

# ANNUAL REPORT

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for the year ended 30 June 2006



# WHAT WE DO

## The Treasury

At the Treasury our job is to help the Government to improve economic performance and manage scarce resources. All of this is focused on improving living standards for New Zealanders.

The Treasury has four main roles:

- We provide advice to improve the economic and fiscal conditions for high levels of economic growth and improved living standards.
- We monitor and manage the financial affairs of the Crown.
- We assess and test other agencies' advice and proposals which have economic and financial implications.
- We provide leadership, with other central agencies, to develop a high-performing State sector.

The Treasury provides advice and services through nine output classes provided to the Minister of Finance through Vote Finance.

## Crown Company Monitoring Advisory Unit (CCMAU)

CCMAU is responsible for maintaining and enhancing the Crown's ownership interest in Crown research institutes (CRIs), State-owned enterprises (SOEs) and a number of Crown-owned companies and entities. CCMAU provides advice to relevant Vote Ministers through output classes under Vote Crown Research Institutes and Vote State-Owned Enterprises.

## The Treasury/CCMAU relationship

CCMAU is a stand-alone unit within the Treasury. The Executive Director of the Unit is directly accountable to the Secretary to the Treasury for the Crown's investment in CCMAU, and for CCMAU's performance.

# CONTENTS

Minister's foreword .....	2
Highlights of our year.....	3
Chief Executive's summary .....	4
Our outcome contribution .....	7
Improved overall economic performance .....	8
Stable and sustainable macroeconomic environment .....	14
Effective and efficient use of State resources and regulatory powers, including improved decision-making and performance management systems .....	19
Efficient management of the Crown's assets and liabilities .....	23
Organisational structure – the Treasury .....	28
<b>THE TREASURY</b>	
Vision and management objectives .....	29
Maintaining and developing capability .....	30
Organisational responsibilities .....	44
Vote Finance at a glance .....	47
Output performance – Vote Finance .....	48
<b>CROWN COMPANY MONITORING ADVISORY UNIT</b>	
Vision and purpose .....	71
CCMAU executive summary .....	72
Output performance – CCMAU .....	79
Votes at a glance.....	79
Vote State-Owned Enterprises .....	79
Vote Crown Research Institutes .....	83
<b>FINANCIAL STATEMENTS</b>	
Statement of responsibility .....	88
Departmental .....	89
Non-departmental .....	109
New Zealand Debt Management Office.....	125
Audit Report.....	135
<b>ANNEXES</b>	
Quality standards for analysis and advice .....	138
Legislation.....	139
Working and policy perspectives papers .....	140

## MINISTER'S FOREWORD



The Treasury, as the Government's lead economic and financial advisor, has a significant role to play in achieving our goal of transforming the New Zealand economy into a high-income, knowledge-based market economy which is both innovative and creative, and provides a unique quality of life for all New Zealanders.

This *Annual Report* outlines the contribution the Treasury has made over the 2005/06 year to support this central aim.

Over the past 12 months, the Treasury has continued its work to lift New Zealand's economic growth, ensure a stable and sustainable macroeconomic environment, and improve public sector performance.

The Treasury has also made an important contribution to a number of Government initiatives such as the launch of the KiwiSaver scheme, the business tax review and the development of a single economic market with Australia.

Once again, the Government has received valuable Treasury support through its running of an effective Budget process. Budget 2006 was the first to be organised on the basis of the Government's three key themes of *Economic Transformation*, *Families – Young and Old* and *National Identity*. The Treasury's input was vital to ensuring the new process ran smoothly, and that departmental activities in the 2006/07 financial year will be closely aligned with Government objectives.

I look forward to working with the Treasury in 2006/07 to further progress the Government's goals and raise living standards for New Zealanders.

A handwritten signature in black ink, appearing to read 'M. Cullen'. The signature is fluid and cursive, with a long horizontal line extending to the right.

Hon Dr Michael Cullen  
Minister of Finance

## HIGHLIGHTS OF OUR YEAR

- Completed in-depth reviews of the justice, education, energy and health sectors and provided advice to Ministers.
- With the State Services Commission, provided advice and support to Ministers, departments and Crown entities on the provision of the new Crown Entities Act.
- Provided advice on transport and infrastructural issues.
- Provided advice on the Government's commitments to the Rugby World Cup 2011, including negotiations with the New Zealand Rugby Union to develop incorporation documentation for the Tournament Management Vehicle to run the event.
- Negotiated a capital restructure with TVNZ, leading to the payment of a special dividend of \$70 million.
- Produced and tabled in the House the first *Statement on the Long-Term Fiscal Position*.
- Completed the Supplementary Stabilisation Instruments Report, a review of policy instruments that could be used to supplement monetary policy, and held a follow-up Macro Policy Forum (both jointly with the Reserve Bank).
- Moved to electronic production of the Estimates of Appropriations via CFISnet.
- Completed a study of Auckland's economic performance and provided a range of advice on Auckland issues, including transport.
- Contributed to the interdepartmental review of climate change policies.
- Led the coordination and development of legislation and further policy details for KiwiSaver.
- Provided advice on policy and budget priorities for the government themes of *Economic Transformation* and *National Identity*.
- Continued to investigate and identify critical issues for growth and apply this knowledge in policy advice for a range of areas including business taxation, innovation, infrastructure and quality of regulation.
- Launched the Development Centre, a comprehensive learning and development resource for all Treasury staff.

## CHIEF EXECUTIVE'S SUMMARY



I am pleased to present this *Annual Report for the Treasury for the 2005/06 year*.

Over the past 12 months, the Treasury has continued to concentrate on its primary role of providing quality economic and financial policy advice for the Government. Our efforts have been clearly focused on achieving the Government's long-term goals, as well as providing an effective contribution to more immediate issues as they arise.

One particularly positive feature of the year has been the opportunity to demonstrate our leadership role as a central agency on a range of projects involving close collaboration with our colleagues across the public sector.

Our successes in this area have included:

- leading the coordination and development of legislation and further policy details for the KiwiSaver scheme, working closely with the Ministry of Economic Development and the Inland Revenue Department
- completing in-depth reviews of the justice, education, energy and health sectors, and providing advice to Ministers
- working in partnership with the State Services Commission and Department of Prime Minister and Cabinet to implement the new Crown Entities Act 2004
- completing, in conjunction with the Reserve Bank, a review of policy instruments that could be used to supplement monetary policy
- taking a coordination and leadership role for pandemic planning across the public sector.

### Taking a long-term view

Another highlight of our year has been the opportunity to take a step back from the economic and fiscal issues of the day to consider the more long-term challenges and opportunities facing New Zealand's economy. This work was reflected in our first *Statement on the Long-Term Fiscal Position*, published in June 2006. The future state of New Zealand's finances is increasingly a factor that governments take into account when setting today's policies. We hope that publication of the Statement will increase the public's understanding of the long-term implications of any significant spending and revenue decisions.

Our focus on long-term economic and fiscal issues was further underlined with the establishment of the Treasury's Strategy Unit. The Unit is charged with supporting me as Chief Executive on strategic policy issues such as new, "next generation" or emerging issues facing New Zealand. Already, the Strategy team has engaged with a range of stakeholders to help us identify the key, long-term economic and financial challenges facing New Zealand. The Treasury intends to develop further its understanding of these issues and their implications, in order to help us position New Zealand and our economy to take advantage of important opportunities and to mitigate significant risks.

It's no surprise that this "forward thinking" has also been reflected in internal work that is underway on how the Treasury itself will meet the challenges ahead. This work follows wide-ranging senior management discussions on the role of the Treasury and the performance results we want to see over the next three to five years.

A full-time project team is now working closely with the Treasury's senior management team and me to determine how we can improve the way we operate as an organisation in order to achieve our strategic goals while meeting the Government's needs.

I am excited by the challenge this work offers us and look forward to providing more details in the next annual report.

## Improving organisational capacity

In 2005/06 we have progressed a number of key initiatives that will make the Treasury a better place to work and a more effective organisation as a whole.

In mid-2005, the Treasury established the Development Centre to provide coordinated and responsive learning and development programmes for staff. The launch of the Centre followed a review of the Treasury's staff capability to ensure we were well placed as an organisation to achieve our key outcomes. In 2005/06, the Development Centre has focused on providing learning and development programmes in three priority areas: management and leadership, relationship and communications, and technical capability.

Another important milestone has been the introduction of a comprehensive recycling scheme at No 1 The Terrace, as part of our commitment to incorporating sustainable business practices into our day-to-day work. The scheme, which has received positive feedback from staff, has resulted in an 80% reduction in the amount of waste we send to landfill each year.

The Treasury web site represents the key means by which we communicate with external audiences and the wider public. A comprehensive review of the Treasury's internet presence is almost complete, with new-look Treasury web sites expected in 2007. Visitors to all three sites – The Treasury, New Zealand Debt Management Office and New Zealand Export Credit Office – can expect faster and easier navigation; more up-to-date and topical information on current Treasury work programmes; and greater consistency and clarity in design, content and language.

## Crown Company Monitoring Advisory Unit (CCMAU)

CCMAU is a stand-alone unit within the Treasury that monitors Crown research institutes (CRIs), State-owned enterprises (SOEs) and Crown-owned companies and entities – organisations which together play a significant part in New Zealand's economy.

During 2005/06, CCMAU has made good progress towards putting in place the foundations of its strategic plan. CCMAU has also continued its focus on implementing the Government's long-term ownership policy for SOEs, with owners' reviews being completed for seven SOEs and another four underway. In April, CCMAU staff returned to refurbished, open plan offices which provide an excellent environment for effective and open interactions among staff.

### The year ahead

We enter the 2006/07 year with the aim of making further progress towards our vision of becoming a world-class Treasury working for higher living standards for New Zealanders.

The work that is underway to improve the way we operate as an organisation will enable us to make significant progress towards achieving our vision. A key challenge for us this year will be ensuring the successful implementation of this work, whilst continuing to fulfil the more immediate requirements of our role as the Government's primary economic and fiscal advisor, and our central agency role in supporting the Government to achieve high levels of public sector performance.

I am confident of the Treasury's ability to meet this challenge, due to the high level of professionalism and commitment displayed by Treasury staff on a daily basis. I would like to thank all staff for their positive contribution over the past 12 months.



John Whitehead  
Secretary to the Treasury

## OUR OUTCOME CONTRIBUTION

The Government's themes of *economic transformation*, *families – young and old* and *national identity* are its priorities for the next decade. The Treasury will contribute to all these themes, with a particular focus on economic transformation.

A series of Treasury "outcomes" supports these themes – the areas where we are well placed to make a positive contribution to the Government's goals. These are key outcomes for the Minister of Finance, or Vote Ministers in the case of CCMAU.

The Treasury's outcomes are articulated individually (refer to the blue boxes in the diagram below), and we use them as goals to focus our efforts. We also have a role in making sure they all work together, and in considering how best as a whole our work underpins our overall vision of higher living standards for New Zealanders.



As the Government's primary economic and fiscal advisors, we bring a particular perspective to achieving these outcomes. We also work alongside other agencies to achieve the desired results.

As a central agency, we continue to work with the State Services Commission (SSC) and the Department of Prime Minister and Cabinet (DPMC) towards delivering a high-performing, trusted and accessible State sector – which delivers

the right things in the right way, at the right prices. We each have our individual contributions to make to this outcome and, by working together, can improve overall results.

Last year, we sought to bring all of our activities into a consistent business planning framework, and in 2005/06 have focused on ensuring our results are driven by government priorities. We have also developed our planning framework even further and are currently undertaking a significant strategic planning exercise to incorporate what we have learned into our practices and framework.

The Managing for Outcomes framework has enabled us to be more focused on our work priorities and better at aligning resources to support them.

In this section we report on progress during 2005/06 and the challenges ahead, in the context of improved outcomes for the Government in the longer term.

## Improved overall economic performance

### Overview

The Government continues to place a high priority on policies designed to lift New Zealand's economic performance and to improve living standards (Prime Minister's 14 February 2006 *Statement to Parliament*). As the Government's chief economic advisor, our role is to understand what drives growth in New Zealand's real GDP per capita and advise the Government on how the wide range of policies it considers (including institutions, regulations, ownership, expenditure and revenue options) will affect economic growth.

In *Growing an Innovative New Zealand 2002*, the Government set out its economic objective to return New Zealand to the top half of the OECD in terms of real GDP per capita and maintain that standing. New Zealand's current ranking is 20th out of the 30 OECD countries. An increase in economic growth since the early 1990s has arrested the earlier decline in real GDP per capita relative to the OECD. Growth in real GDP per capita increased to the point where it averaged 2.5% between 1993 and 2005. This growth rate exceeded the OECD average. To move into the top half of the OECD in terms of real GDP per capita will require sustained growth rates higher than the OECD average.

Growth in GDP per capita since the early 1990s came initially from growth in labour utilisation and more recently from labour productivity growth, which by the late 1990s had become the dominant source of growth in GDP per capita. The Treasury's most recent forecasts, summarised in Table 1, incorporate the view that although labour productivity growth is expected to remain the dominant driver over the next five years, real GDP per capita growth is not expected to accelerate. The forecasts reflect a cyclical slowdown, although the Treasury view of trend real GDP growth remains at around 3% per annum.

Table 1 – New Zealand average annual economic growth rates: history and forecasts

	1993 to 2005	2005 to 2010**
GDP per capita growth* %	2.5	1.7
GDP growth* %	3.7	2.6
Labour productivity growth %		
– economy-wide	1.3	1.4
Labour utilisation growth %	1.2	0.3
Population growth %	1.2	0.9
Labour productivity growth %		
– measured sector***	2.4	

Notes:

\* GDP per capita growth is the sum of the growth rates for labour productivity and labour utilisation (or GDP growth less population growth). GDP growth is the sum of the growth rates for labour productivity, labour utilisation and population.

\*\* Average March year growth derived from the Treasury, 2006 Budget Economic and Fiscal Update (BEFU).

\*\*\* A key difference between this and the economy-wide measure of labour productivity growth is that the "measured sector" excludes property and business services, Government administration and defence, education, health and community services, and personal and other services. The measured sector comprises around two-thirds of GDP.

### Our outcome contribution

Improving economic performance has been the Treasury's focus for a number of years. During 2005/06 our contributions to improving economic performance included:

- reporting on progress and critical issues for growth to help with setting strategic priorities
- developing a sound understanding of New Zealand firm productivity growth and the factors that influence firm productivity, including the role of taxation, product market regulation, firm finance and innovation
- advice on removing barriers to labour force participation, including improving education attainment, skills and labour mobility
- advice on improving regulations and institutions – particularly those related to property rights and resource management, infrastructure and external linkages.

In 2005/06, these contributions provided the basis for an agreed Treasury-wide game plan to prioritise and implement our growth policy work. Identifying and discussing with the Minister of Finance the critical issues for New Zealand growth is an important part of the prioritisation process. The growth programme involves collaborative work with other agencies, and we continue to keep internal and relevant external parties informed of the status of the various growth projects and to raise important issues.

### Our progress

The Treasury's briefing to the incoming government, *Sustaining Growth*, sought to assist the organisation to come to a consensus on key outcome issues and was explicitly linked to the outcomes framework. The briefing concluded that sustaining and increasing economic growth require an emphasis on policies that assist the transition from labour-absorbing growth to productivity-enhancing growth. Factors identified to support this shift include:

- strong external linkages (focusing on improving externally oriented policies, the World Trade Organisation, trade in the Asia-Pacific region and our relationship with Australia)
- a sound business environment (focusing on natural resource management/ climate change, infrastructure, innovation and tax)
- skill development and labour markets (especially tertiary education, work-based skills and further lifting labour force participation).

In terms of monitoring New Zealand's growth performance, the release of the official productivity series by Statistics New Zealand in March represents a significant step forward. The development of the new measures has involved collaborative work between Statistics New Zealand and the Treasury.

In line with statistical agencies in other countries, Statistics New Zealand has focused the new measures on those parts of the economy where outputs are currently measured with reasonable accuracy. These parts comprise around two-thirds of the economy and are referred to as the "measured sector". The measured sector excludes areas such as health, education, central government and some business services.

The new statistics allow us to make more robust comparisons with similar official productivity statistics in other countries. For example, from 1993 to 2005 New Zealand's measured sector recorded average annual labour productivity growth of 2.4%, compared with 2.3% for the comparable Australian measure. The Treasury has contracted the National Institute of Economic and Social Research to prepare a study comparing New Zealand productivity at the industry level with the UK, with additional comparisons against France, the US, Germany and (eventually) Australia.

The new productivity statistics also highlight interesting patterns in the labour inputs to the measured sector and the rest of the New Zealand economy. After a period of declining labour input from 1988 to 1993 and a strong rebound in the mid-1990s, there has been slower growth in labour hours in the measured sector since then. On the other hand, labour hours in the non-measured sector rose 44.2% from 1993 to 2005.

Although the strength of labour productivity growth in the measured sector is encouraging, New Zealand's level of labour productivity is still low relative to most other OECD countries. This underscores the importance of identifying policies that will sustain and further enhance productivity growth across the whole economy, including the hard-to-measure sectors.

During 2005/06 we have continued to accumulate knowledge on what matters for economic growth and have applied this when delivering policy advice in a wide range of areas. These have included:

- substantial and wide-ranging policy analysis and advice contributing to the business tax review
- research and policy development on the impact of taxes on small and medium-sized businesses, including possible policy interventions
- advice on government support for research and development
- a review of the innovation system
- ongoing work on the quality of regulation, including a Policy Perspectives Paper on international comparative surveys of regulatory impact
- assisting the Ministry of Economic Development to develop Terms of Reference for the review of regulatory frameworks
- contributing to the development of interdepartmental advice on the reform of the benefit system to increase labour market participation
- reviewing the literature on policies to improve the performance of city-regions
- advice on economic transformation priorities and policies
- advice on land transport funding
- reporting on funding for Auckland transport and work on the Auckland transport strategic alignment project
- work on electricity issues and work programmes
- assisting the Ministry of Economic Development with the telecommunications stocktake and advice on telecommunications regulation
- contributing to a review of current climate change policies, options for adjustment, and implications of climate change policies for economic growth.

During 2005/06 Treasury staff also completed a number of growth-related Working Papers on areas such as the role of research and development in the agricultural sector, the links between migration and economic growth, and Auckland's economic performance.

### Looking ahead

New Zealand needs to sustain a relatively high growth rate in order to continue to lift its income relative to the OECD. During 2006/07 we will place renewed emphasis on developing a sound understanding of New Zealand firm productivity growth and the factors that influence firm productivity. This work will build on the analysis of firm productivity growth we have carried out over recent years.

The Government has stated, through its *Economic Transformation* theme, that it will continue focusing on new initiatives to lift New Zealand's economic performance. The Treasury can play a significant role in helping to frame these initiatives so they achieve the desired increase in innovation and productivity.

### Feedback on economic performance

“Growth in GDP per capita has risen markedly in the past decade, albeit not sufficiently for a catch-up with the top-half of OECD countries. The large gap in labour productivity has widened.”

Source: OECD, *Economic Policy Reforms: Going for Growth 2006* ([www.oecd.org/dataoecd/39/43/36012805.pdf](http://www.oecd.org/dataoecd/39/43/36012805.pdf))

The OECD identified challenges and recommendations, together with an assessment of actions taken, on five policy priorities:

- Strengthening incentives to move from welfare to work.
- Reducing barriers to foreign ownership.
- Reducing the extent of educational under-achievement observed among specific groups.
- Ensuring employment relations legislation supports efficient labour market outcomes.
- Addressing infrastructural bottlenecks, especially in transport and energy.

### Improving the economic performance of Auckland

New Zealand’s prospects for economic growth are closely linked with the performance of Auckland – a city which comprises about a third of the national economy.

In 2005/06, the Treasury was involved in a wide range of activities to lift Auckland’s performance and enable it to compete internationally as a world-class city.

Improving Auckland’s economic performance requires a coherent, long term-effort, not only from central government, but from Auckland’s eight local authorities, business and the community.



Working to improve the economic performance of Auckland – Geoff Lewis, Dieter Katz, Megan Claridge, Warwick Terry and Nick Graham.

Over the past year, the Treasury's involvement in lifting Auckland's performance has included:

#### Research

The Treasury contributed to the development of accurate information on Auckland's economic performance by comparing wage levels and movements there with other parts of New Zealand. Our findings challenged the commonly reported view of Auckland's relatively poor performance.

#### Economic transformation

The Treasury contributed to shaping work led by the Ministry of Economic Development to lift the economic performance of Auckland. In particular, by looking at comparable policies across other OECD countries, we emphasised leadership, good governance and coherent planning as key prerequisites for economic transformation.

#### Transport

The Treasury has been closely involved in Auckland transport issues for the past three years. In 2005/06 we led a joint Auckland/central government project which examined forecast revenue and costs for Auckland transport projects over the next 10 years. The Treasury is currently co-leading a project seeking joint agreement on the overall long-term strategy for Auckland transport.

#### Business and community engagement

The Treasury's senior management team engaged in a programme of one-on-one meetings with key business and community leaders in Auckland. These meetings are aimed at giving us a richer picture of the city's underlying challenges and opportunities.

#### Government coordination

The Treasury has continued to maintain a cross-government overview of key policy work streams affecting Auckland. This work involved effective coordination across economic, social and environmental agencies.

## Stable and sustainable macroeconomic environment

### Overview

A stable and sustainable macroeconomic environment is an essential precondition for achieving the Government's objective of growing per capita income. It allows individuals, businesses and the Government to plan more effectively for the longer term, thus improving the quality and quantity of investment in physical and human capital, and helps to raise productivity.

A stable and sustainable macroeconomic environment requires good fiscal management, good monetary policy and financial stability, as well as reliable information on fiscal and economic variables. Our role is to provide advice on macroeconomic and fiscal policy. We also provide timely and accurate economic and fiscal data, firstly through economic and fiscal forecasts and secondly through reporting the Crown accounts. In fulfilling these roles we work closely with the Reserve Bank, the Ministry of Economic Development (MED) the Inland Revenue Department (IRD), Statistics New Zealand and other relevant agencies for monetary and financial stability, and with all departments to ensure a sustainable fiscal position.

### Our desired outcome contribution

- Advising on the economic impact and sustainability of fiscal policy in both the short and long term.
- Providing high-quality financial information that informs debate and analysis of fiscal policy.
- Monitoring the performance of the current Budget frameworks and developing options for revising them where necessary.
- Examining and, where necessary, refreshing our economic and fiscal forecasting processes.
- Further analysing the suitability of fiscal and monetary policy institutions to enhance resilience to domestic or international shocks.
- Further developing our understanding of cyclical and trend developments with respect to growth and other key macroeconomic variables.
- Increasing our understanding of the complementarities and trade-offs in anchoring inflation expectations, stabilising output and moderating fluctuations in financial and asset markets.
- Monitoring and advising the Minister of Finance on the Reserve Bank's performance and working with the Reserve Bank to advise on monetary and financial policy, regulation and governance as appropriate.

### Our progress

#### Economic performance

Growth in the New Zealand economy began to slow in the 2005/06 year. Growth in real GDP eased from 3.7% in the year to March 2005 to 2.2% in March 2006. Growth in real per capita incomes fell from 2.5% in March 2005 to 1.3% in

March 2006. The main reasons for the slowdown were tighter monetary policy, lower terms of trade, lower net immigration and higher business costs. The slowdown was most apparent in the domestic sectors of the economy. Private consumption growth slowed from 5.8% in March 2005 to 4.1% in March 2006 and growth in residential investment declined from 2.3% in March 2005 to a contraction of 5.1% in March 2006. Net exports made a negative contribution to growth. The reasons were poor seasonal conditions for agricultural production, lower manufactured exports and tourism, and strong import growth due to consumption and investment growth.

Inflation, measured by the Consumer Price Index, was 4.0% in the year to June 2006, up from 2.8% in June 2005. The reasons were increases in international oil prices and the fall in the New Zealand dollar in the first half of 2006. Inflation in the domestic sector of the economy was also high with non-tradables inflation running at 4% or above for the past two and a half years. The Reserve Bank raised the Official Cash Rate a total of 50 basis points in two steps in the second half of 2005 to 7.25% and held it at that level in the first half of 2006.

The current account deficit increased sharply to 9.3% of GDP in the year to March 2006, up from 7.4% the year before. In the past year both the goods and investment income deficits continued to increase as a result of poor export performance combined with strong import growth, and servicing the large net negative international investment position.

The exchange rate declined sharply in the first half of 2006, falling 12% between the December quarter of 2005 and June quarter of 2006 on a trade-weighted basis. An expected continuation of this depreciation will help reduce the current account deficit by boosting demand for exports (particularly manufactured products and services) and curtailing import growth. Continuing high interest rates and the flow-through from past increases are expected to lead to a further slowing in domestic demand, particularly private consumption. Growth in real GDP is forecast to be only 1.0% in the year to March 2007 but to rebound to 3.3% in the year to March 2008 as a strong recovery in exports offsets continuing low growth in consumption. The lower growth and rebalancing of its components are expected to lead to lower inflation and a decline in the current account deficit.

#### Treasury contribution

In 2005/06, our contribution to this outcome centred on the provision of economic and fiscal forecasts and information on the performance of the economy. This information was contained in the Financial Statements of the Government; the Economic and Fiscal Updates, including a Pre-Election Update; and the Government's *Budget Policy Statement* and *Fiscal Strategy Report* which included a revised long-term debt objective. We continued to support the systems and processes, and provided advice, for the preparation of the Government's 2006 Budget.

The first *Statement on the Long-Term Fiscal Position* was published in June 2006 with the aim of making a major contribution to the quality and depth of public information and understanding about the long-term consequences of spending and revenue decisions. The Statement is a requirement of the Public Finance Amendment Act and must be prepared at least once every four years, incorporating

projections of the fiscal position looking out 40 years. The major inputs to the model are the trend rate of economic growth and demographic projections, along with spending assumptions relating to superannuation and health care. The Statement helps to identify key decisions that will need to be made related to either fiscal objectives or levels of spending and revenue. Prior to the release of the Statement, the Treasury published a Policy Perspectives Paper setting out the methodology to be adopted for the projections. Following publication, the Treasury commenced a programme of wider communication to increase awareness of the pressures on New Zealand's long-term fiscal position.

The Treasury carried out a review of the fiscal management approach in support of the Budget framework, implemented a new model for managing capital expenditure and implemented new processes for unappropriated expenditure, as required by the Public Finance Amendment Act.

The Treasury updated its regular analysis of its economic and tax forecasting performance and conducted an internal review and commissioned an external review of tax forecasting. The recommendations of those reviews are being implemented in order to achieve better forecasting performance. The Treasury also conducted a detailed comparison of its economic forecasts with other individual forecasters and the results were published as a Treasury Working Paper. A survey of users of the financial statements and forecasts was conducted to discover how they might be improved.

In 2005/06, the Treasury undertook further analysis of the resilience of the macroeconomy to domestic or international shocks. Reports were completed on the likely impact of a revaluation of the Chinese Renminbi. A Policy Perspectives Paper was published on the likely effects of an influenza pandemic on the economy, including the ability of macroeconomic institutions to cope with such an event. Research was also undertaken on the experience of countries moving from fiscal surpluses to deficits.

The Treasury also undertook analysis of the impact of cyclical and trend developments on growth and other key macroeconomic variables. Work commenced on the evaluation of different measures of trend growth and on developing a quality-adjusted measure of labour input in order to enhance our measure of labour productivity and multi-factor productivity. Work was completed on trends and determinants of the current account deficit and how the terms of trade have impacted on growth, the latter being published as a Treasury Working Paper. A Working Paper was also published which examined the contribution of fiscal policy to the business cycle.

The Treasury and the Reserve Bank cooperated on work on the stability of the macroeconomy in response to concerns about the effectiveness of monetary policy to curb high inflation, and the resultant high exchange rate and external imbalances. A report was prepared for the Minister of Finance in January 2006 examining Supplementary Stabilisation Instruments and a Forum was organised in June, which brought together international experts who delivered papers on different aspects of macroeconomic policy in New Zealand. The Forum concluded that our macroeconomic policy institutions are fundamentally sound,

but suggestions emerged of ways to further improve monetary and fiscal policy. The proceedings of the Forum will be published. The Treasury also engaged with the Reserve Bank on the implications for gross debt and the Government's debt programme arising from changes to liquidity operations management.

The Treasury's work does not have a one-to-one impact on the key macroeconomic variables and institutions. Rather, the impact of our work was to:

- provide high-quality advice to the Minister of Finance so that he could make timely and informed fiscal policy decisions
- provide information to both the Government and private sector on actual and prospective economic and fiscal results, to help improve the basis for their decision-making
- continue to implement the objectives of the Public Finance Amendment Act 2004, in particular the publication of the first *Statement on the Long-Term Fiscal Position*
- prepare for the full implementation of the new international accounting standards from 2007. Implementing these standards will give enhanced credibility and transparency to the Government's published fiscal information.

### Challenges ahead

Although the core policies and institutions supporting the macroeconomic environment are considered to be sound, there will be a number of pressures ahead. Some of these relate to the reduction of high inflation and a large current account deficit. The context of slowing growth in the economy will place more pressure on fiscal policy in both the short term and long term. Our work will continue to focus on these issues, as well as:

- communicating the messages of the first *Statement on the Long-Term Fiscal Position* to a wider audience
- providing fiscal policy advice on fluctuations in revenue, expenses and aggregate balance sheet issues and reviewing long-term fiscal objectives
- providing advice on the overall macroeconomic framework and its operation
- monitoring, analysing and forecasting developments in the domestic and international economy likely to affect the nominal economy for purposes of forecasting tax revenue
- improving forecasts of tax and expenditure forecasts
- providing advice on the implementation of the International Financial Reporting Standards in 2007.

### Predicting New Zealand's long-term fiscal position

Trying to predict the state of the Government's finances 40 years from now might seem a rather academic exercise. But the reality is that New Zealand's financial health in the year 2046 will matter a great deal to many current – and future – taxpayers.

Changes to the Public Finance Act require the Treasury to produce a statement on the Government's long-term fiscal position over a period of at least 40 years, and to update the outlook at least every four years. The Treasury published the first of these statements in June 2006.

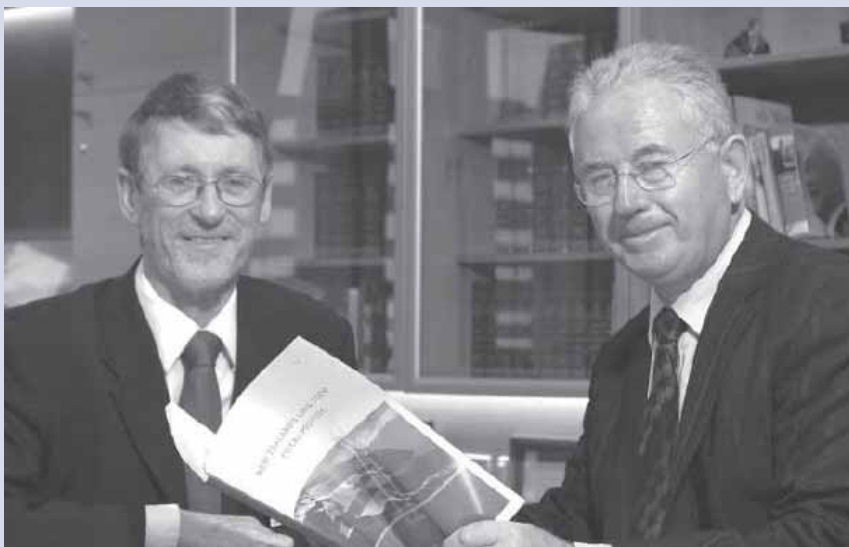
The *Statement on the Long-Term Fiscal Position* uses currently available information to outline a set of potential scenarios, based on the likely drivers of Government fiscal policy in the decades ahead. These scenarios represent a series of "What if" questions – for example: What if economic growth is higher than we expect? What if fertility increases? What if governments choose to spend more on education?

The Statement indicates that the projected ageing of New Zealand's population, combined with current policy settings, is likely to lead to growing challenges in the nation's fiscal position.

"The future state of New Zealand's finances is increasingly a factor that governments take into account when setting today's policies," says Secretary to the Treasury John Whitehead. "A prime example is the New Zealand Superannuation Fund, where a portion of today's tax take is being invested to contribute to the future cost of New Zealand Superannuation.

"We expect departmental policy advisors to refer to the Statement as they advise Ministers of the day about the long-term fiscal implications of any significant spending and revenue decisions. Similarly, we hope the Statement will increase the quality and depth of public information and understanding."

The *Statement on the Long-Term Fiscal Position* is available on the Treasury web site at [www.treasury.govt.nz/longtermfiscalposition/](http://www.treasury.govt.nz/longtermfiscalposition/)



Discussing New Zealand's long-term fiscal position – Secretary to the Treasury, John Whitehead, and the Minister of Finance, Hon Dr Michael Cullen.

## Effective and efficient use of State resources and regulatory powers, including improved decision-making and performance management systems

### Overview

The extent to which the Government uses State resources and regulatory powers effectively and efficiently determines the extent to which the Government is able to achieve its desired economic, social and environmental outcomes.

The Treasury's role in relation to encouraging the effective and efficient use of State resources and regulatory powers is both from a central agency perspective – we have a responsibility to ensure the public sector is performing well – and from a financial perspective as the Government's chief economic and financial advisor.

The Treasury fulfils this role by:

- assessing departmental votes (baselines and additional spending)
- providing second opinion policy advice, enhancing the quality of advice Ministers receive from government agencies
- advising Ministers directly on how to maximise value for money from public sector investment
- providing advice to both Ministers and government agencies that cuts across agency “silos” and sectors
- working with the State Services Commission to design systems that encourage and maintain public sector effectiveness and accountability.

### Our outcome contribution

Ensuring greater clarity about goals/desired results:

- engage more effectively with key Ministers
- help Ministers make well informed choices about relative priorities
- engage more at a sectoral level.

Getting the system to focus on performance:

- advise on changes to the Budget process
- use a range of other methods to strengthen the performance of government departments
- refocus our Vote analysts' work to emphasise sectors where significant problems and opportunities are emerging
- pay greater attention to regulatory effectiveness, the adequacy of the regulatory framework and the quality of regulatory interventions.

Building capability so that the public sector delivers better results:

- encourage government departments to adopt a more strategic approach to capability issues
- identify areas where we can intervene directly to raise capability in the public sector.

#### Our progress

Ensuring greater clarity about goals/desired results

Work has included:

- providing advice on the Kyoto Protocol and the Government's other climate change commitments, particularly through the secondment of senior Treasury officials who contributed to the Ministry for the Environment's Review of Climate Change Policies
- working with the Ministry of Economic Development and the Inland Revenue Department on the Government's proposed KiwiSaver scheme
- working jointly with education agencies on approaches for improved long-term fiscal sustainability and predictability in tertiary education funding
- supporting the "themes" approach of Ministers in the Budget 2006 process, including the development of balanced theme packages.

Getting the system to focus on performance

Work has included:

- undertaking five in-depth reviews of the electricity, health, innovation, justice and tertiary education sectors
- progressing trans-Tasman coordination and financial sector regulation, and working on a review of domestic institutional arrangements
- providing support and analysis for the Ministerial Expenditure group review process in November/December 2005 on performance and productivity issues in the public sector
- supporting the 2006 Ministerial Expenditure group reviews
- working with the Ministry of Health and District Health Boards New Zealand to improve health sector performance measures
- developing proposals for changes to the Budget 2007 process to better focus on performance and leverage off the themes approach.

Building capability so that the public sector delivers better results

Work has included:

- building awareness of changes to the Crown Entities Act, providing guidance to departments on Crown entity monitoring and providing guidance to Crown entities on Statements of Intent and managing for outcomes
- developing, alongside other central agencies, a framework for identifying early warning signs of a government organisation at risk.

## Challenges ahead

During 2006/07 two of the Treasury's outcomes – the effective and efficient use of State resources and regulatory powers, and the efficient management of Crown assets and liabilities – will be grouped together under one outcome: Improving Public Sector Performance.

The Treasury's overarching objective is to lift the quality and consistency of our advice on public sector performance. Public sector performance is increasingly a matter of public and ministerial interest, with Ministers concerned to identify and evaluate the returns from public sector investment.

The Government is currently seeking to improve performance and value for money in 2006/07 via a series of Ministerial Expenditure group reviews. Specific sectors that will be targeted include capital expenditure, transport, central agencies and health. The Treasury will join the State Services Commission, the Department of Prime Minister and Cabinet and other lead agencies to progress these reviews.

At an organisational level, we have identified a need to increase our analytical focus on value for money. This means advising Ministers as to what should be expected from public sector spending and assessing what is delivered. We intend to focus on providing advice on how the Government can improve performance management processes. A further organisational challenge for the Treasury is to continually reflect on what past experience implies for future investment. In moving our analytical capability towards better analysis of these concerns, the Treasury needs to retain an appropriate focus on effective fiscal management.

The themed Budget process (*National Identity, Economic Transformation and Families – Young and Old*) presents opportunities for the Treasury's objectives in relation to improving public sector performance. The theme-based approach offers an opportunity to review the extent of policy consistency and coordination in support of the Government's objectives. We have a role in helping Ministers make well-informed choices about relative priorities.

The Treasury has a continued role to play in supporting the public sector's focus on managing for outcomes. This requires that we work with other agencies to develop effective evaluation techniques and help disseminate evidence on best practice.

### In-depth review of the criminal justice sector

During 2005/06, the Treasury completed several in-depth reviews of specific government sectors. One of these was the criminal justice sector. A team from across the Treasury was brought together to look at the symptoms and underlying causes of the growth in New Zealand's prison population. The team worked closely with justice sector agencies such as the Ministry of Justice and Department of Corrections, bringing an empirical and financial focus to their work.

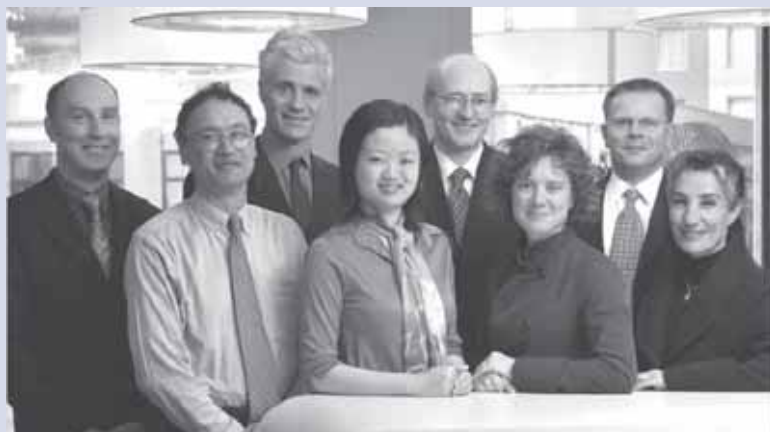
The project's notable achievements included:

- the creation of a spreadsheet model of the criminal justice sector's possible future volumes and costs. This contributed to advancements in the Ministry of Justice's forecasting capability. It also supported the Treasury's advice on the flow-on effects of extra police
- estimating the total cost of crime in New Zealand, analysed by crime category and by cost component. This was documented in a Treasury Working Paper, *Estimating the Costs of Crime in New Zealand in 2003/04*
- in-depth analysis of crime and imprisonment, both in New Zealand and overseas, and of New Zealand's criminal justice system, including its crime reduction programmes and the involvement of victims. This work formed the basis of reporting to the Minister of Finance on a variety of sector issues
- a case study of young, violent male offenders. This culminated in a well-attended seminar that involved justice sector officials, central agency officials and academics
- direct contribution to a package of initiatives announced by the Government in August 2006. The *Effective Interventions* package is a series of measures to improve the criminal justice system and make New Zealand a safer and fairer society.

The Treasury provided further support for the *Effective Interventions* policy development phase through the secondment of a senior staff member to the Ministry of Justice project team.

Overall, the project assisted the Treasury in developing a greater understanding of the criminal justice sector, and helped identify effective policy responses to the increasing prison population.

The Criminal Justice Review team – Tim Roper, Hauraki Greenland, Matthew Bell, Fern Phoon, Andrew Thompson, Mary-Ellen Fogarty, David White and Minoo Meimand.



## Efficient management of the Crown's assets and liabilities

### Overview

Efficient management of the Crown's assets and liabilities contributes to improved overall economic performance through maximising the value of the Government's investments and minimising the costs of the Government's finance. The Treasury and CCMAU contribute by:

- monitoring the performance and governance of organisations that are responsible for the day-to-day management of the Crown's assets and advising Ministers on policy and strategic issues
- managing, through the New Zealand Debt Management Office (NZDMO), the Crown's sovereign-issued debt and associated financial assets
- providing primary policy advice and, in some cases, managing commercial and contractual claims against the Crown.

In June 2005, the Crown owned \$131 billion in total assets, more than any other entity in New Zealand. These included equity interests in SOEs, Crown companies and CRIs, a number of other Crown entities and the financial assets accumulating in Crown Financial Institutions (CFIs). The Crown's assets are expected to grow to over \$160 billion by 2010, with the biggest change being the growth in assets held by the New Zealand Superannuation Fund (NZSF) to pre-fund future pension liabilities.

The Crown's total liabilities in June 2005 were around \$81 billion, of which some \$35 billion was gross sovereign debt. Over the medium term, gross debt is forecast to remain close to this level in nominal terms, but to decline to 19.4% of GDP by 2010 as against 23.2% in June 2005.

The Crown's assets provide a resource to help meet future expenditure commitments and claims on the Crown, and income streams that reduce tax pressure in future years. Sustaining their value is important. By the same token, government debt creates costs and risks for the Crown that need to be managed. The Crown also faces other financial risks arising from contractual and commercial claims. These too need to be monitored and managed, consistent with the Crown's overall economic and other policy objectives.

### Our desired outcome contribution

- Delivering operational outputs as required by Ministers, including continually improving our efficiency and effectiveness.
- Maintaining a high-quality capability to undertake commercial negotiations, transactions and risk management when Ministers require them.
- Continually looking to sustain and improve entity performance in a dynamic environment.
- Working effectively with others in the Treasury to provide integrated and seamless advice and operations.

### Our progress

#### State-owned enterprises/Crown companies

Our core activities are the provision of advice to shareholding Ministers on SOE and Crown company business plans and Statements of Corporate Intent (SCIs), and on a range of specific company issues. In addition to these activities, in 2005/06 we have:

- continued the process of systematically undertaking a strategic (“long-term hold”) review of all SOEs. During the year we concluded one review and progressed four others in consultation with the respective boards and management teams. These exercises have established, among other things, credit-rating benchmarks and have in each case clarified shareholding Ministers’ preferences regarding thresholds for consultation on significant strategic issues
- provided advice on organisational structure options for AgriQuality,ASURE, NIWA and MetService
- negotiated a capital restructure of TVNZ resulting in a special dividend of \$70 million
- increased the focus on companies including realistic commercial valuations in their SCIs to allow better monitoring of performance
- provided advice on the role of SOEs in relation to economic transformation.

#### Crown Financial Institutions

Another priority has been to improve our understanding of the Crown’s financial assets, as they come to dominate the Crown’s balance sheet. To this end, we have provided advice throughout the year on CFI performance, including investment returns, appointments, Statements of Intent and a range of specific issues. This included managing a process for an independent review of the operation of the Government Superannuation Fund Authority. Assisted by favourable market conditions, CFIs have generally significantly exceeded benchmark performance levels over the year and achieved record returns.



Working on the Crown Entities Act – Roger Beckett, Mary Slater and Simon MacPherson.

### Implementing the new Crown Entities Act

The Crown Entities Act 2004 is designed to improve Crown entity governance and accountability, and to strengthen the integration of Crown entities with the rest of the State sector. The new Act came into force on 25 January 2005.

During 2005/06, the Treasury worked in partnership with the State Services Commission and the Department of Prime Minister and Cabinet to ensure the successful implementation of the Act.

The Treasury's work programme had two main areas of focus:

- The development of advice and guidance for Ministers, departments and Crown entities. This focuses on their roles and responsibilities, the Act's expectations around the preparation of Crown entity Statements of Intent and the financial powers contained in the Act. The advice and guidance is available on the SSC web site through [www.crownentities.ssc.govt.nz](http://www.crownentities.ssc.govt.nz).
- Direct engagement between central agencies and the departments which monitor Crown entities on behalf of the responsible Ministers. This has included Treasury support for the establishment of a departmental group whose purpose is to promote good monitoring practice.

Looking ahead, the Treasury will extend existing guidance – for example, to include the preparation of annual reports – and will continue to support good monitoring practice.

### Debt management operations

Improving our delivery of debt management outputs in 2005/06 was achieved through a wide range of activities. In the domestic market we issued \$2,355 million of Government bonds to meet the Government's funding requirement and completed \$2,862 million of New Zealand-dollar interest-rate swaps.

We completed \$44 billion of foreign-currency transactions (including foreign-currency swaps) for the NZSF, and provided loans to the Reserve Bank under new funding arrangements to support the Bank's build-up of foreign-currency reserves.

We introduced new products, analytical tools and system improvements to enhance our ability to fund the Government's borrowing requirements, manage the stock of debt and add value, while balancing cost and risk objectives. Notably, we:

- hedged the Crown's share of foreign-exchange exposure associated with hosting the 2011 Rugby World Cup
- established a new strategic advances portfolio in July 2005 for all new lending to Crown housing entities and District Health Boards
- completed the implementation of registry arrangements for the new immigration investor policy announced on 16 June 2005, as a joint project with the Department of Labour

- continued to develop proposals for infrastructure bonds to fund transport investments, including borrowing by Transit New Zealand to support the ALPURT B2 toll road.

### Efficient management of the Crown's debt

There are many influences on actual results, such as the overall level of debt, the level and evolution of market interest rates, the volume of intermediation and advances to parts of the Crown, and NZDMO's discretionary decisions. In some cases we made a direct contribution, while in others it was second-order. Outlined below is information on performance for the past five years.

Outcome Indicators	2001/02	2002/03	2003/04	2004/05	2005/06
Core Crown finance costs on debt (\$m)	2,324	2,478	2,260	2,239	2,128
Value added in the tactical portfolios (\$m)	6.5	13.4	7.9	23.5	44.7
Value added from NZD interest-rate swaps (\$m)	5.0	6.2	7.3	35.8	26.3
Adherence to policies and controls for managing risk, with nil material breaches	√	√	√	√	√

### Other commercial assets and claims against the Crown

The Treasury has continued to manage a number of the Crown's commercial assets and contractual functions, and also risks on behalf of the Government. We provided advice on the Government's commitments to the Rugby World Cup 2011 and negotiated arrangements for the set-up of the Tournament Management Vehicle; negotiated new funding arrangements with the relevant local authorities for Auckland rail; continued national rail negotiations over the Track Access Charge; negotiated compensation to New Zealand Cricket for the cancellation of the Zimbabwean tour; concluded negotiations to protect the Crown's Maui gas position under open access to the Maui pipeline; continued the management of weathertight homes litigation against the former Building Industry Authority; and provided advice on a number of historic Treaty of Waitangi settlement negotiations and on wider policy settings. We also continued to operate the Export Credit Office.

### Challenges ahead

In 2006/07, this outcome and the previous outcome will be grouped together under one heading: Improving Public Sector Performance. See page 21 for more information on the challenges ahead for this outcome.

### Crown agencies for which either the Treasury or CCMAU has lead monitoring responsibility

#### SOEs (*CCMAU lead, and the Treasury*)

- AgriQuality Ltd (AgriQuality)
- Airways Corporation of New Zealand Ltd (Airways)
- Animal Control Products Ltd (ACP)
- Asure New Zealand Ltd (Asure)
- Electricity Corporation of New Zealand (Residual) Ltd (ECNZ)
- Genesis Power Ltd (Genesis)
- Landcorp Farming Ltd (Landcorp)
- Learning Media Ltd (LML)
- Meridian Energy Ltd (Meridian)
- Meteorological Service of New Zealand Ltd (MetService)
- Mighty River Power Ltd (Mighty River Power)
- New Zealand Post Ltd (NZ Post)
- New Zealand Railways Corporation (ONTRACK)
- Quotable Value Ltd (Quotable Value)
- Solid Energy New Zealand Ltd (Solid Energy)
- Timberlands West Coast Ltd (Timberlands)
- Transpower New Zealand Ltd (Transpower)
- Transmission Holdings Ltd (THL)

#### Other Crown companies

- (*CCMAU lead, and the Treasury*)
- New Zealand Venture Investment Fund Ltd (NZVIF)
  - Radio New Zealand Ltd (RNZ)
  - Television New Zealand Ltd (TVNZ)
  - Research & Education Advanced Network New Zealand Ltd (REANNZ)

#### CRIs (*CCMAU lead, and the Treasury*)

- AgResearch Ltd (AgResearch)
- Institute of Environmental Science & Research Ltd (ESR)
- Institute of Geological & Nuclear Sciences Ltd (GNS Science)
- Landcare Research New Zealand Ltd (Landcare Research)
- National Institute of Water & Atmospheric Research Ltd (NIWA)
- New Zealand Forest Research Institute Ltd (Scion)
- New Zealand Institute for Crop & Food Research Ltd (Crop & Food Research)
- The Horticulture and Food Research Institute of New Zealand Ltd (HortResearch)

#### Other (*CCMAU lead, and the Treasury*)

- Christchurch International Airport Ltd (CIAL)
- Dunedin International Airport Ltd (DIAL)
- Invercargill Airport Ltd (IAL)
- New Zealand Lotteries Commission (NZLC)

#### (*the Treasury only*)

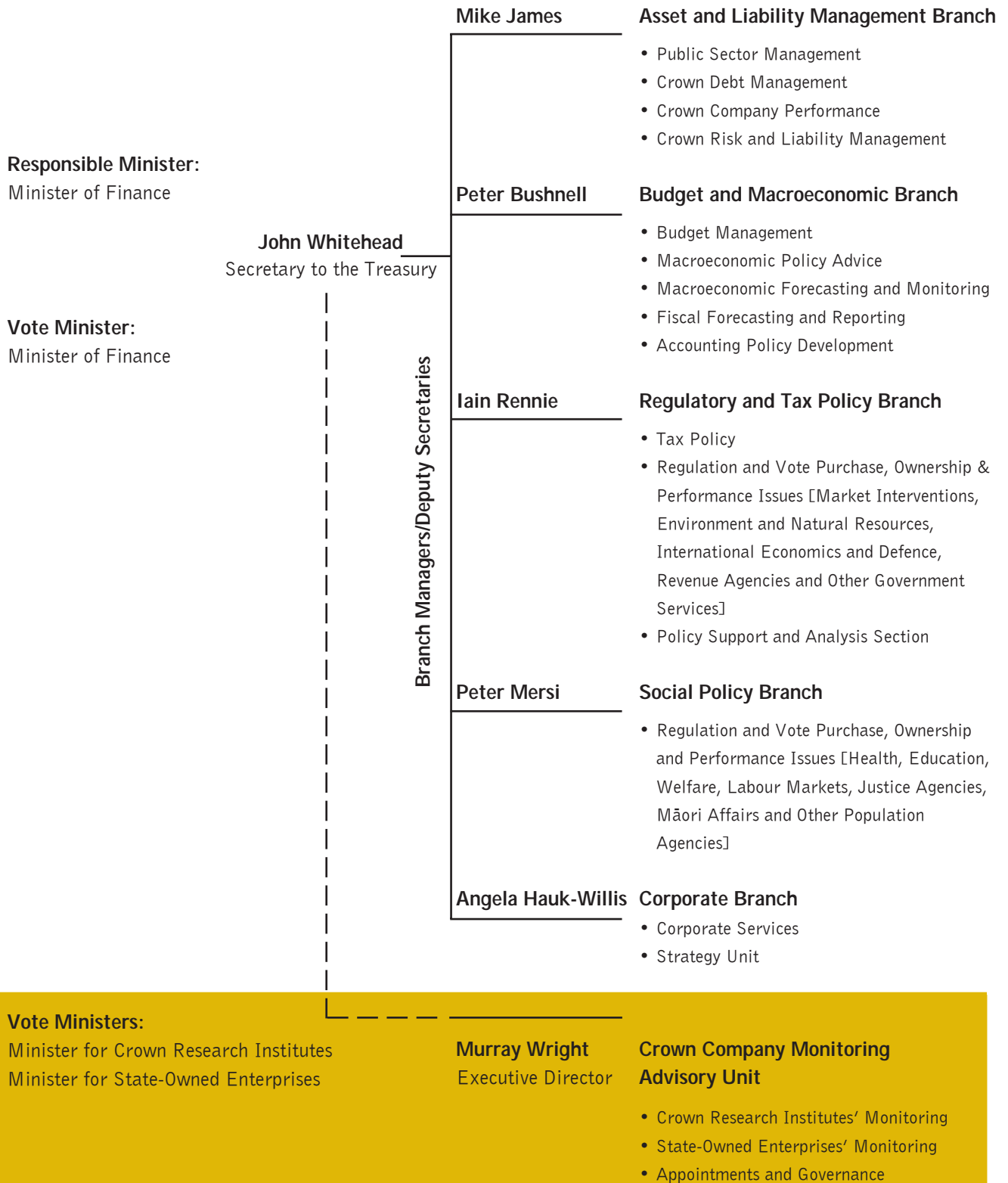
- Air New Zealand Ltd (*CCMAU only*)
- Pacific Forum Line Ltd (PFL)
- Public Trust (Public Trust)

#### CFIs (*the Treasury only*)

- Earthquake Commission (EQC)
- National Provident Fund (NPF)
- New Zealand Superannuation Fund (NZSF)
- Government Superannuation Fund (GSF)

# ORGANISATIONAL STRUCTURE – THE TREASURY

as at April 2006



# THE TREASURY – VISION AND MANAGEMENT OBJECTIVES

## Our vision

A world-class Treasury working for higher living standards for New Zealanders

## Our management objectives (T-I-M-E)

Our four management objectives summarise how we're going to achieve our vision:

### T Take the lead

- Shape the economic agenda and proactively identify new areas of opportunity.
- Anticipate ministerial needs and issues for the future and position ourselves to improve advice on key Government priorities.
- Respond quickly and innovatively to changing demands and circumstances.

### I Invest in our organisation and its people

- Encourage and develop effective leadership.
- Enhance the capability of our people, addressing any talent gaps to support our outcome priorities.
- Develop the systems, structures and processes required to become a more flexible and capable organisation.

### M Manage for outcomes

- Achieve results in the outcome areas where we know we can make a difference, through harnessing our collective capability.
- Achieve effective use of resources, by ensuring maximum focus in the areas of highest priority.
- Achieve continuous improvement in our core areas of business, through stretching and working smarter.

### E Engage effectively

- Consistently communicate a clear Treasury vision across the organisation.
- Work together as “one Treasury” in order to provide integrated policy advice to the Minister and Government.
- Develop strong external relationships that enable us to provide high-quality advice and deliver on our responsibilities in the most effective way.

## MAINTAINING AND DEVELOPING CAPABILITY

Over the past year, we've continued to focus on maintaining and developing the Treasury's capability, so we can provide even better economic and financial advice to Ministers. The T-I-M-E management objectives outlined on the previous page provide us with a broad framework for doing this.

### Taking the lead

#### Overview

The Treasury's role requires it to work across a very broad range of areas. This in turn makes it a real challenge for us to cover the areas we need to cover, while still anticipating emerging issues and meeting changing ministerial needs.

A main focus for us has therefore been on how we can position ourselves to best help Ministers shape economic and fiscal strategy, whilst providing leadership as a central agency across the entire public sector.

#### Our management objectives

- Shape the economic agenda and proactively identify new areas of opportunity.
- Anticipate ministerial needs and issues for the future and position ourselves to improve advice on key Government priorities.
- Respond quickly and innovatively to changing demands and circumstances.

#### Our progress

During the year we undertook several initiatives that demonstrated our ability to provide leadership as an organisation.

In 2005/06 the Treasury established a Strategy Unit to support the Chief Executive on strategic policy issues such as new, "next generation" or emerging issues facing New Zealand. An early priority for the Unit has been the identification of strategic challenges facing the New Zealand economy over the next 20-25 years (see box on page 32).

We responded to the heightened threat of a worldwide influenza pandemic by commissioning a pandemic preparedness work programme. This involved an examination of the potential economic impact, taking a coordination and leadership role for government-wide preparedness and managing Vote issues.

The annual Budget process is an important component of the Treasury's ongoing work to improve public sector performance, and provides an opportunity

for Ministers to ensure departmental activities are closely aligned with the Government's objectives. Budget 2006 was the first Budget to be organised in line with the Government's key themes (*Economic Transformation, Families – Young and Old* and *National Identity*) rather than sector-based allocations. This resulted in better cross-department and cross-sectoral trade-offs. The Treasury also used the Budget process to focus more closely on what departments were delivering with additional funding.

Efforts to improve collaboration and alignment between the three central agencies – the Treasury, DPIC and SSC – have continued this year. To give further impetus to this work, the three departments proposed that the scope for improving their contribution to the work of the wider public service be considered specifically, as part of the Government's Expenditure Reviews launched in March. This work is currently underway, led by a team of experienced external advisors, and a report to Ministers is expected in the first quarter of 2006/07.

Following the passage of the new Crown Entities Act (see box on page 25), there was significant interest from departments on how they could improve monitoring of Crown entities. The Treasury, together with SSC, established a departmental monitoring group which provides an opportunity for departments to share their experiences and learning with each other. It has also been a useful vehicle for central agencies to get a better understanding of the support that departments require.

The Treasury's Legal group, with assistance from SSC and the Crown Law Office, was instrumental in setting up a shared workspace known as Public Sector Law NZ. Launched in November 2005, the workspace was established to provide access to legal advice and precedents across the public sector. It continues to grow with just over 200 members in core government sector legal teams. The Treasury's Legal team is responsible for administration of the site.

Mailena Rawiri and Jane Meares from the Treasury's Legal group, who were instrumental in setting up a shared public sector legal workspace. In the background is the "Corporate Lawyer of the Year" trophy received by Jennifer Lynch (see page 36).



We continued to use invitations for external presentations and internal seminars to disseminate Treasury work more widely. Our guest lecture series enabled us to hear a variety of perspectives on relevant issues. In June 2006, the Treasury co-hosted a Macroeconomic Policy Forum with the Reserve Bank of New Zealand, bringing together domestic and international experts to evaluate the implications of macroeconomic imbalances that had emerged during the recent period of strong economic growth. The main purposes of the Forum were to test the robustness of New Zealand's macroeconomic policy frameworks and to evaluate opportunities to improve these frameworks or the way policy is operated within them. An edited version of the Forum's proceedings will be published and made available on the Treasury and Reserve Bank web sites.

### Challenges ahead

This is an area where we need to keep improving our ability to show leadership and to work strategically and responsively. To do this, it is imperative that we try to find ways to avoid our day-to-day work crowding out our capacity to think longer-term and our responsiveness to ministerial demands.

### An eye to the future

The Treasury's overarching vision of higher living standards for New Zealanders means that part of our role is to scan the horizon for future developments which may affect New Zealand's economic wellbeing – and to help governments ready the country for that future.

In order to inform and challenge the Treasury's thinking on future issues and opportunities facing New Zealand, the Strategy Unit held a series of semi-structured interviews with representatives from across the public and private sectors, as well as community and voluntary organisations.

The insights gathered from the interviews were used to supplement material from reviews of relevant research and literature in order to identify challenging issues which are likely to have a profound and pervasive impact on New Zealand and its economy. These issues include population ageing and demographic change, and the impact of globalisation and climate change.

The Treasury intends to further develop its understanding of these issues and their implications. We will also work with Ministers and government agencies to shape how the issues unfold, to position New Zealand and our economy to take advantage of important opportunities and to mitigate significant risks.

Not every issue we identified is one for which the Treasury has primary responsibility. As a central agency, the Treasury has a strong interest in the quality and robustness of policy advice tendered by all public sector agencies. That's why we have been actively working with other organisations — both public and private sector — who are engaged in futures scanning, sharing our work and learning from theirs.

## What's the point of speculating about the future? Isn't it inherently unknowable?

Thinking about the future and exploring plausible possibilities have several potential benefits:

### Preparedness

Thinking about and analysing possible futures can lead to better decisions later when there simply may not be enough time for full consideration of the policy options. Pandemic planning is an example of this.

### Timely policy-making

Sometimes policy changes are needed today if we are to be prepared for the future. An example is managing the fiscal costs of population ageing and health technology.

### Robustness

Good policy is robust under a range of possible futures. Sometimes the future operating environment turns out differently from expectations. So it is useful to consider a policy's effectiveness under a range of plausible futures.

### Anticipation

Thinking about potential future operating environments and the drivers of change can heighten awareness of signals in the current environment that may indicate how the future is unfolding – and therefore allow earlier action.



Scanning the future economic horizon – Anand Kochunny, Charles Tallack, Bryan Dunne, Brian McCulloch, Kirsty Hutchison, Rachel Grove, Tracy Mears and Struan Little.

## Investing in our organisation and its people

### Overview

Our success depends on maintaining and developing a talented workforce and making full use of their experience and expertise.

#### Our management objectives

- Encourage and develop effective leadership.
- Enhance the capability of our people, addressing any talent gaps to support our outcome priorities.
- Develop the systems, structures and processes required to become a more flexible and capable organisation.

### Our progress

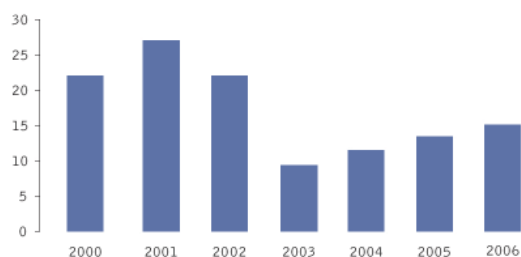
#### Changing staff profile

The Treasury employed 303 staff at the end of June 2006, a decrease from 320 the previous year. We also seconded 17 staff to various agencies and had 45 staff on leave without pay, including parental leave.

Staff turnover was 15.4% compared with 13.2% last year. The average length of service increased from 6.2 years in 2004/05 to 6.6 years as at 30 June 2006, and the proportion of staff staying more than one year increased from 84% at 30 June 2005 to 86% this year. The profile of our economic and financial analysts has shifted over recent years, with an increasing proportion of analysts in senior analyst and principal advisor roles.

#### TREASURY STAFF TURNOVER

% turnover at 30 June



The percentage of women in the Treasury has increased over recent years to stabilise around the current level of 47% at the end of 2005/06. Māori comprise 5.3% of Treasury staff, with Pacific Island people representing a further 2.6%.

Each year our Graduate Recruitment Programme brings new faces and fresh thinking to the Treasury. The programme attracts graduates from a range of academic disciplines who possess an incisive, questioning intellect and enjoy open and lively debate while operating in a challenging environment.

During 2005/06, 12 Graduate Analysts joined the Treasury in one of our five branches. Upon joining the Treasury, Graduate Analysts are immediately involved in a wide range of interesting work areas and are working with, and providing advice to, other government departments.

#### A flexible approach to work

The Treasury has recognised the need to help employees balance their work and personal lives within the context of meeting our business objectives. We employ

a number of best practice work/life balance initiatives, including opportunities for flexible working arrangements, assistance for staff with childcare responsibilities and reimbursement for health and fitness-related memberships.

Flexible working arrangements at the Treasury may be ongoing or temporary and can include a combination or variation of:

- different hours of work
- different working days of the week
- working off-site
- extra leave – for example, short-term leave without pay or the exchange of salary for extra annual leave.

Support for flexible working was enhanced during the year through the simplification and increased availability of remote computing facilities, along with the adoption of wireless technologies.

With flexible working arrangements available, the percentage of staff working fewer than full-time hours has increased to 14.5% in June 2006 from 6.9% in June 2002.

### Enhancing organisational systems, structures and processes

With personnel costs representing approximately 65% of our total expenses, good human resource information is vital. In 2005/06 the Treasury committed to sourcing a new software system and this will be further considered in terms of suitable products and suppliers at the end of 2006.

We continued to leverage our investment in intranet portal tools, utilising collaborative workspaces and a range of sophisticated techniques to support core business processes. For example, the Budget Workspace provided Vote Analysts with timely, convenient access to the latest guidance material, and ensured consistency of process across all areas of the Treasury.

Online access to the most relevant external information sources has been enhanced throughout the year with new services such as a full-text social sciences database. Staff have been trained to use these services effectively.

We responded to the heightened threat of a worldwide influenza pandemic by taking steps to ensure our critical operations will be able to continue in such an event. We reviewed our off-site data centre facilities to ensure critical operations such as NZDMO banking system transactions can continue in the event of the temporary loss of infrastructure at the Treasury building. This review prompted a number of improvements, such as greater use of mobile computers, which will be implemented over the coming year.

### Challenges ahead

The key challenges ahead focus around supporting the current work to improve the way the Treasury operates as an organisation. Much of this work will be about changing and adapting behaviours. This will impact on Development Centre work and other HR policies and practices.

### Staff achievements

Acting Treasury Solicitor and Legal Group Manager **Jennifer Lynch** received the “Corporate Lawyer of the Year” award from the Corporate Lawyers Association of New Zealand. Sadly, Jennifer passed away in March 2006, and the award was accepted on her behalf by Senior Treasury Solicitor Jeremy Salmond at the Association’s annual conference in May 2006. Jennifer joined the Treasury in 1988 and worked on a number of important projects, including the Auckland Rail project and the corporatisation of Crown research institutes. The “Corporate Lawyer of the Year” award is granted to an in-house lawyer who has made an outstanding contribution to their employer and to the legal profession.

Treasury staff take time out from their day to enjoy a lunchtime yoga class in the Whareniui.



Senior Analyst **Mary Slater** was joint winner of the Prime Minister’s Prize in Public Policy Studies at Victoria University’s School of Government. The

prize is awarded annually to the best student in the Master of Public Policy programme. Mary received her award from Prime Minister Rt Hon Helen Clark in October 2005. Her research involved an evaluation of the decision not to devolve public health funding to District Health Boards when the health reforms set out in the New Zealand Public Health and Disability Act 2000 were implemented.

Justice and Welfare Manager **Iain Cossar** completed the Speight’s Multisport Coast to Coast race, the world’s premier multisport event. Competitors traverse the South Island over two days by cycling 140 kilometres, running 36 kilometres and kayaking 67 kilometres. Iain completed the event in a total time of 15 hours and seven minutes.

Tech Solutions Manager **Franz Ombler** developed *He Kupu o te Rā* – a “Word of the Day” service for Te Reo Māori – with Kelly Keane, Teaching Fellow at Te Kawa a Maui, the Victoria University School of Māori Studies. The service enables users to receive daily word updates by email, news feed or mobile phone text. Franz developed the service in his spare time while learning Te Reo Māori. In 2005/06, Franz also received the KJ Scott prize from Victoria University. The prize is awarded annually to a student who completes a Bachelor of Arts degree majoring in Politics and is deemed to be the best student of the year.

### Taking a smarter approach to learning and development

In mid-2005 the Treasury established the Development Centre, a centralised learning and development unit within the Human Resource and Organisational Development team. The Centre provides coordinated and responsive learning and development opportunities for Treasury staff through the design and management of programme delivery.

In 2005/06 the Development Centre's focus has been on three priority areas: management and leadership, relationship and communications, and technical capability.

Technical capability design has been targeted at ensuring all staff have a good understanding of the basic technical skills required of an analyst, and are familiar with key policy frameworks and analytical tools used by the Treasury. The programme has included the design and delivery of:

- Introductory Micro and Macro Economics courses
- Introductory Financial Management and Accounting
- Applied Policy and Business Analysis, a three-day, off-site programme for new policy staff. One of the first programmes to be offered by the Development Centre, the course covers topics such as government systems and the policy process, public sector management, organisation and business analysis, growth and policy analysis. It was developed internally and is run by Treasury staff. Feedback on the course has been extremely positive and it is expected to remain one of the core technical programmes offered by the Development Centre in future.

The management and leadership programme has focused on team leader development and the development of managers who are new to the role or to the Treasury.

Other key programmes have focused on meeting facilitation and presentation skills.

An intranet portal enables staff to access information about Development Centre courses, register online and provide course feedback. This mechanism has increased feedback by over 50%, providing richer information that is essential to ensuring high-value programmes for staff.



The Development Centre team – Kathryn Fraser, Sarah Colquhoun and Maxine Walker (absent: Sophie Mellor).

## Managing for outcomes

### Overview

In 2005/06, our main focus was on the continued development and improvement of the Assessing our Performance framework to help support and reinforce our focus on managing for outcomes. This process is encouraging a more outcome-based progress review and enabling more dynamic resource reprioritisation. Much effort was also put into identifying and improving performance, impact assessment and capability measures.

### Our management objectives

- Achieve results in the outcome areas where we know we can make a difference, through harnessing our collective capability.
- Achieve effective use of resources, by ensuring maximum focus in the areas of highest priority.
- Achieve continuous improvement in our core areas of business, through stretching and working smarter.

### Our progress

The Managing for Outcomes framework has enabled us to be more focused on our work priorities and better at recognising how to best align resources to support them. In 2005/06, we developed this framework even further, and the current strategic direction work will continue to inform and drive that development.

In addition, we have adopted an incremental “learning by doing” approach and regularly review, update and develop our performance measures. In doing this we are attempting to improve alignment between the Treasury’s strategic priorities, branch objectives and section goals to clarify overall direction and performance expectations at every level.

In terms of our financial management, we aim for a 0% to 3% year-end underspend – this encourages us to budget and prioritise effectively and to make effective and efficient use of the resources available to us, while not exceeding our appropriation. For 2005/06, the Treasury had an underspend of 3.4%, which was just outside our desired 0% to 3% range. During 2005/06 we returned \$0.6 million to the Crown and reprioritised our work to support new initiatives.

### Challenges ahead

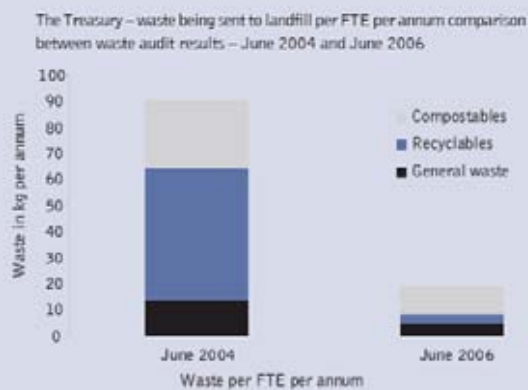
An ongoing challenge will be to ensure the Treasury is able to respond quickly and be flexible in moving resources to areas of highest priority. This includes being prepared to meet new resource requirements that may be identified by the work that is underway to improve the way the Treasury operates as an organisation. A review of planning, delivery and reporting requirements will also be commissioned in the year ahead. We will also review our output structure and streamline our management of outcomes and cross-Treasury projects.

Looking ahead, we also see strong potential for continued collaboration with other agencies on shared outcomes, especially in identifying opportunities to work with central agencies to improve public sector effectiveness.

## Reducing our impact on the environment

An important goal for the Treasury is to incorporate sustainable business practices into our day-to-day work, thereby contributing to a more sustainable economy, environment and society. Our initial focus is environmental sustainability.

In 2003/04, the Treasury identified that one of the major environmental impacts of our business was the amount of waste being sent to landfill – about 90 kilograms per full-time employee, according to a June 2004 waste audit. Of that waste, almost 85% was recyclable material. From this data, the Treasury set itself the goal of reducing waste to landfill by 50% during the 2005/06 financial year.



A comprehensive pilot recycling system was established on Levels 7 and 8 of No 1 The Terrace. After much refinement of the original system, positive feedback from staff and a noticeable reduction in waste going to landfill, the recycling system was rolled out across the entire organisation. The Treasury café also began recycling in July 2006.

The results of a second waste audit in June 2006 exceeded all expectations, with an 80% reduction in the amount of waste going to landfill.

The Treasury's comprehensive recycling system includes separation of:

- paper
- cardboard
- compostable material (including food and paper hand towels from bathrooms)
- mixed recyclables (including glass, cans, and plastics 1 and 2)
- printer toner cartridges
- general non-recyclable waste.



Treasury staff carry out a waste audit in June 2006, following the introduction of a comprehensive recycling system at No 1 The Terrace.

## Engaging effectively

### Overview

Engaging effectively both within the Treasury and with our external stakeholders continues to be a priority. A key emphasis has been on coordinated and consistent staff communications – so that all staff can link strategic initiatives to their own work and be clear about how they fit into the overall picture. Externally, we continue to explore ways to build and retain good relationships across a range of stakeholders.

### Our management objectives

- Consistently communicate a clear Treasury vision across the organisation.
- Work together as “one Treasury” in order to provide integrated policy advice to the Minister and Government.
- Develop strong external relationships that enable us to provide high-quality advice and deliver on our responsibilities in the most effective way.

### Progress

Over the past two to three years, our stakeholder relations activity has been guided by the outcomes set out in our stakeholder communications plan:

- Being perceived as an effective and influential policy ministry.
- Demonstrating leadership, and working cooperatively across the public sector.
- Having strong links to a wide range of stakeholders both within and outside Wellington.
- Having a reputation and internal culture that enable us to attract and retain staff with the skills and experience we need.

In 2005/06, we have looked to bed down some of the initiatives developed during that time with our internal and external stakeholders.

### External outreach

We identified and took up a number of speaking opportunities for the Secretary and other members of the senior management team. A growing proportion of these speaking engagements are generated proactively by the Treasury, which helps to ensure they are high value and well targeted to our stakeholder priorities.

The Treasury was one of 18 sponsors of the Climate Change and Governance Conference organised by the Institute of Policy Studies and held in Wellington in March 2006. Some 200 stakeholders attended the conference, which explored the nature and likely impact of climate change, and options for accelerated action by governments, business and the wider community. Held over two days, the conference featured prominent scientific and policy experts from both New Zealand and overseas. It also included a live video link by British Prime Minister Tony Blair, who was visiting Auckland at the time.

Our Business Relations group, made up of representatives from each of the five branches, is charged with taking a strategic, cross-Treasury approach to relationships with the business sector. Work in 2005/06 focused on a core programme of Auckland relationship-building, the development of appropriate systems to support and encourage sharing of information and the coordination of key relationship management, and engagement with groups such as Treasury alumni.

Our research and policy work was made regularly available as Working Papers on our internet site and through direct contact with media, and we promoted debate on policy implications through seminars, workshops and other channels. We also engaged directly with media and other interest groups on key work such as the *Statement on the Long-Term Fiscal Position* – an engagement process that will be ongoing ahead of the next Statement due by June 2010.

We continued to send regular email newsletters to Treasury alumni in New Zealand and around the world, to develop and maintain links with former staff.

The Treasury's web site presence remains a key source of information for our stakeholders. As a result of a detailed review in 2005, a major redevelopment of all Treasury-managed web sites was initiated, and a new-look primary Treasury site ([www.treasury.govt.nz](http://www.treasury.govt.nz)) and secondary sites (including [www.nzdmo.govt.nz](http://www.nzdmo.govt.nz) and [www.nzeco.govt.nz](http://www.nzeco.govt.nz)) are expected to be launched in early 2007.

### Public sector

We contributed to a number of whole-of-Government initiatives, including work on climate change, KiwiSaver, pandemic planning and the Ministerial Expenditure Review group.

During the year the Treasury led a project where DPMC, SSC and the Treasury shared staff directory information to help foster collaboration amongst the central agencies. All employees now have the ability to look up the names, email addresses, phone numbers, positions and job functions of other central agency staff.

### Internal engagement

Clear, consistent and regular internal communication remains a key priority. The strategic direction work has seen an increased focus on Treasury-wide communication, including regular use of “all staff” meetings and other face-to-face contact. The intranet is also one of our core communication tools for organisation-wide information, and is used in a variety of ways to encourage engagement across the Treasury.

### Challenges ahead

While we have made good progress in recent years, there is more we can do to capitalise on relationships with key stakeholders. More work is needed to ensure that we engage early and well on important issues, that we have relationships with depth and breadth across the public and private sectors, that we engage well with business and political media, and that our senior management is visible and accessible.

On internal communications, our challenge is to ensure that we are clear with staff about the implications of our strategic direction for their day-to-day work. A comprehensive programme of consultation and communication will continue for much of the 2006/07 year.

### Treasury internet review

A comprehensive review of the Treasury's internet presence is almost complete, with new-look Treasury web sites expected in 2007.

The primary Treasury web site was established more than 10 years ago to provide online access to the Budget and the Government's financial statements. Since then, the site has grown to become a key means by which the Treasury communicates with external audiences and the wider public. Together with the Treasury's secondary web sites – which include the New Zealand Debt Management Office and the New Zealand Export Credit Office sites – it has become the “window” through which the organisation and its work are seen by the rest of the world.

The web site review was initially aimed at ensuring Treasury compliance with the New Zealand Government Web Guidelines, but has also provided an opportunity to assess the Treasury's internet presence more generally, with key aspects such as accessibility and navigation, content and design under review.

The project is being managed by Knowledge Infrastructure Services and Communications, and will see a new content management system and “look” in place on all Treasury web sites next year. Visitors to the revamped sites can expect easier and faster navigation, including a better search engine and publication indexes; more up-to-date and topical information on current Treasury work programmes; and greater consistency and clarity in design, content and language.



Working on the Treasury's internet review – Helena Brow, Gavin Hamilton and Rose Wilton.

## ORGANISATIONAL RESPONSIBILITIES

The Treasury is led by John Whitehead, the Secretary to the Treasury, and comprises five branches. Each branch has a specific focus; however, there is a great deal of interaction across the Department.

### Asset and Liability Management Branch

#### Mike James

The Asset and Liability Management Branch has both operational and policy advice functions. The Branch:

- manages the Crown's debt, overall cash flows and interest-bearing deposits through NZDMO
- advises Treasury Ministers on public sector financial management systems and managing commercial, contractual and litigation risks on behalf of the Crown. The Branch also provides policy advice on managing and negotiating Treaty of Waitangi claims
- advises on the Crown's ownership interests and obligations in respect to SOEs, Crown companies, Air New Zealand and CFIs.

Senior managers –  
Peter Bushnell, Peter Mersi, Angela Hauk-Willis, John Whitehead, Iain Rennie and Mike James.



## Budget and Macroeconomic Branch

### Peter Bushnell

The Branch has three broad lines of work that include:

- advising the Government on Budget strategy, design, process and management; preparing fiscal projections and the Crown financial statements; and reviewing departmental financial management systems to provide assurance that there is a reasonable system of internal control
- monitoring the economic situation, preparing macroeconomic and tax forecasts and providing advice on macroeconomic policy
- advising on Crown accounting policies.

## Regulatory and Tax Policy Branch

### Iain Rennie

The Regulatory and Tax Policy Branch advises Ministers on regulatory issues with important economic consequences. These include environmental policy, competition and trade policy as well as transport, local government, land use and natural resources.

The Branch also advises on the structure and operation of a range of government departments and entities in these areas.

Tax policy advice covers the level and mix of direct and indirect taxes, the taxation of international income and the taxation of particular types and sectors of business.

The Branch is also home to the newly formed Policy Support and Analysis Section (PSAS). This section is a strategic resource that works across the Treasury providing the policy advice sections with high-quality support through empirical analysis and development of appropriate analytical frameworks.

## Social Policy Branch

### Peter Mersi

The Social Policy Branch advises Ministers on the purchase and regulation of social services and public goods, ranging from education and health services to labour market policies, social support services, housing and law enforcement. These are all areas involving a large share of government expenditure.

In addition to advice on spending proposals, the Branch reports on the budgets and financial performance of government agencies.

The Branch provides advice to give assurance to Finance Ministers about departmental proposals. It advises the Minister of Finance on policy developments in the area of social policy and often participates in interdepartmental working parties on reform proposals.

## Corporate Branch

### Angela Hauk-Willis

The Corporate Branch provides advice to the Chief Executive and senior managers on corporate strategy, policies and practices for the Treasury. The Branch also provides services and specialist advice in relation to finance and planning, human resources, risk management, communications, legal and knowledge management.

The Branch is also home to the newly formed Strategy Unit, whose role is to support the Chief Executive on strategic policy issues. The Strategy Unit maintains an overview across Treasury policy development, identifies important emerging issues, and provides high-quality and concise analysis of the issues aimed at advising how work should be taken forward by the relevant sections across the organisation.

As at 30 June 2006 we had the following number of staff in each of the branches, compared with the previous year.

	2005	2006
Asset and Liability Management Branch	57	51
Budget and Macroeconomic Branch	57	46
Corporate Branch*	82	78
Regulatory and Tax Policy Branch	62	75
Social Policy Branch	62	53
Full-time Training	-	-
Total Treasury Staff	320	303

\* Corporate Branch includes the Secretary to the Treasury's office.

## VOTE FINANCE AT A GLANCE

Actual expenditure for 2005/06 by output



# OUTPUT PERFORMANCE – VOTE FINANCE

Statement of Service Performance section 45A of the Public Finance Act 1989

## Budget Management

This class of outputs covers the development of Budget strategy, and the management and delivery of the Budget process. These outputs contribute to an efficient, effective and innovative State sector by providing credible public sector management and decision-making systems that encourage value for money.

In addition to managing the annual Budget, outputs include the provision of advice to identify and implement further improvements in the design of the Budget process. The focus is on:

- implementing changes arising from the passage of the Public Finance Amendment Act 2004
- improving linkages between the allocation of resources and achieving desired results.

## Significant work completed during the year

- Prepared Budget-related legislation including the Appropriations Bills, Imprest Supply Bills and Financial Review Bill.
- Undertook work to implement aspects of the Public Finance Amendment Act.
- Provided advice on the strategy for managing Budget 2006, including spending allocations and other ways to manage pressures.
- Provided detailed advice on managing individual initiatives as part of Budget 2006.
- Prepared the Budget Executive Summary and Estimates (Supplementary and Mains) documentation.
- Introduced a government-wide system to automate the publication of the Estimates Vote chapters, encompassing the new provisions of the Public Finance Act.

Service performance\*

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Outputs produced under this output class:                             <ul style="list-style-type: none"> <li>will meet the agreed standard for publication of parliamentary papers</li> <li>will be prepared within the Budget timetable set by the Government and the statutory time limits of the Public Finance Act 1989.</li> </ul> </li> </ul>	<p>Met and frequently exceeded expectations</p> <p>✓</p> <p>✓</p>
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.</p>	<p>✓</p>
<p><b>Timeliness</b></p> <p>All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.</p>	<p>✓</p>

Cost (\$000)

2005/06 Actual	2,225
Supp. Est. - Voted	2,303
Main Est.	2,359
2004/05 Actual	2,456

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$78,000 or 3% under Supplementary Estimates budgets. The appropriation for this output class was decreased by \$56,000 in the Supplementary Estimates.

\* General service performance objectives are detailed on pages 68 to 69.

## Debt and Related Financial Asset Management

This class of outputs contributes to achieving an optimal Crown balance sheet and concerns the operational management of the Crown's portfolio of sovereign-issued debt and associated financial assets. All expenses are incurred under section 61 of the Public Finance Act 1989. Specific activities include:

- developing and maintaining an appropriate framework for efficiently managing the portfolio and the risks associated with it
- issuing domestic-currency debt to meet the Government's funding requirements
- disbursing cash to departments and facilitating departmental cash management
- advancing funds to government entities in accordance with Government policy
- providing capital market services and derivative transactions for departments and government entities
- funding the Reserve Bank's foreign-exchange reserves
- managing foreign-currency assets required to meet net foreign-currency interest and principal payments
- maintaining hedges of foreign-currency debt that cannot be bought back from investors.

### Significant work completed during the year

- Issued \$2,355 million of Government bonds to meet the Government's funding requirements.
- Completed \$2,862 million of interest-rate swaps and \$1,280 million of foreign-currency swaps under NZDMO's swap programme.
- Completed \$43.6 billion of foreign-currency transactions (including foreign-currency swaps) for the New Zealand Superannuation Fund (NZSF).
- Provided USD230.7 million and EUR433.1 million in loans to the Reserve Bank of New Zealand (RBNZ) under new funding arrangements to support the Bank's build-up of foreign-currency reserves.
- Completed the implementation of registry arrangements for the new immigration investor policy announced on 16 June 2005, as a joint project with the Department of Labour.
- Established a new strategic advances portfolio in July 2005 for all new lending to Crown housing entities and district health boards.
- Executed a new loan agreement with RBNZ for funding foreign-exchange intervention on a short-term basis.
- Undertook hedging of the Crown's share of foreign-exchange exposure associated with hosting the 2011 Rugby World Cup (RWC). Also entered into a foreign-exchange exposure management agreement with the New Zealand Rugby Union (NZRU) to document the conditions under which NZDMO and NZRU would independently manage their respective shares of the foreign-exchange risk from hosting the RWC.
- Exercised the Crown's right to repay CHF57.3 million of outstanding Swiss Franc bonds originally issued in 1986 by the New Zealand Railways Corporation.

- Implemented two changes to Government Kiwi bonds; the first to dispense with an interest-rate differential (previously 50 basis points) for investments under \$5,000, and the second to discontinue the four-year maturity.
- Coordinated the visit in June 2006 of international credit rating agency Standard & Poor's (S&P). New Zealand is currently rated AA+ by S&P.
- Participated in a work programme to advance a "central agency" shared outcome aimed at improving the performance of the State sector.
- Completed a review of the rate of return assumptions to be applied to CFIs.
- Completed work measuring the risk and return properties of the Government's overall balance sheet.

### Service performance\*

Performance Dimensions	Achieved?
<b>Quality</b>	
<ul style="list-style-type: none"> <li>• All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> </ul>	Met and frequently exceeded expectations
<ul style="list-style-type: none"> <li>• The Secretary to the Treasury will monitor the operation of NZDMO with the assistance of an Advisory Board. Performance in portfolio management, debt issuance, capital market transactions and advice, transactional processing, and compliance with risk management policies will be reported regularly to the Secretary to the Treasury and the Advisory Board, and to the Minister in the context of the Treasury's three times a year reporting to the Minister.</li> </ul>	✓
<ul style="list-style-type: none"> <li>• Policies regarding the strategic objectives for domestic- and foreign-currency debt, instruments and currencies for transactions, limits in respect of market and credit risk utilisation, composition requirements for the liquidity asset portfolio, and maturity profile requirements will be adhered to.</li> </ul>	✓
<ul style="list-style-type: none"> <li>• Policies, delegations, limits, reporting and performance management requirements, procedural manuals, and established processes, and other controls for managing internal operations will be adhered to.</li> </ul>	✓
<ul style="list-style-type: none"> <li>• Issuance of domestic-currency debt will be transparent and predictable.</li> </ul>	✓
<b>Quantity</b>	
The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.	✓
<b>Timeliness</b>	
All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.	✓

### Cost (\$000)

2005/06 Actual	3,721
Supp. Est. - Voted	3,791
Main Est.	4,352
2004/05 Actual	4,218

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$70,000 or 2% under Supplementary Estimates budgets.

The appropriation for this output class was decreased by \$561,000 in the Supplementary Estimates due largely to lower information and other operating costs.

\* General service performance objectives are detailed on pages 68 to 69.

## Economic and Fiscal Forecasting and Reporting

This class of outputs involves the preparation of macroeconomic and fiscal forecasts, and the monitoring of economic and fiscal conditions.

Economic and fiscal updates are published in the middle of the financial year (typically in December) and at the time of the Budget (typically in May). Monitoring outputs include reports on major economic data releases and preparation of the annual and monthly financial statements of the Crown. In addition, the Minister is provided with regular assessments of how current events are affecting the economic and fiscal outlooks since the last update as an aid to Budget decision-making.

The outputs also include advice on the application and development of generally accepted accounting practice (GAAP) as it applies to the Crown. It also includes assessments of the adequacy of departmental management controls to detect or prevent errors in the financial information submitted to the Treasury.

These outputs contribute to the understanding by Ministers, Parliament and the public of the expected and actual consequences of government decisions, by entity and in the aggregate.

### Significant work completed during the year

- Prepared and published the *2005 Pre-Election Economic and Fiscal Update*, *2005 Half-Year Economic and Fiscal Update* and *2006 Budget Economic and Fiscal Update*.
- Provided analysis on the possibility and likely impact of a revaluation in the Renminbi (the Chinese currency); developments in the current account; and other forecasters' views of future economic developments.
- Regularly reported on domestic and international economic developments through the *Monthly Economic Indicators (MEI)* reports and *Weekly Economic Update* briefs.
- Commissioned external consultant to review Treasury's tax forecasting processes. Consultant's report and recommendations on areas for process improvements completed in October 2005.
- Prepared the Annual Crown Financial Statements for the 12 months ended 30 June 2005.
- Published BEFU 2005 and DEFU 2005 forecasts in System of National Accounts (SNA) format.
- Submitted the 2005 Government Finance Statistics (GFS) return to the IMF for the 2004 year and revised the 2003/04 return.
- Issued draft accounting policies and data requirements to entities for NZIFRS implementation for Crown reporting.
- Provided submissions to, and representation on, the FRSB/IASB on financial reporting standards and their applicability to public benefit entities.
- Project managed 2005/06 departmental internal control evaluations (DICE).
- Prepared and monitored imprest supply requirements and maintained the requirements of the controller function.
- Maintained daily operational activity for bank and trust account delegations and for cash payment schedules.
- Published a *Guide to the Public Finance Act*.

## Service performance\*

Performance Dimensions	Achieved?
<b>Quality</b> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Forecasting publications produced under this output class will meet the requirements of the Public Finance Act 1989.</li> <li>The Crown financial statements will conform with GAAP and fairly reflect the operations, cash flows and financial position of the Crown for the year ending 30 June 2005, the quarter ending 30 September 2005, and at monthly intervals after that until the end of the financial year.</li> <li>The monitoring report on appropriations for the Auditor-General (the Controller function report) will be prepared and forwarded to the Auditor-General on a monthly basis as required by the Public Finance Act 1989.</li> <li>Delegations for the management of foreign-exchange risks, Crown bank accounts and trust money will be managed to ensure that the conditions of the delegations are not breached and that they permit financial activity to be authorised at an appropriate level.</li> <li>Management statements required under section 29 of the Public Finance Act 1989 will be signed within the time limits set out in that Act and will be supported by analysis and reviews of departmental financial management.</li> </ul>	Met and frequently exceeded expectations ✓ ✓ ✓ ✓ ✓
<b>Quantity</b> The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.	✓
<b>Timeliness</b> All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.	✓

## Cost (\$000)

2005/06 Actual	5,939
Supp. Est. - Voted	5,972
Main Est.	6,107
2004/05 Actual	6,052

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$33,000 or 1% under Supplementary Estimates budgets.

The appropriation for this output class was decreased by \$135,000 in the Supplementary Estimates.

\* General service performance objectives are detailed on pages 68 to 69.

## Management of Claims Against the Crown, Contractual Liabilities and Crown Properties

This class of outputs involves managing a range of commercial, contractual and Treaty of Waitangi-related claims against the Crown. Outputs contribute to minimising Crown financial risk within the bounds of Government objectives. Specific outputs include:

- management of commercial and contractual risks associated with the 1973 Maui Gas Contract, including the operation of the gas notification system with downstream gas users
- management of contractual and commercial issues arising from completed asset sales and wind-up of the Crown's previous ownership interests in SOEs, Crown companies and other entities
- advice on the management of historical claims under the Treaty of Waitangi and assistance with the Crown's negotiation of specific settlements
- provision of legal title to land sold to SOEs and other Crown companies as a part of their sale and purchase agreements with the Crown
- management of New Zealand House, London
- management of the export credit guarantee policy and scheme.

Specific outputs often depend on the actions of third parties.

### Significant work completed during the year

- Concluded negotiations to protect the Crown's Maui gas position under open access to the Maui pipeline.
- Provided advice on various historical Treaty claims.
- Provided advice on the Government's commitments to Rugby World Cup 2011 including negotiating with the New Zealand Rugby Union to develop incorporation documentation for the Tournament Management Vehicle to run the tournament.
- Provided advice on compensation to New Zealand Cricket for the cancellation of the Zimbabwean tour.
- Progressed settlement of Ralph Estate claim against the Crown and Solid Energy in respect of coal royalties, including taking key issues to arbitration.
- Progressed transfer of land access rights at Wairakei Thermal Park to Contact Energy.
- Continued the programme of identifying and transferring legal land title to various SOEs and other companies.
- Continued management of the Export Credit Office operations, with maintained emphasis on communications and marketing.
- Continued management of weathertight homes litigation against the former Building Industry Authority.
- Managed New Zealand House, London, including investigating options to refurbish the property over the medium term.

Service performance\*

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Outputs produced under this output class will:                             <ul style="list-style-type: none"> <li>explore all opportunities to reach a satisfactory settlement of liabilities within parameters set by Ministers</li> <li>meet the Treasury’s policies and procedures for the employment of advisors and consultants</li> <li>meet the Crown’s contractual responsibilities and enforce the Crown’s contractual rights.</li> </ul> </li> <li>The Secretary to the Treasury will monitor the operation of the ECO with the assistance of an Advisory Board. It is expected that performance will conform with international best practices for the provision of export credit insurance.</li> </ul>	<p>Met and frequently exceeded expectations</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.</p>	<p>✓</p>
<p><b>Timeliness</b></p> <p>All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.</p>	<p>✓</p>

Cost (\$000)

2005/06 Actual	2,381
Supp. Est. - Voted	2,806
Main Est.	2,279
2004/05 Actual	2,295

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$425,000 or 15% under Supplementary Estimates budgets. This variance was due mainly to less demand for Export Credit Office outputs than anticipated and consulting services not being required during the financial year.

The appropriation for this output class was increased by \$527,000 in the Supplementary Estimates owing largely to expected increases in demand for Building Industry Authority and Maui gas monitoring outputs.

\* General service performance objectives are detailed on pages 68 to 69.

## Policy Advice: Financial and Public Sector Management Systems

This class of outputs involves policy advice on financial and public sector management systems in use across the Crown and contributes to:

- improved decision-making and performance management systems that facilitate the effective and efficient use of State resources and regulatory powers
- efficient management of the Crown's assets and liabilities.

It covers the development and design of specific public sector management regimes applicable to departments and Crown entities. It also includes the development of financial policy that takes into account the Crown's overall pattern of expenditure, revenue, assets, liabilities and risks, in order to minimise the economic costs through time arising from financing a given profile of government expenditure.

Outputs will specifically include advice on:

- the governance, incentives, operating framework and reporting systems for departments and Crown entities to ensure effective performance and accountability relationships between entities and their stakeholders
- the range and nature of financial risks to which the Crown is exposed and the degree to which these can be managed more efficiently when considered as part of an integrated set of risks, assets and liabilities across the Crown.

### Significant work completed during the year

- Commissioned an external report on Crown balance sheet management, which considered where changes to balance sheet management policies are likely to lead to material improvements in fiscal or economic outcomes.
- With SSC, provided advice and support to Ministers, departments and Crown entities on the provision of the new Crown Entities Act, including:
  - development of guidance to departments on monitoring Crown entities
  - preparation of guidance for Crown entities on statements of intent and managing for outcomes
  - the development of updated Cabinet Office Circulars *Roles and Responsibilities of Ministers in Relation to Crown Entities*; and *Process for Whole of Government Directions*
  - the establishment of a Crown entity monitoring group
  - reporting to the Ministers on Crown entity financial powers.
- With SSC, reported to the Minister of State Services on review of NGO contracting practices in selected departments.
- Negotiated reporting and governance arrangements for the Joint Therapeutics Authority with Australia.
- Updated annual report guidance for departments.
- Updated SOI guidance for departments.
- Supported the continued roll-out of the Public Finance Act changes.

Service performance\*

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <p>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</p>	Met and frequently exceeded expectations
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.</p>	✓
<p><b>Timeliness</b></p> <p>All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.</p>	✓

Cost (\$000)

2005/06 Actual	2,328
Supp. Est. - Voted	2,444
Main Est.	2,952
2004/05 Actual	3,006

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$116,000 or 5% under Supplementary Estimates budgets owing to staff vacancies and staff working on the Central Agencies Review within the Policy Advice: Regulation and Vote Purchase, Ownership and Performance Issues output.

The appropriation for this output class was decreased by \$508,000 in the Supplementary Estimates owing to unfilled staff vacancies and the capitalisation of personnel costs utilised in the development of the tax modelling system.

\* General service performance objectives are detailed on pages 68 to 69.

## Policy Advice: General Economic and Fiscal Strategies

This class of outputs involves policy advice on the Government's broad economic strategy and macroeconomic policy settings, and their effect on living standards for New Zealanders.

This includes advice for the Government on strengthening the fiscal policy framework and reporting on monetary policy developments.

General economic and fiscal strategy requires empirical and analytical research to support and inform policy advice. Outputs include research and policy advice with a medium-term perspective, taking account of the characteristics of the New Zealand economy. This research and policy advice will focus on how to improve New Zealand's economic performance, looking at growth, productivity and macrostability issues.

### Significant work completed during the year

- Completion of the Briefing to the Incoming Minister following the 2005 election.
- Produced the 2006 Budget Policy Statement and 2006 Fiscal Strategy Report.
- Published a Policy Perspectives Paper outlining the modelling approach used in the *Statement on the Long-Term Fiscal Position*.
- Produced and tabled in the House the *Statement on the Long-Term Fiscal Position*. Undertook associated communication and briefing work.
- Planned, hosted and participated in the International Monetary Fund Article IV mission to New Zealand, including preparing briefing material and following up questions to the satisfaction of Fund staff. Final staff report was published in early May.
- Produced policy advice on the Government's fiscal and macroeconomic strategy as input into the 2006 Budget. This included analysis and advice relating to the increase in price pressures in the economy, the increase in the current account deficit, and developments in offshore demand for New Zealand-dollar assets and its impact on the New Zealand dollar.
- Completed, with the Reserve Bank, a review of policy instruments that could be used to supplement monetary policy. The Supplementary Stabilisation Instruments Report with associated recommendations was forwarded to the Minister of Finance in March, and followed up with a joint Macro Policy Forum that explored current macroeconomic policy issues.
- Produced research, analysis and reports on household savings, household wealth and housing affordability.

Service performance\*

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Fiscal publications produced under this output class will meet the requirements of the Public Finance Act 1989.</li> </ul>	<p>Met and frequently exceeded expectations</p> <p>✓</p>
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.</p>	<p>✓</p>
<p><b>Timeliness</b></p> <p>All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.</p>	<p>✓</p>

Cost (\$000)

2005/06 Actual	4,397
Supp. Est. - Voted	4,650
Main Est.	4,168
2004/05 Actual	3,972

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$253,000 or 5% under Supplementary Estimates budgets due to unexpected staff vacancies and resources being diverted to growth-related outputs in the Policy Advice: Regulation and Vote Purchase, Ownership and Performance Issues output.

The appropriation for this output class was increased by \$482,000 in the Supplementary Estimates largely due to greater demand for economic growth outputs.

\* General service performance objectives are detailed on pages 68 to 69.

## Policy Advice: Ownership and Performance of Crown Companies and Financial Institutions

This class of outputs involves the provision of policy advice on the Crown's financial position and the Crown's ownership interest in Air New Zealand, Crown companies (including SOEs) and CFIs. This contributes towards enhancing and protecting the value of the Crown's interest in these institutions.

The outputs include:

- advice to the Minister of Finance as shareholder in SOEs, CRIs and other Crown companies, on issues impacting on the Crown's ownership strategies, business plans and SOIs, capital structure, dividends, diversification and expansion proposals, and divestments. This also includes advice on Air New Zealand, rail infrastructure and certain other entities where the Crown has an ownership interest
- advice on significant company restructurings, and on establishing commercially related activities in an appropriate institutional form and on Crown negotiations in relation to changes in asset structure and form
- advice on the Crown's ownership interests and guarantee and indemnity obligations in relation to the GSF, the National Provident Fund, Public Trust, the Earthquake Commission (EQC) and the NZSF, especially in relation to Crown financing, financial performance, management of risk (as owner or guarantor), unfunded Crown liabilities, and any residual implementation issues in relation to the NZSF.

### Significant work completed during the year

Provided advice on:

- long-term hold reviews for New Zealand Post, Genesis, AgriQuality, Asure and Airways Corporation
- organisational structure options for AgriQuality and Asure and associated legal issues
- purchase and organisational structure options for NIWA and MetService
- national rail negotiations over the Track Access Charge
- new funding arrangements for Auckland rail
- TVNZ's capital structure
- Air New Zealand
- various SOE/Crown company/CRI business plans and SCIs and various other company-related issues
- Crown Financial Institution performance, board appointments, statements of intent, and various entity-specific issues
- commercial valuations for SOEs
- opportunities to manage de-forestation activities involving SOEs
- the strategic risks facing Industrial Research Limited.

## Service performance\*

Performance Dimensions	Achieved?
<b>Quality</b> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Outputs produced under this output class will be undertaken in conjunction with CCMAU where reports are prepared on the financial performance of SOEs, CRIs and other Crown companies and in conjunction with the Ministry of Housing in relation to Housing New Zealand Corporation.</li> </ul>	Met and frequently exceeded expectations √
<b>Quantity</b> The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.	√
<b>Timeliness</b> All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.	√

## Cost (\$000)

2005/06 Actual	2,566
Supp. Est. - Voted	2,685
Main Est.	2,637
2004/05 Actual	2,673

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$119,000 or 4% under Supplementary Estimates budgets. The appropriation for this output class was increased by \$48,000 in the Supplementary Estimates.

\* General service performance objectives are detailed on pages 68 to 69.

## Policy Advice: Regulation and Vote Purchase, Ownership and Performance Issues

This class of outputs contributes primarily to ensuring that the State's resources and regulatory powers are used effectively and efficiently to achieve the Government's desired outcomes, including a stable and sustainable macroeconomic environment.

The outputs include:

- advice on cost, quality and quantity of output sought by the Government, the financial performance of departments and Crown entities, and the capability of departments and Crown entities
- monitoring of appropriations to ensure expenditure is within parliamentary authority and advice on the non-departmental revenue and expenditure administered by departments and Crown entities
- identification and assessment of opportunities for the Government to achieve its goals relating to improving economic performance, inclusive society, environmental management and an efficient and effective State sector.

Areas covered are:

- health
- education
- welfare (including housing and social services)
- justice
- labour market (including employment, immigration and ACC)
- population agencies
- external linkages, defence and national security
- research, science and technology
- economic development (regional and industry development and firm performance)
- the regulatory environment (for example business law and competition policy)
- infrastructure (including energy, telecommunications, water and transport)
- environment
- primary sector
- government services (for example Internal Affairs, the SSC, local government)
- parliamentary agencies.

### Significant work completed during the year

- Contributed to cross-government advice on ways to increase the labour market participation options for parents and carers.
- Contributed to cross-departmental advice on ways of upskilling the low-skilled end of the existing workforce.

- Worked jointly with the State Services Commission to provide input into the Department of Labour's strategic baseline review.
- Provided input into the Ministry of Social Development's Single Core Benefit work programme, including development of the single benefit operational rules and expectations, changes to the method of assessing and paying disability support, and development of necessary draft legislation.
- Provided advice on the increase in the minimum wage.
- Worked with the Ministry of Education and the Tertiary Education Commission (TEC) to develop a range of options for tertiary funding to address long-term tertiary fiscal sustainability.
- Contributed to cross-departmental analysis of changes to the student loans and allowances schemes.
- Provided advice on a range of policy proposals in Vote Education, school property business case, and interventions in at-risk TEIs.
- Worked with the Ministry of Education and TEC on the workstreams of advice for Cabinet for decisions on funding, planning and quality assurance arrangements for the tertiary sector reform agenda.
- Worked with the Ministry of Health to develop potential funding tracks for health expenditure from the 2005/06 fiscal year.
- Worked with the Ministry of Health and District Health Boards (DHBs) on the development and implementation of performance information and management frameworks across the health sector.
- Contributed to a Ministry of Health and DHB working group on the measurement of productivity in the health sector.
- Proposed areas for Expenditure Review in the health sector, as part of the EXG review process, building on insights from last year's in-depth review of the health sector.
- Provided advice on all the major decisions for the 2006 Budget, including the management of capital expenditure pressures, and worked with MoH on the development of their National Systems IT project for Vote Health.
- Reported on DHB District Strategic Plans and draft District Annual Plan.
- Reported on key ACC decisions for the 2006 Budget, and provided advice on how to manage levy pressures arising from ACC's increased focus on injury prevention and rehabilitation.
- Reported to the Minister of Housing on affordability and home ownership rates.
- Provided advice to Ministers as part of the establishment of the expenditure review process and input to these reviews as they have progressed.
- Reported on the effectiveness of the Ministry for the Environment in coordinating government office accommodation.
- Completed Treasury Working Papers 05/09 – *The Effect of New Zealand Superannuation Eligibility Age on the Labour Force Participation of Older People*, and 05/11 – *Income Growth and Earnings Variations in New Zealand, 1998-2004*.
- Contributed to an interdepartmental review on current climate change policies.
- Provided advice, with other departments, to Ministers on improving the management of New Zealand's freshwater resources and the development of oceans policy.
- Completed a study of Auckland's economic performance and provided a range of advice on Auckland issues.
- Provided advice on preliminary findings on innovation policy.

- Provided advice on the approach to Economic Transformation, policy priorities and budget priorities.
- Provided advice on transmission regulation including Commerce Commission announcement of intention to declare control of Transpower.
- Contributed advice on a number of significant transport issues (with other agencies), including tolling policy development and implementation, design and implementation of new planning and funding arrangements for State highway improvements and external reviews examining value for money and roading cost increases.
- Contributed advice (with other agencies) on a number of significant Auckland transport issues, including the Auckland Road Pricing Study, implementing new funding/governance arrangements for Auckland passenger rail and setting up Auckland Transport Strategic Alignment Project (in progress).
- Provided policy advice on the Telecommunications Stocktake.
- Led and contributed to the interdepartmental working group on the Review of Domestic Institutional Arrangements for financial sector regulation and negotiated and agreed proposed legislative changes with Australian authorities to allow RBNZ and APRA to better support each other.
- Participated in the interdepartmental working group on options and recommendations for trans-Tasman coordination of financial sector regulation.
- Led and coordinated the development of legislation and further policy details for KiwiSaver, working closely with IRD, MED and Parliamentary Counsel Office.
- Led and contributed to the review of domestic institutional arrangements for prudential regulation.
- Provided advice and participated with the New Zealand Defence Force, the Ministry of Defence, SSC and DPMC on the implementation of the Defence Sustainability Initiative.
- Provided advice on Defence acquisitions, including the Helicopter Capability Project, and on the scoping work for the capital management review of the Defence agencies.
- Treasury worked closely with the Ministry of Civil Defence and Emergency Management (MCDEM) to provide Government with policy options regarding the May 2005 floods. Treasury has also been closely involved, along with DPMC, with coordinating the funding request from Whakatane District Council regarding the restoration of Matata.
- Participation in the Local Authority Funding Project Group (brief includes Crown Contributions in lieu of rates, Regional Development levies, funding sustainability, and local authority petroleum tax).
- Advice on fire service issues and representation for the Minister at stakeholder consultation workshops in relation to restructuring and funding proposals.
- Led negotiations on investment issues in the FTA negotiations with ASEAN, China and Malaysia and in the CER Investment Protocol. Provided policy analysis and advice to support those negotiations.
- Coordinated workflows to support Single Economic Market initiatives, in particular the CER investment protocol, policy scenarios work and regulatory policy, and supported the Minister at the annual SEM Treasurer/Finance Ministers' meeting.
- Preparations for New Zealand chairing the "Honiara Club" (a grouping of Solomon Islands creditors aiming to reduce Solomon's debt burden), and attendance at Honiara Club meetings in Canberra and Honiara.
- Attended and provided input to the Technical Working Group supporting the APEC Finance Ministers' Process. Commenced planning for workshop to support New Zealand's Policy Dialogue on Savings.
- Provided input into the reviews of the Pacific Security Strategy and Pacific Security Fund.

- Led team reviewing the Regional Assistance Mission to Solomon Islands (RAMSI) Financial Management Strengthening Programme.
- Prepared briefing and organised programme for the Minister's attendance at the Forum Economic Ministers' Meeting.

#### Service performance\*

Performance Dimensions	Achieved?
<b>Quality</b> All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.	Met and frequently exceeded expectations
<b>Quantity</b> The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.	✓
<b>Timeliness</b> All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.	✓

#### Cost (\$'000)

2005/06 Actual	20,383
Supp. Est. - Voted	20,714
Main Est.	21,281
2004/05 Actual	21,625

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$331,000 or 2% under Supplementary Estimates budgets. The appropriation for this output class was decreased by \$567,000 in the Supplementary Estimates.

\* General service performance objectives are detailed on pages 68 to 69.

## Policy Advice: Tax

This class of outputs involves the provision of advice on tax policy and contributes to raising required tax revenue at least cost to the economy in line with fiscal strategy.

The Treasury, jointly with the Policy Advice Division of Inland Revenue, will provide advice on:

- tax strategy (overall objectives of the tax system, including choice of tax bases and the mix of taxation)
- international taxation (including taxation agreements with other countries; tax on New Zealanders' foreign-source income and the taxation of income earned by New Zealanders overseas)
- personal taxation (that is, direct taxes imposed on individuals)
- indirect taxes (including GST and taxes on specific goods and services, like excises)
- corporate taxation (that is, direct taxes imposed on companies, trusts and other forms of legal entity; and taxes imposed on individuals through such business organisations)
- tax systems and compliance (including withholding taxes, tax penalties, taxation administration rules, taxpayer rights and obligations and taxpayer compliance costs).

The Government purchases tax policy advice from both the Treasury and Inland Revenue to ensure that its tax policies are based on all relevant economic, legal and administrative factors.

The Treasury will also provide advice, in cooperation with the collection agencies, on excises that are not collected by Inland Revenue.

In respect of Votes Revenue and Customs, the Treasury will provide:

- advice on cost, quality and quantity of output sought by the Government, the financial performance of the departments, and the capability of the departments
- monitoring of payments for outputs against appropriations and advice on the non-departmental revenue and expenditure administered by the departments.

### Significant work completed during the year

- Reported to Ministers on the Taxation of Partnerships discussion document.
- Reported to Ministers on the taxation of Investment Income policy changes included in the Taxation (Annual Rates, Savings Investment and Miscellaneous Provisions) Bill.
- Reported on options for the reform of the controlled foreign company rules.
- Substantial and wide-ranging policy analysis and advice to contribute to the ongoing Business Tax Review.
- Reported to Ministers on the Government's revenue strategy.
- Reported to Ministers on implementing changes to Family Support announced during the election campaign.
- Coordination and delivery of the Government's proposed KiwiSaver workplace savings scheme.

Service performance\*

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <ul style="list-style-type: none"> <li>All reports will comply with the Quality Standards for Analysis and Advice. The Minister will be requested to indicate his level of satisfaction with the overall quality of outputs at the end of each trimester.</li> <li>Outputs produced under this output class are to be undertaken in conjunction with Inland Revenue and other relevant collection agencies where reports are produced on revenue policy issues.</li> </ul>	<p>Met and frequently exceeded expectations</p> <p>✓</p>
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister of Finance and the Secretary to the Treasury (as amended from time to time) for 2005/06.</p>	<p>✓</p>
<p><b>Timeliness</b></p> <p>All outputs will be delivered to timeframes as agreed between the Minister and the Secretary to the Treasury for 2005/06.</p>	<p>✓</p>

Cost (\$000)

2005/06 Actual	2,739
Supp. Est. - Voted	2,966
Main Est.	2,742
2004/05 Actual	2,373

(Figures are GST exclusive)

Actual 2005/06 output class expenditure was \$227,000 or 8% under Supplementary Estimates budgets due largely to unexpected delays in filling staff vacancies.

The appropriation for this output class was increased by \$224,000 in the Supplementary Estimates largely due to an anticipated increase in demand for tax outputs.

\* General service performance objectives are detailed on pages 68 to 69.

## Service Performance Objectives: All Vote Finance Output Classes

Performance Dimensions	Achieved?
<p><b>Quality</b></p> <p>All reports will comply with the Quality Standards for Analysis and Advice outlined on page 138. Output quality will be assessed as follows:</p> <ul style="list-style-type: none"> <li>The Minister will expect the Treasury to implement suitable quality control procedures to support the expectations for analysis and advice delivered under this Vote.</li> <li>Managerial and peer (internal and external) review will be maintained to ensure that the quality standards are met.</li> <li>The Minister will be formally requested, at least three times a year, to indicate his level of satisfaction with the overall quality of the outputs produced.</li> </ul>	<p>√</p> <p>√</p> <p>Met and frequently exceeded expectations</p>
<p><b>Coverage</b></p> <p>A comprehensive range of services will be provided as agreed with the Minister. These will include the capacity to react quickly and provide support for the Minister in Cabinet committees, including relevant briefings on significant issues and regular evaluation of the impacts of policy on the Government's desired outcomes.</p>	<p>√</p>
<p><b>Cost-effectiveness</b></p> <p>Analysis and advice will be delivered within the cost parameters agreed with the Minister (or as subsequently modified by agreement).</p>	<p>√</p>
<p><b>Timeliness</b></p> <p>Timeframes will be agreed between the Minister and the Secretary to the Treasury for the financial year.</p> <ul style="list-style-type: none"> <li>Advice will be delivered within the agreed and/or statutory timeframe so that Ministers have sufficient time to consider the issues and take appropriate action. Where agreed deadlines will not be met, extensions are to be requested formally.</li> <li>Ministerial correspondence (MCs), parliamentary questions (PQs), Cabinet agendas and Official Information Act requests (OIAs) will be responded to within agreed and/or statutory timeframes.</li> <li>The Department will respond appropriately to requests for attendance at Parliament during debates and at Cabinet and select committee meetings.</li> <li>Drafting instructions in the form of draft legislation will be provided to the Parliamentary Counsel Office within the timeframe agreed with that Office.</li> <li>Reporting three times a year will enable the Minister to assess actual performance in the timeliness of output delivery against those expectations.</li> </ul>	<p>√</p> <p>Refer page 69</p> <p>√</p> <p>√</p> <p>√</p>

2005/06	PQs	MCs	OIAs
<b>Policy Advice: General Economic &amp; Fiscal Strategies</b>			
Estimated	5-10	80-90	10-20
Actual draft replies	18	92	1
% answered by due date	100	95	-
<b>Policy Advice: Financial &amp; Public Sector Management Systems</b>			
Estimated	0-5	10-20	0-5
Actual draft replies	6	2	3
% answered by due date	100	100	67
<b>Policy Advice: Tax</b>			
Estimated	10-20	150-200	10-20
Actual draft replies	14	455	10
% answered by due date	100	68	80
<b>Budget Management</b>			
Estimated	0-5	0-5	0-5
Actual draft replies	12	1	2
% answered by due date	100	100	100
<b>Economic &amp; Fiscal Forecasting &amp; Reporting</b>			
Estimated	100-120	0-5	5-10
Actual draft replies	7	-	1
% answered by due date	100	-	100
<b>Debt &amp; Related Financial Asset Management</b>			
Estimated	0-5	0-5	0-5
Actual draft replies	2	4	-
% answered by due date	100	100	-
<b>Management of Claims Against the Crown, Contractual Liabilities &amp; Crown Properties</b>			
Estimated	5-10	5-10	5-10
Actual draft replies	3	18	2
% answered by due date	100	100	50
<b>Policy Advice: Ownership &amp; Performance of Crown Companies &amp; Financial Institutions</b>			
Estimated	15-30	130-180	25-45
Actual draft replies	30	91	16
% answered by due date	100	100	94
<b>Policy Advice: Regulation &amp; Vote Purchase, Ownership &amp; Performance Issues</b>			
Estimated	150-200	400-450	50-100
Actual draft replies	71	360	41
% answered by due date	100	86	93
<b>Ownership</b>			
Estimated	30-40	0-10	0-5
Actual draft replies	19	6	5
% answered by due date	100	100	80

## Explanation:

- All PQs were provided to the Clerk's office by the due date, but a few failed to meet our internal deadline to the Minister's office, typically by one day.
- Most of the late MCs and OIAs were provided one day after our internal deadline.
- The balance of MCs and OIAs tended to be late because they involved complex or multiple issues and/or required additional information or agreement from third parties. This was exacerbated by staff absences over holiday periods and workload pressures, particularly for small teams.

### Treasury Publications Committee

The Treasury sees publishing papers as an important way to raise awareness, add to the stock of knowledge, stimulate debate and influence thinking on issues that are of importance to New Zealanders' wellbeing.

The Treasury Publications Committee encourages the publication of relevant papers, ensures consistent quality and manages the release of the Treasury's Working Papers and Policy Perspectives Papers.

"It is important that the Treasury maintains the capacity to advise on longer-term as well as current economic, financial and public sector policy issues, and that we are transparent about the analysis behind our advice. Publishing allows us to achieve these objectives, as well as helping to develop staff capability," says Committee Leader Michele Lloyd.

All Treasury Working Papers and Policy Perspectives Papers are available on the Treasury web site at <http://www.treasury.govt.nz/workingpapers/>



The Treasury Publications Committee – Gerald Minnee, Bryan McDaniel, Michele Lloyd, Patrick Conway, Charmaine Barrett and Dieter Katz.

# CCMAU – VISION AND PURPOSE

## Vision

The New Zealand Government's ownership advisor of choice – a sought-after leader in the provision of commercial and wider ownership advice, highly respected worldwide for what we do.

## Purpose

CCMAU contributes to the efficient management of the Crown's balance sheet and net worth by providing services which enable shareholding Ministers to hold Crown company and entity boards accountable for their performance in maintaining and enhancing shareholder value.

CCMAU monitors companies and entities to advise Ministers on: company and entity performance; significant investment and divestment decisions by boards; and strategies to achieve effective management of the Crown's assets.

CCMAU provides services in the following areas:

- Monitoring – reporting on business plans, company reports, performance against targets and sectoral trends.
- Ownership advice – advising on strategic issues, investment and diversification opportunities, restructuring issues, and the impact of policy positions.
- Ministerial servicing – managing issues and drafting replies to correspondence, parliamentary questions and Official Information Act requests.
- Governance – identifying and screening potential directors, managing the appointments processes and promoting best-practice corporate governance of Crown companies and entities.

## Relationship with the Treasury

The Executive Director of CCMAU is directly accountable to the Secretary to the Treasury for the Crown's investment in CCMAU, and for CCMAU's performance in providing the output classes Ministers seek.

## CCMAU EXECUTIVE SUMMARY



Executive Director – Murray Wright

CCMAU's aim is to be the Government's ownership advisor of choice in the provision of commercial and wider ownership advice. This year, CCMAU has continued to assist Ministers to clarify their ownership expectations to enhance the performance of the companies and commercial entities in its portfolio<sup>1</sup>.

During 2005/06, CCMAU has made good progress towards putting in place the foundations of its strategic plan. We are well placed to build on our capability to take advantage of opportunities that may arise in the years ahead. We have taken a leadership role in the development of an international network of CCMAU-like agencies and in a monitoring departments group established to share best practice across the public sector.

We continued our focus on implementing the Government's long-term ownership policy for SOEs – owners' reviews have now been completed for seven SOEs and work is well underway on another four SOEs. Also, a shareholders' expectations document was developed for Television New Zealand Ltd (TVNZ) and the CRI Operating Framework was reviewed to provide greater clarity on financial and non-financial expectations of the CRIs. Our Appointments and Governance team provided advice on a significant number of director appointments and reappointments this year, including a number of new Chair appointments.

We have continued our focus on making CCMAU a great place to work. In April we returned to refurbished, open plan offices which provide an excellent environment for effective and open interactions among staff. CCMAU staff are skilled individuals fully committed to exceeding Ministers' future expectations.

### Science and innovation sector

Manager – Adrian Wimmers

The Crown-owned science and innovation (S&I) companies (nine CRIs, the New Zealand Venture Investment Fund Ltd (NZVIF) and Research and Education Advanced Network New Zealand Ltd (REANNZ)) continue to make significant contributions to the Government's economic transformation strategy.

<sup>1</sup> See page 27 for a full list of the companies and entities monitored by CCMAU.

Through this strategy, the Government aims to move New Zealand towards an economy based on sustainable innovation. Scientific research, the sharing of new knowledge and research data, and the transfer of technologies developed through such research, have a pivotal and increasing role in achieving this goal.

During 2005/06, CCMAU broadened its contribution to the S&I sector through a number of initiatives. We worked with the Minister for CRIs, and in consultation with the Ministry of Research, Science and Technology (MoRST) and the Treasury, to reframe the CRI Operating Framework and provide greater clarity on financial and non-financial expectations of the CRIs. We led cross-departmental policy development work on expectations to guide CRIs in all technology transfer and commercialisation activities, and developed new guidance for CRIs regarding shareholder consent thresholds for such transactions. We continued our engagement with other cross-departmental groups such as the Innovation Working Group and the Ocean Survey 20/20 group. In consultation with MoRST, the Foundation for Research, Science and Technology (FRST), the Treasury and the CRIs, we also developed a new set of research application indicators for CRIs. These indicators will measure CRIs' engagement with industry, and the ways in which they transfer their research findings and new technologies, and provide insights into the impact these are having on New Zealand's economy, environment and society.

CCMAU also became responsible for administering the CRI Capability Fund, which is managed by MoRST. The purpose of the Fund is to assist CRIs to retain and develop strategic research, science and technology capabilities for New Zealand's benefit. We are currently working with MoRST and the CRIs to share best practice in the ways in which the CRIs report their plans for, and use of, CRI Capability Fund monies.

CCMAU supported the Treasury and MoRST in completing the incorporation and establishment of REANNZ. We also worked closely with REANNZ as it developed its inaugural accountability and planning documents and, following its appointment of a Chief Executive Officer and senior staff, we have now moved into a more stable monitoring phase with the company.

NZVIF progressed well during the year, and is performing in line with expectations. During 2005/06, CCMAU assisted with the transition of shareholder responsibility to the Minister for Economic Development and the establishment of the Seed Co-Investment Fund, for which NZVIF was made responsible.

Our role in the Equity Investment Fund (EIF) continued, notably through our work in the due diligence process for a \$3 million investment into one CRI. We also worked with MoRST and the Treasury to review and amend the assessment criteria under which the EIF Steering Group makes investment recommendations to Ministers. We expect demand for EIF funds to increase in coming years, as CRI commercialisation activities lead to capital constraints.

## Energy, land and environment sector

### Manager – Michael Moore

The Energy, Land and Environment (ELE) team advises the Minister for SOEs on the performance of, and issues relating to, the 13 SOEs that comprise the energy, land and environment sectors.

The energy sector companies control almost \$12 billion in assets, of which around \$8 billion is shareholder equity, returning a combined net surplus of around \$1.2 billion. Land and environment sector companies control around \$1.5 billion in assets, most of which is land owned by Landcorp Farming Ltd (Landcorp), with a combined net surplus of around \$25 million. The ELE companies range from large electricity generator/retailers such as Meridian Energy Ltd (Meridian), Mighty River Power Ltd (Mighty River Power) and Genesis Power Ltd (Genesis) in the energy sector to a diverse range of companies in the land and environment sector such as Landcorp, AgriQuality Ltd (AgriQuality), Quotable Value Ltd and Timberlands West Coast Ltd. Collectively, ELE companies have a significant impact on the New Zealand economy.

SOEs in the energy sector continued to attract considerable public focus throughout 2005/06. In particular, Transpower New Zealand Ltd's (Transpower's) proposals for major upgrades to the national grid highlighted the challenges that SOEs face in investing in New Zealand's energy infrastructure. The ELE team worked closely with energy sector SOEs as they developed their plans to help meet the nation's energy infrastructure needs, while at the same time addressing shareholder expectations over strategic direction and performance, both financial and non-financial.

The issues in which we contributed across all sectors included:

- the review of dividend distribution policies by a number of SOEs
- the classification of financial instruments as liabilities or equity under International Financial Reporting Standards
- the increasingly competitive environment facing AgriQuality and Asure New Zealand Ltd (Asure)
- the native land snail issue at Solid Energy New Zealand Ltd's Stockton mine
- the Meteorological Service of New Zealand Ltd's relationship with the National Institute of Water and Atmospheric Research Ltd
- issues associated with the sale of properties by Landcorp as part of its rationalisation strategy.

The ELE team continued its focus on implementing the Government's long-term hold ownership policy, which will ultimately involve owners' reviews of all SOEs. Significant work in this area was completed for AgriQuality, Asure and Genesis over the course of 2005/06. These reviews cover key ownership expectations including:

- company strategy and scope of business
- company performance and benchmarking
- capital management – investment strategy, capital structure and dividend policy.

## Communications, services and infrastructure sector

Manager – James Cunningham

The Communications, Services and Infrastructure (CSI) sector comprises a diverse group of companies in the broadcasting, telecommunications, services and transport infrastructure fields, as well as two Crown entities (Public Trust and the New Zealand Lotteries Commission).

These businesses collectively control approximately \$5.9 billion in total assets (or approximately \$2.4 billion after netting off Kiwibank Ltd's and Public Trust's liabilities from their assets to avoid distortion), play a key role in providing products and services to New Zealanders, and operate in a commercial way to generate profits and increase shareholder value.

Over the last year, we have advised shareholding on a number of matters, including:

- assessment of the business case for Christchurch International Airport Ltd's (CIAL's) \$198 million terminal redevelopment project
- monitoring Dunedin International Airport Ltd's terminal redevelopment project
- completion of a report on aviation industry developments and their implications for the Crown's aviation investments
- completion of a capital structure review of TVNZ, the appointment of a new Chair for the company, and the development of an expanded/enhanced shareholders' expectations document for it
- the proposed implementation of free-to-air digital television
- residual issues arising in respect of Terralink Ltd (In Liquidation).

The Government's long-term ownership policy for SOEs and Crown companies has increased our role in ensuring shareholder value is protected and enhanced over the medium to long term, while allowing for a prudent level of commercial risk-taking in developing new initiatives. During the year, the CSI team completed a long-term hold review of Airways Corporation of New Zealand Ltd (Airways) and undertook the preparatory work for the long-term hold review of New Zealand Post Ltd (NZ Post).

## Appointments and governance

Manager – Steve Rich

The primary role of the appointments and governance team is to manage, on behalf of Ministers, the processes for identification and appointment of the directors of the companies and entities that CCMAU monitors. Our focus is on providing Ministers with a wide range of options for appointment based around the individual skill requirements of each board. In performing this function we devote considerable resource in the identification of new candidates for ministerial consideration, and management of the large number of expressions of interest we receive. We also run associated processes for Ministers in board fee setting, director induction and training and board evaluation.

To avoid any clash with the General Election in late 2005, the bulk of our appointments activity was moved into early 2006. In the period we managed processes for around 90 appointments and reappointments across all but two of the companies and entities we monitor. This involved 83 specific due diligence interviews, management of several hundred nominations and expressions of interest; and ultimately resulted in the appointment of 28 new individuals into the portfolio. We ran two induction seminars for new SOE and CRI directors during the year.

Of particular note were a number of new company Chair appointments, notably Sir John Anderson as the new Chair of TVNZ, Rakihia Tau at AgriQuality, and Derek Kirke at Animal Control Products Ltd. We also completed the processes that saw the appointments as chair of Dr Brian Rhoades at Industrial Research Ltd (IRL) and Jim McLean at the Horticulture and Food Research Institute of New Zealand Ltd, although these terms did not commence until 1 July 2006.

At year's end there were a total of 227 individual director positions across the companies and entities monitored by CCMAU, 148 (65%) male and 79 (35%) female. Of these, 84% identified themselves as European, and 13% as Māori.

Interest in Crown company directorships continues to be strong, and the "pool" of candidates available for consideration has continued to grow. In addition to the 83 company-specific due diligence interviews noted above we conducted 145 general interviews of candidates who have expressed an interest or been nominated for a Crown company directorship. As part of the Government's ongoing commitment to developing the talent pool available for consideration, we ran two prospective director training seminars. In addition to our own appointment processes, we are frequently called upon to assist other agencies in candidate searches and appointment processes, and during the year we responded to 35 such requests.

A review of the fee levels paid to Crown company directors was completed during the year, with changes agreed by Cabinet in December 2005 and implemented from 1 January 2006. Overall this saw a 7.5% increase in the total fees paid to the boards, but within this there were a number of boards (typically of the larger companies) that received more significant increases, and several that received either a very modest, or no, increase. Given the volatility in the director remuneration benchmarks, Cabinet has directed CCMAU to move to an annual review process of fees, and therefore an additional review was carried out in the first half of 2006. Any further changes from this were not confirmed before the end of the year, and are likely to be considered by Cabinet in September 2006.

A significant new development for CCMAU during the year was the hosting of a number of functions for the directors of the companies and entities we monitor. We initially ran these on a trial basis in Auckland and Wellington in November 2005, following numerous requests from serving directors that we do so. Following very positive feedback we ran a further series in Auckland, Wellington and Christchurch in June 2006. The functions serve the joint purpose of facilitating networking among directors, and also providing a forum for board members to be briefed on relevant governance topics. We are very pleased with the positive response to this initiative, and will look to continue it going forward.

## Maintaining and developing capability

### Setting strategic direction

During the year good progress was made on a number of initiatives supporting our five organisational goals. This progress will continue in 2006/07.

Our focus is on building our capability – getting better at what we do and extending what we do. The key to our success is the performance of the companies and entities in our portfolio and how we use our unique position to influence this.

In 2005/06 we have continued to refine our products and codify our processes. Our involvement in a number of cross-sector policy-related issues has continued and we have sought to improve the clarity of our advice at every opportunity. We have also continued to assist the Government to set its ownership expectations for the various classes of companies and entities in our portfolio.

### Managing our people

During the year we continued to fine-tune our staff policies to reflect commonly recognised best practice. For instance, we introduced new policies covering health and fitness, and child care and amended the policy regarding annual leave. A continuity, succession and recruitment plan was also completed as part of our human resource strategy.

Staff continued to take advantage of the opportunities to upskill and extend their industry knowledge through attendance at relevant conferences.

For most of the year CCMAU operated from temporary accommodation while our offices at No 1 The Terrace were refurbished. The return to a new, open plan environment in April 2006 was well received by staff. We now have a very modern workspace that is conducive to effective and open interactions among staff which support our “one CCMAU” objective.

We commissioned another staff climate survey towards the end of the year and it is pleasing to note that CCMAU’s overall index increased again compared with the previous year.

CCMAU employed 22 staff as at 30 June 2006, with one person on maternity leave. Of the total staff, one was seconded to the office of the Minister for SOEs. Staff turnover was 15% (30% in 2004/05) and the average length of service is now 3.49 years (2.74 years in 2004/05).

### Improving communications and stakeholder relationships

Ministerial satisfaction is a key indicator of CCMAU’s performance and ability to produce outputs that make a difference. Throughout the year, Vote Ministers continued to express satisfaction with the quality of our advice.

We produced informative Briefings to the Incoming Ministers for CRIs and SOEs so that they had an immediate and clear understanding of their portfolios following the General Election. We received favourable comment from Ministers on these Briefings.

CCMAU has also played an active role in a monitoring departments group which was established to encourage and promote best practice monitoring for departments who support and interact with non-corporate Crown entities.

During the year we consolidated the development of the International Network of Government Ownership Agencies (INGOA), which CCMAU is leading. INGOA is now a well-established concept, with 26 international agencies having expressed an interest in participating in the Network. Of the 26, eleven have confirmed this interest and commitment by participating in the establishment meeting in Singapore in mid-2005, or contributing money to the development of a web site. CCMAU has a mandate to be the “lead agency” until 30 June 2007, and an Advisory Committee comprising CCMAU (NZ), Shareholder Executive (UK), Government Businesses and Financing Unit (Australia), Crown Agencies Secretariat (British Columbia, Canada), National Treasury (South Africa), and Khazanah (Malaysia) has been established to guide the operations of the Network.

We were pleased to be invited to present at the Corporate Governance in the Public Sector conference in Wellington in January 2006, on CCMAU’s experience of “Integrated Board Performance Monitoring”.



Murray Wright  
Executive Director

CCMAU leadership team  
– Adrian Wimmers,  
Murray Wright, Janine  
Stewart, Michael Moore,  
James Cunningham and  
Steve Rich.

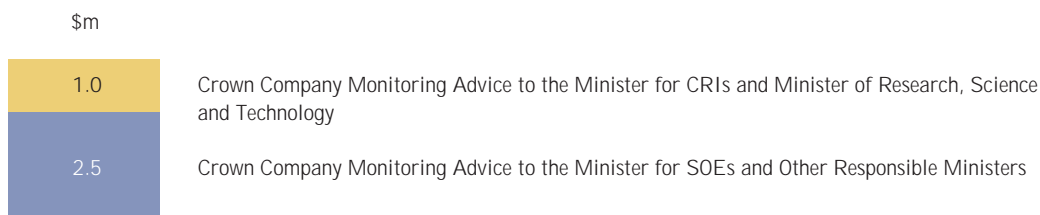


# OUTPUT PERFORMANCE – CCMAU

Statement of Objectives and Service Performance  
section 45A Public Finance Act 1989

## VOTES AT A GLANCE

Actual expenditure for 2005/06 by output class:



## VOTE STATE-OWNED ENTERPRISES

Crown Company Monitoring Advice to the Minister for State-Owned Enterprises and Other Responsible Ministers

This class of outputs involves the provision of policy and ownership monitoring advice on the SOEs, Crown companies and Crown entities covered by Vote SOEs (collectively referred to below as "SOEs"). This includes:

- advising the Minister for SOEs and other responsible Ministers on the strategic direction of SOEs; the commercial and fiscal risks associated with Crown ownership; proposals to establish and restructure SOEs; and the processes and outcomes of significant SOE divestments and acquisitions
- providing advice which assists Ministers to set ownership objectives and targets for SOEs
- monitoring and advising Ministers of SOEs' performance against these objectives and targets
- providing policy advice on, and managing issues arising out of, the ownership of SOEs, including residual implementation issues
- managing, on behalf of responsible Ministers, the appointment of SOE directors and monitoring the performance of those directors and boards
- assisting responsible Ministers in the formulation of shareholders' expectations in relation to the governance practices and structures companies adopt.

Maintaining and enhancing the Crown's ownership interest in these entities contribute to the efficient management of the Crown's assets and liabilities.

### Significant work completed during the year

- Completed the 2005/06 SOE business planning, which includes analysing and reporting on each company's draft SCI and business plan so that shareholding Ministers are able to provide informed feedback to boards. The 2006/07 SOE business planning round was also substantially completed by 30 June 2006.
- Completed a Briefing to the Incoming Minister for SOEs and other responsible Ministers that CCMAU advises under the purview of Vote SOEs.
- Completed Crown Company Quarterly Performance reports for the June, September, December and March quarters, which were presented to Cabinet.
- Completed long-term hold owners' reviews for Meridian and Airways; and the commencement of reviews for Genesis and NZ Post. The long-term hold reviews of Asure and AgriQuality were put on hold pending the outcome of an organisational review involving these two companies, which was still outstanding at year end.
- Completed a capital structure review of TVNZ, the appointment of a new Chair for the company, and the development of an expanded/enhanced shareholders' expectations document for it.
- Managed a number of company issues, and the provision of advice to Ministers on them, including:
  - the business case for CIAL's terminal redevelopment plan
  - the proposed implementation of free-to-air digital television
  - the impact on Meridian of the final Waitaki Water Allocation Board plan for allocating water in the Waitaki catchment
  - the proposed increase in dividend distribution ratio by Mighty River Power
  - energy regulatory issues affecting Transpower in particular
  - a number of smaller-scale acquisitions by SOEs.
- Completed a report on aviation industry developments and their implications for the Crown's aviation investments.
- Took a "lead agency" role in the establishment of an international best-practice sharing network of organisations with a similar role to that of CCMAU.
- Convened an SOE Chairs' meeting in May with the Minister for SOEs and other Ministers.
- Provided advice to Ministers on a number of appointments and governance issues, including:
  - completion of the 2006/07 SOE appointment round
  - completion of a directors' fees review for 2006/07
  - continuing active participation in the wider governance officials' forum
  - hosting two prospective directors' seminars
  - hosting a one-day induction seminar for new SOE directors
  - hosting a number of networking functions for serving directors to share issues of common interest
  - managing expressions of interest from candidates wishing to be considered for Crown governance roles
  - continuing to provide assistance to other agencies regarding nominations.

## Service performance

Performance Dimensions	Achieved?																
<p><b>Quality</b></p> <p>The Minister for SOEs and other responsible Ministers will expect advice to demonstrate a sound knowledge of the Crown company's business, the environment within which the company operates and the consequences of shareholder or company actions.</p> <p>All reports will comply with the generic quality standards for analysis and advice outlined on page 138. Output quality will be assessed as follows:</p> <ul style="list-style-type: none"> <li>The Ministers will expect CCMAU to implement suitable quality control procedures to support the expectations for analysis and advice delivered under the relevant Votes. ✓</li> <li>Managerial and peer (internal and external, where appropriate) review will be maintained to ensure that the quality standards are met. ✓</li> <li>The Minister for SOEs will be formally requested, on a quarterly basis, to indicate his level of satisfaction with the overall quality of the outputs produced. More than satisfied</li> </ul>																	
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister for SOEs and the Executive Director of CCMAU (as amended from time to time) for 2005/06. ✓</p> <p>Quarterly and end-of-year reporting will enable the Minister to assess actual performance in output delivery against those expectations. ✓</p>																	
<p><b>Coverage</b></p> <p>A comprehensive range of services will be provided as agreed with the Minister for SOEs. These will include the capacity to react quickly and provide support for the Minister in Cabinet committees, including relevant briefings on significant issues and regular evaluation of the impacts of shareholder decisions and company actions on the Government's desired outcomes. ✓</p>																	
<p><b>Cost-effectiveness</b></p> <p>Analysis and advice will be delivered within the cost parameters agreed with the Minister for SOEs (or as subsequently modified by agreement). ✓</p>																	
<p><b>Timeliness</b></p> <p>Timeframes will be agreed between the Minister and the Executive Director of CCMAU for the financial year.</p> <ul style="list-style-type: none"> <li>Advice will be delivered within the agreed and/or statutory timeframe so that Ministers have sufficient time to consider the issues and take appropriate action. Where agreed deadlines will not be met, extensions are to be formally requested. ✓</li> <li>Ministerial correspondence (MCs), parliamentary questions (PQs), Cabinet agendas and Official Information Act requests (OIAs) will be responded to within agreed and/or statutory timeframes. ✓</li> <li>CCMAU will respond appropriately to requests for attendance at Parliament during debates and at Cabinet and select committee meetings. ✓</li> <li>Quarterly and end-of-year reporting will enable the Minister to assess actual performance in the timeliness of output delivery against those expectations. ✓</li> </ul>																	
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2005/06	PQs	MCs	OIAs														
Estimated	120-160	160-180	12-20														
Actual draft replies	69	132	4														
% answered by due date	100	99	100														

## Cost (\$000)

2005/06 Actual	2,480
Supp. Est. - Voted	2,553
Main Est.	2,448
2004/05 Actual	2,260

Actual 2005/06 output class expenditure was \$73,000 or 3% under Supplementary Estimates budgets.

The appropriation for this output class was increased by \$105,000 in the Supplementary Estimates owing to a fiscally neutral transfer from Vote CRIs to cover the actual allocation of overhead costs between the two Votes that fund CCMAU and by an increase to cover the costs of the State Sector Retirement Savings Scheme.

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# VOTE CROWN RESEARCH INSTITUTES

## Crown Company Monitoring Advice to the Minister for Crown Research Institutes and Minister of Research, Science and Technology

This class of outputs involves the provision of policy and ownership monitoring advice on nine CRIs, the New Zealand Venture Investment Fund Limited (NZVIF<sup>1</sup>) and the Advanced Network Co Ltd (ANCO<sup>2</sup>), and the provision of advice on the performance of the CRI Capability Fund, and includes:

- advising the Minister for CRIs and the Minister of Research, Science and Technology (RS&T) on the strategic direction of CRIs, NZVIF and ANCO respectively, and the commercial and fiscal risks associated with Crown ownership
- providing advice which assists the Minister for CRIs and the Minister of RS&T to set ownership objectives and targets for CRIs, NZVIF and ANCO
- monitoring and advising the Minister for CRIs and the Minister of RS&T of CRIs', NZVIF's and ANCO's performance against these objectives and targets
- providing policy advice on, and managing issues arising out of, the ownership of CRIs, NZVIF and ANCO, including residual implementation issues
- managing, on behalf of the responsible Ministers, the appointment of CRI, NZVIF and ANCO directors and monitoring the performance of those directors and boards
- assisting the responsible Ministers in the formulation of shareholders' expectations in relation to the governance practices and structures companies adopt.

Maintaining and enhancing the Crown's ownership interest in these entities contribute to the efficient management of the Crown's assets and liabilities. CRIs, NZVIF and ANCO have an important role to play in the New Zealand innovation system, thereby contributing to improving New Zealand's overall economic performance.

### Significant work completed during the year

- Completed the 2005/06 CRI strategic planning round, which includes analysing and reporting on each company's draft SCI and strategic plan so that shareholding Ministers are able to provide informed feedback to boards. The 2006/07 CRI business planning round was also substantially completed by 30 June 2006.
- Completed a Briefing to the Incoming Minister for CRIs.
- Completed Crown Company Quarterly Performance reports for the June, September, December and March quarters, which were presented to Cabinet.
- Contributed to the 2006 Operating Framework for CRIs.

1 During the year, the Minister for Economic Development assumed responsibility for NZVIF.

2 During the year ANCO changed its name to REANZ.

- Led a cross-departmental initiative to develop policy options relating to CRI technology transfer and commercialisation activities. This resulted in a policy framework being approved by Cabinet and included in the 2006 Operating Framework for CRIs.
- Managed a number of company issues, and provided advice to Ministers on them, including:
  - the sale of Agvax Developments Ltd by AgResearch Ltd (AgResearch)
  - AgResearch's purchase of intellectual property and shares in new entities arising from the restructure of the Ovita sheep research consortium
  - a risk analysis of IRL based on its financial position in late 2005
  - the sale of IRL's Auckland property
  - a request from NZVIF to exceed the 15% portfolio limit imposed by Cabinet on the VIF programme
  - an application from New Zealand Institute for Crop & Food Research Ltd for \$3.0 million EIF monies.
- Completed a working paper on a target cost of equity for CRIs.
- Facilitated the establishment of the Seed Co-investment Fund and the resulting adjustments to NZVIF expectations and reporting requirements.
- Worked alongside MoRST and the Treasury to establish and incorporate REANNZ, and worked with REANNZ to ensure that its inaugural public accountability documents were acceptable.
- Completed a set of CRI-specific research application indicators, for implementation from 1 July 2007.
- Completed a review of EIF guidelines, as part of the EIF Steering Group.
- Completed a review of the consent and notification levels and information guidelines for significant transactions by CRIs.
- Took a "lead agency" role in the establishment of an international best-practice sharing network of organisations with a similar role to that of CCMAU.
- Provided advice to Ministers on a number of appointments and governance issues, including:
  - completion of the appointment process for the new REANNZ board
  - completion of the 2006/07 CRI appointment round
  - completion of a directors' fees review for 2006/07
  - continuing active participation in the wider governance officials' forum
  - hosting two prospective directors' seminars
  - hosting a one-day induction seminar for new CRI directors
  - hosting a number of networking functions for serving directors to share issues of common interest
  - managing expressions of interest from candidates wishing to be considered for Crown governance roles
  - continuing to provide assistance to other agencies regarding nominations.

## Service performance

Performance Dimensions	Achieved?																
<p><b>Quality</b></p> <p>The Minister for CRIs or the Minister of RS&amp;T will expect advice to demonstrate a sound knowledge of the business, the environment within which the organisation operates and the consequences of shareholder or CRI or fund actions.</p> <p>All reports will comply with the generic quality standards for analysis and advice outlined on page 138. Output quality will be assessed as follows:</p> <ul style="list-style-type: none"> <li>The Ministers will expect CCMAU to implement suitable quality control procedures to support the expectations for analysis and advice delivered under the relevant Votes. ✓</li> <li>Managerial and peer (internal and external, where appropriate) review will be maintained to ensure that the quality standards are met. ✓</li> <li>The Minister for CRIs will be formally requested, on a quarterly basis, to indicate their level of satisfaction with the overall quality of the outputs produced. More than satisfied</li> </ul>																	
<p><b>Quantity</b></p> <p>The quantity and nature of advice and operational services will be supplied on the basis agreed between the Minister for CRIs and the Executive Director of CCMAU (as amended from time to time) for 2005/06. ✓</p> <p>Quarterly and end-of-year reporting will enable the Minister to assess actual performance in output delivery against those expectations. ✓</p>																	
<p><b>Coverage</b></p> <p>A comprehensive range of services will be provided as agreed with the Minister for CRIs. These will include the capacity to react quickly and provide support for the Minister in Cabinet committees, including relevant briefings on significant issues and regular evaluation of the impacts of shareholder decisions and company actions on the Government's desired outcomes. ✓</p>																	
<p><b>Cost-effectiveness</b></p> <p>Analysis and advice will be delivered within the cost parameters agreed with the Minister for CRIs (or as subsequently modified by agreement). ✓</p>																	
<p><b>Timeliness</b></p> <p>Timeframes will be agreed between the Minister and the Executive Director of CCMAU for the financial year.</p> <ul style="list-style-type: none"> <li>Advice will be delivered within the agreed and/or statutory timeframe so that Ministers have sufficient time to consider the issues and take appropriate action. Where agreed deadlines will not be met, extensions are to be formally requested. ✓</li> <li>Ministerial correspondence (MCs), parliamentary questions (PQs), Cabinet agendas and Official Information Act requests (OIAs) will be responded to within agreed and/or statutory timeframes. ✓</li> <li>CCMAU will respond appropriately to requests for attendance at Parliament during debates and at Cabinet and select committee meetings. ✓</li> <li>Quarterly and end-of-year reporting will enable the Minister to assess actual performance in the timeliness of output delivery against those expectations. ✓</li> </ul>																	
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2005/06	PQs	MCs	OIAs														
Estimated	20-40	30-50	4-8														
Actual draft replies	43	38	3														
% answered by due date	100	100	100														

## Cost (\$000)

2005/06 Actual	970
Supp. Est. - Voted	981
Main Est.	1,068
2004/05 Actual	957

Actual 2005/06 output class expenditure was \$11,000 or 1% under Supplementary Estimates budgets.

The appropriation for this output class was decreased by \$87,000 in the Supplementary Estimates owing to a fiscally neutral transfer to Vote SOEs reflecting the actual allocation of overhead costs between the two Votes that fund CCMAU, offset by an increase to cover the costs of the State Sector Retirement Savings Scheme.

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# FINANCIAL STATEMENTS

for the year ended 30 June 2006

Statement of Responsibility .....	88
Departmental .....	89
Non-Departmental .....	109
New Zealand Debt Management Office .....	125
Audit Report .....	135

## STATEMENT OF RESPONSIBILITY

Pursuant to sections 45 and 45C of the Public Finance Act 1989, the Secretary to the Treasury is responsible for the preparation of the Department's financial statements and non-departmental supplementary schedules, and the judgements made in the process of producing these financial statements and supplementary schedules.

The Department's internal control procedures provide reasonable assurance as to the integrity and reliability of its financial reporting.

In the opinion of the Secretary to the Treasury:

- the Department's financial statements and statements of service performance fairly reflect its financial position and operations for the financial year ended 30 June 2006
- the supplementary schedules fairly reflect the assets, liabilities, contingencies and commitments managed by the Treasury on behalf of the Crown as at 30 June 2006 and revenues and expenses managed by the Treasury on behalf of the Crown for the year ended on that date.



John Whitehead  
Secretary to the Treasury

22 September 2006



John Matheson  
Chief Financial Officer  
(countersigned)

22 September 2006



Phillip Combes  
Treasurer  
(countersigned)

22 September 2006

# FINANCIAL STATEMENTS – DEPARTMENTAL

for the year ended 30 June 2006

Overview of Departmental Financial Results .....	90
Financial Performance .....	92
Movements in Taxpayers' Funds .....	93
Financial Position .....	94
Cash Flows .....	95
Commitments .....	96
Contingent Assets and Liabilities .....	97
Expenditure and Appropriations .....	98
Unappropriated Expenditure .....	99
Accounting Policies .....	100
Notes to the Financial Statements .....	103

# OVERVIEW OF DEPARTMENTAL FINANCIAL RESULTS

for the year ended 30 June 2006

The following significant movements in actual results between 2005/06 and 2004/05 are explained below.

	2006 Actual \$000	2005 Actual \$000
Revenue		
Crown	49,079	51,153
Other revenue	1,050	734
Expenses		
Personnel	34,890	33,423
Operating	11,622	14,310
Consultants	1,446	1,996
Capital charge	698	630
Non-Current Assets		
Property, plant and equipment	6,414	6,116
Taxpayers' Funds		
General Funds	8,527	8,927

## Revenue

**Revenue Crown** for departmental outputs decreased by \$2.1 million, mainly due to reductions in funding for the cost of leasing No 1 The Terrace, following a reduction in leased office space since 1 July 2005.

**Other revenue** increased by \$0.3 million due mainly to increased funding for the State Sector Retirement Savings Scheme of \$0.5 million. This increase was partially offset by a reduction in rental income received from sublet office space in 2004/05.

## Expenditure

**Personnel** increased by \$1.5 million due mainly to a market increase in salaries, introduction of additional leave and an increase in employers' State Sector Retirement Savings Scheme contributions.

**Operating** decreased by \$2.7 million due mainly to the reduction in costs of leasing premises as a result of less space occupied in 2005/06.

**Consultants** decreased by \$0.6 million due largely to less demand for external advice and process management services.

**Capital charge** increased by \$0.07 million due to increased taxpayers' equity following capital contributions of \$1.8 million during 2004/05 for the capital costs of the accommodation project. However, taxpayers' equity was reduced by a \$0.4 million capital repayment during 2005/06 which partly offset the increase in capital charge.

### Non-current assets

**Property, plant and equipment** increased by \$0.3 million due mainly to the capitalisation of computer software developments undertaken during the year and completion of the CCMAU accommodation project.

### Taxpayers' funds

**General funds** decreased by \$0.4 million due to a capital repayment to the Crown during 2005/06. The Treasury is repaying capital provided for the recent upgrade of office accommodation.

# STATEMENT OF FINANCIAL PERFORMANCE

for the year ended 30 June 2006

The Statement of Financial Performance details the revenue and expenses relating to all outputs (goods and services) produced by the Department, including CCMAU, during the financial year ended 30 June 2006. Total Expenses equals Total Departmental Output Classes Expenditure and Appropriations in the Statement of Expenditure and Appropriations on page 98.

2005 Actual \$000		Notes	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
<b>Revenue</b>					
51,153	Crown	1	49,079	51,393	50,714
734	Other revenue	2	1,050	1,000	1,151
51,887			50,129	52,393	51,865
<b>Expenses</b>					
33,423	Personnel		34,890	35,678	35,138
14,310	Operating	3	11,622	11,889	12,560
1,996	Consultants		1,446	2,400	1,970
1,528	Depreciation	4	1,473	1,744	1,483
630	Capital charge	5	698	682	714
51,887			50,129	52,393	51,865
-	Net Surplus		-	-	-

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

## STATEMENT OF MOVEMENTS IN TAXPAYERS' FUNDS

for the year ended 30 June 2006

The Statement of Movements in Taxpayers' Funds combines information about the net surplus with other aspects of the financial performance of the Department, including CCMAU, to give a degree of measure of comprehensive income.

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
7,127	Taxpayers' funds at the beginning of the year	8,927	8,927	8,927
	Movements during the year			
-	- Net surplus	-	-	-
	- Total Recognised Revenue and Expenses for the Year	-	-	-
1,800	Capital contributions from the Crown	-	-	-
	- Capital withdrawal repaid to the Crown	(400)	(400)	(400)
8,927	Taxpayers' Funds at the End of the Year	8,527	8,527	8,527

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF FINANCIAL POSITION

as at 30 June 2006

The Statement of Financial Position reports the total assets and liabilities of the Department, including CCMAU, as at 30 June 2006. Taxpayers' funds are represented by the difference between the assets and liabilities.

2005 Actual \$000		Notes	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
	<b>Taxpayers' Funds</b>				
8,927	General funds		8,527	8,527	8,527
8,927	<b>Total Taxpayers' Funds</b>		<b>8,527</b>	<b>8,527</b>	<b>8,527</b>
	Represented by:				
	Assets				
	Current Assets				
3,261	Cash and bank balances		3,182	2,880	3,008
581	Advances and prepayments		444	364	581
324	Accounts receivable		408	377	364
5,653	Debtor - Crown		5,753	5,954	4,596
9,819			<b>9,787</b>	<b>9,575</b>	<b>8,549</b>
	Non-Current Assets				
6,116	Property, plant and equipment	6	6,414	5,977	6,765
6,116			6,414	5,977	6,765
15,935	<b>Total Assets</b>		<b>16,201</b>	<b>15,552</b>	<b>15,314</b>
	Less:				
	Liabilities				
	Current Liabilities				
3,082	Payables and accrued expenses		3,312	3,162	2,978
3,509	Provision for employee entitlements	7	4,005	3,456	3,470
30	Provision for onerous contracts	8	25	28	30
-	Finance lease liability	9	18	-	-
6,621			<b>7,360</b>	<b>6,646</b>	<b>6,478</b>
	Non-Current Liabilities				
358	Provision for employee entitlements	7	276	360	292
29	Provision for onerous contracts	8	17	19	17
-	Finance lease liability	9	21	-	-
387			<b>314</b>	<b>379</b>	<b>309</b>
7,008	<b>Total Liabilities</b>		<b>7,674</b>	<b>7,025</b>	<b>6,787</b>
8,927	<b>Net Assets</b>		<b>8,527</b>	<b>8,527</b>	<b>8,527</b>

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF CASH FLOWS

for the year ended 30 June 2006

The Statement of Cash Flows summarises the cash movements in and out of the Department during the financial year. It takes no account of money owed to the Department or owing by the Department and therefore differs from the Statement of Financial Performance on page 92.

2005 Actual \$000	Notes	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
<b>Cash Flows from Operating Activities</b>				
Cash was provided from:				
52,413	Supply of outputs to the Crown	48,979	52,241	51,771
739	Supply of outputs to third parties	1,028	152	1,151
53,152		50,007	52,393	52,922
Cash was disbursed to:				
33,298	Personnel	34,476	35,364	35,244
18,617	Operating	12,481	14,869	14,642
630	Capital charge	698	674	714
52,545		47,655	50,907	50,600
607	Net Cash Flows from Operating Activities	10 2,352	1,486	2,322
<b>Cash Flows from Investing Activities</b>				
Cash was provided from:				
3	Sale of property, plant and equipment	10	2	-
Cash was disbursed to:				
(3,199)	Purchase of property, plant and equipment	(2,041)	(1,387)	(2,175)
(3,196)	Net Cash Flows from Investing Activities	(2,031)	(1,385)	(2,175)
<b>Cash Flows from Financing Activities</b>				
Cash was provided from:				
1,800	Capital contribution	-	-	-
Cash was disbursed to:				
-	Capital withdrawal	(400)	(400)	(400)
1,800	Net Cash Flows from Financing Activities	(400)	(400)	(400)
(789)	Net Decrease in Cash and Bank Balances	(79)	(299)	(253)
4,050	Cash and bank balances at the beginning of the year	3,261	3,179	3,261
3,261	Cash and Bank Balances at the End of the Year	3,182	2,880	3,008

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

## STATEMENT OF COMMITMENTS

as at 30 June 2006

The Department has a non-cancellable lease on its principal premises at No 1 The Terrace, Wellington. The Department also has a non-cancellable lease over office space in Boulcott Street, Wellington. The Department has other operating commitments consisting of computer maintenance contracts, building services contracts and contracts for services. These operating lease commitments have been recorded at their gross values in the Statement of Commitments. However, onerous contract provisions have been recorded for the office space the Department does not occupy, which is detailed in Note 8.

2005 Actual \$000		2006 Actual \$000
	Operating Lease Commitments	
3,656	Less than one year	3,737
3,234	One to two years	3,201
8,861	Two to five years	9,114
20,362	Greater than five years	18,340
36,113		34,392
-	Capital Commitments	-
36,113	Total Commitments	34,392

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF CONTINGENT ASSETS AND LIABILITIES

as at 30 June 2006

As at 30 June 2006, the Department had no departmental contingent assets or liabilities (30 June 2005: nil).

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF EXPENDITURE AND APPROPRIATIONS

for the year ended 30 June 2006

The Statement of Expenditure and Appropriations details expenditure against appropriations. Total Departmental Output Classes Expenditure and Appropriations equals total expenses in the Statement of Financial Performance on page 92. The 2004/05 comparatives have been restated as GST exclusive following the passing of the Public Finance Amendment Act 2004.

2005 Actual \$000	Notes	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
	Vote Finance: Departmental Output Classes			
2,456	Budget Management	2,225	2,359	2,303
4,218	Debt and Related Financial Asset Management	3,721	4,352	3,791
6,052	Economic and Fiscal Forecasting and Reporting	5,939	6,107	5,972
2,295	Management of Claims against the Crown, Contractual Liabilities and Crown Properties	2,381	2,279	2,806
3,006	Policy Advice: Financial and Public Sector Management Systems	2,328	2,952	2,444
3,972	Policy Advice: General Economic and Fiscal Strategies	4,397	4,168	4,650
2,673	Policy Advice: Ownership and Performance of Crown Companies and Financial Institutions	2,566	2,637	2,685
21,625	Policy Advice : Regulation and Vote Purchase, Ownership and Performance Issues	20,383	21,281	20,714
2,373	Policy Advice: Tax	2,739	2,742	2,966
48,670		46,679	48,877	48,331
	Vote Crown Research Institutes: Departmental Output Classes			
957	Crown Company Monitoring Advice to the Minister for Crown Research Institutes	970	1,068	981
	Vote State-Owned Enterprises: Departmental Output Classes			
2,260	Crown Company Monitoring Advice to the Minister for State-Owned Enterprises and Other Responsible Ministers	2,480	2,448	2,553
51,887	Total Departmental Output Classes Expenditure and Appropriation	50,129	52,393	51,865
	Vote Finance: Capital Contributions to the Department			
1,800	Capital investment	-	-	-
53,687	Total Departmental Expenditure and Appropriations	50,129	52,393	51,865

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF UNAPPROPRIATED EXPENDITURE

for the year ended 30 June 2006

## Vote Finance, Departmental Output Expenses: Debt and Related Financial Asset Management

The Treasury identified a technical appropriation issue regarding the classification of NZDMO overhead costs in the departmental output Debt and Related Financial Asset Management. NZDMO overhead costs relating to managing lending and Crown bank accounts had been charged to a permanent legislative authority (PLA) output when they were in fact outside the scope of the PLA and therefore should have been charged to an output having an annual appropriation.

This issue existed from the introduction of the Public Finance Act 1989 on 1 July 1989 until 1 April 2006 when the classification of the departmental output Debt and Related Financial Asset Management was changed to an annual appropriation and its scope expanded to cover all NZDMO activities in the Supplementary Estimates of Appropriation.

Period	Total \$000
1 July 2005 to 31 March 2006	482
1 July 2004 to 30 June 2005	785

Overhead expenditure incorrectly classified as PLA from 1 July 1989 to 30 June 2004 was not separately recorded and therefore is not able to be quantified. This expenditure was a proportion of the total expenses incurred through the output of between \$4.69 million and \$6.67 million (GST exclusive) per year.

The Minister of Finance has approved that validation for these items is to be sought within the 2005/06 Financial Review Bill, in accordance with section 26C of the Public Finance Act 1989.

*The accounting policies on pages 100 to 102 and accompanying notes on pages 103 to 108 are an integral part of these financial statements.*

# STATEMENT OF ACCOUNTING POLICIES

## Reporting entity and statutory base

These are the financial statements of the Treasury, a government department (the “Department”) as defined by section 2 of the Public Finance Act 1989 for the financial year ended 30 June 2006. The statements have been prepared pursuant to section 45 of that Act.

The activities of CCMAU have been incorporated into these financial statements.

## Measurement system

These financial statements have been prepared on the basis of historical cost.

## Accounting policies

### Revenue

The Department derives revenue through the provision of outputs to the Crown and for services to third parties. Such revenue is recognised in the Statement of Financial Performance when earned.

### Cost allocation

The Department has derived the cost of outputs using a cost allocation system, which is outlined below.

### Definition of terms

“Branch” is a cost centre that directly and indirectly contributes to outputs.

“Corporate overhead costs” are those costs attributed to support service cost centres.

“Direct costs” are costs that can be identified with a single output.

“Indirect costs” are costs that cannot be identified with an output in an economically feasible manner. They are incurred for the common benefit of more than one output.

### Corporate overhead costs

Corporate overhead costs are assigned to branches on an approximate resource usage basis.

### Direct costs

Where possible, costs are assigned directly to outputs.

### Direct labour costs

A time recording system is used to collect and assign direct labour costs to outputs.

### Indirect costs

Indirect costs, including corporate overhead costs, are allocated to outputs on a direct labour cost basis.

### Accounts receivable

Accounts receivable are recorded in the Statement of Financial Position at the amounts expected to be ultimately collected.

## Leases

### Operating lease

The Department leases office premises. Substantially all the risks and benefits of ownership are retained by the lessor and therefore these leases are classified as operating leases. Operating lease costs are recognised as an expense in the Statement of Financial Performance in the year in which they are incurred, except for onerous lease provisions.

### Finance lease

The Crown Company Monitoring Advisory Unit leases computer equipment. Substantially all the risks and benefits of ownership belong to the lessee and therefore this lessee is classified as a finance lease. The obligation under this lease is capitalised at present value of the minimum lease payments. The capitalised values are amortised over the period in which CCMAU expects to receive benefits from their use.

## Property, plant and equipment

Property, plant and equipment are stated at the lower of cost less accumulated depreciation or fair value. All computer equipment assets and all other assets costing more than \$5,000 are capitalised.

## Depreciation

Depreciation is calculated on a straight line basis to allocate cost of property, plant and equipment, less estimated residual value, over their useful lives. The estimated economic useful lives are:

Furniture and fittings:	Safes	15 years
	Shelving	10 years
	Other	5 years
Leasehold improvements:		12 years
Office machinery and electrical equipment:	Photocopiers	5 years
	Other	5 years
	Electronic white boards	3 years
	Facsimile machines	3 years
Computer hardware:	UPS/Air conditioning	5 years
	Equipment	5 years
	Cabling	5 years
	PCs, terminals and printers	3 years
Computer software:	System software	3 years
Plant:		5 years

## Provisions

### Employee entitlements

Provision is made in respect of the Department's liability for resigning, retirement and long service leave. These provisions have been calculated on an actuarial basis based on the present value of expected future entitlements.

### Onerous contract

Where the benefits expected to be derived from a contract are lower than the unavoidable costs of meeting the Department's obligation under the contract, a provision is recognised. The provision is stated at the present value of the future net cash outflows expected to be incurred in respect of the contract.

### Foreign currency

Foreign-currency transactions, relating primarily to information, travel and training costs, are reported at the New Zealand-dollar exchange rate at the date of the transaction.

### Financial instruments

Financial instruments primarily comprise cash and bank balances, receivables and payables. All financial instruments are recognised in the Statement of Financial Position. Revenues and expenses in relation to all financial instruments are recognised in the Statement of Financial Performance.

### Goods and services tax

Amounts in the financial statements are reported exclusive of GST except for advances and prepayments, accounts receivable, debtor – Crown and payables.

The amount of GST owing to or from the Inland Revenue Department as at balance date, being the difference between output GST and input GST, is included in the Statement of Financial Position as either a payable or a receivable (as appropriate).

The 2004/05 comparatives in the Statement of Expenditure and Appropriations have been restated as GST exclusive following the passing of the Public Finance Amendment Act 2004.

### Income tax

Government departments are exempt from the payment of income tax in terms of the Income Tax Act 1994. Accordingly, no charge for income tax has been provided for.

### Commitments

Commitments disclosed include those operating and capital commitments arising from non-cancellable contractual obligations.

### Contingent assets and liabilities

Departmental contingent assets and liabilities are disclosed in the Statement of Contingent Assets and Liabilities at the point at which the contingency is evident.

## Changes in accounting policies

There have been no changes in accounting policies, including cost allocation accounting policies, since the date of the last audited financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

## 1 Revenue – Crown

This is revenue earned for the supply of outputs to the Crown.

## 2 Other revenue

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
186	Rental income	12	-	-
489	State Sector Retirement Superannuation Scheme	956	994	950
-	- Gain on sale of assets	10	-	-
59	Miscellaneous	72	6	201
734		1,050	1,000	1,151

## 3 Operating costs

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
5,322	Lease of premises	2,937	3,116	3,011
250	Fees to KPMG for audit of the Department and NZDMO	243	254	254
130	Fees to Auditor-General for audit of the Crown Financial Statements	182	130	191
147	Other fees to Department and NZDMO auditors	58	15	45
200	Other fees to Crown auditors	247	275	275
(9)	Provisions for onerous lease	17	-	17
-	- Finance charges on finance lease	3	-	-
-	- Foreign-exchange losses - realised	2	-	-
1,704	Process management services	1,598	1,707	1,607
1,313	Transport and travel	1,140	1,497	1,330
840	Training and development	735	1,023	1,070
825	Information costs	748	858	800
709	Data processing costs	547	690	554
66	Furniture/office equipment purchases	18	16	22
2,813	Other operating costs	3,147	2,308	3,384
14,310		11,622	11,889	12,560

## 4 Depreciation

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
135	Furniture and fittings	189	193	187
397	Leasehold improvements	385	388	381
43	Office machinery and electrical equipment	17	35	16
935	Computer hardware	847	1,110	864
17	Computer software	35	18	35
1	Plant	-	-	-
1,528		1,473	1,744	1,483

## 5 Capital charge

The Treasury pays a capital charge to the Crown on its average taxpayers' funds for the six months ended 30 June and 31 December.

The capital charge rate for the financial year ended 30 June 2006 was 8% (30 June 2005: 8%)

## 6 Property, plant and equipment

The following categories of property, plant and equipment were used by the Department.

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
	<b>Computer Hardware</b>			
4,161	Cost	4,407	5,714	4,546
(3,048)	Accumulated depreciation	(3,253)	(4,345)	(3,172)
1,113		1,154	1,369	1,374
	<b>Computer Software</b>			
2,767	Cost	1,369	2,812	1,518
(2,757)	Accumulated depreciation	(1,115)	(2,767)	(1,115)
10		254	45	403
	<b>Furniture and Fittings</b>			
1,002	Cost	1,089	1,248	1,102
(213)	Accumulated depreciation	(364)	(575)	(400)
789		725	673	702
	<b>Leasehold Improvements</b>			
4,592	Cost	5,025	4,897	5,071
(430)	Accumulated depreciation	(814)	(1,061)	(810)
4,162		4,211	3,836	4,261
	<b>Leased Equipment</b>			
-	Cost	56	-	-
-	Accumulated depreciation	(17)	-	-
-		39	-	-
	<b>Office Machinery and Electrical Equipment</b>			
750	Cost	647	1,082	750
(708)	Accumulated depreciation	(616)	(1,028)	(725)
42		31	54	25
6,116	<b>Total Property, Plant and Equipment*</b>	6,414	5,977	6,765

\* The 30 June 2006 total actual balance includes \$163,000 of work in progress (30 June 2005: \$10,800) which has not been depreciated.

## 7 Provision for employee entitlements

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
1,285	Retirement, resigning and long service leave	1,267	1,499	1,234
2,058	Annual leave	2,355	1,789	2,000
314	Accrued salaries	244	240	240
139	Accrued performance payments	131	96	96
71	Accrued other entitlements	284	192	192
3,867		4,281	3,816	3,762
	Represented by:			
3,509	Current	4,005	3,456	3,470
358	Non-current	276	360	292
3,867		4,281	3,816	3,762

## 8 Provision for onerous contracts

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
161	Balance at the beginning of the year	59	59	59
	Additional provisions made	17	17	17
(9)	Unused provision reversed	(3)	-	-
(93)	Amount utilised	(29)	(29)	(29)
	Effect of discounting	(2)	-	-
59		42	47	47
	Represented by:			
30	Current	25	28	30
29	Non-current	17	19	17
59		42	47	47

The Department has a non-cancellable lease, which is at Level 14, 47 Boulcott Street in Wellington. Owing to the change in its activities, the Department no longer occupies Level 14 at the Boulcott Street premises. These premises are currently sub-leased. Owing to market conditions, the rental income is lower than the rental expense being incurred. The net obligation under the lease agreement has been provided for as an onerous lease and this liability will be incurred over the next two years.

## 9 Term liabilities

2005 Actual \$000	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
Analysis of finance lease liabilities			
- Payable no later than one year	20	-	-
- One to two years	20	-	-
- Two to five years	2	-	-
- Less future finance charges	(3)	-	-
-	39	-	-
Represented by:			
- Current	18	-	-
- Non-current	21	-	-
-	39	-	-

The effective interest rate for the life of the finance lease is 6.5%. The finance lease is secured over the assets to which it relates. The ownership of these assets passes to the Department at the conclusion of the lease term. The Minister of Finance, pursuant to section 47 of the Public Finance Act 1989 has approved this finance lease.

## 10 Reconciliation of net surplus to net cash flow from operating activities

This reconciliation discloses the non-cash adjustments applied to the net surplus reported in the Statement of Financial Performance on page 92 to arrive at the net cash flows from operating activities disclosed in the Statement of Cash Flows on page 95.

2005 Actual \$000	2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
- Net Surplus from Statement of Financial Performance	-	-	-
Non-cash items:			
1,528 Depreciation	1,473	1,744	1,483
Add /(less) working capital movements -			
(218) (Increase)/decrease in advances and prepayments	137	(1)	-
(77) (Increase)/decrease in accounts receivable	(84)	-	(40)
1,260 Decrease/(increase) in debtor - Crown	(100)	-	1,057
(1,991) (Decrease)/increase in payables, accrued expenses and provisions	495	(438)	(65)
113 Increase/(decrease) in other current liabilities	514	232	(39)
(29) Increase/(decrease) in non-current liabilities	(73)	(49)	(74)
Investing activity items			
21 Net loss/(gain) on sale of property, plant and equipment	(10)	(2)	-
607 Net Cash Flows from Operating Activities	2,352	1,486	2,322

## 11 Financial instruments

The Department is party to financial instrument arrangements as part of its everyday operations. These financial instruments include cash and bank balances, advances, accounts receivable, debtor Crown, and payables and accrued expenses.

### Credit risk

In the normal course of its business the Department is subject to credit risk from debtors other than the Crown.

The Department does not require any collateral or security to support financial instruments with financial institutions with which the Department deals, as these entities have high credit ratings. For its other financial instruments the Department does not have significant concentrations of credit risk.

### Fair value

The fair value of financial instruments is equivalent to the carrying amount disclosed in the Statement of Financial Position.

### Currency and interest-rate risk

The Department has no significant exposure to currency exchange loss risk and its financial instruments are not interest-rate sensitive.

## 12 Output Class: Debt and Related Financial Asset Management

The Public Finance Act 1989 requires all appropriations authorised under permanent legislative authority to be disclosed by the section providing the authority.

2005 Actual \$000		2006 Actual \$000	2006 Main Estimates \$000	2006 Supp. Estimates \$000
	Debt and Related Financial Asset Management			
3,433	Section 61: Borrowing	802	-	-
-	Section 65H: Derivatives	1,096	-	-
-	Section 65J: Investments	294	-	-
3,433	Total Appropriated under Permanent Legislative Authority	2,192	4,352	2,703
-	Annual Appropriation	1,047	-	1,088
785	Unappropriated Expenditure	482	-	-
4,218	Total Output Class	3,721	4,352	3,791

The total output class disclosed within the Main and Supplementary Estimates was not required to be separately allocated across the specific sections of the Public Finance Act 1989.

### 13 Related party information

The Department is a wholly owned entity of the Crown. The Government significantly influences the roles of the Department as well as being its major source of revenue.

The Department enters into numerous transactions with other government departments, Crown agencies and SOEs on an arm's length basis. These transactions are not required to be disclosed as related party transactions.

### 14 Events subsequent to balance date

There were no events subsequent to balance date that required adjustment to the financial statements or disclosure (2005 none).

### 15 Transition to New Zealand equivalents to International Financial Reporting Standards

The Department will be adopting New Zealand IFRS for the first time in its audited financial statements for the year ending 30 June 2008. This timetable is in line with the adoption of the New Zealand equivalents to IFRS in the consolidated financial statements of the government reporting entity. The Department will be adopting the accounting policies of the financial statements of the Government. The Department is evaluating the differences, if any, between these and current policies. The Treasury has established a team to manage the New Zealand IFRS implementation. At this stage no material issues have been identified. However, the actual impact of adopting New Zealand IFRS may vary from this initial assessment as changes to NZIFRS are approved under the Financial Reporting Act 1993 and this variation may be material.

# SUPPLEMENTARY FINANCIAL SCHEDULES – NON-DEPARTMENTAL

for the year ended 30 June 2006

Overview .....	110
Accounting Policies .....	113
Expenses .....	114
Expenditure and Appropriations .....	115
Unappropriated Expenditure .....	117
Revenue .....	118
Capital Receipts .....	119
Assets .....	120
Liabilities .....	121
Commitments .....	122
Contingent Liabilities .....	123
Trust Monies .....	124

The following supplementary financial schedules record the expenses, revenue and capital receipts, assets and liabilities that the Department manages on behalf of the Crown. These supplementary financial schedules include NZDMO balances reported on pages 125 to 134.

The Department administered \$4,142 million of expenses, \$4,182 million of revenue, \$406 million of capital receipts, \$24,765 million of assets and \$52,290 million of liabilities on behalf of the Crown for the year ended 30 June 2006.

The financial information reported in these schedules is consolidated into the Crown financial statements, and therefore readers of these schedules should also refer to the Crown financial statements for the year ended 30 June 2006.

## OVERVIEW

### Air New Zealand:

In 2004/05, the Crown took up its share of a rights issue by Air New Zealand, at a cost of \$149 million (page 116). This was a one-off transaction.

### Amortisation of goodwill in Air New Zealand:

Following the passage of the Public Finance Amendment Act 2004, amortisation of goodwill is required to be appropriated (page 115).

### Atihau-Whanganui Incorporation:

In 2005/06, the Crown made a grant of \$3 million to the Atihau-Whanganui Incorporation (page 115) to assist in buying back leased land before the leases expire. This was a one-off transaction.

### Capital charge:

Capital charge receipts in 2005/06 increased by 17% compared with 2004/05. This was primarily due to recent revaluations of property, plant and equipment increasing the capital base of departments (page 118).

### Cash and bank accounts:

Total cash and bank accounts is \$1,672 million higher than in June 2005 (page 120), as a result of an increase in DMO's Crown Settlement Account balance with the Reserve Bank.

### Crown overseas properties:

The Crown's portfolio of overseas properties, except for New Zealand House, was transferred to the Ministry of Foreign Affairs and Trade on 1 July 2005, reducing the balance sheet item "Property, plant and equipment" by \$195 million (page 120).

### Depreciation:

Following the passage of the Public Finance Amendment Act 2004, depreciation is required to be appropriated. Depreciation on New Zealand House was added to the appropriation "Other expenses incurred by the Crown, Crown overseas properties" and depreciation on Wellington Railway Station was added to the appropriation "Other expenses incurred by the Crown, Wellington Railway Station expenses" (page 115).

### Dividends:

SOE dividends increased by \$744 million from 2004/05 (page 118), primarily as a result of a special dividend from Meridian Energy following the sale of their Australian assets. Crown entity dividends increased by \$32 million, as a result of a further special dividend from Television New Zealand.

### Foreign-exchange gains/(losses):

Foreign-exchange gains were \$26 million in 2005/06, compared with losses of \$18 million in 2004/05, as a result of movements in the NZD/USD exchange rate affecting the value of New Zealand's shareholding in the Asian Development Bank and the World Bank (page 118).

### Geothermal trading:

Most of the Crown's geothermal assets were transferred to Mighty River Power on 1 July 2005. This resulted in a gain on sale of \$12 million (page 118).

#### GSF benefits:

GSF benefit payments were 32% higher than 2004/05, as a result of Police members transferring their funds to a dedicated Police scheme (page 115).

#### Interest on investments:

Interest from Investment Income was 36% higher (\$279 million) than for 2004/05 (page 118). The increase was the result of an increase in foreign-exchange trades, increased lending to the Reserve Bank and a higher level of marketable securities.

#### International financial institutions:

No capital contributions to the International Monetary Fund (IMF) were required in 2005/06 (page 116), whilst returns of capital totalled \$313 million (page 119). This reflects the cyclical nature of the IMF lending programme.

#### Net debt repayment, and net borrowing receipts:

The Public Finance Amendment Act 2004 removed the requirement to appropriate net repayment of debt (page 116) and net borrowing receipts are no longer recorded (page 119).

#### NPF Defined Benefit Plan (Annuitants) Scheme liability movement:

The NPF DBP (A) Scheme liability as at 30 June 2006 was \$998 million (page 121), an increase of \$54 million compared with 30 June 2005. The primary reason for the increase was movements in the economic assumptions used in calculating the liability.

#### NZDMO other expenses and other income:

NZDMO's other expenses increased by \$10 million from 2004/05, primarily as a result of foreign-exchange rate movements (page 114). Other income increased by \$180 million from 2004/05, primarily as a result of a change in the market valuation methodology applied in respect of foreign-currency advances to the Reserve Bank (page 118).

#### Reserve Bank surplus:

The Reserve Bank's "notional surplus payable to the Crown" fell from \$192 million to \$139 million, as a result of a change to the definition of "notional surplus" to reflect only realised gains, rather than reported gains (which includes unrealised gains) (page 118).

#### Rugby World Cup:

During the year, the Crown agreed to underwrite the 2011 Rugby World Cup, at an estimated net present value cost of \$32 million (page 115).

#### Rail issues:

During the year, the Crown:

- transferred responsibility for management of the Auckland rail corridor to New Zealand Railways Corporation
- transferred administrative and accounting responsibility for the land under the national rail corridor, which required a \$99 million appropriation (page 116), and sold certain other rail assets, to New Zealand Railways Corporation totalling \$36.7 million (page 119)

- continued the structural upgrade of Wellington Railway Station, at a cost of \$6 million in 2005/06 (page 116)
- spent a further \$59 million (GST inclusive) on upgrading the national rail network (page 115)
- provided \$3 million of working capital, and long-term loans of \$56 million, to New Zealand Railways Corporation (page 116)
- Spent \$4 million of the \$600 million committed in the 2006 Budget to the development of rail services in Auckland (page 115).

# STATEMENT OF ACCOUNTING POLICIES

for the year ended 30 June 2006

The Public Finance Amendment Act 2004 removed the requirement to appropriate the GST content of expenditure, commencing from the 2005/06 year. All comparative figures for 2004/05 have been restated to exclude GST.

Measurement and recognition rules applied in the preparation of these non-departmental supplementary financial schedules are consistent with GAAP and Crown accounting policies.

The financial information reported in these schedules is consolidated into the Crown financial statements, and therefore readers of these schedules should also refer to the Crown financial statements for the year ended 30 June 2006.

## SCHEDULE OF EXPENSES

for the year ended 30 June 2006

The Schedule of Expenses summarises expenses that the Department administers on behalf of the Crown. Details of non-departmental expenditure and appropriations are provided on page 115.

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates \$000
	<b>Vote Finance</b>		
9,675	Non-departmental output classes	7,875	9,995
827,384	Benefits and other unrequited expenses	1,091,367	1,030,347
2,588,917	Borrowing expenses	2,674,921	2,608,000
234,700	Other expenses incurred by the Crown	289,405	372,354
4,978	Other expenses - NZDMO	14,473	6,000
	<i>Remeasurements:</i>		
11,316	- Rail asset writedowns	-	-
53,151	- Change in NPF DBP (A) Scheme liability	54,101	-
1,261,111	- Change in GSF unfunded liability	9,960	161,758
4,991,232		4,142,102	4,188,454
	<b>Vote Crown Research Institutes</b>		
847	Other expenses incurred by the Crown	-	-
847		-	-
4,992,079	Total Non-Departmental Expenses	4,142,102	4,188,454

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# STATEMENT OF EXPENDITURE AND APPROPRIATIONS

for the year ended 30 June 2006

The Statement of Expenditure and Appropriations details expenditure and capital payments incurred against appropriations. The Department administers these appropriations on behalf of the Crown.

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates Voted \$000
	<b>Vote Finance</b>		
	<b>Non-Departmental Output Classes</b>		
4,556	GSF Authority	3,641	4,133
3,689	Guardians of New Zealand Superannuation	3,728	4,711
905	Management of Auckland Rail Corridor	-	-
426	Management of Crown Overseas Properties	441	1,000
99	Management of Geothermal Trading	65	151
9,675		7,875	9,995
	<b>Benefits and Other Unrequited Expenses</b>		
806,249	GSFA - subsidy to Government Superannuation Fund	1,068,476	1,007,203
16,336	GSFA - subsidy to judges' superannuation account	17,167	17,170
4,445	GSFA - subsidy to parliamentary superannuation account	5,339	5,622
354	GSFA - NZ Superannuation Corporation annuities	385	352
827,384		1,091,367	1,030,347
	<b>Borrowing Expenses</b>		
2,588,917	Debt servicing	2,674,921	2,608,000
2,588,917		2,674,921	2,608,000
	<b>Other Expenses Incurred by the Crown</b>		
46,900	Amortisation of Air New Zealand goodwill	46,900	46,900
-	Auckland rail development	3,686	25,000
16,524	Crown overseas properties	13,955	16,000
27	Crown residual liabilities	426	852
1,867	Geothermal Trading	45	500
-	Grant to Atihau-Whanganui Incorporation	3,000	3,000
1	GSF Appeals Board	3	50
5,945	GSF: Crown share of custodial and investment management expenses	6,880	6,361
103,875	Maui gas contracts	112,673	141,900
50,296	National rail network upgrade	59,098	73,125
6,133	NZRC operating and maintenance costs	10,070	12,900
19	Overseas Investment Commission honoraria	4	4
-	Rugby World Cup	32,093	44,000
2,378	Track Co establishment costs	-	-
720	Wellington Railway Station expenses	548	1,262
15	Unclaimed money	24	500
234,700		289,405	372,354

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# STATEMENT OF EXPENDITURE AND APPROPRIATIONS (CONTINUED)

for the year ended 30 June 2006

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates Voted \$000
	Vote Finance (continued)		
	Capital Expenditure		
149,350	Air New Zealand	-	-
10,414	Auckland Regional Council loan to purchase and upgrade rolling stock	-	-
1,554	Development of Crown overseas properties	-	-
4,268	Double tracking Auckland rail corridor	-	-
3	Geothermal Trading	-	-
-	Guardians of New Zealand Superannuation	200	200
-	International financial institutions	-	200,000
-	Invercargill Airport loan	-	1,500
15,000	NZ Railways Corporation - loans	56,000	56,000
20,000	NZ Railways Corporation - equity	3,000	3,000
7,048	NZ Railways Corporation - purchase of rail network assets	-	-
-	NZ Railways Corporation - transfer of land	98,892	98,892
2,107,000	New Zealand Superannuation Fund	2,337,000	2,337,000
1,000,000	Reserve Bank of New Zealand	-	-
-	Rugby World Cup Joint Venture	-	20,000
950	Taitokerau Forests	700	700
6,138	Wellington Railway Station upgrade	5,642	10,314
-	Wellington Regional Council loans	-	7,420
3,321,725		2,501,434	2,735,026
	Repayment of debt		
661,937	Net domestic debt repayment	-	-
661,937		-	-
7,644,338	Total Vote Finance	6,565,002	6,755,722
	Vote Crown Research Institutes		
	Other Expenses Incurred by the Crown		
3	CRI residual liabilities	-	-
844	CRI non-excluded liabilities	-	-
847	Total Vote Crown Research Institutes	-	-
7,645,185	Total Non-Departmental Expenditure and Appropriations	6,565,002	6,755,722

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# STATEMENT OF UNAPPROPRIATED EXPENDITURE

for the year ended 30 June 2006

## Vote Finance, Capital Contributions to Other Persons or Organisations

Housing New Zealand Corporation: Refinancing of Crown debt: \$156.751 million in 2002/03 only.

Vote Finance did not incur any unappropriated expenditure in the 2005/06 year. However, one item relating to the 2002/03 year was discovered. Eight loans advanced to Housing New Zealand Corporation (HNZC) and Housing New Zealand Ltd (HNZL) between August 2001 and the present were to refinance previous Crown loans to HNZC and HNZL that were maturing.

As these matured, they were treated as being rolled over for further terms, with no expenses incurred beyond the original 2001 appropriations.

However, while these funds were not physically repaid or redrawn, the loan agreements were renewed for a new term. Therefore, the new loans required new appropriations.

Whilst all eight of the loans will require validation under the 2005/06 Financial Review Bill, only three of these fall within Vote Finance. The remainder are being dealt with through Vote Housing.

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# SCHEDULE OF REVENUE

for the year ended 30 June 2006

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates \$000
	<b>Vote Finance</b>		
7,278	Auckland rail double tracking - grant from Infrastructure Auckland	-	-
1,119,431	Capital charge	1,308,228	1,312,757
2,309	Contact Energy Ltd Crown margin interest	3,869	2,198
48,698	Dividends from Crown entities	80,452	10,452
329,369	Dividends from SOEs	1,073,109	325,204
2,837	Dividends - other	2,848	2,848
10,000	Earthquake Commission guarantee fee	10,000	10,000
65,035	Employers' superannuation contributions	61,562	61,783
12	Export Credit Office	150	150
769,101	Interest from investments	1,048,269	883,000
13,430	Interest income - other	7,459	7,350
51,677	Other income - NZDMO	231,793	99,000
103,875	Maui Gas contracts	100,632	128,000
23,115	Rentals from Crown overseas properties	15,535	16,400
191,747	Reserve Bank of New Zealand net surplus	139,284	139,284
29,849	Sale of goods and services	21,502	24,700
1,100	Gain on sale of physical assets	12,222	12,222
(18,258)	Foreign-exchange gains/(losses)	25,939	4,675
13,543	Other current revenue	18,506	979
1,744	Unclaimed money	373	500
(22,378)	Remeasurements - other	1,919	-
2,743,514		4,163,651	3,041,502
	<b>Vote Crown Research Institutes</b>		
15,000	Dividends from CRIs	18,000	18,300
15,000		18,000	18,300
2,758,514	<b>Total Non-Departmental Revenue</b>	<b>4,181,651</b>	<b>3,059,802</b>

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## SCHEDULE OF CAPITAL RECEIPTS

for the year ended 30 June 2006

The Schedule of Capital Receipts details non-departmental capital receipts that the Department administers on behalf of the Crown.

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates \$000
	Vote Finance		
47,600	Contact Energy Ltd Crown margin	55,800	55,802
567,933	Net foreign borrowing	-	-
15,084	Loan repayments from other parties	-	-
230,000	Return of capital from the International Monetary Fund	313,000	313,000
1,472	Sale of rail assets to NZ Railways Corporation	36,700	36,700
862,089		405,500	405,502

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## SCHEDULE OF ASSETS

as at 30 June 2006

The Schedule of Assets summarises the assets that the Department administers on behalf of the Crown.

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates \$000
715,172	Cash and bank accounts	2,386,956	1,766,713
2,552,934	Accounts receivable and advances	2,780,683	2,768,249
16,675,281	Marketable securities, deposits and equity investments	18,984,784	17,234,216
23,045	Inventory	10,975	9,057
338,390	Intangibles and goodwill	257,950	257,950
185,769	Other investments	211,427	189,892
426,056	Property, plant and equipment	132,480	135,203
20,916,647	Total Non-Departmental Assets	24,765,255	22,361,280

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## SCHEDULE OF LIABILITIES

as at 30 June 2006

The Schedule of Liabilities summarises the liabilities that the Department administers on behalf of the Crown.

2005 Actual \$000		2006 Actual \$000	2006 Supp. Estimates \$000
3,317,000	Overdrafts	3,040,000	3,333,000
11,430,000	Government Superannuation Fund unfunded liability	11,439,960	11,591,758
944,171	NPF DBP (A) Scheme unfunded liability	998,272	944,171
-	Rugby World Cup provision	31,793	24,000
735,422	Other payables and provisions	678,293	421,547
36,072,000	Borrowings	36,102,000	35,999,000
52,498,593	Total Non-Departmental Liabilities	52,290,318	52,313,476

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## SCHEDULE OF COMMITMENTS

as at 30 June 2006

2005 \$000		2006 \$000
	By Type	
	Operating commitments	
1,766	Non-cancellable property lease	2,021
-	Auckland rail development	575,000
133,293	National rail network upgrades	80,761
364	Other non-cancellable operating commitments	213
135,423		657,995
	By Term	
	Operating commitments	
83,223	Less than one year	195,261
29,223	One to two years	335,809
21,417	Two to five years	125,145
1,560	More than five years	1,780
135,423		657,995
	Capital Commitments	
8,525	Wellington Railway Station	4,867
8,525		4,867
143,948	Total Commitments	662,862

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## SCHEDULE OF CONTINGENT LIABILITIES

as at 30 June 2006

2005 \$000		2006 \$000
	Quantifiable Contingent Liabilities:	
61,275	Guarantees and indemnities	50,536
2,221,272	Uncalled capital	2,577,091
1,350	Legal proceedings and disputes	750
1,292,322	Other contingent liabilities	1,817,312
3,576,219		4,445,689

Contingent liabilities are costs which the Crown will have to face if a particular event occurs. Typically, contingent liabilities consist of guarantees and indemnities, uncalled capital, legal disputes and claims. The contingent liabilities managed by the Department on behalf of the Crown are a mixture of operating and balance sheet risks and they vary greatly in magnitude and likelihood of realisation. In general, if a contingent liability were realised it would have a negative impact on the operating balance, net Crown debt and net worth. However, in the case of contingencies for uncalled capital, the negative impact would be restricted to net Crown debt.

Where contingent liabilities have arisen as a consequence of legal action being taken against the Crown, the amount included is the amount claimed and thus the maximum potential cost. It does not represent either an admission that the claim is valid or an estimation of the possible amount of any award against the Crown.

The majority of the quantified contingent liabilities shown above arise from the uncalled capital element of the Crown's investments in the Asian Development Bank and the World Bank, and promissory notes issued in favour of the International Monetary Fund.

### Unquantifiable Contingent Liabilities

The Treasury also administers a number of contingent liabilities which cannot be quantified. These arise primarily from institutional guarantees and indemnities. Readers are referred to the Crown financial statements for further details.

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# STATEMENT OF TRUST MONIES

for the year ended 30 June 2006

30 June 2005 Actual \$000		30 June 2006 Actual \$000
912	Balance at the beginning of the year	824
325	Contribution	76
(3)	Distribution	(3)
60	Revenue	31
(470)	Unclaimed money returned to the Crown	(79)
824	Balance at the end of the year	849

The Trust Account is established pursuant to section 67 of the Public Finance Act 1989, for the purposes of depositing money paid to the Crown under section 77 of the Trustee Act 1956.

The source of funds is principally estates of deceased persons where the beneficiaries cannot be traced. Funds are retained in the Trust Account for six years, and are then transferred to the Crown as unclaimed money. During the financial year ended 30 June 2006, \$3,000 was paid to claimants and interest of \$31,000 was earned from trust money on term deposit.

Details of funds held in the Trust Account are gazetted annually.

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# NEW ZEALAND DEBT MANAGEMENT OFFICE

for the year ended 30 June 2006

Nature and Extent of Activities .....	126
Assets and Liabilities .....	127
Revenues and Expenses.....	128
Risk Management.....	129
Credit Risk.....	129
Interest-rate and Foreign-exchange Risk .....	131
Refinancing and Repricing Risk .....	132
Liquidity Risk .....	133
Derivatives .....	134
Operational Risk .....	134

NZDMO is an operating unit of the Treasury. NZDMO is responsible for managing the Crown's debt, overall cash flows and interest-bearing deposits. To facilitate a greater level of transparency regarding NZDMO operations as distinct from other entities, a separate section on NZDMO is provided in the Treasury Annual Report.

The following supplementary financial schedules reflect the activity of NZDMO as though it were a stand-alone entity. Cross-holdings or other financial positions between NZDMO and other government entities are not eliminated.

NZDMO managed \$17,626 million of assets, \$39,794 million of liabilities, \$1,288 million of revenue and \$2,689 million of expenses on behalf of the Crown for the year ended 30 June 2006.

Further information on NZDMO's performance in managing the Crown's sovereign-issued debt and related financial assets is provided in the Debt and Related Financial Asset Management output performance section of this report on pages 50 to 51. NZDMO's contribution to the "efficient management of the Crown's assets and liabilities" outcome is discussed on pages 25 to 26 of this report.

The financial information reported in these schedules is consolidated into the Crown financial statements. Readers should refer to the Crown financial statements for the year ended 30 June 2006.

## NATURE AND EXTENT OF ACTIVITIES

NZDMO, established in 1988, is part of the New Zealand Treasury and is responsible for the efficient management of the Crown's debt and associated assets within an appropriate risk management framework. NZDMO's strategic objective is to maximise the long-term economic return on the Crown's financial assets and debt in the context of the Government's fiscal strategy, particularly its aversion to risk. NZDMO's major responsibilities involve:

- financing the Crown's gross borrowing requirement, managing foreign-currency assets required to meet net foreign-currency interest and principal payments, and settling and accounting for all related debt transactions
- maintaining and developing an appropriate framework for efficiently managing the portfolio and the risks associated with it
- disbursing cash to departments and facilitating departmental cash management
- advancing funds to government entities in accordance with Government policy
- providing capital markets services and derivative transactions for departments and government entities
- providing reporting for fiscal forecasting and financial statements
- maintaining a diversified funding base and, where appropriate, enhancing relationships with investors who hold, or are potential holders of, New Zealand government securities and with financial intermediaries and the international credit rating agencies.



The New Zealand Debt  
Management Office Team

# SCHEDULE OF ASSETS AND LIABILITIES

as at 30 June 2006

The Schedule of Assets and Liabilities summarises the assets and liabilities managed by NZDMO.

Book Value 2005 \$m	Fair Value 2005 \$m		Book Value 2006 \$m	Fair Value 2006 \$m
		<b>Foreign-currency Assets</b>		
4,865	4,873	Marketable securities	6,003	5,988
533	533	External deposits	715	714
3,940	3,940	Advances to Reserve Bank of New Zealand <sup>1</sup>	5,281	5,281
(218)	(54)	Derivatives <sup>2</sup>	4,792	4,806
609	609	IMF reserve position	341	341
67	67	Debtors and receivables	57	57
6	6	Foreign bank accounts	5	5
9,802	9,974		17,194	17,192
		<b>NZ Dollar Assets</b>		
667	667	Crown settlement account	2,248	2,248
814	810	Advances to Crown Financing Agency	912	908
1,288	1,288	Advances to Housing New Zealand	1,331	1,331
67	97	Other advances	129	162
923	935	Derivatives <sup>2</sup>	(4,281)	(4,219)
80	80	Debtors and receivables <sup>3</sup>	93	93
3,839	3,877		432	523
13,641	13,851	<b>Total Assets</b>	<b>17,626</b>	<b>17,715</b>
		<b>Foreign-currency Liabilities</b>		
2,995	3,185	Debt	2,209	2,310
6,685	6,569	Derivatives <sup>2</sup>	14,745	14,444
219	219	Creditors and payables <sup>3</sup>	233	233
9,899	9,973		17,187	16,987
		<b>NZ Dollar Liabilities</b>		
5,466	5,469	Treasury bills	4,993	4,992
25,024	25,678	Government bonds <sup>4</sup>	25,496	25,819
1,730	2,032	Inflation indexed bonds	1,796	2,073
416	416	Kiwi bonds	389	387
3,317	3,317	Crown balances with Westpac <sup>5</sup>	3,040	3,040
(6,262)	(6,120)	Derivatives <sup>2</sup>	(13,539)	(13,204)
475	475	Creditors and payables	419	419
18	19	Other	13	15
30,184	31,286		22,607	23,541
40,083	41,259	<b>Total Liabilities</b>	<b>39,794</b>	<b>40,528</b>

1 The methodology for estimating the fair value of advances to the RBNZ was changed during the year to reflect a change to the pricing methodology following a review of the underlying funding structure for these loans. The effect of this change in valuation methodology has been to record a gain for the period of \$80 million compared with a loss of approximately \$83 million if it had not been applied.

2 Each derivative transaction is recorded as an asset or a liability based on its year-end value.

3 Accrued interest, including on derivatives, is recognised under payables or receivables.

4 Government bonds include non-market issues to the Reserve Bank of New Zealand.

5 Crown balances with Westpac at 30 June 2006 include the NZDMO Disbursement account (\$3,357 million O/D). NZDMO disburses funds from this account to bank accounts maintained by departments and the account operates as an effective contra to the balances held by departments.

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

# SCHEDULE OF REVENUES AND EXPENSES

for the year ended 30 June 2006

The Schedule of Revenues and Expenses summarises the revenues and expenses associated with the assets and liabilities managed by NZDMO.

2005 \$m		2006 \$m
	Foreign-currency Revenue	
95	Marketable securities	186
12	External deposits	23
108	Advances to Reserve Bank of New Zealand	158
327	Derivatives	371
12	IMF reserve position	8
(84)	Unrealised gains/(losses) on advances to Reserve Bank of New Zealand	80
470		826
	New Zealand Dollar Revenue	
77	Crown settlement account	73
51	Advances to Crown Financing Agency	55
85	Advances to Housing New Zealand	97
138	Derivatives	229
4	Other	8
355		462
825	<b>Total Revenue</b>	<b>1,288</b>
	Foreign-currency Expenses	
169	Debt	141
72	Derivatives	54
8	Foreign-exchange (gains)/losses	14
(3)	Other	-
246		209
	New Zealand Dollar Expenses	
338	Treasury bills	360
1,654	Government bonds	1,655
134	Inflation-indexed bonds	149
23	Kiwi bonds	23
183	Derivatives	270
16	Other	23
2,348		2,480
2,594	<b>Total Expenses</b>	<b>2,689</b>

*The Crown's accounting policies are an integral part of these supplementary financial schedules.*

## Risk management

With ministerial approval, NZDMO maintains a portfolio and risk management framework within which it operates. That includes NZDMO's strategic objective, objectives for New Zealand-dollar and foreign-currency debt, the instruments in which NZDMO may transact, limits in respect of market and credit risk utilisation, composition requirements for the liquidity asset portfolio and maturity profile requirements.

The risk management framework has been in place since NZDMO was established. The specifics of implementation have been subject to continuous improvement as resources allow and as information technology capability and analytical techniques have improved. Careful prioritisation ensures that resources are allocated to managing the most significant risks first and that fundamental risks are covered. In addition, NZDMO periodically commissions reviews by external experts of its risk management framework and practices, including the strategic parameters of the portfolio.

The basis of operation is well defined, including the legal authority to borrow and service debt and NZDMO's internal organisation. Internal operations are managed through an established risk culture, body of policies, ethical guidelines and codes of conduct, defined responsibilities and accountabilities, formal delegations, segregated duties, limits, reporting and performance management requirements, procedural manuals and established processes.

## Credit risk

Credit risk refers to the risk of a counterparty failing to discharge an obligation.

Credit losses arise when NZDMO is required to find a transaction counterparty to replace one that is no longer of acceptable credit quality. In finding a suitable replacement, NZDMO would incur transaction costs and potentially suffer a loss in the market value of the original transaction. Credit losses also arise when the issuer of a financial obligation that NZDMO holds as an asset is downgraded or defaults.

Financial instruments that subject NZDMO to credit risk include bank balances, advances, investments, interest-rate swaps, currency swaps, and foreign-exchange forward contracts.

NZDMO manages credit risk through the use of credit exposure limits. Credit exposures are maintained only with highly rated institutions for which the probability of default is low. To diversify credit exposure, NZDMO limits its exposure to any one institution. The creditworthiness of counterparties is continuously monitored. Credit risk is further controlled by incorporating credit support annexes into master swap agreements with swap and foreign-exchange counterparties. Credit risk is measured using an in-house credit model that conforms to industry best practice.

As at 30 June 2006, total credit exposure was calculated as follows:

2005 \$m		2006 \$m
13,641	Total NZDMO assets	17,626
	Less	
6,755	Crown-related balances	9,876
129	Crown-related derivatives	179
148	Receivables	150
6,609	Total Credit Exposure	7,421
	Comprising	
6	Foreign bank accounts	5
50	Advances	58
533	External deposits	715
4,836	Marketable securities	5,971
575	Derivatives	331
609	IMF	341
6,609		7,421

As at 30 June 2006, concentrations of credit exposure by industry type were as follows:

2005 \$m		2006 \$m
2,514	Sovereign issuers	3,291
1,147	Supranationals	1,306
2,158	Banks	2,081
790	Other	743
6,609	Total Credit Exposure	7,421

As at 30 June 2006, concentrations of credit exposure by geographical area were as follows:

2005 \$m		2006 \$m
1,056	United States	560
3,505	Europe	4,216
24	Japan	2
436	Australia	931
366	New Zealand	286
1,147	Supranationals	1,306
75	Other	120
6,609	Total Credit Exposure	7,421

As at 30 June 2006, concentrations of credit exposure by credit rating were as follows:

2005 \$m		2006 \$m
4,458	AAA	5,322
1,350	AA	1,688
192	A	70
609	IMF reserve position	341
6,609	Total Credit Exposure	7,421

## Collateral

For swaps and foreign-exchange contracts transacted under NZDMO's customised International Swaps and Derivatives Association (ISDA) swap documentation, collateral is required when the mark-to-market exposure exceeds the credit exposure limit for a counterparty.

As at 30 June 2006, NZDMO held the following as collateral against counterparties under credit support annexes to master swap agreements:

2005 \$m	2006 \$m
423 Cash deposits	59
- US Treasury bills	-
423 Total Collateral Held	59

## Settlement exposure

The settlements process involves the receipt and payment of funds and securities, and default by a settlement agent would result in NZDMO being unable to make or receive payments with that agent.

The nature of NZDMO's business is such that large amounts may be settled on one day. For that reason, monetary limits are not placed on NZDMO's exposure to transaction banks, custodians, fiscal agents and clearing brokers. Risk in respect of those institutions is managed through procedures for selecting and monitoring transaction settlement agents.

## Interest-rate and foreign-exchange risk

Interest-rate risk refers to the risk of loss due to adverse movements in interest rates. Foreign-exchange risk refers to the risk of loss due to adverse movements in foreign-exchange rates.

### New Zealand-dollar assets and liabilities

The New Zealand-dollar portfolio is driven by a set of principles that support NZDMO's debt management objective, rather than one strategic benchmark. These principles are used to manage the risks and costs of the New Zealand-dollar portfolio and help NZDMO issue debt cost-effectively. The market value of New Zealand-dollar debt is not actively managed.

In general, interest-rate risk is managed strategically. To diversify interest-rate risk and lower the cost of the portfolio, NZDMO maintains a mix of fixed-rate and floating-rate debt and uses interest-rate swaps. Inflation-indexed debt makes up a component of the portfolio and has been issued when it was cost-effective to do so. Bonds are issued into benchmark lines to improve liquidity in the market and, consequently, reduce the Crown's cost of borrowing. When issuing domestic securities, NZDMO samples interest rates throughout the year by conducting monthly auctions of Government bonds and weekly auctions of Treasury bills. NZDMO is committed to transparency, predictability and even-handedness in its domestic securities' issuance.

### Foreign-currency assets and liabilities

NZDMO manages interest-rate and foreign-exchange risk in the foreign-currency portfolio in an integrated manner.

Unless otherwise directed by the Minister of Finance, NZDMO's net foreign-currency debt position is kept close to zero when measured on a market value basis. With ministerial approval, there are specified conservative position and loss limits that allow some discretionary trading to take place. Market risk is incurred from that discretionary activity due to movements in interest rates and foreign-exchange rates. The range of

instruments used to minimise exposure to market risk includes foreign-exchange contracts, currency swaps, interest-rate swaps and futures contracts.

Market risk associated with discretionary trading is managed through the use of value at risk (VAR) limits and stop-loss limits. A VAR limit is maintained for the overall foreign-currency portfolio. It is expressed over daily, monthly and annual time horizons at a 95% confidence level and reflects the risk tolerance of the Government in respect of discretionary activity undertaken by NZDMO.

A stop-loss limit is in place to protect NZDMO from further losses once actual losses reach a certain point. It reflects the tolerance of the Government in respect of maximum acceptable losses over monthly, quarterly and annual time horizons.

NZDMO uses back-testing to evaluate the performance of the VAR model. Actual profit and loss are compared with the market risk estimates calculated using the VAR model to determine its integrity and performance. Consistent with industry best practice, VAR is supplemented with stress-testing to understand how extreme or unusual events would impact on the portfolio.

## Refinancing and repricing risk

Refinancing and repricing risk refers to the risk that maturing debt is refinanced, maturing assets are reinvested or instruments are repriced at an unacceptable yield.

To manage the refinancing risk associated with New Zealand-dollar borrowing, NZDMO establishes a relatively even maturity profile for debt across the yield curve to manage the funding requirement, and the uncertainty around it arising from fiscal shocks, flexibly and without putting undue pressure on interest rates. In respect of foreign-currency borrowing, NZDMO establishes a maturity profile for debt that reduces the likelihood of being unable to access markets in a timely manner or raise funds at an acceptable cost.

Repricing risk is further diversified through the use of interest-rate swaps.



*The New Zealand Economic and Financial Overview wins Gold at the 2006 Pride in Print Awards.*

As at 30 June 2006, assets and liabilities will mature or reprice within the following periods:

	2006 \$m	0-12 Months \$m	1-2 Years \$m	2-5 Years \$m	5-10 Years \$m	>10 Years \$m
<b>Foreign-currency Assets</b>						
Marketable securities	6,344	5,876	132	170	166	-
External deposits	715	715	-	-	-	-
Advances to RBNZ	5,281	5,243	38	-	-	-
Derivatives	4,792	4,042	426	(11)	242	93
Debtors and receivables	57	57	-	-	-	-
Foreign bank accounts	5	5	-	-	-	-
	<b>17,194</b>	<b>15,938</b>	<b>596</b>	<b>159</b>	<b>408</b>	<b>93</b>
<b>New Zealand-dollar Assets</b>						
Crown settlement account	2,248	2,248	-	-	-	-
Advances to Crown Financing Agency	912	481	188	188	55	-
Advances to Housing New Zealand	1,331	1,281	-	50	-	-
Derivatives	(4,281)	(6,028)	51	930	766	-
Debtors and receivables	93	93	-	-	-	-
Other	129	56	-	1	16	56
	<b>432</b>	<b>(1,869)</b>	<b>239</b>	<b>1,169</b>	<b>837</b>	<b>56</b>
<b>Total Assets</b>	<b>17,626</b>	<b>14,069</b>	<b>835</b>	<b>1,328</b>	<b>1,245</b>	<b>149</b>
<b>Foreign-currency Liabilities</b>						
Debt	2,209	800	697	67	600	45
Derivatives	14,745	14,802	(60)	111	(155)	47
Creditors and payables	233	233	-	-	-	-
	<b>17,187</b>	<b>15,835</b>	<b>637</b>	<b>178</b>	<b>445</b>	<b>92</b>
<b>New Zealand-dollar Liabilities</b>						
Treasury bills	4,993	4,993	-	-	-	-
Government bonds	25,496	3,762	-	7,328	12,024	2,382
Inflation-indexed bonds	1,796	-	-	-	1,796	-
Kiwi bonds	389	328	40	21	-	-
Crown balances with WestPac	3,040	3,040	-	-	-	-
Derivatives	(13,539)	(8,022)	(643)	(1,460)	(2,120)	(1,294)
Creditors and payables	419	419	-	-	-	-
Other	13	13	-	-	-	-
	<b>22,607</b>	<b>4,533</b>	<b>(603)</b>	<b>5,889</b>	<b>11,700</b>	<b>1,088</b>
<b>Total Liabilities</b>	<b>39,794</b>	<b>20,368</b>	<b>34</b>	<b>6,067</b>	<b>12,145</b>	<b>1,180</b>

1 The figures reported above, including derivatives, are exclusive of accrued interest. Derivative values will differ from the book values reported in the "Derivatives" table where accrued interest is included.

2 Derivatives may contribute to two different repricing buckets. Floating legs would reprice within 12 months while the fixed leg would be classified according to swap maturity.

## Liquidity risk

Liquidity risk refers to the risk of loss due to the lack of market liquidity preventing timely or cost-effective liquidation of products, positions or portfolios. To manage liquidity risk, NZDMO holds readily liquefiable assets in sufficient quantity to cover off all obligations falling due over rolling six-week and 12-week horizons.

## Derivatives

NZDMO's involvement in derivatives comprises foreign-exchange contracts, currency swaps, interest-rate swaps and futures contracts.

As at 30 June 2006, the value of derivatives\* was as follows:

Book Value 2005 \$m	Fair Value 2005 \$m		Book Value 2006 \$m	Fair Value 2006 \$m
Foreign-exchange Contracts				
182	175	In gain position	202	206
(136)	(135)	In loss position	(537)	(521)
46	40	Net Position	(335)	(315)
Currency Swaps				
413	469	In gain position	216	242
(258)	(262)	In loss position	(646)	(631)
155	207	Net Position	(430)	(389)
Interest-rate Swaps				
137	322	In gain position	136	207
(21)	(102)	In loss position	(25)	(114)
116	220	Net Position	111	93
Futures				
2	2	In gain position	-	-
-	-	In loss position	-	-
2	2	Net Position	-	-

\* Derivatives' positions include accrued interest.

As at 30 June 2006, the notional value of derivatives was as follows:

Notional Value 2005 \$m		Notional Value 2006 \$m
13,062	Foreign-exchange contracts	18,844
5,143	Currency swaps	5,558
6,776	Interest-rate swaps	8,925
625	Futures	560
25,606		33,887

## Operational risk

Operational risk refers to the risk of loss due to an event that could impact on NZDMO's ability to produce its outputs to the quality, quantity and cost specified. Risk events include resource failures or constraints, control and security breaches or failures, transaction errors, compliance breaches, poor strategic decisions, the breakdown of key relationships and disasters.

Operational risks are managed in a number of ways. Operational risk policies span, for instance, transaction processing, legal and regulatory issues, ethical standards, physical and systems security, and business continuity. Independent experts provide additional support in managing operational risk. NZDMO managers assess the organisation's operational risk profile annually.

# AUDIT REPORT



## To the Readers of the Treasury's Annual Report for the year ended 30 June 2006

The Auditor-General is the auditor of the Treasury (the Department). The Auditor-General has appointed me, Andrew Dinsdale, using the staff and resources of KPMG, to carry out the audit on his behalf. The audit covers the financial statements, statement of service performance and schedules of non-departmental activities included in the annual report of the Department for the year ended 30 June 2006.

### Unqualified opinion

In our opinion:

- The financial statements of the Department on pages 92 to 108:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect:
    - the Department's financial position as at 30 June 2006;
    - the results of its operations and cash flows for the year ended on that date.
- The statement of service performance of the Department on pages 47 to 69 and 79 to 86:
  - complies with generally accepted accounting practice in New Zealand; and
  - fairly reflects for each class of outputs:
    - its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
    - its actual revenue earned and output expenses incurred, as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.
- The schedules of non-departmental activities on pages 114 to 124 and 127 to 134 fairly reflect the assets, liabilities, revenues, expenses, contingencies, commitments and trust monies managed by the Department on behalf of the Crown for the year ended 30 June 2006.

The audit was completed on 22 September 2006, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Chief Executive and the Auditor, and explain our independence.

### Basis of opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and statement of service performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and the statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Secretary to the Treasury;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements or statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. We obtained all the information and explanations we required to support our opinion above.

### Responsibilities of the Secretary to the Treasury and the Auditor

The Secretary to the Treasury is responsible for preparing financial statements and a statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Department as at 30 June 2006 and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Department's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. In addition, the schedules of non-departmental activities must fairly reflect the assets, liabilities, revenues, expenses, contingencies, commitments and trust monies managed by the Department on behalf of the Crown for the year ended 30 June 2006. The Secretary to the Treasury's responsibilities arise from sections 45A, 45B and 45(1)(f) of the Public Finance Act 1989.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and section 45D(2) of the Public Finance Act 1989.

### Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

In addition to the audit we have carried out assignments in the areas of assistance with the implementation of New Zealand International Financial Reporting Standards for the Crown and taxation advice, which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Department.



Andrew Dinsdale  
KPMG  
On behalf of the Auditor-General  
Wellington, New Zealand

# QUALITY STANDARDS FOR ANALYSIS AND ADVICE

Quality Characteristic	Description
Purpose	The objective for the advice is clearly stated; it answers any financial and economic issues raised by the Minister and demonstrates a clear understanding of the desired outcome(s) of the Government and/or the Minister.
Problem definition	Any public policy problem, including the underlying causes, size and materiality of issues, is identified and supported by data or other evidence.
Context	It is clear where the advice stands in the context of the wider policy process, including what has already been undertaken and what is expected to occur in the future. CCMAU's advice is undertaken in the context of the Government's ownership expectations for SOEs and/or CRIs.
Logic	An appropriate analytical framework is used. Assumptions behind the advice are explicit and the argument is logical and supported by facts.
Accuracy	All material facts are present and accurate. Known gaps that could significantly affect the conclusions are identified and the range of uncertainty stated. Forecasts are credible at the time they are produced and take into account all relevant information.
Options	A range of options is presented that provides clearly differentiated choices and these are rigorously evaluated against the analytical framework. Costs, benefits, consequences and risks/opportunities of the options are assessed as part of the analysis. Where it is not appropriate to use a range of options the reasons are clearly stated.
Recommendations	Recommendations are clear, logical and action oriented and can stand alone from the rest of the advice. They are sufficient to enable a decision to be made on the proposal or to move to the next decision/action point.
Consultation	Evidence of thorough and timely consultation with other government departments and interested parties is presented, and their views, including objections, incorporated as appropriate.
Practicality	Issues of implementation, technical feasibility, practicality and timing are considered and advice accurately identifies compliance, transitional, political, legislative, revenue, expense and administrative implications and costs (quantified where possible).
Communication	Guidance is provided on how communications arising from decisions on the advice should be handled, including an assessment of key stakeholders who should be informed and how.
Presentation	Material is presented to suit the target audience and: <ul style="list-style-type: none"> <li>• is concise and structured in a way which assists others to understand the aim of the advice, key features of the information, analysis and recommendations, and their key implications</li> <li>• uses appropriate language and style</li> <li>• uses empirical evidence</li> <li>• avoids clichés and technical jargon (or where the latter is not possible, it is used appropriately for a general audience)</li> <li>• is consistent with departmental and Cabinet Office presentation requirements.</li> </ul>

Note: All aspects of the standards may not apply to specific pieces of policy advice, given considerations of urgency or the particular nature of the advice to be provided. For instance, much of our work is second-opinion advice on other departments' proposals often undertaken under tight time pressures.

# LEGISLATION

as at 30 June 2006

Budget legislation administered by the Treasury during the year:

Appropriation Act(s)

Imprest Supply Act(s)

Other legislation administered by the Treasury:

Bank of New Zealand Act 1988  
 Crown Entities Act 2004 (Part 4)  
 Crown Forest Assets Act 1989  
 Crown Research Institutes Act 1992  
 Export Guarantee Act 1964  
 Farm and Fishing Vessel Ownership Savings Schemes (Closure) Act 1998  
 Finance Acts (Various)  
 Government Superannuation Fund Act 1956  
 Hawkes Bay Earthquake Act 1931  
 Institute of Chartered Accountants of New Zealand Act 1996  
 International Finance Agreements Act 1961  
 National Expenditure Adjustment Act 1932  
 National Provident Fund Restructuring Act 1990  
 National Savings Act 1940  
 New Zealand Council Planning Dissolution Act 1991  
 New Zealand Government Property Corporation Act 1953  
 New Zealand Railways Corporation Restructuring Act 1990  
 New Zealand Railways Staff Welfare Society Dissolution Act 1999

New Zealand Superannuation Act 2001  
 (various provisions)  
 New Zealand Superannuation and Retirement Income Act 2001  
 Overseas Investment Act 2005  
 Post Office Bank Act 1987  
 Public Audit Act 2001  
 Public Finance Act 1977  
 Public Finance Act 1989  
 Radio New Zealand Act 1995  
 Radio New Zealand Act (No 2) 1995  
 Rural Banking and Finance Corporation of New Zealand Act 1989  
 Southland Electricity Act 1993  
 State Insurance Act 1990  
 State-Owned Enterprises Act 1986  
 Superannuation Schemes Act 1989  
 Tourist Hotel Corporation of New Zealand Act 1989  
 Treasurer (Statutory References) Act 1997

Delegated legislation administered by the Treasury:

Bank of New Zealand Order 1989  
 Cityline (NZ) Vesting Order 1992  
 Crown Entities (Financial Powers) Regulations 2005  
 Crown Research Institutes Act Commencement Order 1998  
 Electricity Industry Reform Act Commencement Orders (various)  
 Export Guarantee Amendment Act Commencement Order 1990  
 Finance Acts Orders (various)  
 International Finance Agreements Amendment Act Commencement Order 1978  
 National Provident Fund (Approval of Amendments to Restructuring Proposal) Order 1993  
 National Savings Investment Account Regulations (various)  
 New Zealand Railways Corporation Restructuring Act Orders (various)

New Zealand Railways Staff Welfare Society Dissolution Act Commencement Order 1999  
 Overseas Investment Regulations (various)  
 Post Office Bank Amendment Act Orders (various)  
 Public Audit (West Coast Development Trust) Order 2002  
 Public Finance Act Orders (various)  
 Radio New Zealand Orders (various)  
 Southland Electricity Act Commencement Order 1994  
 State Insurance Act (Vesting) Order 1990  
 State-Owned Enterprises Act Orders (various)  
 Tourist Hotel Corporation of New Zealand Act Commencement Order 1990  
 Tower Corporation Act Commencement Order 1990



# WORKING AND POLICY PERSPECTIVES PAPERS

for the year ended 30 June 2006

Treasury Working and Policy Perspectives Papers contain work in progress on a variety of economic, financial, trade and social issues.

Our aim in publishing is to make papers available to a wider audience, and to inform and encourage public debate. All papers can be viewed on our web site: [www.treasury.govt.nz/workingpapers](http://www.treasury.govt.nz/workingpapers)

Papers added during 2005/06 include:

## Policy Perspectives Papers

2006

- 06/03 Impacts of a Potential Influenza Pandemic on New Zealand's Macroeconomy by James Douglas, Kam Szeto and Bob Buckle
- 06/02 Financing Infrastructure Projects: Public Private Partnerships by Dieter Katz
- 06/01 Modelling New Zealand's Long-Term Fiscal Position by Paul Rodway and Peter Wilson

2005

- 05/05 The Economics of Knowledge: What Makes Ideas Special for Economic Growth? by Nic Blakeley, Duncan Mills and Geoff Lewis
- 05/04 The Contribution of the Primary Sector to New Zealand's Economic Growth by Alex Harrington

## Working Papers

2006

- 06/03 Affordability of Housing: Concepts, Measurement and Evidence by Mark Robinson, Grant Scobie and Brian Hallinan
- 06/02 Migration and Economic Growth: A 21st Century Perspective by Cat Moody
- 06/01 The Role of R&D in Productivity Growth: The Case of Agriculture in New Zealand: 1927 to 2001 by Julia Hall and Grant Scobie

2005

- 05/11 Income Growth and Earnings Variations in New Zealand, 1998-2004 by Dean Hyslop and Suresh Yahanpath
- 05/10 Measures of Human Capital: A Review of the Literature by Trinh Le, John Gibson and Les Oxley
- 05/09 The Effect of New Zealand Superannuation Eligibility Age on the Labour Force Participation of Older People by Roger Hurnard
- 05/08 Regional Economic Performance in New Zealand: How Does Auckland Compare? by Geoff Lewis and Steven Stillman