆ Comprehensive, in that it takes account of all key interests of Parliament; and

- ◆ Clear, in that it minimises the potential for conflicting accountability requirements.

Answering to Parliament

- 209 Through legislation Parliament has charged most Crown Entities with performing certain functions and exercising specific powers. Parliament therefore has the right to examine the objectives and intentions of Crown Entities and to review their performance against those objectives.
- 210 A Vote Minister (who is not necessarily the Responsible Minister) may seek an appropriation from Parliament to obtain services provided by a Crown entity. What the Vote Minister expects to obtain from the Crown Entity in exchange for the money may be the subject of scrutiny in the course of the select committee examination of the estimates for the vote concerned and in the course of the general Estimates debate in the House.
- 211 The main forum for parliamentary examination of a Crown Entity's performance is the annual financial review. The review of those Crown Entities required to produce a Statement of Intent (irrespective of their sources of funding) must be carried out by the appropriate select committee following the tabling of the entity's annual report. This examination addresses both performance in the previous financial year and the current operations of the entity. Select Committees may draw on the Statement of Intent for the purpose of reviewing performance.
- 212 The House may also, in the course of the year, debate particular matters connected with the operations of a Crown Entity. Other avenues for parliamentary scrutiny include formal questions to the Responsible Minister, petitions, and special inquiries initiated by select committees.

The Statutory Requirements Vary

- 213 The Public Finance Act 1989 specifies the accountability reporting obligations for all Crown Entities. The Act divides Crown Entities into groups, differentiating:
- ◆ Those for which the Minister may direct the payment of profits to the Crown;
 - ◆ Those which must prepare a Statement of Intent; and
 - ◆ These which must prepare a Statement of Service Performance.
- 214 The operations of individual Crown Entities are governed by the legislation or other instrument(s) under which they were established. These statutes contain some common provisions, but all contain provisions that are unique to the particular entity. The enabling legislation for the six Crown Entities varied in scope and content, and governance issues are dealt with differently from one entity to another. Figure 2 illustrates some of those differences.

Figure 2
The Six Crown Entities: A Comparison of Some Provisions of the Enabling Legislation

Entity	Board Members Required to Declare Interests	Provision for a "Performance Agreement" or "Document of Accountability"	Good Employer and Equal Employment Opportunity Obligations	Chief Executive a Member of the Board	Departmental Representation on the Board
A	×	✓	✓	✓	×
B	×	×	✓	×	×
C	✓	×	×	×	✓
D	✓	×	✓	×	×
E	✓	×	×	✓	✓
F	✓	✓	✓	×	×

- 215 One of the six Crown Entities, for example, is required to draw up and promulgate a service charter. It must also consider delegating or contracting out its functions or powers wherever appropriate. None of the other legislation we reviewed contains comparable provisions.
- 216 The composition requirements of the board also differ. The board members of one of the six Crown Entities must be drawn from specified groups within the community. In another case persons must be appointed whom the Minister considers will represent the public interest. Other legislation requires persons to be appointed who have business, financial or managerial expertise, or knowledge, skills or experience relating to the functions or powers of the entity concerned.
- 217 As Figure 2 shows, the enabling legislation for two of the six Crown Entities stipulates that the chief executive of the entity is a member of the board. For one of those two entities, the legislation also includes among the board members two chief executives of government departments. The legislation for one other of the six entities also includes a departmental chief executive among the board members.
- 218 There are various possible explanations for these differences. In some cases special statutory provisions reflect the functions or activities of the individual Crown Entity, or the circumstances under which it was established. For other entities, contracting-out or service obligations may be addressed as administrative or managerial issues, rather than through the legislation.
- 219 Under the enabling legislation for two of the six Crown Entities the Responsible Minister may require the board to negotiate specific accountability documents. Under the Public Finance Act 1989 both entities must also prepare a Statement of Intent, which requires the board to provide similar information about its objectives and projected financial performance. This creates the potential for the scope and purpose of the two documents to overlap or conflict.

Board Members' Obligations

- 220 Under company law, company directors have a fiduciary duty to act in good faith and in the best interests of the company. They also have a duty of care when exercising powers or performing duties as a director. The obligations of the members of boards of Crown Entities which are not companies are frequently not set out in statute or any other form of authoritative guidance.
- 221 Some Crown Entity legislation absolves members from personal liability for the actions of the board where they are acting in good faith and with reasonable care. Despite this provision, some boards were unclear about the personal liability of members, and about the balance between the fiduciary duties on members to act in the best interests of the entity on the one hand, and compliance with the Crown's policy objectives and priorities on the other. Two boards had sought legal advice on the statutory obligations of the board and its members. Legal advice obtained by Crown Entities and by the Crown provided no consistent interpretation of those obligations.⁵

Conclusions

- 222 The various legislative provisions which collectively define the governance arrangements of individual Crown Entities are not necessarily consistent as to their scope and purpose. This has created the potential for those arrangements to overlap or conflict.
- 223 The differing treatment of governance issues from one Crown Entity to another raises questions as to whether the legislation as it currently stands takes account of all contemporary key interests of Parliament.
- 224 For the six Crown Entities, responsibilities to the Crown Entity on the one hand, and to the Crown on the other, left the boards and their members in some uncertainty as to where they owed their primary obligations.

Recommendations

We recommend that:

- 225 *A minimum set of governance arrangements for Crown Entities be drawn up, having regard to the arrangements for other bodies owned by the Crown and the differences in the relationships between various Crown Entities and the Crown.*
- 226 *Authoritative guidance be made available to Crown Entity boards and their members on the responsibilities they owe to the entity on the one hand, and to the Crown on the other.*

⁵ The Law Commission considered the question of immunities in its draft report *Crown Liability: Baigent's Case: Judicial Immunity* (May 1996). The Commission found a variety of different legislative provisions protecting public bodies, officials, and others acting under statute.

THE ROLE OF THE RESPONSIBLE MINISTER

- 301 The Public Finance Act 1989 and enabling legislation make a Minister responsible for each Crown Entity. However, apart from a few specific duties (such as to table accountability documents in Parliament), no legislative guidance is given as to how a Minister is expected to discharge that responsibility.
- 302 Particular functions of the Responsible Minister include:
- ◆ To appoint, or in some instances recommend the appointment of, board members, as prescribed by the legislation. This is discussed in Chapter 5.
 - ◆ To consider, comment on, and (if thought necessary) require modification to, the Statement of Intent (or other accountability document that the legislation may require) prepared by the board.
 - ◆ To hold the board to account for its stewardship responsibilities and for meeting the objectives set out in accountability documents.
 - ◆ To be answerable to Parliament for the performance of the entity.
- 303 A Responsible Minister may also have a right to issue a directive to the board or to make other executive decisions affecting the entity.
- 304 We examined three aspects of how a Responsible Minister might discharge their role:
- ◆ The way in which particular functions are carried out.
 - ◆ Whether and, if so, how advisers are used.
 - ◆ The use of ministerial directives.

How Does the Minister Carry Out Particular Functions?

- 305 Each Responsible Minister is free to decide how best to carry out their functions. The way in which a Minister does so can, and should in our view, take account of the functions of the Crown Entity. We would therefore expect a different approach from one Crown Entity to another.
- 306 However, an effective relationship between any Responsible Minister and the governing body needs to be based on an agreed set of arrangements. We expected to find:
- ◆ Regular communication between them; and

- ◆ Formal reporting by the board on performance against the objectives set out in the Statement of Intent or other specific accountability document.

Findings

- 307 For each of the six Crown Entities the nature of the relationship between the Responsible Minister and the board differed markedly. The way the Ministers exercised their responsibilities reflected the differing style and preference of the individual Minister.
- 308 Three Ministers were comfortable with infrequent contact, preferring exception reporting and an informal liaison with the board to a systematic and structured relationship. In contrast, the other three Ministers took an active interest in the affairs of the entity through regular meetings with the board and the chief executive, and formal reporting on board performance.



Are Advisers Used and, If So, How?

- 309 The functions which Responsible Ministers are expected to perform place demands on them which can be eased by having access to advisers with an understanding of the key issues at the strategic, public policy and operational levels. A Minister might also wish to call on administrative support in carrying out tasks such as appointing board members.
- 310 For a number of reasons government departments are frequently the primary source of advice for Ministers. Departments have a natural interest in issues affecting their sectors of responsibility, and normally have some responsibility for administering the enabling legislation for Crown Entities operating in their sectors. Departments are also the conduit for any Crown payments to Crown Entities.
- 311 The role of advisers in helping Ministers carry out their monitoring responsibilities is discussed in Chapter 8.
- 312 Our expectation was that the functions which a Minister expects a department or other adviser to perform on their behalf would be clearly understood by the board, the Minister and the advisers themselves, and be formally documented.

Findings

- 313 All six Responsible Ministers had a range of portfolios and Parliamentary duties. These duties can limit the time available to devote to their Crown Entity responsibilities.
- 314 Four Ministers were using advisers, in each case from a government department. The Ministers valued the advice they were receiving from their departmental officials.
- 315 Where Ministers were using advisers we found a well-structured, formal approach to board reporting on performance. The Ministers, the departments and the entities were all clear about the role to be played by officials as the Minister's advisers.

- 316 Two Ministers had assigned no monitoring role to their departmental officials. One Minister took the view that departmental monitoring would be inconsistent with the board's own responsibilities. Both Ministers sought assurance about the performance of the entity through informal meetings with the board or the chairperson. Neither Minister was receiving formal or regular performance reports from the board.

What Use Is Made of Ministerial Directives?

- 317 Parliament has given the boards of Crown Entities particular functions, and the powers necessary to perform those functions. Boards normally expect to be held to account for the manner in which they perform those functions and exercise those powers.
- 318 A board may embark on a course of action which conflicts with Government policy. For some Crown Entities Parliament has given the Responsible Minister a statutory right to direct the board on the policy it must follow, although the power is rarely used. A directive must be tabled in the House and published in the *Gazette*.
- 319 Issuing a directive has implications for the governance relationship between the Responsible Minister and the board, and for the accountability of the board in discharging its statutory functions. Accountability for any decision to issue a directive to the board, and for the effect of any such directive, lies with the Minister.
- 320 We expected that the process for issuing a ministerial directive would be consistent with the requirements of the legislation, and would clearly reflect the implications for the respective accountabilities of the Responsible Minister and the board.

Findings

- 321 The board of one of the six Crown Entities had recently received a directive from the Responsible Minister. This came about in the following manner.
- 322 The board formalised its desire to follow a particular investment policy, and sought the Minister's endorsement of that decision. The Minister sought advice from his officials and obtained Cabinet support for a different policy. After lengthy consultation with the board, the Minister instructed the board to abandon its proposal.
- 323 Although at the time of our audit a formal directive was still being drafted, the Minister had advised the board in writing of the Crown's views, and made it clear that the board would not be held accountable for the consequences of his decision. The effect of the directive was thus that the Minister assumed accountability for this aspect of the entity's business.

Conclusions

- 324 We found no common set of principles to guide Responsible Ministers in their relationships with Crown Entity boards. This has led to different Ministers taking a different approach in what are, in our view, comparable circumstances.
- 325 Advisers were providing valuable support to Responsible Ministers. The use of advisers led to a structured, formal approach to board reporting on performance.

Recommendations

We recommend that:

- 326 *All Responsible Ministers consider the merits of using appropriately skilled advisers to help them discharge their Crown Entity responsibilities.*
- 327 *When using advisers, Responsible Ministers define what roles they expect their advisers to perform on their behalf, and ensure that those roles are clearly understood by Crown Entity boards.*
- 328 *Consideration be given to drawing up a set of principles to guide Responsible Ministers in their relationships with Crown Entity boards. These principles would:*
- ◆ *Outline the key aspects of a communications protocol between the board and the Minister.*
 - ◆ *Specify minimum requirements for performance reporting by boards to Ministers.*
- 329 *In the interests of accountability and good governance, Parliament reviews the effect of ministerial directives and obtains appropriate assurance that the Minister's decision in each case was prudent and based on sound advice.*

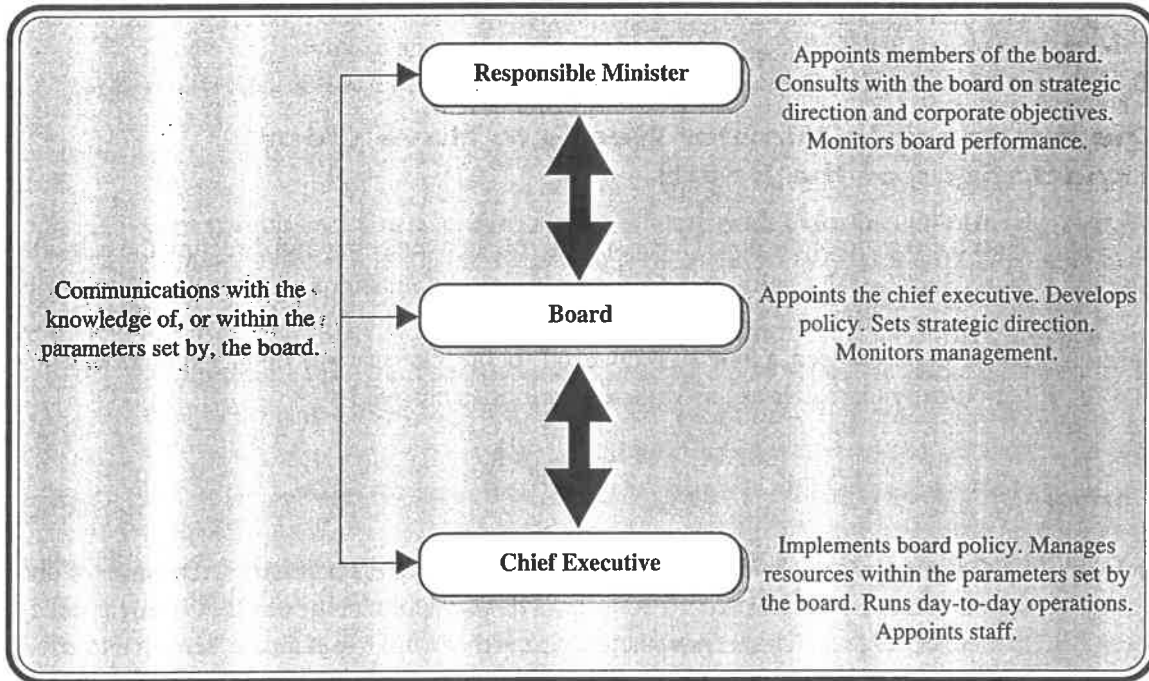
THE ROLE OF THE BOARD

What is the Role of the Board and What are its Functions?

- 401 The role of the board is to govern the Crown Entity by directing and supervising the conduct of the entity's business. This chapter outlines some of the arrangements necessary to allow the board to carry out its functions, and identifies barriers to the board fulfilling those functions in a proper manner. It also discusses the key obligations of the Crown Entity as a public body.
- 402 The board is responsible for setting the strategic direction of the organisation in accordance with the interests of the Crown as owner, and for overseeing management of the resources which are entrusted to it. The board must account to the Responsible Minister for the discharge of these stewardship responsibilities.
- 403 The board, in turn, appoints the Chief Executive to implement its policies, manage the resources of the organisation, and to run its day-to-day operations, within the parameters set by the board.⁶ The Chief Executive is responsible to the board by which he or she is appointed, and to which he or she must account for achieving the specific management objectives set by the board.
- 404 The primary functions of and relationships between the Responsible Minister, the board and the Chief Executive can be depicted as shown in Figure 3.
- 405 Boards perform a number of functions within the entity and externally. Although these functions will vary from one Crown Entity to another, a set of obligations and expectations is common to all boards. As evidence of the board operating effectively we, expected to see:
- ◆ An explicit record of the relationship between the board and the Responsible Minister, giving rise to a shared understanding between the board and the Minister as to what the board is there to do;
 - ◆ Clear lines of accountability between the chief executive, the board and the Responsible Minister; and
 - ◆ That board members had an understanding of public sector legislation, procedures and practices; and an awareness of the importance of following acceptable standards of corporate conduct and behaviour.

⁶ Not all enabling legislation provides for separation of the role and accountability of the chief executive; some legislation combines the offices of chief executive and chairperson of the board.

Figure 3
Relationships Between the Responsible Minister, the Board and the Chief Executive



BARRIERS TO THE EFFECTIVE OPERATION OF THE BOARD

Differing Expectations about the Role of the Board

Findings

406 The Responsible Ministers and the board chairpersons sometimes had a different interpretation of the board’s primary role, creating the potential for conflict between what the board saw as its obligations and the expectations of the Minister. Neither the Ministers nor the boards consistently identified the board’s role and responsibilities.

Attendance at Board Meetings

Findings

407 Given the importance of the stewardship responsibilities of the board, we were concerned to note instances of a low level of attendance at board meetings. For one of the six Crown Entities, on only four occasions out of a possible 22 over an 18-month period did all the members attend a board meeting. Five of the 22 meetings had been held with the minimum number required to make a quorum. The board of another entity was unable to form a quorum at one meeting. The percentage of members attending the board meetings for that same entity fluctuated over a 12-month period, falling as low as 50% on two occasions.

- 408 Although these were isolated instances and may have occurred for a variety of reasons, poor attendance at board meetings has practical implications for the effective operation of the governing body. It also affects the board's ability to retain full and effective control over the organisation, monitor the performance of management, and draw on the full range of skills and experience for effective decision-making.

The Responsible Minister Needs to Have Clear Expectations of the Board

- 409 The chairperson of the board has a special role in overseeing and directing the activities of the board and the entity, and in maintaining communications between the entity and the owner. Given this special role we expected the Responsible Minister's expectations of the board to have been explicitly conveyed to the chairperson upon appointment, and periodically thereafter as the Minister's priorities changed.

Findings

- 410 Chairpersons were sometimes briefed by the Responsible Minister at the time of their appointment. Some Ministers also informed boards of changes to Government policy, explaining in general terms how they expected the board to put those changes into effect. The Ministers did not, however, record their expectations of the board and document their mutual obligations through a formal agreement with the chairperson.

Managing the Relationship Between the Responsible Minister and the Chief Executive

- 411 A Responsible Minister's relationship with a Crown Entity is primarily through the board. In practice, occasional communication may take place directly between the entity's chief executive and the Minister, and in some circumstances the chief executive may act as a conduit for representing the board's views. We expected such communications to take place with the full knowledge of the board, preserving the accountability of the chief executive to the board and the board to the Minister.

Findings

- 412 Responsible Ministers had, on occasions, dealt directly with the chief executive, rather than through the board. In some of those cases, the extent to which the chief executive was interacting with the Minister on their own account or on behalf of the board was not clear. This situation creates the risk that the board may not be involved in key consultations or decisions for which it is responsible.

Being Involved in the Government's Policy Development Processes

- 413 Because of their functions or their knowledge of the sector in which they operate, some Crown Entities make an important contribution to the policy development process within government. If not carefully managed, doing so can create difficulties for the role of the board.
- 414 Often as the result of a Cabinet or Ministerial directive to a government department, Crown Entity staff can be called upon to work with departmental officials on policy development. The circumstances of their participation may make it difficult for the Crown Entity staff to seek the endorsement of their boards before adopting or agreeing to a policy position. The policy development process may thereby prevent the board from exercising its legitimate prerogative to determine a view on policy matters affecting the entity for which it is responsible.

Findings

- 415 In some instances, Responsible Ministers had, without reference to the board, called on the chief executive or other staff of a Crown Entity to carry out policy development work. In one case, Crown Entity staff on an inter-departmental working party were obliged to take a policy position without the prior express authority of the board. The effect of such an arrangement is to put the staff in the invidious position of divided, and potentially conflicting, obligations to the board and the Minister. It also has the potential to undermine the board's authority.

OBLIGATIONS FROM BEING A PUBLIC BODY

Board Members Need to Understand Public Sector Conventions and Practices

- 416 People appointed to be board members from outside the public sector may not be familiar with public sector legislation, procedures and practices. Most appointees to the boards of the six Crown Entities came from the private sector. This makes some form of induction programme necessary if members are to be fully aware of their responsibilities.
- 417 In addition, we expected the boards to be organising periodic briefing sessions for their members on corporate governance issues. Such sessions might cover changes in legislation, evolving board management practices, developments in the industry or sector, public policy matters, and revised performance reporting procedures.

Findings

- 418 In some cases, boards undertook the induction of new members themselves, with the guidance of existing members. One administering department sent papers to the incoming

chairperson to brief him on relevant current issues and Government policy. However, we found no evidence that the induction of new board members and ongoing briefings were undertaken in a systematic or comprehensive way.

419 One administering department had held a training day for all the board members of Crown Entities within its sector. The session covered statutory responsibilities, the workings of the Public Finance Act 1989, personal responsibilities of board members, and an introduction to the activities undertaken by other entities within the sector. This was a useful initiative.

420 We also commend the initiative taken by the Cabinet Office to issue a circular in October 1995 on guidance for members of statutory, commercial and other bodies appointed by the Crown. The circular sets out guidelines for letters of appointment, and suggests additional material to accompany such letters.

Public Bodies Need to Meet Minimum Standards Of Corporate Behaviour

421 As public bodies, Crown Entities have an obligation to conduct their activities in an open and ethical manner, and to play a responsible role in the community as a corporate citizen.

422 Being organisations separate from the Crown, Crown Entities tend to develop their own distinctive culture. In addition, board members may be unfamiliar with the obligations on persons holding public office. Together, these factors heighten the need to ensure that the ethical behaviour of Crown Entities is consistent with their responsibilities as public bodies.

423 We expected to find standards and principles to guide Crown Entities in matters of corporate conduct and behaviour; for example:

- ◆ Ensure that they are operating in a manner which is fully consistent with the substance and intent of the law.
- ◆ Treat their employees in a fair and reasonable way.
- ◆ Follow unbiased tendering and other purchasing procedures.
- ◆ Control and account for sensitive expenditure, such as on travel, entertainment, advertising and sponsorship, and the use of consultants.
- ◆ Manage potential or actual conflicts of interest.
- ◆ Use transparent and open processes to distribute funds.
- ◆ Provide public access to information about the organisation and its operations.

Findings

- 424 The State Services Commission has issued a *Code of Conduct for Public Servants* and a collection of papers relating to practices and procedures in the public sector. No similar guidance is available to meet the needs of Crown Entities generally or of groups of Crown Entities.
- 425 We did not examine matters of corporate behaviour in any depth. Nevertheless, from our limited investigations two significant issues emerged: the handling of conflicts of interest, and the relationship between Crown Entities and the Government.

Boards and Board Members Need to Identify and Manage Conflicting Interests

- 426 Some board members are appointed because they bring to the board the benefits of their experience or involvement in activities closely related to the business of the Crown Entity. Because of their backgrounds, therefore, such board members may not be free of competing interests and consequently may encounter situations where they face a conflict between their duties to the board and their activities outside the entity.
- 427 The enabling statutes for five of the six Crown Entities prescribe ways in which conflicts of interest should be addressed. The provisions are widely drawn and place the onus on board members to take appropriate action when they face a potential or actual conflict of interest.
- 428 Some guidance on handling conflicts of interest is already available to bodies within the public sector and for other Crown-owned entities. Newly appointed directors to the boards of State-owned Enterprises are sent a letter which explains how such situations should be handled. Cabinet Office Circulars outline principles and practices to be adopted by those holding public office. The State Services Commission has issued guidance on what should be contained in letters of appointment to statutory boards, suggesting that such letters include reference to the handling of potential conflicts of interest. We examined the way in which conflicts of interest were managed in the six Crown Entities.

Findings

- 429 In five of the six Crown Entities board members had experienced or faced potentially conflicting interests. These arose in the following circumstances:
- ◆ One board member was a director of a company which tendered for a contract with the Crown Entity, but failed to declare this interest at the time.
 - ◆ A member of another board was interested in bidding to purchase an asset which the Crown Entity was itself considering purchasing. The same member had also made a substantial private donation to the Crown Entity.

- ◆ A chairperson accepted appointment to a board in the same industry. This was seen as making the Crown Entity vulnerable to questions about the integrity of its processes.
- ◆ Two board members held offices on bodies receiving grants from the Crown entity concerned.
- ◆ The chief executive and some board members were directors of companies which were potential beneficiaries of the services provided by the entity.

430 Issues arising from such competing interests were handled in different ways in the absence of a common set of principles governing conduct and behaviour. Boards and board members were not consistently aware of the need to anticipate and address the implications of potential conflicts.

431 In two instances the individuals concerned had recognised and declared a conflict of interest. In one case, advice was sought on the nature and implications of the conflict, and on the adequacy of arrangements to address the situation. Two board members resigned in the face of actual or perceived conflicts of interest. Board members of two other entities were not seen as facing potentially competing interests, even though some were directors of companies or members of other boards or interest groups in the same industry, and therefore associated with potential clients or customers.

432 One board had recently developed a policy to deal with such issues as they arose, and to guide members faced with potentially conflicting interests. That policy involved:

- ◆ Establishing an interests register.
- ◆ Outlining the circumstances in which disclosure should be made.
- ◆ Specifying the terms under which members may participate in board business where they face a potential conflict of interest.

The Relationship with the Government Needs to be Clearly Understood

433 We expected Crown Entities' relationships with Responsible Ministers and government agencies to be based on an explicit understanding of their respective responsibilities.

Findings

434 Each of the six Crown Entities had a different relationship with the Responsible Minister and with the government agencies.

435 As an illustration, correspondence received by the Responsible Minister was handled in different ways. In some instances the Minister replied. One Crown Entity, however,

followed the practice of responding to ministerial correspondence directly. These different practices point to the importance of minimising possible misunderstandings by ensuring that the Minister and the board have a shared understanding of the respective responsibilities of the Minister and the Crown Entity for dealing with different entity related matters.

436 The six Crown Entities also interpreted in different ways their right to comment publicly on Government policy. Some boards lobbied politicians and political parties when they considered this to be in the entity's best interests. The objective of lobbying may have been, for example, to preserve market share or to promote sectoral interests. In some instances Crown Entities publicly criticised Government policies and processes.

437 The relationships between one of the six Crown Entities, the Government and Parliament are outlined in a "Guidelines and Protocols" document. This document describes the procedures and protocols which the board and staff of the Crown Entity are expected to follow in their dealings with the Responsible Minister, departments, the Cabinet and Cabinet Committees, the media, and Parliament. That Crown Entity followed a practice of advising the Responsible Minister of any impending media release or publication of a contentious report. This reflected the fact that the entity was dealing with issues which were sensitive and had implications for the Government.

438 The guidelines and protocols document also provides a basis for cooperation and consultation within the sector between the entities with different responsibilities. Disagreements or disputes are to be handled as far as possible without comment to outside parties.

439 For the other five of the six Crown Entities, no comparable document existed.

Conclusions

440 The extent to which the board and the Responsible Minister had the same understanding of the board's primary role differed for each of the six Crown Entities. Differing role expectations create the potential for conflict between what the board perceives as its obligations, and the expectations of the Minister.

441 Communications between Responsible Ministers and Crown Entity boards, chief executives and other staff were not always consistent with recognised principles for good relationships. For example, the involvement of Crown Entity staff in Government policy development, without reference to the board, creates the risk that the board may not be fully consulted on matters affecting its operations.

442 Structured induction programmes and periodic briefing sessions were not widely used to make board members familiar with public sector practices and procedures and conversant with developments in corporate governance.

- 443 Our limited investigations revealed differing approaches to issues of corporate behaviour, reflecting the absence of explicit standards of conduct for boards.
- 444 The relationship between the six Crown Entities and the Government was not based on a common understanding of the respective roles of the board and the Responsible Minister. This has led to different ways of handling issues that have implications for the Government.

Recommendations

We recommend that:

- 445 *Every Responsible Minister and board formally record the terms of their relationship. This record could take the form of an agreement with the chairperson, setting out the Minister's expectations of the board and their mutual obligations.*
- 446 *Responsibility for the induction of new board members be made explicit by the Minister. In consultation with the Minister's advisers, the board could organise periodic briefings for its members on evolving issues concerned with corporate governance.*
- 447 *A protocol be agreed between the Responsible Minister and the board dealing with the relationship between the Crown Entity and the Responsible Minister, the Government, and Parliament and its Select Committees. The protocol might cover the following matters:*
- ◆ *The legislation with which the entity is required to comply.*
 - ◆ *The role (if any) played by the entity within its sector and the relationship with any other entity within the sector.*
 - ◆ *The responsibilities of the Minister, the Government, the entity, the administering department, other advisers, and Parliament.*
 - ◆ *Relationships with the Cabinet, Cabinet committees, and Parliament and its Select Committees.*
 - ◆ *Procedures for providing answers to questions in Parliament and ministerial correspondence, for making statements in the media, and for handling other matters concerned with the Crown Entity's relationship with the Minister and the Government.*
- 448 *An explanatory guide be developed for Crown Entities or groups of Crown Entities on expected standards of corporate behaviour, the statutory duties of governing bodies, and the obligations of board members. Among other matters, the guide might address:*
- ◆ *The way in which conflicts of interest ought to be managed (including complying with relevant legislation).*

- ◆ *Relationships with the Responsible Minister, the Government, the administering department, and Parliament and its Select Committees.*
- ◆ *The conventions to be observed in commenting on Government policy and handling other aspects of the relationship with Ministers and the Government.*
- ◆ *The obligations on board members to participate fully in the decision-making processes of the board through attendance at meetings of the board and board committees.*

HOW BOARD MEMBERS ARE APPOINTED

- 501 This chapter discusses the process used to appoint members to the boards of the six Crown Entities. It examines:
- ◆ The administration of the process; and
 - ◆ The way in which members are selected.

Administering the Appointment Process

- 502 Responsible Ministers appoint, or recommend the appointment of, members to serve on Crown Entity boards. In carrying out this task, Ministers and their advisers must comply with the provisions of the enabling legislation and with the administrative procedures notified by the Cabinet Office. The enabling legislation for two of the six Crown Entities, for example, requires the Responsible Minister to consult particular interest groups in appointing new members.
- 503 Board members are appointed for specific terms which are normally laid down in statute. Before a board member's term expires the Responsible Minister should decide to re-appoint the existing member or make a new appointment. If a decision is made not to re-appoint an existing member, then the candidate selection process should be initiated to make a timely appointment.
- 504 Proposed appointments to the boards of Crown Entities are considered by the Cabinet Appointments and Honours Committee, and then ratified by the Cabinet⁷. Following this process the Responsible Minister makes the appointment, or makes a recommendation to the Governor-General to appoint, depending on the provisions of the enabling legislation.
- 505 The Cabinet Office has issued guidelines for the preparation and submission of papers recommending the appointment or reappointment of board members⁸. These guidelines are a valuable source of reference for Ministers and their advisers, and cover :
- ◆ The information required by the Cabinet Appointments and Honours Committee.
 - ◆ Legislative requirements.
 - ◆ The skills and qualifications required for the position.
 - ◆ Possible conflicts of interest.

⁷ Some proposed appointments are also considered by the parliamentary party caucus.

⁸ Cabinet Office Circular CO(95)6 of 4 May 1995. See also paragraphs 4.44-4.46 of the *Cabinet Office Manual* (August 1996 edition).

- ◆ Timeliness and other administrative matters.

506 We expected that the appointment processes would include steps to ensure that all statutory and administrative requirements are followed.

Findings

507 Responsibility for managing the process for appointments to two Crown Entity boards lay with the administering departments. In both cases the appointment process was well understood and was being managed effectively. Departmental officials brought appointment matters to the attention of the Responsible Minister at the appropriate time, briefed the Minister on the administrative requirements and the provisions of the legislation, coordinated the process for the seeking of nominations and, in some instances, identified the attributes and skills needed on the board. One department drew up a list of candidates, and assessed them against the skills required for the position. It also kept a record of the reasons for nominating certain candidates in preference to others.

508 No advisory agency was clearly responsible for managing the process for appointments to the other four Crown Entity boards. The absence of an adviser creates the risk that proper appointment procedures may not be followed. Crown Entities had, on occasions, initiated the appointment process themselves in order to fill an impending vacancy. This should not be necessary if the task is clearly assigned to the Minister's advisers.

509 Failure to follow the necessary procedures can have potentially serious consequences. In one instance, neither the Responsible Minister's office nor the administering department took responsibility for handling the appointment process. Because of the number of members whose terms were expiring at the time, the board's ability to raise a quorum became a significant issue. A board needs a quorum to act lawfully. A board also needs its complement of members if it is to have access to the full range of skills and experience necessary to perform its duties.

Finding the Best Candidates

510 Responsible Ministers need to have confidence in the persons they are appointing or recommending for appointment. This is important for establishing an effective personal relationship between the Minister and the board, and with the chairperson in particular.

511 The Minister may also be asked in Parliament to justify the suitability of an appointee.

512 To discharge its role and functions competently, a Crown Entity board needs to have the right mix of skills and experience. In some instances the nature of the business may demand technical skills and specific expertise.

513 As far as possible the appointment process should provide assurance that board members have been chosen from the available candidates best able to meet the requirements of the position.

HOW BOARD MEMBERS ARE APPOINTED

- 514 In our view, the appointment process should incorporate the following steps:
- ◆ Identify the skills, experience and other attributes required for the position.
 - ◆ Identify candidates (including, possibly, by seeking nominations or other expressions of interest so as to provide the opportunity for all suitable candidates to make their availability known).
 - ◆ Evaluate the candidates against objective criteria.
 - ◆ Select from the short list of candidates the person most likely to fulfil the requirements of the position.
- 515 We also believe that board chairpersons should have the opportunity to comment on the skill requirements for membership of the board and on the performance of existing members.

Findings

Identifying Position Requirements

- 516 No person specifications or competency requirements had been established for the board positions reviewed. In some instances, however, officials did identify the attributes and skills required on the board. Some submissions to the Cabinet Appointments and Honours Committee specified the skills required in relation to the board's strategy and objectives for the coming year. This practice is not followed routinely, however.
- 517 We were told that consultation with the board chairperson took place in most cases.

Identifying Candidates

- 518 The process for seeking candidates for positions on the boards of the six Crown Entities generally was not documented. Where this process was not clearly documented we asked the Responsible Minister and the administering department directly about the manner in which candidates were sought. The Ministers' responses indicated that they drew heavily on personal contacts, who may have been fellow Ministers or parliamentary party colleagues in caucus.
- 519 None of the vacant positions on the boards of the six Crown Entities was advertised publicly so as to widen the field of candidates.
- 520 The Cabinet Office guidelines provide a useful framework for the Cabinet to consider whether prospective appointees have the skills and other attributes required for the position. Details of a proposed appointment are recorded on a standard form which sets out personal particulars, information about other board positions held, and a statement of personal qualities, qualifications and experience relevant to the position. The Minister

must also state whether any possible conflicts of interest could arise from the proposed appointment.

Representatives of Crown Entity Constituencies

521 The boards of two of the six Crown Entities include representatives drawn from the constituency served by the entity. In one case the enabling legislation specifies the interest groups from which members must be drawn. Other boards also include members who are representative of their sectors. This arrangement brings sector knowledge into the organisation and makes the entity responsive to the needs of its constituency. The boards played an important role in consulting with interest groups.

522 However, limiting the sources from which members can be drawn may not bring to the board the full range of professional skills and experience necessary to form an effective board. In general, the skills, attributes and experience needed by board members were not clearly defined.

Evaluating Candidates and Deciding Whom to Appoint

523 We could find no record of the reasons for selecting one candidate over others. However, a key consideration for all Ministers we interviewed was trust, creating a tendency for them to appoint persons known to them personally or enjoying their confidence for other reasons.

Conclusions

524 Statutory and administrative requirements were met where responsibility for managing the appointment process was clearly assigned by the Responsible Minister to an advisory agency. The key steps of the process were followed in a systematic way.

525 The position requirements for board vacancies were not identified in all cases, and the process of identifying candidates did not provide the opportunity for a wide range of suitable people to express their interest or be considered.

526 The source of membership of some boards is limited to representatives of the entity's constituency. Limiting the sources from which board members can be drawn may also limit access to the full range of skills and experience necessary for the board to perform its functions.

Recommendations

We recommend that:

527 *Responsible Ministers consider the merits of using advisers to manage the appointment process. A suggested guide to the key steps of the appointment process is set out in Appendix C (page 60).*

HOW BOARD MEMBERS ARE APPOINTED

- 528 *Ministers and their advisers review periodically the mix of skills, attributes and experience needed for Crown Entity boards, using the results to determine the skill profile for positions as they become vacant. These position requirements can then be used to assess the merits of candidates and select the best person.*
- 529 *The appointment process allows consideration of suitable candidates from the widest practicable pool.*

BUSINESS PLANNING

- 601 Business planning refers to the process of setting goals and objectives and making operating plans for an entity over a defined period, and is a key responsibility of the board. The business planning process of a Crown Entity should ensure that the intentions of the board have regard to the expectations and priorities of the Responsible Minister.
- 602 We believe that, to achieve this outcome, a successful business planning process requires the existence of:
- ◆ A strategic assessment which identifies the Crown's interests, and the risks and opportunities having a bearing on those interests.
 - ◆ The board's strategic business plan.
 - ◆ The Statement of Intent (or equivalent document) prepared by the board, setting short- and medium-term targets for the entity and specifying the scope of the business or operations.
 - ◆ An explicit statement of the Minister's expectations of the board about its management of the performance of the entity, consistent with the priorities outlined in the Statement of Intent.
 - ◆ An operational plan for the entity (and, if appropriate, a sub-plan for each separate business unit) drawn up by the management and endorsed by the board, showing how the organisation will achieve each of the objectives agreed in the Statement of Intent.

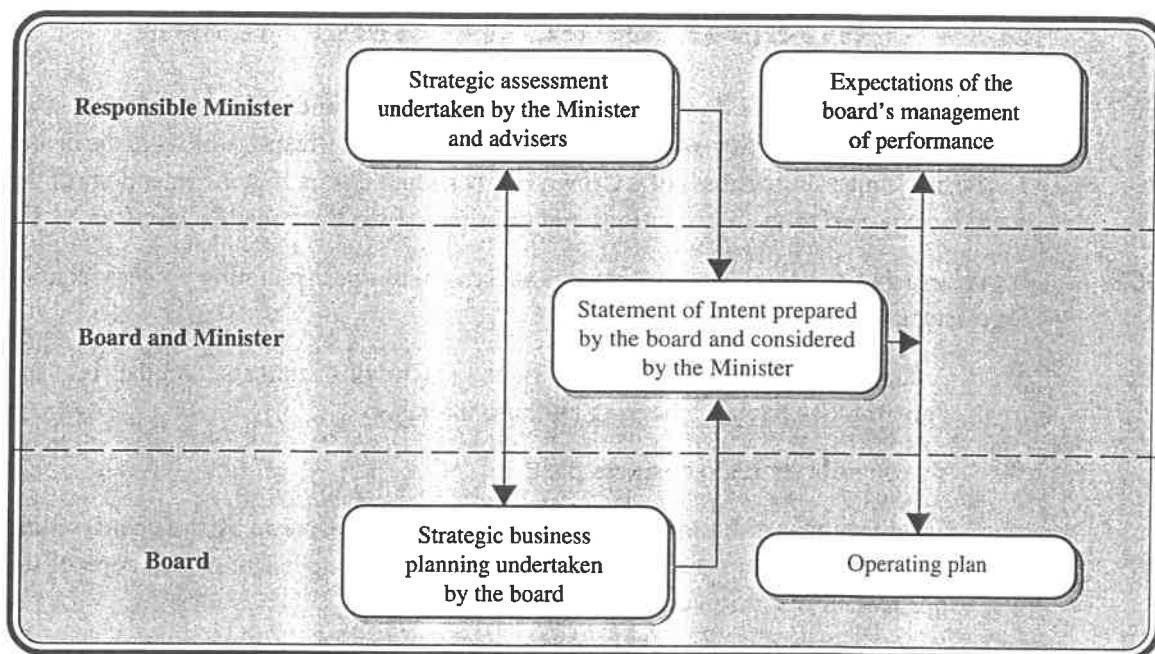
Figure 4 shows our view of the relationship between each of these business planning components and identifies the party responsible for undertaking each part of the planning process.

The Business Plan and Strategic Assessment

- 603 In setting goals, and developing strategies to achieve those goals, the board needs to understand the Crown's interests and priorities. The board should consult the Responsible Minister on the key features of its strategic business plan, with a view to reaching a common understanding on the board's key priorities.
- 604 The Responsible Minister, in turn, needs access to information and analysis from which to determine the Crown's strategic priorities for the board. The Crown's interests should focus on the medium and long-term direction of the Crown Entity, the risks and opportunities facing the business, and the stewardship responsibilities of the board. Issues related to these broad areas of interest should be identified in a strategic assessment or outlook document. This is likely to be developed by the Minister's advisers, in consultation with the board.



Figure 4
A Model of the Business Planning Process



605 The board’s strategic business plan and the strategic assessment of the Crown’s interests together ought to provide the basis for the Minister and the board to agree on the contents of the Statement of Intent, in which the direction of the entity for the medium term is translated into specific performance targets.

Findings

606 Officials in all four administering departments identified issues to be addressed in the Statement of Intent or other accountability document and either brought them to the attention of the Responsible Minister or raised them with the entity on the Minister’s behalf. The Minister’s comments on the Statement of Intent or other accountability document did not draw on any comprehensive strategic assessment of the entity. Without a strategic assessment any input from Ministers or their advisers may not reflect a considered view of the Crown’s interests.

607 Most of the boards of the six Crown Entities did not generally consult the Responsible Minister on the key features of their strategic business plan. This lack of consultation creates the risk that the board’s objectives will not have adequate regard for the interests of the Crown. Without the opportunity to communicate the views of the Crown through the business planning process the Minister’s role is limited to responding to the draft Statement of Intent prepared by the board.



608 One of the six boards did consult the Responsible Minister as part of its strategic planning process, and submitted its business plan to the Minister along with the Statement of Intent. This provided an opportunity for the Minister and the board to address outstanding policy issues, and for the board to outline both its detailed budget and the strategies it was following to meet the objectives in the Statement of Intent.

The Contents of Statements of Intent

609 All Crown Entities listed in the Sixth Schedule to the Public Finance Act 1989 must prepare a Statement of Intent each year. The statement covers a three-year period, and contains information about:

- ◆ The objectives of the entity;
- ◆ The scope of the entity's activities; and
- ◆ The financial and non-financial performance targets for the entity.

610 The draft must be delivered to the Responsible Minister by 1 June. After considering the Minister's comments the entity is required to deliver the final version of the statement to the Minister by 1 July. The Minister must then table it in the House within 12 sitting days of receipt.

611 The Statement of Intent represents a public expression of the board's commitment to a set of operating parameters for the forthcoming three years. It is a key statutory document for establishing public accountability.

612 All of the six Crown Entities are required to produce Statements of Intent. The statements produced for the three financial years commencing on 1 July 1994 were examined for references to the Crown's ownership interests, and for the quality of performance targets.

Findings

613 The Statements of Intent for four of the six Crown Entities contained little direct reference to the Crown's ownership interests. The statements were predominantly output-focused, and did not generally address the broader interests of the Crown, such as long-term financial viability, corporate behaviour, standards of service, relationships with the community, or human resource management.

614 The Statement of Intent for the fifth entity referred clearly to a number of ownership interests. The statement included the following objectives:

- ◆ Acting as a responsible corporate citizen.
- ◆ Meeting statutory obligations.

- ◆ Operating to high professional and ethical standards.
- ◆ Managing the entity's resources in a prudent manner.
- ◆ Demonstrating a commitment to good human resource management.

The statement did not, however, contain any specific performance measures to support these objectives.

- 615 The sixth entity also referred to ownership interests in its Statement of Intent. The document referred to the bicultural focus of the entity's operations, identified the need for a strategic human resources management plan, and contained a commitment to prudent management of its physical assets. Each of these objectives was matched by a description of how it was intended to be achieved and specified the date by which the task would be completed.

Performance Benchmarks

- 616 Benchmarks can be important tools for evaluating performance by comparison with that of similar operations or businesses. Benchmarks can be particularly useful where an entity faces little or no competition for its products or services, and for this reason we looked at whether the six Crown Entities were using them.

Findings

- 617 All of the six Crown Entities operate in markets which are largely protected from direct competition. Some of them have counterparts in the same sector or industry, or overseas, against which they may be able to measure their own performance. For example, State-owned Enterprises are encouraged to compare their performance against similar organisations, or against objective indicators.
- 618 Two of the six Crown Entities had included benchmarks in the Statement of Intent as an objective basis for measuring performance. One entity, responsible for managing a large fund, matched its investment performance against three market indices. Another entity measured its sales revenue against a variety of economic indicators, such as GDP growth, inflation, and real disposable income. These indicators provided a useful measure of the entity's ability to maintain its share of consumer spending on its particular product group.
- 619 However, none of the Statements of Intent for the other four entities contained benchmarks or indicators against which to compare performance.

The Functions of the Statement of Intent and Other Accountability Documents

- 620 In addition to the statutory requirement to produce a Statement of Intent, two of the six Crown Entities were required by their enabling legislation to prepare another accountabil-

ity document: one is described as a “Document of Accountability” and another as a “Performance Agreement”. Unlike the Statement of Intent, which must be made public through tabling in the House, the enabling legislation does not require these other two documents to be tabled.

- 621 Notwithstanding any requirement to produce other accountability documents, for those entities specified in the Sixth Schedule to the Public Finance Act 1989 the Statement of Intent remains the primary statutory mechanism for public accountability. We expected, therefore, that any other document would perform a clearly defined function distinct from that of the Statement of Intent.

Findings

- 622 The Statement of Intent for two of the six Crown Entities was finalised after a process of discussion between the board, the Responsible Minister and officials. In the other four cases, however, the Responsible Minister agreed to table the document after minimal discussion and analysis, and without any substantive exchange of views with the board.
- 623 Some of the Responsible Ministers and board chairpersons viewed the Statement of Intent as a document of little importance. Its structure was seen as inflexible⁹ and its scope and content limited, and therefore of little practical value for monitoring purposes.
- 624 In contrast, the two other accountability documents referred to in paragraph 620 were originally negotiated over a number of months between the entity and the Responsible Minister’s advisers, and each year their content has been further refined. These documents were serving as a practical monitoring framework, and as the basis for the ongoing relationship between the Minister and the board.
- 625 Both the Statement of Intent and other accountability document in each case specified the nature, quantity, and standard of the outputs to be produced. However, there were also marked differences in scope and content between the Statements of Intent of the two entities concerned and the accountability documents prescribed under their enabling legislation. The Statements of Intent were largely confined to describing the terms under which the entities undertook to supply services to the Crown. By contrast, the “Document of Accountability” and “Performance Agreement” outlined a detailed and comprehensive operating framework for the Crown Entity. They addressed the Crown’s interests in a much broader way than the Statements of Intent, dealing not simply with the purchasing relationship between the Minister and the board, but also with longer-term ownership interests such as organisational maintenance, corporate behaviour, and the quality of management.

9

This view was held notwithstanding that section 41D(1)(j) of the Public Finance Act 1989 allows the Responsible Minister and the governing body to agree on other matters to be included in the statement.

- 626 Both accountability documents took the form of performance agreements between the Responsible Minister and the entity. They specified the nature of the relationship between the Minister and the board, defined rights and responsibilities such as the Minister's rights to information, and provided for the resolution of disputes. Both documents therefore provided a useful foundation for the accountability relationship between the board and the Minister. Suggested components of a set of expectations between the Responsible Minister and the board are listed in Appendix D (page 61).

Conclusions

- 627 In most cases, the business planning process for the six Crown Entities did not provide the means for the Responsible Minister and the board to reach a shared understanding of the board's intentions on the one hand, and the Crown's interests and priorities on the other.
- 628 The Statements of Intent prepared by the six entities were limited in scope, and most statements contained little or no reference to the interests of the Crown as a long-term owner. Only two statements made use of specific performance measures or industry benchmarks against which to measure entity performance.
- 629 The other accountability documents prepared by the two Crown Entities were developed in a different way from the Statements of Intent, and varied from those statements in both content and the manner in which they were used.
- 630 The general lack of importance placed on the Statement of Intent and the use of alternative documents for performance monitoring and board reporting suggest that Parliament may not be adequately informed about key goals and strategies for some Crown Entities.

Recommendations

We recommend that:

- 631 *Boards consult the Responsible Minister on the key features of their business plans, so as to reach a clear understanding of each other's interests and priorities.*
- 632 *In consultation with the board, the Responsible Minister's advisers periodically prepare a strategic assessment of the Crown Entity. Ideally, this document would identify the strategic, financial and management risks for the entity, and for the Crown as owner. Appendix E (page 62) suggests areas which might be covered in a strategic assessment.*
- 633 *The Statement of Intent reflects the Crown's interests and priorities as long-term owner, and contains objective measures (including, if appropriate, benchmarks) as a means for assessing performance.*
- 634 *Any negotiated accountability document that a board may be required to prepare (either in accordance with enabling legislation or by agreement with the Responsible Minister):*
- ◆ *Be consistent with the contents of the Statement of Intent.*

- ◆ *Be sufficiently informative about the entity's business plans to facilitate more comprehensive performance monitoring.*

MONITORING FOR RISK AND MAINTAINING ENTITY VALUE

Monitoring Needs to be Targeted

- 701 Monitoring arrangements for any entity need to reflect an assessment of the risks and opportunities facing the business, with a view to protecting and promoting the owner's interests.
- 702 The Crown's interests in Crown Entities also flow from its roles as purchaser, funder, investor, and policy-maker. The activities undertaken by each of the six Crown Entities studied gave rise to a variety of risks for the Crown. We expected that monitoring would be directed at those aspects of the entity's operations which placed the Crown's interests at greatest risk. In addition, we expected that monitoring would provide assurance that the value of the entity is being maintained for long-term performance and capability.

Findings

- 703 Some areas of Crown Entity activity had been singled out for special attention and ongoing monitoring. The separate accountability document for one of the six Crown Entities specified broadly the content of contracts between the entity and third parties for the disbursement of grants. Contracting was a key risk area because contract quality dictated the effectiveness of the grant allocation process.
- 704 The same Crown Entity was required to follow written standards for the delivery of government-funded programmes. These standards specified the factors which the entity should consider in its tendering and purchasing specifications, and made the entity responsible for monitoring and evaluating the performance of service providers. The administering department said it was going to seek assurance that the board was complying with procedures for purchasing and contract management.
- 705 Another of the six Crown Entities was charged with drawing up industry safety rules. The rule-making process raises a wide range of policy issues for the Government because of the public interest, the need for consultation with participants in the industry, and the implications for New Zealand's international obligations. The process therefore had to take account of those considerations. In consultation with the board, the administering department had drawn up a set of procedures to ensure that all relevant government agencies and their Ministers had the opportunity to comment on the rules as they were drafted. This represented a sensible approach to a public policy issue which had the potential to create significant risks for the Crown.

706 However, among the six Crown Entities some significant areas of management critical to long-term performance and capability had not been singled out for special monitoring. These included:

- ◆ Control and use of physical assets.
- ◆ Recruitment and retention of specialised staff.
- ◆ Contract specification and supervision.

Boards Need to Report on Changes in Risk

707 An owner needs to be informed about significant changes to risk or business value, which can arise from both external factors and initiatives taken by the entity itself. Responsible Ministers rely on the board to alert them to matters which may affect the Crown's interests.

708 We expected that boards would be clear about the circumstances under which they needed to consult with the Minister, and, where necessary, they would seek agreement to proposals which may materially affect the Crown's interests.

Findings

709 None of the six Crown Entities had been told of the circumstances under which the board should consult the Responsible Minister on matters affecting the Crown's interests. Some reporting was taking place in the absence of an agreed framework and set of expectations.

710 Some boards had taken the initiative to raise particular issues with the Responsible Minister as they arose. Sometimes the Minister or departmental officials had singled out issues for special reporting. One Minister, for example, had sought more detailed and frequent reporting at a crucial stage in the development of a major project. Another Minister had introduced a special reporting regime to oversee board action on the recommendations of a Ministerial review. However, special reporting was not always occurring where the Crown's interests were directly affected. One such instance is described below.

711 The trading activities undertaken by one Crown Entity were earning significant amounts of money to be applied to public purposes. Because of the large cash flows involved and the nature of the business, changes in the market or product mix had a material financial impact. We expected the entity to be reporting regularly to the Responsible Minister on its trading performance, providing explanations for fluctuations where these occurred. No such reporting was occurring.

712 Nor was the same Minister fully briefed on the economic feasibility of major new products or marketing initiatives which might affect the revenue out-turn, and therefore the amount of profit generated by the entity. In 1994, for example, the same entity launched a major



new product with the potential to increase cash flow. In the short-term, the new product was also likely to reduce returns from other products, and had significant set-up costs, making the projected out-turn uncertain. Board minutes record that the Minister was consulted on the board's decision to introduce the product. There is no evidence, however, that the Minister was formally briefed on the financial implications. Nor did the Minister seek advice on the board's proposal.

- 713 When we raised this matter with them, the chairperson and the chief executive of the entity expressed the view that financial analysis was the board's preserve, and that there was no need to seek the Minister's views on the proposal.

Accountability for Compulsory User Charges

- 714 Some Crown Entities recover part or all of their operating expenses from compulsory user charges or levies. Of the six Crown Entities, one relies substantially on user charges and another manages a fund built up from levies on a section of the population.
- 715 We expected that the amounts of compulsory charges would be fair and reasonable, and would bear a clear relationship with the value of services provided. Specifically, we expected that individual charges would not subsidise inefficiencies within an entity and monitoring arrangements would ensure that the power of compulsion is used in a responsible and transparent way.

Findings

- 716 The one Crown Entity that obtains 70% of its revenue from compulsory user charges had begun reviewing its charges and costs, to determine whether its cost-recovery mechanisms were fair and efficient. This approach is consistent with the equitable principle that revenue from compulsory user charges should match the cost of the services to which the charges relate.
- 717 We did not look at the compulsory levies administered by the other Crown Entity because the policy basis on which the fund operates is under review by the Government.

Monitoring Should Not Compromise Statutory Independence

- 718 Parliament has established a number of Crown Entities with the intention that they operate independently of government control. Some exercise regulatory functions, some have independent powers of inquiry and some make quasi-judicial decisions. In a few cases Parliament has vested the powers and independence in an officer of the entity free from direction by the board.
- 719 We believe that these special powers should be exercised responsibly, fairly and with integrity. While Responsible Ministers are usually precluded from intervening in regula-

tory matters, they inevitably carry some political responsibility when matters affecting public confidence are involved. Accordingly, we expected that monitoring arrangements for these Crown Entities would take account of the need to preserve the distinction between the interests of the Responsible Minister and the special independent character of these bodies.

Findings

720 One of the six Crown Entities is charged with overseeing industry practice in an important area of public safety. The Responsible Minister is briefed formally each week in a written report — and sometimes informally as well — about investigations, impending issues likely to attract news media attention, and other relevant matters of public or political interest. Contact between the entity and the Minister was frequent. We found no evidence to suggest that statutory independence was in any way affected by such reporting.

Conclusions

721 Some key Crown risks had been targeted for special monitoring. However, arrangements for monitoring Crown Entity performance did not reflect a systematic and comprehensive analysis of those areas where the Crown's interests were at risk. Nor were Responsible Ministers receiving the necessary information about all aspects of stewardship critical to an entity's long-term performance and capability.

722 Boards lacked clear guidance on when they should consult their Responsible Minister on matters affecting the Crown's interests. Ministers were not always properly informed of board decisions that had implications for the Crown.

Recommendations

We recommend that:

723 *Responsible Ministers establish a monitoring regime for Crown Entities directed at areas of greatest risk, focusing on key aspects of board stewardship and requiring boards to report periodically on their strategies to address risk and maintain value.*

724 *Responsible Ministers formally advise boards of those matters on which they would expect to be consulted. In general, Ministers would require boards to brief them on board decisions having significant financial, policy or other strategic implications for the Minister or the Crown.*



MONITORING ARRANGEMENTS

- 801 The decision as to how the monitoring function is discharged rests with the Responsible Minister. In exercising their responsibilities Ministers may need access to a special mix of knowledge and skills as well as advice and administrative support — in particular, to monitor board performance.
- 802 On behalf of the Responsible Minister advisers can:
- ◆ Interpret and advise on the Crown's interests, using their skills to analyse Crown Entity issues.
 - ◆ Establish a monitoring regime, support the Minister in carrying out monitoring, analyse Crown Entity performance, and recommend courses of action for the Minister.
 - ◆ Promote a flow of information between the board and the Minister.
 - ◆ Act as the Minister's agent in discussions on the Statement of Intent and other accountability documents.
 - ◆ Handle the administrative aspects of matters such as the tabling of accountability documents and the appointment of board members.
 - ◆ Consult with central agencies and other departments as necessary on public policy matters.
- 803 Monitoring arrangements should enable Responsible Ministers to carry out their responsibilities in an active and informed manner.

Formal Reporting is to be Preferred

- 804 Agreed reporting practices provide the basis for a clear and effective accountability relationship between the board and the Responsible Minister.
- 805 In our view, the level of regular formal reporting by the board to the Responsible Minister should achieve three key purposes:
- ◆ To enable performance to be measured against stated targets.
 - ◆ To provide assurance that the board is discharging its stewardship responsibilities.
 - ◆ To identify emerging issues facing the organisation.



Findings

- 806 Monitoring arrangements differed from one Crown Entity to another; reflecting the preference of the particular Responsible Minister and the administering department's interpretation of its responsibilities.
- 807 Reporting by some of the six Crown Entities to the Responsible Minister was frequent and detailed. One Minister, for example, was receiving weekly formal reports alerting him to current issues. He also received informal briefings from the entity. The Minister's advisers negotiated performance targets with the Crown Entity on the Minister's behalf, and worked with its management to resolve various sector policy issues.
- 808 One department had drawn up a set of principles for monitoring Crown Entities within its sector. The principles dealt with:
- ◆ Compliance with the Public Finance Act 1989.
 - ◆ Provision of financial and operational information.
 - ◆ Awareness of operational and strategic concerns.
 - ◆ Compliance with other legislative and contractual obligations.
 - ◆ The information needs of the Minister.
- 809 The department also performed an important role on the Responsible Minister's behalf; providing the board with background detail to the Minister's requests for information, and following up on such requests with the board or management.
- 810 Three Responsible Ministers received formal reports from the board every quarter. The administering departments analysed the reports received from a financial, public policy and contractual perspective. On some occasions the Ministers would use this analysis to convey their assessment of the entity's performance to the board — noting achievements of excellence, matters for concern, and performance needing improvement.
- 811 These quarterly reports:
- ◆ Outlined issues that had arisen during the period;
 - ◆ Compared performance against targets; and
 - ◆ Summarised the financial position.
- 812 The Ministers regarded these reports as a key tool for ongoing performance monitoring, and a valuable source of information about the entity's operations.
- 813 One administering department had drafted guidelines for the content and format of quarterly reports for use by all the Crown Entities within its sector. Appendix F (page 63)

sets out a suggested content for performance reporting to the Responsible Minister, drawing on those guidelines and the results of our own review of board reporting.

Informal Reporting is Generally Not Satisfactory

- 814 In our view, reliance on informal reporting arrangements exposes the Responsible Minister to the risk that issues may be overlooked until they reach a stage where they have major implications for the Crown.
- 815 Informal reporting also depends on personal relationships to work effectively. Any changes in board membership or of Responsible Minister pose the risk that future relationships may not succeed.
- 816 Finally, informal relationships make it difficult for the Responsible Minister and the administering department to align practices and procedures for the various entities within the Minister's portfolio.

Findings

- 817 Three of the six Crown Entities did not provide regular formal reports to the Responsible Minister or their advisers of progress against the performance targets specified in the Statement of Intent.
- 818 One Minister relied entirely on informal reporting for monitoring the entity, while two others relied on exception reporting from the board and their departmental officials.
- 819 For two of the six Crown Entities no adviser had been assigned with monitoring responsibility and therefore no systematic oversight of board performance was taking place. Neither entity was reporting regularly against the objectives set out in the Statement of Intent, nor were the boards providing any basis for the Responsible Minister to be assured about key operational or strategic matters.

Crown Representation on the Board

- 820 Designated public servants sometimes sit on the boards of Crown Entities (see paragraph 217). The role of these officials needs to be clearly understood by boards, Ministers and their advisers. We examined the impact of this arrangement to establish to what extent it was enhancing the quality of governance.

Findings

The Benefits of Crown Representation

- 821 One benefit asserted for Crown representation is that board decisions are more closely aligned with public policy considerations. As departmental chief executives may sit on the

governing bodies of other Crown Entities or public agencies within the same sector, board representation might also help to build useful relationships between the relevant department and the constituency served by the entity.

822 The departmental chief executives we spoke to said that they were able to transfer their own personal knowledge to other board members, as well as providing general guidance to the board on matters affecting the Responsible Minister and the Crown. The presence of the departmental chief executive was seen as complementing the skills and expertise of the rest of the board. One chairperson saw the presence of departmental representatives as helping to integrate the entity's activities with the responsibilities of other government agencies.

823 One Responsible Minister had instituted an arrangement whereby officials from the administering department attended meetings of the board and board committees as observers. This was designed to ensure that the Minister was kept aware of developments and issues of concern to the entity, and received timely and accurate advice from the officials. Departmental staff present at those meetings were sometimes called on to provide advice to the board.

Avoiding Conflict Between Roles and Responsibilities

824 While departmental chief executives are likely to be better placed to advise their Ministers on Crown Entity matters if they are well informed about board affairs, sitting as Crown representatives on Crown Entity boards can lead to conflicting obligations. For example, they can be placed in an invidious position where they face a conflict between the roles of:

- ◆ Impartial adviser to the Minister; and
- ◆ Member of the board.

825 In order to ensure the accuracy of his contribution to the board, one departmental chief executive had sought legal advice from his own departmental lawyer. He had reported this advice to the board. On that occasion the board chose to accept the differing legal view provided by its own lawyers. As a member of the board he was therefore obliged to accept this board decision, but he considered that he had discharged his responsibility to the board and as a public servant by ensuring that the board had the best possible information in front of it when it made the decision.

826 One Responsible Minister had sought advice from his departmental chief executive on the findings of a Ministerial review of a Crown Entity. That chief executive was also a member of the entity's board, creating a conflict between his role of providing impartial advice to his Minister and his obligations to the board.

827 Departmental nominees participate fully in the affairs of the board, and receive detailed information about the affairs of the entity. The board chairpersons we interviewed had no



knowledge of how departmental representatives were using the information obtained at the board table outside the entity, and to whom it was being passed.

- 828 The chief executive of one Crown Entity stated that he was reluctant to put commercially sensitive proposals in the board papers, knowing that this information could be made available to others through the departmental representative. The potential effect is to inhibit the ability of the board to have the benefit of full and frank discussion.

Ministerial Expectations

- 829 Ministers had not made clear to departmental officials what role they were expected to perform as board members. None of the three departmental board members had a brief from their Minister to monitor and report on the performance of the Crown Entity, and neither of the two Ministers identified benefits in this arrangement or endorsed the practice. Although they had regular access to information about the affairs of the Crown Entity, the departmental representatives were not using this to broaden the scope of monitoring or to focus on areas of risk.

Reviews of Crown Entity Performance

- 830 Where a Crown Entity operates in a market protected from competition, establishing whether it is operating as efficiently and effectively as it could is difficult. We expected the Responsible Ministers for the six Crown Entities:
- ◆ To have the means of carrying out their own reviews of Crown Entity performance; and
 - ◆ To have used those reviews, where necessary, to ensure continued alignment of the board's objectives with the interests of the Crown.

Findings

- 831 Neither the enabling legislation nor any of the six Statements of Intent we examined provided for a periodic review of Crown Entity operations.
- 832 The enabling legislation for one entity provided for a single ministerial review after three years. The review was undertaken by an independent panel and considered submissions from a wide range of interested parties. It:
- ◆ Examined key areas of the entity's operations, and assessed the effectiveness of the entity against the relevant public policy objectives.
 - ◆ Examined the entity's relationship with the sector, inviting suggestions for improving the entity's performance.

- ◆ Produced specific recommendations, which the Cabinet and the Responsible Minister used to hold the board to account.
- ◆ Was used by the relevant Select Committee of Parliament charged with reviewing the performance of the entity.

833 The performance agreement between another Crown Entity and its Responsible Minister contains a clause providing for independent reviews to be carried out at intervals not exceeding three years. These are to include reviews of the quality management system, output quality, and cost effectiveness, and are seen to be an integral part of the accountability framework.

Conclusions

834 No explicit set of requirements had been established for monitoring Crown Entity performance. The nature and extent of monitoring and board reporting varied according to the style and preference of individual Ministers.

835 Systematic oversight of board performance relied on formal reporting at regular intervals, and the use of appropriately skilled advisers with a clear mandate to analyse Crown Entity issues and recommend courses of action to the Minister.

836 Public servants sitting on the boards of Crown Entities can provide useful advice to boards on public policy issues, contribute personal knowledge and experience, and build useful networks within the sector. This arrangement can therefore make a positive contribution to the quality of board discussions and decision-making.

837 On the other hand, the presence of officials may inhibit the free operation of the board and undermine formal lines of communication between the board and the Minister. Officials sitting on boards may also face conflicting interests where they are called on to advise the Minister on board performance.

838 No general practice existed of carrying out independent reviews of Crown Entity operations. Where a review was carried out, it was an important ingredient of ongoing monitoring; providing a stocktake of progress, highlighting problems and providing a valuable means of assessing board performance.

Recommendations

We recommend that:

- 839 *Responsible Ministers use advisers with financial, analytical and public policy skills to help them monitor the performance of Crown Entities.*
- 840 *At regular intervals boards formally report to the Responsible Minister on performance against the objectives specified in the Statement of Intent and other accountability*

documents as appropriate. In our view, the interval should be no longer than six months and preferably three months or less where circumstances require.

841 *Where the legislation requires designated public servants to sit on Crown Entity boards, Ministers brief those officials on the role they are expected to perform and inform the boards of the role. The potential benefits and problems associated with such arrangements need to be carefully examined before provision is made for officials to sit on the boards of new Crown Entities. In particular, consideration should be given to ways of securing the identified benefits through other arrangements.*

842 *As part of a periodic reappraisal of whether a Crown Entity is continuing to fulfil its intended purpose in an appropriate manner, the following aspects of performance (as appropriate to the entity) might be addressed:*

- ◆ *Relevance of the governing legislation to current conditions.*
- ◆ *Organisational and technical capability.*
- ◆ *Effectiveness of programmes and value for money.*
- ◆ *Output quality.*
- ◆ *Resource use.*
- ◆ *The amounts of compulsory user charges.*

THE ROLE OF THE CENTRAL AGENCIES

- 901 In some circumstances the activities of Crown Entities may affect the Crown's overall financial position, or have implications beyond the Crown Entity and the sector for which the administering department is responsible. Such issues impinge on the responsibilities of the central agencies.
- 902 The Treasury and the State Services Commission both have functions concerned with these wider interests of the Crown. We expected the role of these central agencies to be reflected in the relationships between Crown Entities, Ministers, administering departments and other Ministerial advisers.

THE ROLE OF THE TREASURY

- 903 The Treasury manages the Crown's overall portfolio of assets and liabilities, and prepares regular reports on the Crown's finances. It is the Government's chief adviser on economic and financial strategy and on the financial performance of the Crown.
- 904 These functions give the Treasury an interest in the financial performance of Crown Entities on behalf of the Crown as a whole. Therefore, we expected that the need for the Treasury to be involved would be recognised where there are major implications for the management of the Crown's finances.

The Treasury's Relationship with Crown Entities

Findings

- 905 The Crown's relationship with Crown Entities is primarily through the Responsible Minister and the Minister's advisers. This was well understood by the Treasury officials we interviewed. Treasury relationships with the six Crown Entities were generally distant, and contact was infrequent.
- 906 The Treasury relies largely on administering departments, as the Ministers' advisers, to alert it to issues which may affect the Crown's overall financial risks. In one instance, an administering department had established a close working relationship with the Treasury to analyse a set of issues with implications for the Crown's overall financial position. The Treasury and the administering department jointly engaged consultants to examine the board's funding proposals.
- 907 Although, in some instances, departments had initiated consultation with the Treasury, no-one had made clear under what circumstances consultation should occur. This uncertainty creates the risk that the necessary consultation may not always take place. The

relationship letter negotiated between the Treasury and departmental chief executives is one means of addressing this risk.

The Relationship Letter Between the Treasury and Departments

- 908 Each year the Treasury draws up a relationship letter with each departmental chief executive. The letter outlines the focus of the Treasury's expectations of departmental performance for the forthcoming year — identifying areas which are important to the department's contribution to the strategic, economic and fiscal objectives of the Government. Among other things, the purpose of the letter is to specify the Treasury's expectations of the role which the department will play in overseeing the Crown's investment in Crown Entities.
- 909 The relationship letter could be a useful mechanism for ensuring that monitoring includes the wider aspects of the Crown's financial interests. These interests encompass the public investment in Crown Entities.
- 910 Four relationship letters were examined for reference to the main areas of financial risk associated with Crown ownership of four of the six Crown Entities. For the other two entities no relationship letter had been drawn up.

Findings

- 911 Three of the four relationship letters made no reference to the Crown Entities we reviewed. The other letter contained an expectation that the administering department would monitor a major capital project which at the time posed a material financial risk for the Crown. The letter made no reference to other significant resource management issues such as the maintenance of the substantial fixed assets under the control of the board.
- 912 None of the relationship letters referred to other key aspects of financial risk — such as asset management, resource use, contracting risk, cashflows, and liquidity — with which the administering department as adviser to the Minister on board and entity performance should be concerned.

Applying Crown Financial Management Policies

- 913 The scope of our audit did not include extensive examination in the area of financial management. Nevertheless, we expected relevant Crown financial management policies to be applied consistently to the six Crown Entities.

Findings

- 914 Our limited investigations and observations pointed to a lack of consistent policy in some areas of financial management.

- 915 One of the six Crown Entities was required to pay a capital charge to the Crown. Another was to be subject to the charge, but it had not yet been applied. The other four entities were not subject to a capital charge. We could obtain no explanation for this differing treatment.
- 916 A surplus made by a Crown Entity may be claimed by one or more other parties, which could include the Crown. Therefore, the way in which surpluses are treated has implications for both the entity and possibly the Crown. That treatment also has a potential impact on the incentives for managing the entity and, hence, on the entity's performance.
- 917 One Crown Entity had undertaken a project for which some funding was provided by third parties. No agreement had been reached with those parties, or with the Crown, as to how any over or under-expenditure would be treated. The project was completed under budget, giving rise to discussions between the Treasury and the Crown Entity over the rights of the various stakeholders to a share of that surplus.
- 918 Another Crown Entity was funded predominantly from compulsory user charges, and made an unanticipated surplus when the basis for the charges changed by international agreement. For the 1994-95 year the decision was made to return the surplus directly to the users of the entity's services. The 1995-96 performance agreement between the Responsible Minister and the entity contains a clause allowing the entity to smooth its revenue requirements from users, so that it may retain operating surpluses up to the level of any accumulated deficit.
- 919 A third entity is obliged to return operating surpluses and unused grant funding to the Crown at the end of the financial year. The entity's out-turns are influenced by ongoing changes in programmes and in demand for the services it is responsible for purchasing. These factors — among others — make accurate forecasting difficult and have produced a history of variances between estimated and actual expenditure.
- 920 Our investigations indicate that such issues have been handled flexibly and in a pragmatic manner. However, without a set of guiding principles, problems in individual entities will potentially be solved without due regard to consistency and equity among organisations.

THE ROLE OF THE STATE SERVICES COMMISSION

Personnel-related Matters in Crown Entities

- 921 The State Services Commission (the Commission) is responsible for advising the Government on personnel-related matters throughout the public sector. The Commission also has certain specific personnel-related functions for particular Crown Entities.
- 922 We expected the personnel-related functions of the Commission to be broadly consistent from one Crown Entity or group of Crown Entities to another. We also expected the Commission to be monitoring the entities' compliance with statutory obligations on personnel matters.

Findings

- 923 The functions performed by the Commission in personnel matters differ significantly from one Crown Entity to another. For example, it must be consulted on the level of board members' fees and allowances, and some Crown Entities must consult it before concluding collective employment contracts. Consultation may also be required on the terms and conditions of employment for the Chief Executive. The boards of some other entities must seek the agreement of the Commission to the terms and conditions of employment of staff. The Commission also has direct responsibility for negotiating collective employment contracts for the education service.
- 924 Crown Entities are therefore not subject to common obligations to consult the Commission on personnel-related matters. As a result, some Crown Entities have more independence in this respect than others. Even among the six Crown Entities these obligations differed from one entity to another according to the particular enabling legislation.
- 925 The onus for initiating consultation with the Commission rests with the Crown Entity itself. While some Crown Entities must comply with statutory "good employer" requirements, no monitoring regime has been developed to ensure that those obligations are met.

Conclusions

- 926 The Treasury has taken useful steps to address the Crown's wider financial risks through its relationship letters with departmental chief executives. In their current form these letters are limited in scope and content, but have the potential to ensure that Crown Entity monitoring takes account of the Crown's collective financial interests.
- 927 In some financial management matters, such as the treatment of surpluses and the imposition of a capital charge, no set of principles had been established on which to make sound and consistent decisions.
- 928 The six Crown Entities were not subject to a common set of obligations in relation to personnel management matters, nor was any monitoring of compliance with provisions in the enabling legislation taking place.

Recommendations

We recommend that:

- 929 *Relationship letters between the Treasury and departmental chief executives be used to address issues of financial management and stewardship in Crown Entities, wherever these have significant financial implications for the Crown.*
- 930 *The Treasury reviews the consistency of application of financial management policy as between one Crown Entity and another.*

- 931 *The State Services Commission reviews the rationale for the varying statutory obligations on Crown Entities for personnel-related matters, and consider means of ensuring compliance with such provisions.*



**THE CROWN'S OWNERSHIP INTEREST IN CROWN ENTITIES
AT 30 JUNE 1996¹⁰**

	Total Assets	Equity
	\$ million	\$ million
Earthquake Commission	2,583	2,541
Tertiary Education Institutions	2,191	1,891
Housing New Zealand Limited	4,663	2,801
Crown Health Enterprises (including the Residual Health Management Unit)	2,346	929
Museum of New Zealand Te Papa Tongarewa	739	727
School Boards of Trustees	891	595
Accident Rehabilitation and Compensation Insurance Corporation	1,358	505
Housing Corporation of New Zealand	725	62
Airport Companies	332	235
Crown Research Institutes	307	215
New Zealand Fire Service Commission	284	169
Regional Health Authorities	543	40
Other	760	335
	<hr/>	<hr/>
All Crown Entities	<u>17,722</u>	<u>11,045</u>

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Source: the *Financial Statements of the Government of New Zealand for the year ended 30 June 1996*; parliamentary paper B.1, page 97.

AUDIT APPROACH

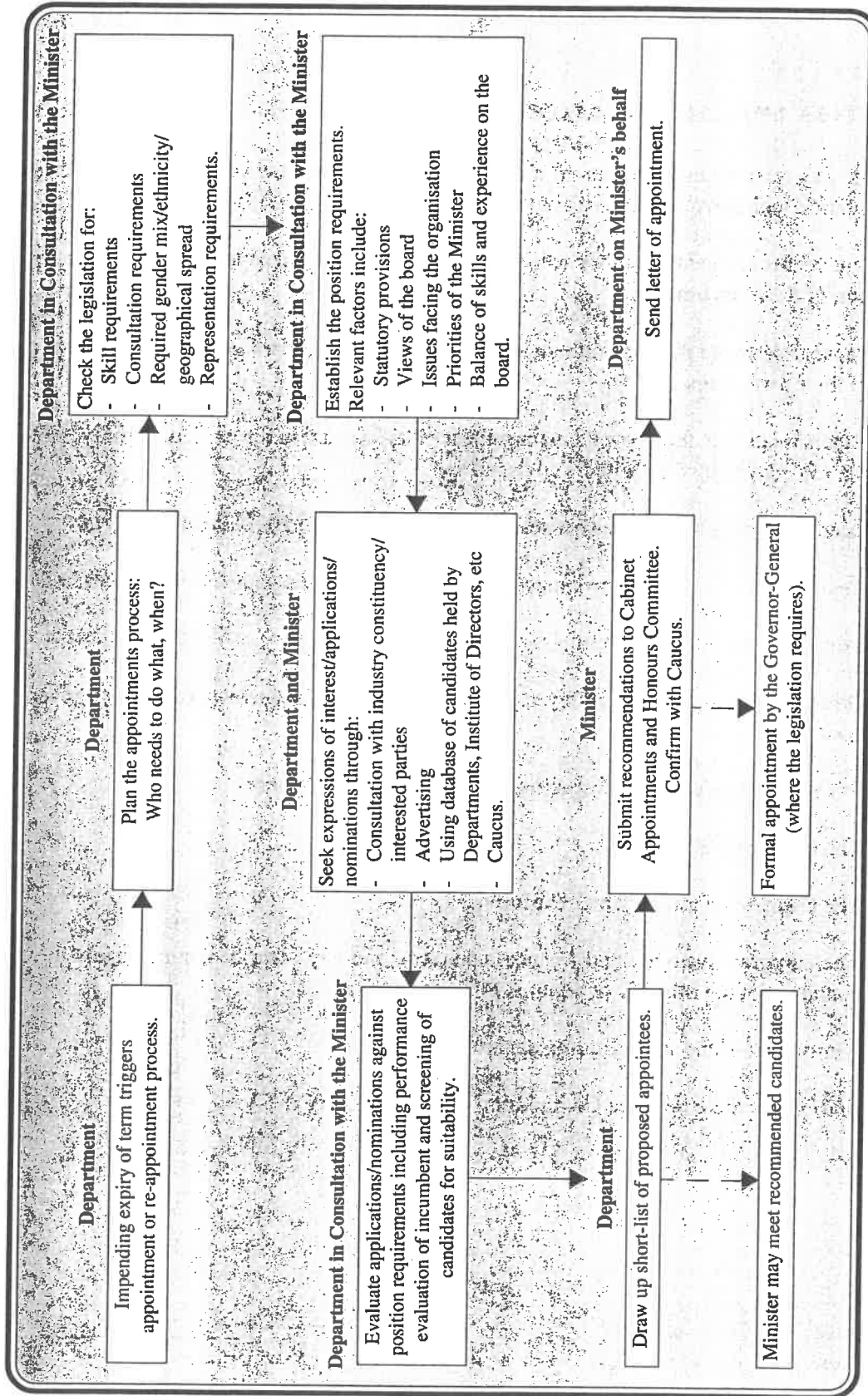
The audit was carried out by means of a review of selected documentation and interviews. The documentation included:

- ◆ Statements of Intent and other accountability documents, and papers relating to the negotiation of those documents.
- ◆ Papers relating to the appointment and re-appointment of board members and to evaluation of their performance.
- ◆ Papers relating to the Crown's management of its interests in the particular entity, including the role played by the Crown's advisers.
- ◆ Records of communications between Ministers and the board or chief executive.
- ◆ Regular and exception reports supplied to the Crown or its agents by the board of the entity.
- ◆ Minutes of entity board meetings.
- ◆ Other statements of board policy and procedures where these related directly to governance issues.

Interviews were held with the following people for each Crown Entity:

- ◆ The Responsible Minister.
- ◆ The chairperson and the chief executive.
- ◆ The corporate planning and finance managers, and any other senior managers in regular contact with the Minister or administering department.
- ◆ Senior staff of the administering department.
- ◆ Staff of the State Services Commission and the Treasury.

SUGGESTED KEY STEPS IN AN APPOINTMENT PROCESS



N.B. This diagram is a guide only. The appointment process may differ from one entity to another, depending on the enabling legislation, particular administrative requirements, or other factors.

SUGGESTED COMPONENTS FOR A SPECIFICATION OF THE RESPONSIBLE MINISTER'S EXPECTATIONS OF THE BOARD

- ◆ The responsibilities of each party.
- ◆ The Minister's rights to information and independent review.
- ◆ The board's reporting obligations and information required by the monitoring agency.
- ◆ Notification of events affecting organisational maintenance and viability.
- ◆ An agreed methodology for costing and pricing entity services.
- ◆ Formal arrangements for resolving disputes between the parties and for dealing with non-performance by the entity.

**SUGGESTED COMPONENTS FOR A STRATEGIC ASSESSMENT
OF THE CROWN'S INTERESTS IN A CROWN ENTITY**

- ◆ Analysis of the statutory framework, outputs, structure and operating environment.
- ◆ Review of the goals of the entity and the way in which they relate to Government policies.
- ◆ Analysis of the nature of the market activities of the entity, and their effectiveness. This includes the consideration of options for aligning the goals and objectives of the entity more closely with Government policy, through options such as cost recovery, changes in strategic focus, or a review of functions.
- ◆ Analysis of the relationship with government departments, other parts of the Crown, and with clients and customers.
- ◆ Analysis of the entity's involvement in joint ventures or other formal relationships with third parties.
- ◆ Review of the effectiveness of accountability arrangements and of strategic planning processes.
- ◆ Financial analysis of sources of funding, the quality of resource management, and an outline of financial management issues.
- ◆ Review of the financial risks associated with Crown ownership.

The strategic assessment could be expected to conclude with a work programme to address areas identified as being of concern.

SUGGESTED CONTENT OF PERFORMANCE REPORTS BY THE BOARD TO THE RESPONSIBLE MINISTER

- ◆ Review of operating results against budget — analysed by revenue source and nature of expenditure, including an explanation of variances.
- ◆ Review of financial position — including levels of equity, assets, liabilities, and items concerned with working capital and liquidity.
- ◆ Review of output performance — against measures of quantity, quality, timeliness, location, and cost.
- ◆ Summary of key events and significant activities over the period, with special emphasis on unforeseen items.
- ◆ Analysis of the business environment, reporting on actions taken by the board to address risk and enhance business value.
- ◆ Summary of any significant changes to the organisation, such as capital up-grading, restructuring, or changes in key personnel.

