

This paper includes references to the Reserve Bank of New Zealand. These references were removed before Cabinet considered the issue. Cabinet Minute CAB (15)11/7A makes clear that the new circular does not apply to the Reserve Bank.

Chair
Cabinet Committee on State Sector Reform and Expenditure Control

NEW CABINET EXPECTATIONS: INVESTMENT AND ASSET MANAGEMENT, AND FINANCIAL AUTHORITIES

Proposal

1. This paper revises the investment management, asset performance, and baseline management expectations across the State Services (and Tertiary Education Institutions). It recommends that Cabinet approve two Cabinet Office circulars to replace:
 - a. CO(10)2 *Capital asset management in Departments and Crown entities: Expectations*; and
 - b. CO(11)6 *Guidelines and Requirements for Proposals with Financial Implications*.

Executive Summary

2. As the Minister of Finance, I expect investments in the State sector will achieve measurably improved outcomes. This expectation is based on the Government meeting public expectations to deliver better public services and making the best use of scarce financial resources.
3. The government's existing investment management system¹ – the rules, policies, practices and frameworks that govern how ministers and agencies make investment decisions – is not currently configured in a way that makes it possible to manage investments in line with that expectation. The existing guidance is out of date, unduly prescriptive, lacks mechanisms to inform Ministers about capability, and has an insufficient focus on the benefits to be achieved from an investment.
4. Last year I instructed the Treasury to lead a change process to reflect the Government's latest expectations on investment and asset management, and on proposals with financial implications and authorities.
5. The Treasury has completed that work in consultation with the Government Chief Information Officer (GCIO) and other agencies to produce the attached two new

¹ Refer Appendix 1 for a schematic overview of the investment system.

Cabinet Office circulars. These circulars are to replace the existing documents referred to as CO(10)2 and CO(11)6.²

6. The new circulars attached to this Cabinet paper address the above issues in that they:
 - a. Establish a Ministerial group to provide oversight on the investment management system.
 - b. Establish a systematic way to inform Ministers on a department's capability to undertake and manage investment proposals.
 - c. Establish mechanisms that recognise sound and poor investment management capabilities.
 - d. Establish expectations on reporting actual performance of assets and benefits of investments compared with those agreed with decision-makers.
 - e. Increase flexibility in the way corporate assurance and business case requirements are applied.
 - f. Require investment-intensive agencies to prepare long-term investment plans.
 - g. Reflect legislative changes (e.g. the 2013 amendments to the Public Finance Act), and decisions taken by Cabinet since the existing circulars took effect.
7. In addition to the consultation on this paper, the Treasury conducted two consultation processes over 6 months to increase awareness about the case for change to the way investments and assets are currently managed, and to invite feedback on specific proposals for change to the investment system. The Treasury also conducted one consultation process around changes to CO(11)6 as agencies were already familiar with the operational requirements set out in the new financial authorities circular.
8. Feedback indicates there is general support among agencies for the proposed changes to the investment management system. The changes promote better stewardship of assets, a greater focus on benefits realisation and transparency over performance. Some agencies have already made progress in the management of scarce public resources as outlined in the new circular. At the same time agencies understandably want more information on new aspects of the system such as the long term investment plans and the investor confidence rating.
9. Based on that feedback and subject to Cabinet approving the attached circulars, I will instruct the Treasury to undertake a three month implementation programme to help prepare agencies for the new expectations on investment and asset management. The Treasury will undertake this work in conjunction with corporate centre agencies to ensure the programme is sufficiently resourced and agencies are clear about the various roles being performed across the investment management system.
10. The feedback supports my intention to extend the scope of the investment circulars to include Schedule 4A companies under the Public Finance Act and to allow Ministers to consider investment choices from a portfolio perspective.

11. There are also aspects of CO(10)2 that I wish to retain. The most important of these is that no changes will be made to the standard financial authorities without future Cabinet approval.

Background

12. With an estimated \$116.3 billion worth of Property Plant and Equipment assets on the Crown's balance sheet at 30 June 2014, the quality, quantity and composition of these investments have significant implications for New Zealand's economic performance, public services and resilience.
13. Owning the right assets, managing them well, funding them sustainably, and managing risks to the Crown balance sheet, are all critical ingredients to the ongoing provision of high-quality and cost-effective public services that New Zealanders value. That means that the quality of investment management is vital to maintaining New Zealanders' living standards now and in the future and it explains why the Government is committed to ensuring investment management and asset performance practices remain fit-for-purpose.
14. The existing Cabinet Office guidance on investment and asset management was set in 2010 and needs to be updated to reflect Cabinet decisions over the past five years as well as developments in investment and asset management practice since 2010.
15. Likewise, the existing guidance for departments to manage proposals with financial implications was set in 2011 and needs to be updated to reflect legislative changes and Cabinet decisions in the intervening period.
16. This Cabinet paper and attached circulars represent the outputs of a robust process the Treasury has undertaken to update both circulars.

Comment on proposed changes to investment and asset management expectations

Improving the Government's Investment Management System

17. Until mid 2014 I chaired the ICT Investment Ministers' meetings which looked at planned ICT investments and ICT investment risks. Those meetings demonstrated the pressing need for greater Ministerial oversight of the Government's investment strategies and intentions on all investments, not just ICT investment.
18. Increasingly, government also expects its investments to be managed as part of a portfolio of inter-related work, rather than solely on an individual agency or project basis. This expectation reflects the fact that often investments by one agency impact on the delivery of services by other agencies, or require other agencies to support the change to enable it to be successful.
19. Building on these experiences and observations, the new investment and asset management circular will introduce the following key improvements to the existing system. It will:
 - a. Set out clear objectives for the investment management system
 - b. Recognise the role of the Investment Ministers in strengthening portfolio management
 - c. Expand the reach of the circular to include Public Finance Act Schedule 4A companies, as well as departments and Crown entities

- d. Update the definition of investments in scope to include “on demand” service offerings
 - e. Introduce an investor confidence rating using performance and capability assessments
 - f. Update the list of capital-intensive agencies, and require these to produce long-term investment plans covering at least 10 years; and
 - g. Improve benefits capability and reporting.
20. The following sections explain these key improvements to the investment management system in more detail.

Objectives of the investment management system

21. The term *investment management system* refers to the processes, rules, capabilities, information and behaviours that affect the way investments are managed throughout their life cycles. A well-performing system has a positive impact on the outcomes the Government is seeking to achieve by bringing about better use of taxpayer funded resources.
22. To be effective, I consider that the system must enable Cabinet and agencies to prioritise and coordinate significant investments according to long term priorities, and to deliver the agreed value from particular investments. This means giving greater effect to stewardship of Crown resources, enabling Ministers and other parties to exercise their roles in a more flexible and efficient manner, and making more systematic use of relevant performance information in decision-making processes.
23. Accordingly, I invite Cabinet to agree that the objectives of the proposed changes are to:
- a. Optimise value generated from new and existing investments
 - b. Increase the efficiency and effectiveness of the system; and
 - c. Enable investments to achieve their specific investment objectives.

The role of the Investment Ministers in strengthening portfolio management

24. Advice to Government has not always taken account of the system-wide and portfolio management impacts of individual investment decisions. To address this gap I am inviting Cabinet to agree to establish a new Investment Ministers group, as a single point Ministerial group that will regularly review the investment management system and the Crown Balance sheet.
25. The Investment Ministers Group will supersede the former ICT Ministers Group. I have instructed the Treasury to provide support to the Investment Ministers group.
26. It is important to note that as a group, Investment Ministers have no approval authority in relation to individual investments.
27. Investment Ministers will identify the strategy for government investment, and the broad make-up of the government’s investment portfolio. Investment Ministers will work with Cabinet, their Ministerial colleagues, and the relevant decision rights holders, to give effect to the system objectives above, consistent with the group’s terms of reference which includes:

- a. Understanding the direction and array of potential investments available
- b. Supporting investment decision-making processes that create the best value investment portfolio, including divestment as well as investment, and targeting resources to their best effect
- c. Scrutinising investments in development with a view to increase their likelihood of success
- d. Reviewing the performance of investments against expectations, including reviews of progress, benefits, the performance of assets, the measurement and performance of the investment system, and the investment portfolio in relation to current and future needs
- e. Better understanding the Crown's financial risk and contingent liabilities
- f. Seeking savings and efficiencies from within the government investment system
- g. Developing an investment strategy to guide investment management across the system
- h. Reviewing agency investor confidence ratings and making recommendations to Cabinet on any changes in agency ratings; and
- i. Resolving sequencing and timing issues in relation to significant investments, including the PPP programme.

Expand the reach of the new investment and asset management circular

28. The existing circular applies to government departments and Crown entities. The new circular again focuses on agencies in the State services. After consulting widely on the scope of agencies covered by the circular, I now propose to extend the reach of the new circular to include all companies listed under Schedule 4A of the Public Finance Act.³ This move is consistent with the reach of the whole of government procurement direction issued last year. It also recognises the prominent role these companies can and do play in terms of delivering government investments.
29. As was the case previously, the new circular will not apply to tertiary education institutions, state-owned enterprises, and mixed ownership companies, nor to school boards of trustees. The circular will not apply to organisations named or described in Schedule 4 of the Public Finance Act.

Update the definition of investments in scope

30. The 2010 circular and associated guidance⁴ covered Cabinet's expectations for the approval of, and assurances relating to, major capital projects, and for the management of owned or leased plant, property, equipment, and software resources used in the delivery of government services.

³ Crown Asset Management Limited, Crown Fibre Holdings Limited, Education Payroll Limited, Fairway Resolution Limited, Health Benefits Limited, Network for Learning Limited, The Research and Education Advanced Network New Zealand Limited, Southern Response Earthquake Services Limited, Tamaki Redevelopment Company Limited.

⁴ For example, business case guidance, monitoring and Gateway materials.

31. I propose to make one change to the definition of investments in scope to recognise the reality of a change in the way government does business. The definition of investments now explicitly includes “on demand” service offerings (also known as “XaaS” which is a term for services and applications accessed over the internet as opposed to being provided in-house).

Application of the broader scope of investments

32. For practical purposes the focus of Investment Ministers and the corporate centre will be targeted to:
- a. Capital expenditure, asset disposals, lease arrangements, and “as a service”⁵ investments, whether funded from baselines or new Crown funding; and
 - b. Asset performance.
33. I consider that any changes to the scope beyond those in this paper should be subject to a separate process of consultation, and Cabinet approval.

Exclusions from definition of investments for the purposes of the new circular

34. For the purposes of the new circular I propose to exclude from the definition of investments the financial investment functions of the five Crown financial institutions⁶ or the Reserve Bank of New Zealand, or the Treasury’s Debt Management Office as these functions are not directly associated with delivering government services. For the same reason I also propose to exclude from the scope of investments all non-departmental official development assistance.

Confirmation of approval thresholds

35. I propose no material changes are needed to the current set of general approval thresholds for investments that require Cabinet or Ministerial approval.
36. In 2010 Cabinet agreed that all PPPs would need to be considered by Cabinet and I consider that policy is still appropriate given the potential scale and risk of such investments. For the avoidance of doubt I propose that all investment proposals be considered by Cabinet (not just those being developed by Crown agents).
37. I also propose that Cabinet may also have an interest in all high risk or high value investments by all agencies covered by this circular irrespective of funding source. The final decision on whether to refer such proposals to Cabinet is one that is made by the responsible Minister in accordance with the Cabinet Manual.

Introduce an investor confidence rating using performance and capability assessments

38. At present there is no systematic account taken of the capacity and capability of an agency to successfully deliver existing and proposed investments or manage assets well over time.

⁵ Changes that result from adopting “on demand” service offerings, also known as “XaaS” - a term for services and applications accessed over the internet as opposed to being provided in-house (for example, Infrastructure as a Service).

⁶ Includes Guardians of New Zealand Superannuation, Government Superannuation Fund Authority, National Provident Fund, Earthquake Commission and Accident Compensation Corporation.

39. In response I propose Cabinet adopt an Investor Confidence Rating (ICR). The ICR will characterise the confidence that investors (e.g. Cabinet, relevant portfolio Ministers, or Investment Ministers) have in an agency's likelihood of successfully realising a promised investment result if funding were committed. This initiative will drive a system-wide focus on the performance of investments and assets and help raise relevant agency and corporate centre capabilities.
40. The ICR will influence the general level of financial authority an agency has over investments, as well as the level of corporate centre scrutiny of, or assistance to, each agency. The ICR is a rating of an agency, not a particular investment or proposal. The Treasury will administer the rating process including regular capability and performance assessments. Ministers will then confirm a rating for an agency.
41. The Treasury has consulted with agencies on the main features of the ICR which are set out in the new circular. Feedback indicates agencies understand and support the ICR and now wish to work with the Treasury to finalise the design⁷. The Treasury will complete that work over the next 3 months in partnership with corporate centre agencies and a reference group of other agencies.
42. The final design is subject to approval by the Investment Ministers group by 1 July 2015. The Treasury will then work closely with Tier 1 investment-intensive agencies to compile the relevant information needed for the rating and complete the first tranche of agency ICRs by 31 December 2015.
43. The Investment Ministers' group will then review the ICRs before these are referred to Cabinet for consideration and approval (the relevant portfolio Minister may be invited to these discussions).
44. Cabinet will determine the final ratings. At the time Cabinet considers an agency's ICR, it will also determine whether the rating affects an agency or sector in one or more of the following ways:
 - a. The level of authority to make different types of investment decisions funded from departmental baselines or balance sheets;
 - b. The level of authority to make different types of investment decisions relating to assets on the Crown account;
 - c. The department's ability to spend depreciation accumulated on its balance sheet;
 - d. Retention of proceeds from asset disposals by departments;
 - e. The level of corporate centre or monitoring department assurance activity;
 - f. The level of project, programme or portfolio reporting by agencies and the corporate centre;
 - g. The assurance requirements an agency is to fulfill;
 - h. Whether agencies are recharged for additional interventions or support; and
 - i. Any other aspects of investment management approved by Cabinet.
45. The ICR for an agency or sector will not directly affect the extent of any capital withdrawal to reduce the level of net assets held by a department. I consider that any capital withdrawals should be subject to a separate process.

⁷ The current design features a mix of lead and lag performance indicators including asset management maturity, portfolio, programme and project maturity, asset performance and project performance.

46. The ICR and any consequential impacts agreed by Cabinet will only apply from when the results have been agreed by Cabinet. Until these are agreed the standard expectations and general approval thresholds contained in the new circular continue to apply.

Update the list of capital-intensive agencies, and reset expectations

47. The current list of 15 capital-intensive agencies and sectors was approved by Cabinet in 2010.⁸ The Treasury has reviewed the list in the light of the broader definition of investments outlined above. As a result of that review I propose the following changes:
- a. Capital-intensive agencies will be renamed investment-intensive agencies;
 - b. There will be a three tier system with Tiers 1 and 2 being investment-intensive agencies, and Tier 3 being non-investment-intensive agencies;
 - c. There will be a review of the classification of agencies at least every two years, to allow for flexibility to move an agency from one Tier to another;
 - d. Changes to the classification of agencies would be approved by the Investment Ministers group; and
 - e. For the purposes of the ICR, there will be different level of investment management and asset performance expectations, with Tier 1 agencies having the highest expectations.
48. Once again the final details on the levels (for ICR purposes) will be developed in consultation with agencies and the corporate centre, and these will also be confirmed by the Investment Ministers group.
49. Given the value and importance of the assets under management by investment intensive agencies I consider it is appropriate that these agencies be required to produce long-term investment plans covering at least 10 years. That planning horizon allows for greater transparency, scrutiny and support and enables government to anticipate the effects of current policy settings. The Treasury will ensure that agency long-term investment plans are integrated with other planning products (e.g. Four-year Plans).

⁸ Current capital-intensive agencies: <http://www.treasury.govt.nz/statesector/ciagencies>

50. I propose Cabinet agree that the following agencies be classified as Tier 1 or Tier 2 investment-intensive agencies. All but four of these agencies have been classified as capital-intensive subject to higher Cabinet expectations since 2010.

Tier 1	Tier 2
1. Ministry of Education	12. Canterbury Earthquake Recovery Authority*
2. New Zealand Defence Force	13. Department of Conservation
3. Department of Corrections	14. Department of Internal Affairs *
4. Ministry of Social Development	15. Ministry of Business, Innovation, and Employment *
5. Inland Revenue Department	16. Ministry of Foreign Affairs and Trade
6. Accident Compensation Corporation	17. Ministry of Justice
7. Housing NZ Corporation	18. Ministry for Primary Industries *
8. NZ Transport Agency	19. New Zealand Customs Service
9. Ministry of Health	20. New Zealand Police
10. Auckland DHB	21. Tertiary Education Commission (for Tertiary Education Institutions)
11. Canterbury DHB	22. Counties-Manukau DHB
	23. Waitemata DHB
	24. Waikato DHB
	25. Capital and Coast DHB
	26. Southern DHB
	27. Northland DHB
* Indicates this agency has not previously been classified as capital-intensive	

51. In coming months, The Treasury will consult further with the four potential new investment-intensive agencies over their investment-intensive status, along with the Tertiary Education Commission (for Tertiary Education Institutions) to determine its continued status as an investment-intensive agency (in Tier 2).
52. The Treasury will consult with the Canterbury Earthquake Recovery Authority during the transition planning process, to determine if the future delivery arrangements will create an investment-intensive agency.
53. The final list of investment-intensive agencies will be approved by Investment Ministers before the new circular comes into effect on 1 July 2015.

Improve benefits reporting and asset management capability

54. Once the new circular comes in to effect on 1 July 2015, I've instructed the Treasury to assist agencies to improve their benefits and asset management capability and reporting starting in 2015/16. It is important to the achievement of our fiscal targets⁹ that investments are managed well and achieve their stated benefits. The significance of benefits realisation will be reinforced through the ICR indicators.

Improve the responsiveness of the system to Ministerial needs

55. The current investment management system is perceived to have prescriptive; one size fits all, compliance heavy business case and assurance frameworks that don't easily accommodate more iterative approaches to investments or tight policy development timeframes. Agencies and the corporate centre struggle to tailor the frameworks to situations where a Minister has directed an agency to the investment option he or she wants the agency to implement.

⁹ The Government has a medium-term target of net Crown debt at a level no higher than 20% of GDP by 2020.

56. In response the Treasury will work with corporate centre agencies and selected agencies to amend the Better Business Case (BBC) framework¹⁰ to better allow for agile, iterative approaches and to more easily accommodate Ministerial policy decisions. These changes will align the framework and decision making with funding processes (e.g. the Budget).
57. Agile and iterative approaches are planned to be delivered by 1 July 2015, with improvements to the BBC framework to accommodate Ministerial policy decisions being made early in 2015/16.
58. These improvements to introduce greater flexibility to the business case framework will be supported by the Treasury providing additional guidance (e.g. an assessment tool), improved reviewer capability and more direct support for business case development and review.

Better integrate assurance services

59. This work has highlighted the need for the Treasury, GCIO, SSC and monitoring departments to better integrate and communicate their respective assurance services. The Treasury will work with these parties to clarify their assurance and monitoring roles (including the Treasury itself), and will update and communicate revised guidance.
60. The new circular is also more principles based and allows scope for other types of investment reviews being made available alongside Gateway reviews. These additional reviews are being developed and will be available from early 2015/16.

Leading the investment management system

61. I consider that the Treasury should lead the government's investment management system and take responsibility for developing and maintaining the integrity of the system as a whole, in consultation with the relevant department, monitor and the corporate centre as appropriate. In this capacity the Treasury will:
 - a. oversee the performance of investments and assets;
 - b. share investment information with agencies;
 - c. develop and contribute to a network of investment and asset management excellence across the system;
 - d. ensure all investment management guidance materials are consistent with and support the objectives of the system;
 - e. review the effectiveness and efficiency of the system rules and processes;
 - f. administer the investor confidence rating;
 - g. determine the level of monitoring and investment reviews (e.g. Gateway reviews);
 - h. determine whether investments or asset portfolios are significant for the purposes of this circular;
 - i. periodically commission independent assessments of investment management capabilities and practices in agencies;
 - j. report on the performance of the system; and

¹⁰ <http://www.infrastructure.govt.nz/publications/betterbusinesscases>.

- k. provide advice on the performance of functional leaders operating within the system.
62. The Treasury advice on the performance of functional leaders within the system will centre on the Treasury's role in preparing purchase advice to Finance Ministers on departmental appropriations.

Reflecting the roles of functional leaders

63. The new investment and asset management circular incorporates the Cabinet-approved roles of the three functional leaders. These are the Government Chief Information Office in the Department of Internal Affairs, the procurement function in the Ministry of Business, Innovation and Employment, and the Property Management Centre of Expertise in the Ministry of Social Development.

Implementation of the new investment and asset management circular

64. The Treasury will use the three month period from April to June 2015 to help departments and Crown entities meet the new expectations in the proposed circular through a series of workshops, roadshow seminars and communications explaining the direction and finalising details around the ICR, long term investment plans, the list of investment intensive agencies and developing updated guidance materials.
65. A working group comprising representatives from corporate centre agencies will assist the Treasury to implement the new circular.
66. The Treasury in conjunction with corporate centre and agency input will complete the following initiatives and report to Investment Ministers to confirm the final details:
- a. Investor Confidence Rating: Agency and corporate centre input into the final design, before a phased rollout in FY 15/16 (starting with the Tier 1 investment-intensive agencies).
 - b. Capability Maturity Assessments: These independent assessments will be used as a key input to the Investor Confidence Rating. The Treasury will procure two types of capability maturity assessments¹¹ from the start of the 2015/16 financial year.
 - c. Long-term Investment Plans: The Treasury will work with investment-intensive and corporate centre agencies to develop guidance and support for these plans which will be developed during 2015/16 and aligned with other planning products e.g. Four-year Plans.

General feedback from agencies

67. The Treasury conducted two consultation rounds with affected State services agencies, including Schedule 4A companies, on the issues and options for improving the investment management system over a 5 month period from October 2014 to February 2015.
68. The feedback the Treasury received and the Treasury's responses are presented in Appendix 2.

¹¹ Being asset management maturity and P3M3 (portfolio, programme and project) maturity.

69. Generally the feedback indicates there is general support among agencies for the proposed changes to the investment management system. Agencies agree with the need to promote better stewardship of assets, focus more on benefits realisation and understand and reveal performance. Some agencies have already made progress in the management of scarce public resources as outlined in the new circular. At the same time agencies understandably want more information on new aspects of the system such as the long term investment plans and the investor confidence rating.

Comment on proposed changes to guidance on financial authorities

70. The second circular attached to this paper is entitled *Proposals with Financial Implications and Financial Authorities*. It will replace Cabinet Office Circular CO (11) 6 *Guidelines and Requirements for Proposals with Financial Implications*.
71. This new circular reflects the amendments made in 2013 to the Public Finance Act, which among other things:
- a. Provides Ministers and departments with increased flexibility to allocate resources to where they are needed most while retaining appropriate Cabinet scrutiny (e.g. through the use of multi-category appropriations); and
 - b. Makes clear the delegations given to departments (through chief executives and their delegates);
72. This circular also reflects procedural and rule changes agreed by Cabinet since 2011 when the current circular came into force (e.g. around the role of Four Year Plans, capital charge).
73. The new circular confirms the same financial approval authorities as those set out in CO(11)6 will apply to three particular types of expenditure, namely:
- a. Publicity expenses;
 - b. Compensation or damages in settlement of claims; and
 - c. Ex gratia payments.
74. Agencies are familiar with the changes set out in the new circular which are already in operation. Given the circumstances I recommend this circular come into effect as soon as practicable in April 2015. There is no need to delay its publication to coincide with the new investment and asset management circular.

Consultation

75. This paper was prepared by the Treasury. The Treasury consulted the following groups of agencies on the two circulars and the content and recommendations in this paper:
- a. Corporate centre (including functional leaders)
 - b. Public Service departments
 - c. Non-Public Service departments
 - d. Crown Agents
 - e. Autonomous Crown entities
 - f. Independent Crown entities
 - g. Public Finance Act Schedule 4A Companies

76. The Department of the Prime Minister and Cabinet was kept informed on the consultation process and provided with copies of the consultation material.

Financial Implications

77. The new circular on Investment Management and Asset Performance in the State Services includes additional services for the Treasury to provide or administer which will be funded from within existing baselines.
78. Agency feedback indicates there is some concern that there could be increased compliance costs to support the expanded scope and new requirements of the investment management system. The Treasury has not attempted to estimate these costs. Cabinet typically considers between 40 and 60 capital investment proposals each year. The Treasury considers that the expanded scope will not materially affect the overall volume of proposals requiring Cabinet approval.
79. Changes to an agency's ICR may result in changes to its financial authorities which could have a bearing on its ability to commit resources to baseline-funded investments. Depending on the ICR there could be greater or lower compliance costs associated with corporate centre reporting and assurance requirements.
80. There are no financial implications from the new circular on Proposals with Financial Implications and Financial Authorities.

Legislative Implications

81. There are no legislative implications.

Regulatory Impact Analysis

82. Regulatory impact analysis requirements do not apply.

Human Rights, Gender Implications, Disability Perspective

83. There are no human rights, gender or disability implications associated with this paper.

Publicity

84. The Minister of Finance may announce the changes described in this paper and the new investment and asset management circular at the NZ Infrastructure Forum on 31 March 2015.
85. Ministers responsible for Crown entities and companies are invited to bring to the attention of boards of those agencies Cabinet's new expectations, noting that the new expectations take effect from 1 July 2015.
86. The two new circulars will be published on the Department of the Prime Minister and Cabinet (DPMC) website from the agreed effective dates.

Recommendations

87. I recommend that the Cabinet Committee on State Sector Reform and Expenditure Control:

Scope and reach of the new investment management circular (to supersede CO(10)2):

1. **note** the government's existing investment management system¹² is not currently configured in a way that makes it possible to manage investments to achieve measurably improved outcomes
2. **agree** to issue a new Cabinet Office circular entitled Investment Management and Asset Performance in the State Services, that sets out Cabinet's expectations for:
 - a. active stewardship of government resources;
 - b. strong alignment between individual investments and government's long-term priorities
 - c. the management of investments, being the commitment of capital or balance sheet resources to the delivery of government services with the expectation of receiving future benefits
 - d. the management of both physical and intangible assets, and also
 - e. recognises the roles of functional leaders as they relate to the investment management system.
3. **note** that a draft of the new circular is attached to this paper
4. **agree** the new circular will be effective from 1 July 2015 and will supersede CO(10)2 Capital Asset Management in Departments and Crown Entities: Expectations
5. **agree** the new circular will apply to:
 - a. all departments (including departmental agencies) as defined by the Public Finance Act (PFA);
 - b. the following types of Crown entities:
 - i. Crown agents
 - ii. Autonomous Crown entities
 - iii. Independent Crown entities
 - iv. Crown entity companies, including Crown Research Institutes
 - c. companies listed on Schedule 4A of the PFA; and
 - d. The Reserve Bank of New Zealand.
6. **note** the new circular will not apply to:
 - a. school boards of trustees, the education service or organisations named or described in Schedule 4 of the PFA; and
 - b. tertiary education institutions, state-owned enterprises, and mixed-ownership model companies.

Objectives of the investment system

7. **note** the investment management system (the system) means the processes, rules, capabilities, information and behaviours that work

¹² The investment management system means the processes, rules, capabilities, information and behaviours that work together to bring discipline to the way investments are managed throughout their life cycles.

together to bring discipline to the way investments are managed throughout their life cycles

8. **agree** the objectives of the system are to:
 - a. optimise value generated from new investments and existing resources
 - b. increase the efficiency and effectiveness of the investment management system; and
 - c. enable investments to achieve their specific investment objectives.
9. **agree** that to be effective the system must:
 - a. enable Cabinet and agencies to prioritise and coordinate significant investments according to government and State sector long term priorities
 - b. establish, disclose and then deliver the agreed value from particular investments
 - c. promote good stewardship of Crown resources
 - d. enable Ministers, agencies, and the corporate centre to exercise their required roles in a flexible and efficient manner; and
 - e. make systematic use of performance information in corporate centre and agency investment management and decision-making processes.

Definition of investments

10. **note** that investments are defined in broad terms to mean the commitment of capital and balance sheet resources to the delivery of government services with the expectation of receiving future benefits, principally through projects and programmes and portfolios
11. **agree** that investments includes the following activity, irrespective of funding source¹³ or appropriation type or whether government financial support is by way of a guarantee or indemnity:
 - a. changes (additions or disposals) to asset portfolios
 - b. changes that result from adopting “on demand” service offerings, also known as services and applications accessed over the internet as opposed to being provided in-house (for example, Infrastructure as a Service); and
 - c. any new lease arrangements, or renewals of lease arrangements (for example, property rentals).
12. **note** that the focus of Investment Ministers and the corporate centre will be on:
 - a. capital expenditure, asset disposals, lease arrangements, and “as a service” investments; and
 - b. asset performance.
13. **agree** that any decision to extend the investments in scope of the circular beyond those set out in 11 above would require further consultation, and Cabinet approval

¹³ Funding sources include baseline, private investment, new funding etc. Appropriation types include expenses or capital expenditure, and departmental or non-departmental.

14. **agree** that for the purposes of the new circular, investments will exclude the following activity:
 - a. financial investment functions performed by Crown Financial Institutions (CFIs)¹⁴ or the Reserve Bank of New Zealand, or the Treasury's Debt Management Office; and
 - b. non-departmental official development assistance.

Role of Investment Ministers

15. **agree** to establish a group of Ministers called Investment Ministers to work with responsible Ministers to give effect to the objectives of the system
16. **note** that as a group, Investment Ministers have no approval authority in relation to individual investments
17. **note** the Investment Ministers group supersedes the ICT Ministers group
18. **agree** the role of Investment Ministers includes:
 - a. understanding the direction and array of potential investments available;
 - b. supporting investment decision-making processes that create the best value investment portfolio, including divestment as well as investment, and targeting resources to their best effect;
 - c. scrutinising investments in development with a view to increase their likelihood of success;
 - d. reviewing the performance of investments against expectations, including reviews of progress, benefits, the performance of assets, the measurement and performance of the investment system, and the investment portfolio in relation to current and future needs;
 - e. better understanding the Crown's financial risk and contingent liabilities;
 - f. seeking savings, and efficiencies from within the government investment system;
 - g. developing an investment strategy to guide investment management across the system;
 - h. reviewing agency investor confidence ratings and making recommendations to Cabinet on any changes in agency ratings; and
 - i. resolving sequencing and timing issues in relation to significant investments, including the PPP programme.
19. **note** that the Treasury will provide administrative support to the Investment Ministers group

System leadership role

20. **direct** the Treasury to lead the government's investment management system and take responsibility for developing and maintaining the integrity of the system as a whole

¹⁴ Includes Guardians of New Zealand Superannuation, Government Superannuation Fund Authority, National Provident Fund, Earthquake Commission and Accident Compensation Corporation.

21. **agree** that in this system leadership role, the Treasury will:
- a. oversee the performance of investments and assets
 - b. share investment information with agencies
 - c. develop and contribute to a network of investment and asset management excellence across the system
 - d. ensure all investment management guidance materials are consistent with and support the objectives of the system
 - e. review the effectiveness and efficiency of the system rules and processes
 - f. administer the investor confidence rating
 - g. determine the level of monitoring and investment reviews (e.g. Gateway reviews)
 - h. determine whether investments or asset portfolios are significant for the purposes of this circular
 - i. periodically commission independent assessments of investment management capabilities and practices in agencies
 - j. report on the performance of the system; and
 - k. provide advice on the performance of functional leaders operating within the system.
22. **note** that advice on the performance of functional leaders within the system refers to the Treasury's role in preparing purchase advice to Finance Ministers on departmental appropriations

Investor confidence rating

23. **agree** to reinforce the objectives of the system by using performance indicators and information to determine an investor confidence rating for each agency or sector
24. **agree** that the level of investor confidence may affect each agency or sector in one or more of the following ways:
- a. the ability to spend depreciation funding accumulated on a department's balance sheet
 - b. the level of authority to make different types of investment decisions funded from departmental baselines or balance sheets (these could vary according to the type, scale, risk or value of transactions, and cover different periods of time)
 - c. the retention of proceeds from asset disposals by departments
 - d. the level of authority to make different types of investment decisions relating to assets on the Crown account
 - e. the level of assistance available to the agency for improvement
 - f. the level of corporate centre support for agency proposals for new funding
 - g. the level of corporate centre or monitoring department assurance activity
 - h. the level of project, programme or portfolio reporting by agencies and the corporate centre

- i. the assurance requirements an agency is to fulfil
 - j. whether agencies are recharged for additional interventions or support; and
 - k. any other changes to the investment management system adopted by Cabinet in future.
25. **agree** that the level of investor confidence for an agency or sector will not directly affect the extent of any capital withdrawal to reduce the level of net assets held by a department
26. **agree** that the investor confidence rating and any consequential impacts will apply from when the investor confidence assessments have been undertaken and the results have been agreed by Cabinet, after prior consideration by Investment Ministers.
27. **agree** that until agency investor confidence ratings are agreed the standard expectations and general approval authorities contained in the new circular will continue to apply
28. **note** that Cabinet may reallocate funds from asset disposals by a department to other parts of the State Services, consistent with its investment strategy, notwithstanding the investor confidence rating of a department

Updating the capital-intensive agencies

29. **agree** to rename the capital-intensive agencies to investment intensive agencies for the purposes of the investment management system
30. **agree** to introduce a three tier system, with Tiers 1 and 2 being investment-intensive, and Tier 3 being non-investment-intensive
31. **agree** that the following agencies are investment-intensive agencies:

Tier 1	Tier 2
Ministry of Education New Zealand Defence Force Department of Corrections Ministry of Social Development Inland Revenue Department Accident Compensation Corporation Housing NZ Corporation NZ Transport Agency Ministry of Health Auckland DHB Canterbury DHB	Canterbury Earthquake Recovery Authority Department of Conservation Department of Internal Affairs Ministry of Business, Innovation, and Employment Ministry of Foreign Affairs and Trade Ministry of Justice Ministry for Primary Industries New Zealand Customs Service New Zealand Police Tertiary Education Commission (for Tertiary Education Institutions) Counties-Manukau DHB Waitemata DHB Waikato DHB Capital and Coast DHB Southern DHB Northland DHB

32. **note** the Treasury will consult further with the following agencies to confirm their investment intensive status
- a. Department of Internal Affairs.
 - b. Ministry of Business, Innovation, and Employment.

- c. Ministry for Primary Industries.
 - d. Canterbury Earthquake Recovery Authority.
 - e. The Tertiary Education Commission (for Tertiary Education Institutions).
33. **agree** to delegate to Investment Ministers the power to make changes to the list of investment-intensive agencies.

Authority to approve investments

34. **note** that the general approval thresholds for investments are set out in the table below and that these are the same as the thresholds for capital investments under the existing circular CO(10)2
35. **agree** that Cabinet approval is required for all investment or asset disposals set out in the table below.

Table 1: Investments that require Cabinet approval		
Type/owner of proposal	All departments	All other agencies covered by this circular
All investments that require new Crown funding	✓	✓
All PPP proposals, even if funded from baselines and balance sheets	✓	✓
All departmental investments with a WOLC over \$25 million, even if funded from baselines and balance sheets	✓	
Proposals to dispose of assets held on the Crown account	✓	✓ ¹⁵
All proposals to dispose of departmental assets with a carrying value of \$25 million or more	✓	
All high risk ¹⁶ or high value investments, irrespective of the scale and funding source	✓	✓ ¹⁷

¹⁵ The general rule for whether a proposal should go to Cabinet is set out in paragraphs 5.11 and 5.12 of the [Cabinet Manual](#).

¹⁶ The investment risk profile is determined by The Treasury based on its risk profile assessment methodology (RPA).

¹⁷ As for footnote 15 above.

36. **agree** that the approval of the responsible Minister is required for the following investments and asset disposals:

Table 2: Investments that require the approval of the responsible Minister		
Type/owner of proposal	All Departments	All other agencies covered by this circular
All departmental investments with a WOLC of between \$15 million and \$25 million, if funded from baselines and balance sheets	✓	
All proposals to dispose of departmental assets with a carrying value of between \$15 million and \$25 million	✓	
All other proposals to dispose of assets held on the Crown account	✓	✓

37. **agree** that the general approval thresholds set out in tables above may be adjusted on the basis of an agency's investor confidence rating
38. **agree** that Cabinet will consider and may approve any recommendations from Investment Ministers for changes in general approval thresholds based on the ICR for any agency

Expectations relating to reporting on investment performance

39. **direct** the Treasury in consultation with the rest of the corporate centre to report annually on the performance of all significant investments that have obtained or will require Cabinet approval, including the status of all current significant investment intentions and a summary of benefits achieved from investments that have been completed

Expectations relating to the operation of the system

40. **note** the new circular contains specific expectations of departmental chief executives and boards that are required to give effect to the system objectives, including:
- a. the quality of long term investment plans, especially information on the performance of current and future investments
 - b. reporting on investment performance, especially the level of actual benefits achieved compared with those expected from any significant investment
 - c. planning and reporting on asset performance
 - d. investment management practices; and
 - e. investment assurance practices.
41. **agree** that departmental chief executives need to ensure their department:
- a. provides the corporate centre with long term investment plans appropriate to their investment-intensive tier with relevant, high quality information on the performance of current and future investments

- b. provides the Treasury with information on the actual level of benefits achieved compared with those outlined in any significant investment, and on relevant asset performance indicators
 - c. demonstrates a level of asset management practice and performance that is appropriate to the scale of assets under their management and the criticality of those assets to the delivery of key public services
 - d. identifies as early as possible all significant investment intentions in multi-year investment plans and in corporate centre reporting processes
 - e. develops all significant investment proposals in accordance with published Treasury business case guidance
 - f. adopts and applies corporate centre investment assurance and business case guidance; and
 - g. accumulates sufficient depreciation funding to appropriately provide for the replacement of those assets needed to underpin future service needs.
42. **note** that for most departments the Four-year plan will satisfy the information requirements of long term investment plans
43. **agree** that boards of Crown entities and companies need to treat the circular as an expression of government policy and take appropriate steps to:
- a. provide the corporate centre with long term investment plans with relevant, high quality information on the performance of current and future investments
 - b. provide the Treasury with information on the actual level of benefits achieved compared with those outlined in any significant investment, and on relevant asset performance indicators
 - c. demonstrate a level of asset management practice and performance that is appropriate to the scale of assets under their management and the criticality of those assets to the delivery of key public services; and
 - d. ensure their agencies adopt and apply corporate centre investment assurance and business case guidance.
44. **note** the draft circular sets out the Cabinet-approved roles of functional leaders

Expectations relating to reporting on investment performance

45. **agree** that unless otherwise agreed by Cabinet, agencies must report to Cabinet (via the responsible Minister) on the actual level of benefits achieved compared with those outlined in any Cabinet-approved investment within 12 months after the in-service date of the Cabinet-approved investment
46. **agree** that agencies must post on the Public Sector Intranet copies of:
- a. any Cabinet-approved business cases within 30 days of obtaining approval, taking account of grounds for withholding information under the Official Information Act (OIA); and
 - b. any benefits realisation reports generated in respect of Cabinet-approved business cases.

Expectations relating to reporting on investment performance

47. **note** that the Treasury will develop an annual report on the performance of all significant investments that require Cabinet approval

Implementation of new investment management circular

48. **note** that the Treasury has developed an implementation plan to support the requirements of the new circular from 1 July 2015

Delegated authority to act

49. **agree** to delegate to the Investment Ministers authority to:
- a. make final decisions on the contents of the new circular to be published in July 2015 provided these are consistent with the circular attached to this paper
 - b. approve the final selection of investment intensive agencies;
 - c. approve changes to the list of Tier 1 and Tier 2 investment-intensive agencies; and
 - d. make administrative changes over time to maintain the currency of the circular, provided these are consistent with the intent of the draft circular attached to this paper.

Scope and reach of the new financial management circular (to replace CO(11)6)

50. **note** the Treasury has prepared a new Cabinet Office circular entitled *Proposals with Financial Implications and Financial Authorities to supersede Cabinet Office circular CO(11)6 Guidelines and Requirements for Proposals with Financial Implications*
51. **note** that the key changes to the new circular relate to the 2013 amendments to the Public Finance Act and to Cabinet-approved rule changes relating to Four-year plans and the capital charge regime
52. **note** the new circular confirms the same approval authorities apply to publicity expenses, compensation or damages in settlement of claims and ex gratia payments as those set out in CO(11)6
53. **note** that departments are familiar with the changes set out in the new circular which are already in operation; and
54. **agree** to issue the new Cabinet Office circular which will supersede CO(11)6.

Hon Bill English

Minister of Finance

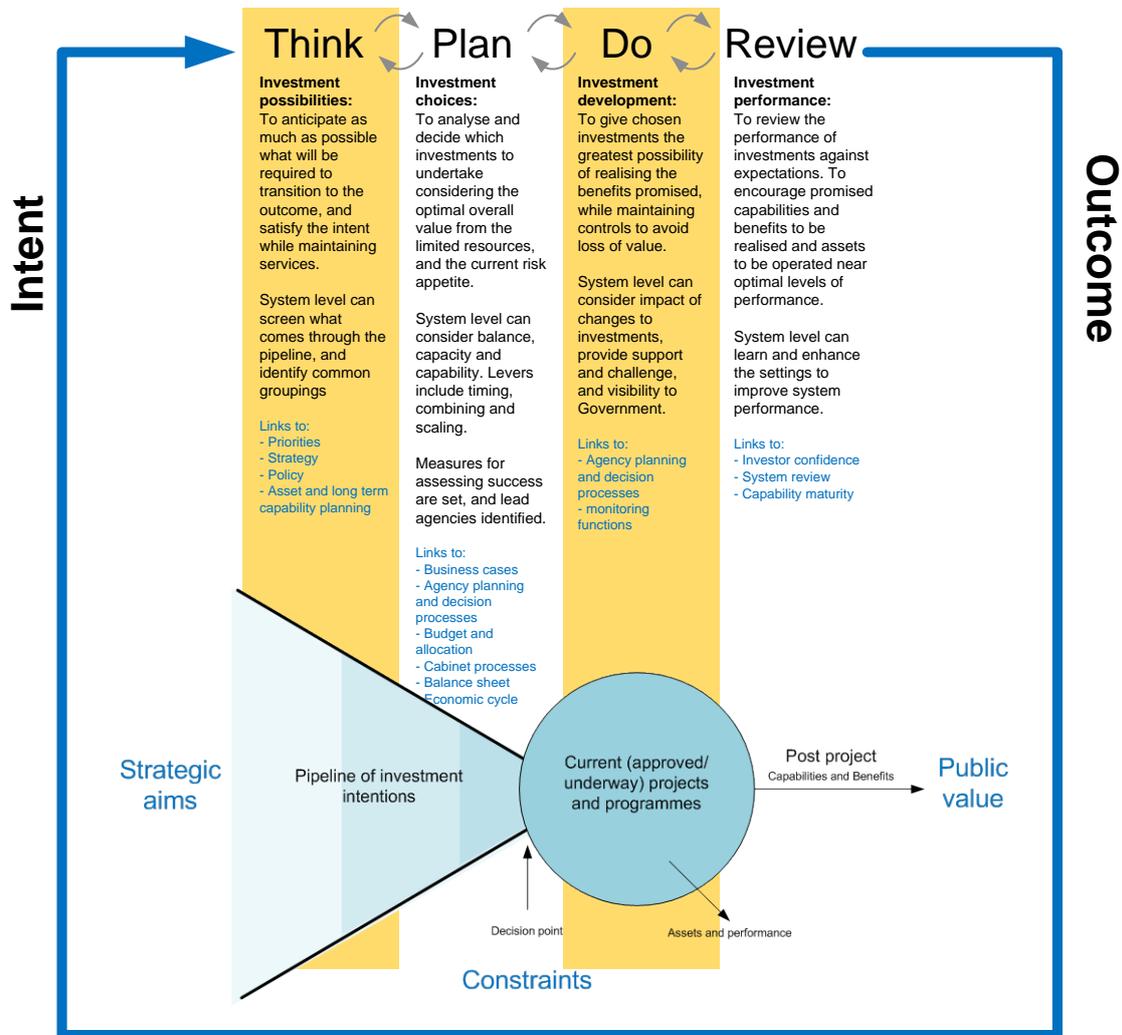
Date: 26 March 2015

Appendix 1 – The Investment System

Investment system

The role of the investment system is to effectively turn intent into outcomes in a way that optimises the 'public value' generated from the available resources. The System is a dynamic with cycles within cycles, and multiple players involved at different stages.

The System covers the breadth of funding sources and types. Although it mentions assets and the balance sheet, this is only one category of investment. Similarly, it is ambivalent on the length or timing of investments that cycle within the System.



Appendix 2 – Consultation Feedback and the Treasury’s Responses

Feedback: The proposed scope of investments and the move to focus on all investments at a later date was too broad and required better signalling and wider consultation.

Response: Following the CAB 100 round and further consideration by Ministers the focus of the new circular will remain on capital investments with the addition of “as a service” investments in recognition of the changing way in which government agencies are doing business. Any change in scope would be subject to a separate consultation process and Cabinet decision.

Feedback: Some Crown entities queried how the circular’s expectations and the investor confidence rating would apply to them, given their statutory independence.

Response: As stated in the circular Crown entities and companies will treat the circular as an expression of government policy. It will not change any existing statutory based funding arrangements. The final design of the investor confidence rating and the detail around how it applies to Crown entities will be confirmed in the next few months.

Feedback: A number of respondents asked for more detail on the design of the Investor Confidence Rating (ICR). It was suggested that having an ICR at an agency level could fail to recognise significant investment groups within an agency and an agency’s strengths or weaknesses around particular types of investment. The State Services Commission specifically queried the need for the ICR and how it would work alongside other existing central agency mechanisms.

Response: The ICR is a mechanism to bring objectivity to the assessment of agencies investment capability, and a mechanism to incentivise agencies to improve their performance. Ministers are also highly supportive of the introduction of the ICR and the incentives, sanctions and flexibility it brings to the investment system. The finalisation of the design of the ICR, and responses to queries raised will be addressed in the detailed design phase of the ICR by July 2015 with corporate centre and agency input.

Feedback: There was some uncertainty as to an agency’s treatment prior to having an investor confidence rating.

Response: The status-quo arrangements set out in the replacement circular will be the basis of expectations of agencies.

Feedback: Will the ICR affect decision rights and threshold levels?

Response: Yes, Cabinet may adjust an agency’s delegation levels based on the agency’s ICR result and advice received from Investment Ministers.

Feedback: Two agencies queried how the investment reporting requirements would be implemented and one expressed concern about possible additional compliance costs. Questions were also raised around the reporting requirements for Minister-approved investments, the types of benefits to be reported, and how other factors that play into investment decisions (such as Ministerial pressure or cost/risk avoidance) would be reported.

Response: The design and implementation of investment reporting will be undertaken in conjunction with corporate centre and agency input, and will carefully consider the compliance cost versus value proposition.

Feedback: Some had concerns around the roles of Investment Ministers. One agency noted an increased risk of short term and politically motivated influence on the use of baseline funding away from a long term investment strategy. It was also noted that there may be too strong a focus from the Corporate Centre on servicing Investment Ministers and not enough support to help agencies lift their capability.

Response: The role of the Investment Ministers group will form a key part of the implementation communications and road shows and the group's terms of reference will be included on the Treasury's website. Investment Ministers don't have decision making authority and so make recommendations on investments or the make-up of the Crown balance sheet to existing decision making authorities e.g. Cabinet. The Treasury has re-prioritised resources to support Investment Ministers, without degrading the resources available to support agencies to improve both their performance and capability.

Feedback: When multiple investment options are presented, is the decision threshold applied on the basis of the highest cost option or preferred option?

Response: The decision threshold is based on the preferred option, as the detailed financial case is only completed on the preferred option.

Feedback: The whole-of-life-cost (WOLC) definition created some confusion. In particular, it was noted that WOLC is different to many other measures used throughout the State sector. One agency suggested that guidance be developed to ensure consistent use of measures across agencies.

Response: We have updated the WOLC guidance. It will now be presented as separate detailed guidance linked to from the on-line version of the circular.