

## Treasury Report: Testing a more flexible approach to financial management

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<b>Date:</b>	1 April 2010	<b>Report No:</b>	
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### Action Sought

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	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<b>Read</b> this report prior to discussing with officials in the week of 12 April  <b>Forward</b> copies of this paper to the Minister of Housing and Minister of Building and Construction	Monday 12 April 2010
Associate Minister of Finance (Hon Simon Power)	<b>Note</b> contents	None
Associate Minister of Finance (Hon Steven Joyce)	<b>Note</b> contents	None

### Contact for Telephone Discussion (if required)

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Name	Position	Telephone		1st Contact
Richard Downing	Acting Manager, Fiscal Management	[withheld - privacy]	[withheld - privacy]	✓
Chris Bunny	Manager, Fiscal Management	[withheld - privacy]	[withheld - privacy]	

### Minister of Finance's Office Actions (if required)

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Refer a copy of this paper to the Minister of Housing and to the Minister for Building and Construction.
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**Enclosure:** Yes

## Treasury Report: Testing a more flexible approach to financial management

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### Executive Summary

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This paper proposes testing a more flexible approach to financial management within the departmental appropriations of Vote Housing. The proposals have been developed by officials from the Treasury and the Department of Building and Housing. The aim of increasing flexibility is to provide more incentive for departments to increase productivity and deliver better services. We have identified two ways to implement a multi-year funding arrangement to introduce greater flexibility, which can be tested in the Departmental Appropriations in Vote Housing, beginning in the 2010/11 financial year.

- Make more use of Multi-Year Appropriations (MYAs); and
- Extend Cabinet delegations to Joint Ministers to approve transfers over time.

The paper proposes the following treatment for each of the departmental appropriations in Vote Housing:

<i>Multi-year appropriations</i>	<i>Rationale</i>
Building Regulation and Control Occupational Licensing	Require flexibility to manage variations in external environment (industry cycles impacting levy and fee revenue). Areas where investment in business improvements can result in long-term performance gains.
Residential Tenancy and Unit Title Services	
<i>Apply increased administrative flexibility through extended delegations</i>	
Sector and Regulatory Policy Performance Monitoring and Advice – Housing New Zealand Corporation	Funded by Revenue Crown, so not exposed to variations in external environment as much as above, instead require flexibility due to small size of monitoring appropriation and need to share resources between functions.
<i>Maintain status quo</i>	<i>Rationale</i>
Weathertight Homes Resolution Service	Leave with current arrangements until decisions on wider policy are made.

This mix of increased delegations and wider use of MYAs provides an opportunity to test a variety of changes to the existing approach. This means that the testing period will operate as a way to assess the success of the new approach and identify what works and what doesn't.

There are some risks in testing these changes. However, the paper proposes that central agencies and other departments remain closely involved to monitor progress and test whether adjustments need to be made. For example, this could include the Chief Executive of DBH reporting periodically to the Senior Executives Group (SEG) regarding progress.

Features of the changes include:

- Greater flexibility, giving agencies the tools to take a business performance approach to financial management.
- Improving the tools available to agencies to shift how they view their capital investment and planning for performance.

- An opportunity to set an 'efficiency dividend' in the form of reduced baselines in return for more flexibility, or the expectation of increased performance within current baselines.

The table below sets out potential productivity and performance improvements that can be expected in return for application of a multi-year approach in the departmental appropriations of Vote Housing.

<i>Appropriation</i>	<i>Improvement</i>
Building Regulation and Control	Improved levels of service for same or reduced fee levels.
Occupational Licensing	Improved performance specification. Reduction in fee levels over time in real terms for same volume of service. Improved timeliness across services.
Residential Tenancy and Unit Title Services	Reduced need for revenue Crown due to business cycle. Dependent on interest rates. Service level improvements for same or less revenue.
Sector and Regulatory Policy	Improved performance specification and quality of advice. For example, regular review by NZIER and improvement in rating, also look for other ways to measure quality of advice.
Performance Monitoring and Advice – Housing New Zealand Corporation	

This paper does not include provision for an efficiency dividend in the form of reduced baselines. The benefits in Vote Housing are expected to be seen primarily from improved services and reduced fees. A number of the appropriations covered by the trial or funded from third part revenue. A dividend in these cases would not consist of money returning to the centre but instead a reduction in the fees paid by third parties. There are two further opportunities for discussions about a dividend:

- Part of the further work prior to the start of the test drive – this could include considered conditions around a dividend return in years 2 and 3.
- As part of an interim report on progress with the test in February 2011.

The changes proposed in this paper can be incorporated into final decisions for the 2010 Budget package, due for Cabinet consideration on April 19. The changes to appropriations could then be captured in Estimates documents and included in the Appropriation (2010/11 Estimates) Bill. If you agree, officials will include the necessary financial recommendations to establish the trial in the Budget Cabinet paper for consideration on April 19. A more detailed explanation of the proposed testing period can be included in the ECC paper on April 20 informing the Committee of new MYAs, as required by Cabinet Office Circular CO(09) 6.

The SEG is also progressing work on possible improvements to reporting requirements and making more efficient use of memorandum accounts. Other work that relates closely to the approach proposed in this paper includes:

- Treatment of forecast changes in the operating allowance;
- Any adjustments to existing relativities between different areas of Government spending; and
- Preparing agencies for performance discussions.

## Recommended Action

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We recommend that you:

1. **note** that this paper proposes test driving a more flexible approach to financial management in the departmental appropriations of Vote Housing beginning in the 2010/11 financial year;
2. **note** that the proposals in this paper build on previous discussions between the Senior Executives Group and the Minister of Finance regarding introducing more flexibility into the system [see T2009/2778];
3. **note** that officials have identified two ways to introduce additional flexibility:
  - Make more use of Multi-Year Appropriations (MYAs); and
  - Seek Cabinet agreement to delegate authority for transfers over time to Vote Ministers and/or the Vote Minister and the Minister of Finance.
4. **agree** to seek Cabinet approval in the Budget Cabinet paper to introduce Multi-Year Appropriations in the following appropriations:
  - Building Regulation and Control (Minister Responsible for Appropriation: Minister for Building and Construction; funded by Revenue Other);

*Agree/disagree.*

- Occupational Licensing (Minister Responsible for Appropriation: Minister for Building and Construction; funded by Revenue Other); and

*Agree/disagree.*

- Residential Tenancy and Unit Title Services (Minister Responsible for Appropriation: Minister of Housing; funded by interest on Tenancy Bond Funds, topped up by Revenue Crown).

*Agree/disagree.*

5. **agree** to seek Cabinet approval to introduce increased delegations to allow the Vote Minister to make transfers over time within an appropriation, but not exceeding 5% of the total size of the appropriation in the following appropriations:
  - Sector and Regulatory Policy (Minister Responsible for Appropriation: Minister for Building and Construction);

*Agree/disagree.*

- Performance Monitoring and Advice – Housing New Zealand Corporation (Minister Responsible for Appropriation: Minister of Housing);

*Agree/disagree.*

6. **agree** to seek Cabinet approval to introduce increased delegations to allow the Vote Minister and the Minister of Finance to agree to make transfers over time within an appropriation, up to an additional 5% of the total size of the appropriation on top of recommendation 5 above in the following appropriations (that is, up to 10% of total size of appropriation);

- Sector and Regulatory Policy (Minister Responsible for Appropriation: Minister for Building and Construction); and

*Agree/disagree.*

- Performance Monitoring and Advice – Housing New Zealand Corporation (Minister Responsible for Appropriation: Minister of Housing).

*Agree/disagree.*

7. **Agree** to seek Cabinet approval to introduce increased delegations to allow the Minister responsible for the appropriation to make transfers that move across time and across appropriations, up to a maximum of 5% of the total size of the appropriation (of the larger appropriation), in the following appropriations:

- Sector and Regulatory Policy (Minister Responsible for Appropriation: Minister for Building and Construction); and

*Agree/disagree.*

- Performance Monitoring and Advice – Housing New Zealand Corporation (Minister Responsible for Appropriation: Minister of Housing).

*Agree/disagree.*

8. **Agree** to seek Cabinet approval to introduce increased delegations to allow Joint Ministers to make transfers that move across time and across appropriations, up to up to an additional 5% of the total size of the appropriation on top of recommendation 7 above in the following appropriations (that is, up to 10% of total size of the larger appropriation) in the following appropriations:

- Sector and Regulatory Policy (Minister Responsible for Appropriation: Minister for Building and Construction); and

*Agree/disagree.*

- Performance Monitoring and Advice – Housing New Zealand Corporation (Minister Responsible for Appropriation: Minister of Housing).

*Agree/disagree.*

9. **direct** officials to incorporate the actions agreed in recommendation 4-8 into the Budget Cabinet paper for consideration on April report back to Joint Ministers, including interim reporting details and a requirement to further develop performance measures over the next 12 months;

*Agree/disagree.*

10. **direct officials** to report to ECC on April 20 to incorporate detailed information about the test of a more flexible approach to financial management into the paper required under Cabinet Office Circular CO(09) 6 that informs the Committee of new MYAs in Budget 2010;

*Agree/disagree.*

11. **refer** a copy of this paper to the Minister of Housing and the Minister of Building and Construction;

*Agree/disagree.*

Richard Downing  
**Acting Manager, Fiscal Management  
for Secretary to the Treasury**

Hon Bill English  
**Minister of Finance**

# Treasury Report: Testing a more flexible approach to financial management

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## Purpose of Report

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1. This paper outlines the basis for taking a more flexible approach to financial management. It is possible to start to test drive this approach in the Vote Housing departmental appropriations in the 2010/11 financial year, with the potential to apply it more widely in subsequent years, contingent on the results of the testing period. The paper has been developed by officials from the Treasury and the Departmental of Building and Housing.

## Analysis

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### Objective

2. On 17 December 2009 the Senior Executives Group (SEG) submitted a report to the Minister of Finance setting out a variety of approaches to financial management that could provide a stronger basis for increased performance and productivity from government agencies [T2009/2778 refers]. The SEG identified a number of barriers to taking a longer term perspective to planning, such as difficulty shifting resources across time, which act as a disincentive to innovation and improving the performance of agencies.
3. Following the meeting between the Minister of Finance and SEG in February 2010, Treasury and the Department of Building and Housing have developed some of the proposals in more depth. This paper focuses on how a more flexible financial management system could be 'test driven' in Vote Housing departmental appropriations. The major innovation to be test driven is the capacity to manage funding over multiple years (described in the rest of the paper as the **multi-year approach**).
4. It is intended that a more flexible system of financial management will provide the following benefits:
  - Provide the right incentives and tools to improve agency performance and lift productivity;
  - Improve agency management of capital assets by extending the focus beyond annual investment to encompass whole of life costs and benefits;
  - Strengthen the focus on baseline spending; and
  - Streamline the Budget process
5. Wider roll-out of these innovations may be possible in Budget 2011, contingent on the early results and learnings of the test drive in Vote Housing. Central agencies and other members of the Senior Executives Group will monitor progress and identify whether adjustments or changes are needed to the initial arrangements outlined below.

## Background – Recent Changes to Financial Management System

6. Cabinet Office Circular CO (09) 6 (Guidelines for Changes to Baselines) replaced CO (02) 17 and introduced a number of changes to the Cabinet delegations. The major features of the delegations are summarised below.

**Table 1: Changes to Financial management System in CO (09) 6**

	<b>Rules as per CO(09) 6</b>	<b>Rules as per CO(02) 17</b>
Expense or capital transfers across years	Only allowed if reflect the effect of external events (e.g. project delays).	Only allowed if reflect the effect of external events (e.g. project delays).
FNAs between departmental and non-departmental appropriations	Delegated to Joint Ministers so long as there are no significant policy issues.	Cabinet approval required.
All other FNAs	Delegated to Joint Ministers so long as there are no significant policy issues.	Delegated to Joint Ministers so long as there are no significant policy issues.
Establishing or amending appropriations	Delegated to Joint Ministers if giving force to existing Cabinet decisions.	Cabinet approval required.
Combinations of changes across appropriations and years	Cabinet approval required.	Cabinet approval required.
Technical changes	Delegated to Joint Ministers so long as there are no significant policy issues.	Delegated to Joint Ministers so long as there are no significant policy issues.

7. These recent changes have introduced more flexibility into the system, providing for a wider range of delegations to Joint Ministers without requiring further Cabinet approval. In particular, the changes allow a wider range of FNAs and to establish or amend appropriations. However CO (09) 6 does not extend delegations to Joint Ministers for expense and capital transfers across years and requires that any decisions with policy implications must be approved by Cabinet.
8. The remainder of this note considers options for taking a more flexible approach to financial management with specific reference to how such an approach could be test driven in Vote Housing departmental appropriations in 2010/11 (as they apply to the Department of Building and Housing). The paper considers both how the more flexible approach would work in the test drive, as well as in a wider roll-out.

### Administrative framework for multi-year approach

9. We have identified two broad ways in which the multi-year approach could be implemented and these are summarised in the boxes below:
- Seek Cabinet agreement to a wider range of joint Minister delegations.
  - Wider use of multi-year appropriations.
10. The smallest change to the existing system would be to expand the existing delegations to Joint Ministers to cover a wider range of changes. Making wider use of multi-year appropriations would be a more fundamental change to the existing system.



11. The table below sets out the two alternative approaches:

<p><b>More widespread use of multi-year appropriations</b></p> <p>Each departmental appropriation in the Vote could be turned into a multi-year appropriation by rolling up the value of the current forecast baseline for the relevant years. Alternatively, the baseline could be slightly reduced to reflect desired higher performance (as per the discussion of a 'dividend' later in this paper).</p> <p>MYA should be fixed for the full 3 financial years with a high hurdle required before any adjustments are approved. Adjustment possible in response to factors entirely external to the department that could not have been contemplated at time MYA was established.</p> <p>Initial MYAs and the conditions around them should be approved by ECC/Cabinet and any adjustments meeting the high hurdle would require ECC/Cabinet approval.</p> <p>Transfers over time would happen within the MYA, rather than requiring approval from Joint Ministers.</p> <p>Transfers across appropriations would require Cabinet approval, unless consistent with CO(09) 6.</p>
<p><b>Make greater use of Cabinet delegations to approve transfers across years for departmental outputs.</b></p> <p>The Minister responsible for the appropriation could have delegated authority to make change of up to 5% across years. Cabinet could delegate more discretion to Joint Ministers, e.g. a further 5% of the size of an appropriation.</p> <p>Expectation that transfers would be approved unless extraordinary circumstances.</p> <p>Provide delegated authority to the Minister Responsible for the appropriation (up to 5% of the appropriation) and Joint Ministers (up to 10% of the appropriation) to make changes that make a combination of transfers across appropriation and over time, authority for which is not currently delegated to Joint Ministers under CO (09) 6.</p> <p>As an alternative, the delegations could be strengthened to replicate the conditions of an MYA, without creating MYAs. This option is available if it is not possible to complete the establishment of an MYA prior to Budget 2010 decisions. This would mean:</p> <ul style="list-style-type: none"><li>• The Minister responsible for the appropriation would have delegated authority to make changes within an appropriation over time, without a limit on the size of the change.</li><li>• Transfers across appropriations would require Cabinet approval, unless consistent with CO(09) 6.</li></ul>

12. On balance our assessment is that a combination of these approaches can be tested in Vote Housing.
13. Making more use of multi-year appropriations provides an opportunity to test an approach that is markedly different from the current annual approach. It will provide more flexibility to more resources overtime and provide certainty about future funding. This should increase incentives to innovate, for example, by making up-front investments to generate future productivity gains.
14. Making more use of MYAs does come with some extra risks. In particular there is less transparency around when funding will be used, which will make it harder to specify precisely when services will be required. It also moves away from the original rationale for MYAs to deal with situations where the amount was reasonably clear but the timing was uncertain; or where the total amount for a multi-year project was clear, but the split between individual financial years was not. This is not the case with a wider extension of MYAs into departmental appropriations as these cover normal ongoing business, not a finite project.

15. Some of these concerns can be addressed in the way the pilot is set up, by tightly specifying performance objectives and a requirement to produce detailed statements of service performance that apply to the three year period. These are discussed in more depth in the section entitled 'Entry to Multi-year Approach'.
16. The advantages and disadvantages of each approach are summarised in Annex One.

### **Application of Multi-year Approach to Vote Housing**

17. We recommend using a combination of the approaches in order to get the most out of the testing period. The paper proposes the following treatment for each of departmental appropriations in Vote Housing:

<i>Multi-year appropriations</i>	<i>Rationale</i>
Building Regulation and Control (Minister for Building and Construction – funded by Revenue Other)	Require flexibility to manage variations in external environment (industry cycles impacting levy and fee revenue). Areas where investment in business improvements can result in long-term performance gains.
Occupational Licensing (Minister for Building and Construction – funded by Revenue Other)	
Residential Tenancy and Unit Title Services (Minister of Housing – funded by interest on Tenancy Bonds, topped up by Revenue Crown)	
<i>Apply increased administrative flexibility</i>	<i>Rationale</i>
Sector and Regulatory Policy (Minister for Building and Construction)	Not exposed to variations in external environment as much as above, instead require flexibility due to size of monitoring appropriation and need to share resources between functions.
Performance Monitoring and Advice – Housing New Zealand Corporation (Minister of Housing)	
<i>Maintain status quo</i>	<i>Rationale</i>
Weathertight Homes Resolution Service (Minister of Housing)	Leave with current arrangements until decisions on wider policy are made.

18. This mix of increased delegations and wider use of MYAs provides an opportunity to test a variety of different changes to the existing approach. This means that rather than the testing period just focussing on improving productivity in the Department of Building and Housing, it will also operate as a way to test the success of the new approach and identify what works and what doesn't. The learnings and adjustments could then be used to refine the approach for consideration of a wider roll-out in the future.
19. There are some risks in testing these changes. However, the paper proposes that central agencies and other departments remain closely involved to monitor progress and test whether adjustments need to be made. For example, this could include the CE of DBH reporting periodically to SEG regarding progress. An additional risk is that replacing the existing appropriations with MYAs will cause a discontinuity in the data. This will make future comparisons of historical spending patterns more difficult.
20. The table below sets out potential productivity and performance improvements that can be expected in return for application of a multi-year approach. These should be seen as tentative and high-level at this stage, and will need to be confirmed and agreed in greater detail with Ministers before the 'test drive' starts (i.e. before the start of the financial year). Confirming these improvements will also include discussion of any potential 'dividend' payment.

<i>Appropriation</i>	<i>Improvement</i>
Building Regulation and Control	Improved levels of service for same or reduced fee levels.
Occupational Licensing	Improved performance specification. Reduction in fee levels over time in real terms for same volume of service. Improved timeliness across services.
Residential Tenancy and Unit Title Services	Reduced need for revenue Crown due to business cycle. Service level improvements for same or less revenue.
Sector and Regulatory Policy	Improved performance specification and quality of advice. For example, regular review by NZIER and improvement in rating, also look for other ways to measure quality of advice.
Performance Monitoring and Advice – Housing New Zealand Corporation	

21. The application of MYAs to the departmental appropriations funded by 'Revenue Other' (effectively third party revenue) does pose an extra complication. For these appropriations, the MYA would set the maximum possible incurring of expenses over the period, however the capacity to spend this money over time is limited by the amount of revenue received. This creates some risks. For example, after two years of the MYA an unexpected lift in demand in year three may not have sufficient room remaining in the appropriation, even though revenue is available and the demand for the service is high. Alternatively early in the MYA the revenue may not have been gathered to meet the required services.
22. The introduction of MYAs in these appropriations funded by 'Revenue Other' will introduce an increasing need for the Department to monitor the appropriations carefully, as well as focussing on ways to manage cost pressures to avoid some of the risks discussed above.

*Further information required*

23. Further work is required on the output classes to be covered by multi-year appropriations, and will need to be completed by 30 June 2010. This work is currently underway and will be reported to you before the beginning of the financial year. It covers:
- forecasts of revenue and expenditure for the length of the appropriation based on a multi-year view;
  - stepped changes in performance information to reflect improvements to be made;
  - outlines of potential business cases for any planned reinvestment of operating surpluses; and
  - linkages to memorandum accounts.

**Surplus discussion**

24. An important part of implementing the multi-year approach is the ability for Ministers and agencies to engage in a conversation about the retention of surpluses over time. This conversation would be closely tied to the performance improvements or productivity dividend being sought from the agency, as well as the actions being undertaken following review under the Performance Improvement Framework.

- 25. Surpluses are currently dealt with in a rather mechanical way, and are not part of a broader consideration of performance or productivity improvement. Placing the surplus discussion within a multi-year funding arrangement should support targeted investment to achieve improvements over time. This would be done on the basis of robust business cases that clearly set out the expected improvements.
- 26. Under a multi-year appropriation the declared accounting surplus would become the focus of a targeted discussion on dividend to the Crown or surplus retention for further investment. For appropriations funded by Revenue Crown, this discussion would be underpinned by progress towards multiyear objectives and the business case in a manner analogous to the dividend discussion between shareholding ministers and a state-owned enterprise board.

**Extracting an ‘efficiency dividend’ in the form of reduced baselines**

- 27. The aim of the multi-year approach promoted by the pilot is to drive better performance and productivity in departments. This provides an opportunity to return some of the benefits of increased productivity to the centre in the form of an ‘efficiency dividend’. The table below shows how this could work in each of the approaches for implementing the multi-year approach:

<p><b>More widespread use of MYAs</b></p> <p>In this approach the ‘dividend’ would need to be captured either up-front or at the end of the MYA when a new one is being set-up.</p> <p>For example, if being captured up front the MYA could be set up in the following way: 99% of yr 1 baseline + 98% of yr 2 baseline + 97% of yr 3 baseline. This could only be applied to appropriations funded from Revenue Crown.</p>
<p><b>More use of Cabinet delegations to Joint Ministers</b></p> <p>Joint Ministers and the Chief Executive would agree to a set efficiency dividend over the period of the multi-year agreement. For example, a three year agreement to increased flexibility could be coupled with a planned pattern of dividend (½% in yr 1, 1% in yr 2, 2% in yr 3).</p> <p>The reduction in appropriation could be automatic or linked to a discussion between Ministers and the CE. This would provide an opportunity for the Vote Minister and/or CE to make a case for an alternative reinvestment of the dividend if there were opportunities to drive further improvement in performance.</p> <p>This approach provides a clear expectation up front, is transparent and flexible.</p>

- 28. The proposed test drive of the multi-year approach in Vote Housing departmental appropriations includes no direct specification of a dividend at the start of the test. Instead there are two opportunities for discussion about a dividend:
  - As part of the further work prior to the start of the test drive, as discussed in paragraph 19.
  - As part of an interim report of progress with the testing period in February 2011.
- 29. Extracting a dividend would vary depending on the type of appropriation. There is an addition dimension of the efficiency dividend in the case of departmental appropriations funded by third party revenue, as is the case with a number of Vote Housing departmental appropriations. Reducing these appropriations through the dividend, whether in the increased delegations or the MYA approach would not return money to the centre, but would instead mean reductions in fees.

30. The opportunity to reinvest savings should also be considered alongside any dividend. For example, a business case for capital investment should highlight not only the depreciation costs to the business of that investment over its economic life (to be met from appropriation) but also the savings in future years that the investment will yield. That intended saving should also form the basis of a discussion about future dividends, lower fees to third parties or increased quality or quantity of service.
31. Expectations about improved non-financial performance can also be set in addition to, or instead of, financial dividend expectations. For example, agencies may be expected to deliver more for the same level of appropriations (with no adjustments for inflation). It will be important that good performance specification is in place and that the improvements expected are clearly set out and measurable.

### **Better Capital Asset Planning**

32. Capital asset planning under a multi-year appropriation should be better aligned to the longer term needs of the organisation. Longer term planning should identify the advantages of investment in capital assets, the projected economic life of such assets, the depreciation and other costs of ownership and the operating costs that flow from the associated system or organisational changes. By extending the planning horizon beyond a single year the risk of failing to refresh the capital base will be reduced.
33. As an example, the residential tenancy services activity is delivered via a technology platform that is close to twenty years old. Core processes are of a similar age. The service requires investment in technology and to accompany that, it requires change to how the service is delivered to the customer by offering alternative delivery channels that reflect the needs of today's customers. Spending on these developments now are expected to result in lower costs in the future as costly manual processes are moved to, for example, internet self-service or multiple-handling of documents is reduced to streamline processes and increase efficiency.

### **Entry into the multi-year approach**

34. It is important that for any Vote with departmental appropriations entering the multi-year approach, the department provides Cabinet with clear information about the existing level of the baseline and how the funding is being used. The priorities set out in the Vote Housing BAP show how the existing baseline fits with the Government's strategic direction.
35. Annex Two provides a detailed breakdown for the departmental appropriations in Vote Housing. The Annex also includes a clear path for departmental spending over the three year period of the trial (2010/11, 2011/12, 2012/13).
36. To be eligible for the wider roll-out in Budget 2011, departments would need to fulfil the following:
  - BAP or other materials show how the existing baseline fits with the Government's strategic direction;
  - BAP or other materials show how intentions fit with the priorities in the PM's priority letters;
  - Prepare a clear and agreed plan for cost optimisation/reduction, so any fiscal pressures will be managed within baseline;
  - Incorporate any information that comes from any ECC reviews during 2010;

- Spending path clearly outlined together with expected deliverables; and
  - Robust performance information regarding deliverables.
37. There is not sufficient time to fully develop robust performance information for the DBH test drive. As an alternative it is recommended that the continuation of the test drive after 12 months be contingent on progress in developing performance measures. If this is not completed then the test drive would end.
38. In order to mitigate some of the risks around wider use of MYAs, Cabinet could require the production of a detailed Statement of Forecast Service Performance or equivalent that covers the full period of the MYA. This would specify the services to be delivered in each year of the MYA.

### **Reporting Requirements**

39. Testing the multi-year approach provides a way to obtain information about proposed transfers and the expected payoffs, if the increased delegations approach is used. Any proposed transfers need to provide a clear description of the nature of the transfer and the expected return. This information should be included in the material provided to the Minister of Finance by the Minister responsible for the appropriation.
40. Transfers can be tracked overtime and measured against performance information. Financial performance can also be monitored through the recovery of dividend as a measure of achieving 'more (or the same) for less.
41. A six month interim report on the trial should be finalised by the end of February 2011. This report should set out:
- Progress to date, including an assessment of the implementation, lessons learned and any adjustments required to the multi-year approach.
  - Actual and expected transfers.
  - Progress against performance standards.
  - Any possible future changes to performance measures that would help measure performance improvement.
  - Discussion around providing an 'efficiency dividend'.

### **Success Factors**

42. At an agency level, by the end of this project we will have:
- A department in which the management team is taking a long-term view of its business, such that the long-term view is reflected in:
    - budgets that extend over multiple years;
    - reporting reflects achievements towards long-term goals; and
    - short-term actions are driven by a regard to long-term outcomes.

- There will be multi-year appropriations that enable spending to be planned across time to reflect and give effect to the long-term plan.
  - Capital investment and related planning will support the long-term view of the business.
  - People planning and investment in their development and skills will reflect the business' identified long-term needs.
43. At a system level, by the end of this project we will have:
- Agencies who are able to manage in a more business-like manner.
  - Increased incentives and tools for Ministers and agencies to drive performance and productivity improvements.
  - Greater alignment between funding decisions and improvements sought through tools such as the Performance Improvement Framework.
  - Better conversations between Ministers and agencies about base spending, where performance needs to shift to, and how to invest for these improvements.
  - Ministers able to focus on what is important (both financial and in policy terms), rather than dealing with low-value transactions or activities.

#### **Process for Extending Pilot into other areas in Budget 2011**

44. Any plans to bring more departments into testing the multi-year approach for Budget 2011 will need to be made well in advance of having detailed results about the success of the test drive in Vote Housing. The introduction of any new departments into the trial will need to consider the following information:
- DBH interim report on test drive – although only limited provisional information is likely to be available after 6-7 months.
  - Assessment of any required changes based on interim test drive results.
  - Alignment of baseline with government priorities.
  - Suitability of performance measures (i.e. need robust performance measures).
  - Any changes in Budget process for Budget 2011.

#### **Links to Other Work Underway**

45. There are currently a number of pieces of work that are related closely to the proposals in this paper. Included in this are:
- Treatment of forecast changes in the operating allowance.
  - Any adjustments to existing relativities between different areas of Government spending.
  - Preparing agencies for performance discussions.

## Risks

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46. If you wish to proceed with the planned test of the multi-year approach in Vote Housing there is only a short period of time remaining to finalise the details to incorporate into the Budget Cabinet paper and into the Estimates and supporting information.

## Other Relevant Information

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### ANNEX ONE: ADVANTAGE AND DISADVANTAGES OF EACH OF THE OPTIONS FOR IMPLEMENTING THE MULTI-YEAR APPROACH

	<b>More use of Cabinet delegations to Joint Ministers</b>	<b>More widespread use of MYAs</b>
Advantages	<p>Increased flexibility relative to current arrangements.</p> <p>Easier to extract a 'dividend' each year compared with MYA approach.</p> <p>Less risk relative to MYA approach as delegations can be changed and there is an opportunity to scrutinise proposed transfers.</p> <p>Maintains annual reporting against performance standards.</p> <p>Easily rolled out to wider range of Votes.</p>	<p>Maximises flexibility compared with current arrangements and increased use of delegations.</p> <p>Easier to invest 'upfront' to achieve productivity gains later.</p> <p>Easier to factor any reinvestment of surplus into a multi-year plan.</p> <p>Can retain annual reporting against performance standards, so long as incorporated into output plans and forecast statements of service provision.</p>
Disadvantages	<p>Easier transfers over time may impose a cost as underspends would be returned to the centre under the current system.</p> <p>May create an incentive to under deliver agreed services in order to free up resources to transfer across time.</p> <p>Provides scope for transfers that alter the original mix of outputs specified by Cabinet/Parliament.</p> <p>Incentives to make transfers may be diluted by perception that the transfers may be declined and money pulled back to the centre.</p>	<p>Some loss of transparency about when funding will be used.<sup>1</sup></p> <p>Makes it more difficult for Parliament to specify when services will be provided.</p> <p>Requires a separate approach for transfers across appropriations.</p> <p>Puts an additional hurdle in front of any more general changes that might be applied across the board.</p> <p>Needs an additional mechanism for transfers across appropriations.</p> <p>Creates a discontinuity in financial data by restructuring appropriations.</p>

<sup>1</sup> Agencies will still be required to complete annual output plans that will set out spending profiles for activities included in the multi-year appropriations.



## ANNEX TWO: DETAILED PROPOSAL FOR TRIAL OF MULTI-YEAR APPROACH IN VOTE HOUSING DEPARTMENTAL APPROPRIATIONS

- 1 Three existing annual departmental output expense appropriations in Vote Housing are proposed for establishment as multi-year appropriations for a period of three years each from 2010/11. The total amounts of the multi-year appropriations will be equal to the sum of the three years currently covered by baselines (i.e. it is fiscally neutral).
- 2 Each of the multi-year appropriations will revert to annual appropriations at the end of the three year period. Continued use of multi-year appropriations can be considered before the end of the period depending on the success of the testing period.
- 3 The Department of Building and Housing will undertake a planning exercise that will provide additional detail on the phasing of expenditure during the multi-year appropriations. The expectation is that the total amount will not change, and that any productivity dividend agreed between joint Ministers will be reflected in Estimated Actuals.
- 4 If the multi-year funding approach is rolled out to other agencies at a later date, the expectation will be that the creation of any multi-year appropriations will already factor in expected productivity dividends.

Table One. Summary of existing annual appropriations and proposed multi-year profiles.

<i>\$m</i>	2009/10	2010/11 to 2012/13			2013/14& Outyears
<b><i>Residential Tenancy and Unit Title Services</i></b>					
Current annual baseline	-	21.894	22.328	22.328	22.328
Proposed multi-year appropriation	-	66.550			22.328
<b><i>Occupational Licensing</i></b>					
Current annual baseline	-	9.384	9.966	7.991	7.991
Proposed multi-year appropriation	-	27.341			7.991
<b><i>Building Regulation and Control</i></b>					
Current annual baseline	-	16.771	16.214	16.503	16.783
Proposed multi-year appropriation	-	49.488			16.783