



CROWN OWNERSHIP
MONITORING UNIT

Guidance on the Monitoring of State-Owned Enterprises

June 2011

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Internet

The URL for this document on the Treasury's Crown Ownership Monitoring Unit's website at August 2011 is <http://www.comu.govt.nz/about-comu/our-role/monitoring/>

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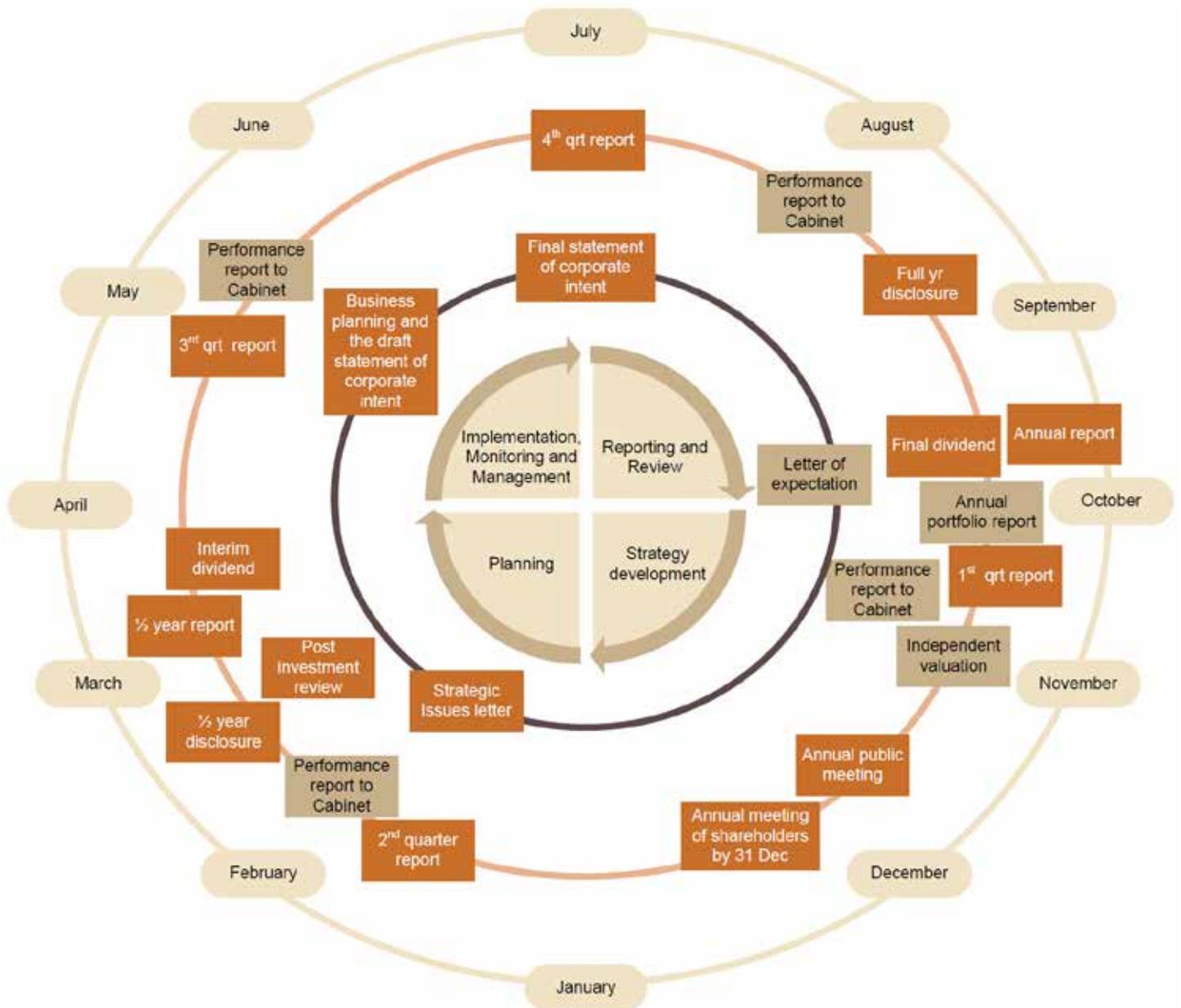
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INTRODUCTION

These guidance documents are a tool used by the Crown Ownership Monitoring Unit (COMU). They are no substitute for a combination of good practice and good judgement as befits the needs of the situation at hand. They do, however, provide a solid foundation from which COMU's monitoring can occur.

Monitoring Driven by the Financial Year 1 July – 30 June



Activities that can take place at any time and feed into COMU's assessments

Benchmarking	Monitoring local and international corporate government changes
Board valuation of SOE	Monitoring plan
COMU engagement with boards	Policy Advice
COMU meetings with shareholding Ministers	Review of business proposals
Continuous disclosures	Select committee
Environmental scanning	Sharing COMU expertise: MAGNet and INGOA
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Key

● Strategic planning
 ○ Reporting
 ○ Performance cycle

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LETTER OF EXPECTATION

Section 14 of the State-Owned Enterprises Act 1986 allows for some annual engagement by shareholding Ministers in the board’s *Statement of Corporate Intent* (SCI). It is recognised that earlier engagement between the shareholding Ministers and boards better supports the development of the SCI. The letter of expectation is a key input to that engagement.

What it is

The letter of expectation is a formal but not legislative tool that provides an opportunity for:

- ▶ shareholding Ministers to consider and clearly set out in a timely manner the performance they would like a State-owned Enterprise (SOE) to achieve, and
- ▶ the SOE board to consider shareholding Ministers’ expectations.

Subject to commercial sensitivities, letters of expectation are publicly released on COMU’s website: refer

<http://www.comu.govt.nz/portfolio-entities/a-z/>

How the letter of expectation fits with the annual SCI development process is shown in the table below.

Annual planning process	
Timing	Action
October	<i>Setting expectations:</i> Shareholding Ministers send letter of expectation to board.
End January	<i>Setting expectations:</i> Board may respond with a strategic issues letter, which also outlines the key strategic issues facing the

	SOE and the board’s responses to those issues.
January–May	<i>Consultation:</i> As required.
1 May	<i>Approval:</i> Board submits draft SCI to the shareholding Ministers.
On or before 1 July, unless extension agreed	<i>Tabling:</i> Board submits final SCI to the shareholding Ministers for tabling in Parliament.

What we do

The Crown Ownership Monitoring Unit (COMU) agrees internally on what we think are the key expectations that shareholding Ministers should be communicating to the board. COMU then meets with Ministers (and quite often staff from their offices) to have discussions about the expectations.

Once COMU is comfortable that we are clear on the expectations, we will draft the letters and provide Ministers with these along with a covering report for their consideration. The kinds of topics that may be discussed in a letter of expectation are:

- ▶ total shareholder return
- ▶ dividend policy
- ▶ major investment plans,
- ▶ and capital retention and injection.

When Ministers are satisfied with the letters these will normally be signed by the responsible Minister, on behalf of shareholding Ministers, and sent to the chair.

Boards are invited to engage with COMU to discuss the expectations in further detail.

How this supports shareholding Ministers

This engagement process provides shareholding Ministers with:

- ▶ a definite time, aligned to the planning cycle, to consider what performance the Government is seeking for each SOE, the SOE portfolio as a whole and in terms of the Crown's balance sheet
- ▶ the opportunity to be very clear and transparent about expectations, and
- ▶ the opportunity to resolve any divergence of expectations well in advance of the publication of the SCI.

STRATEGIC ISSUES LETTER



Section 14 of the State-Owned Enterprises Act 1986 allows for some annual engagement by shareholding Ministers in the board's *Statement of Corporate Intent* (SCI). It is recognised that earlier engagement between the shareholding Ministers and boards better supports the development of the SCI. A State-owned Enterprise's (SOE's) strategic issues letter is a key engagement in the development of the SCI.

What it is

The strategic issues letter is the way in which SOEs respond to the Ministers' letters of expectations. It provides an opportunity for SOE boards to:

- ▶ provide shareholding Ministers with information on the key challenges and opportunities the SOE is facing over the planning horizon and early indication on the likely impact on the upcoming SCI
- ▶ provide shareholding Ministers with an early indication of the major changes to strategic focus over the planning horizon, and
- ▶ to respond to the shareholding Ministers' annual expectations letter.

SOEs are not obliged to submit a strategic issues letter.

How the strategic issues letter fits with the annual SCI development process is shown in the table below.

Annual planning process

Timing	Action
October	<i>Setting expectations:</i> Shareholding Ministers send letter of expectation to board.

End January	<i>Setting expectations:</i> Board may respond with a strategic issues letter, which also outlines the key strategic issues facing the SOE and the board's responses to those issues.
January–May	<i>Consultation:</i> As required.
1 May	<i>Approval:</i> Board submits draft SCI to the shareholding Ministers.
On or before 1 July, unless extension agreed	<i>Tabling:</i> Board submits final SCI to the shareholding Ministers for tabling in Parliament.

What we do

The responsible Minister will forward the board's strategic issues letter to the Crown Ownership Monitoring Unit (COMU) and we assess:

- ▶ the broad fit between shareholding Ministers' expectations for SOE future performance and the board's, and
- ▶ if there are any strategic areas that need further engagement between either the board and COMU or the board and shareholding Ministers.

The strategic issues letter also provides COMU with early information on what is likely to be in the board's draft SCI and time to consider what, if any, changes will need to be implemented with regard to COMU's monitoring regime.

Depending on the content of the board's strategic issues letter, COMU may provide either a written or verbal briefing to shareholding Ministers, which

could include a recommendation for the Minister to meet with the board.

How this supports shareholding Ministers

This engagement process provides shareholding Ministers with:

- ▶ the board's view of how it can meet the performance expectations, and
- ▶ the opportunity to resolve any divergence of expectations well in advance of the publication of the SCI.



BUSINESS PLANNING AND THE DRAFT STATEMENT OF CORPORATE INTENT

A key board responsibility is strategic planning, and advising of those plans so that the board can be held to account. While business planning is ongoing, a periodic statement of what will be achieved, including why, how and in what timeframe, allows a company to be held to account. In State-owned Enterprises (SOEs), that periodic statement is the publicly available *Statement of Corporate Intent* (SCI).

What it is

The Crown Ownership Monitoring Unit's (COMU's) approach sees it focus its engagement with SOEs at the start of the business planning cycle. This allows Ministers' expectations to be incorporated early into the SOE's planning, which then flows into the draft SCI.

The engagement cycle

The business planning process is the set of engagements and correspondence that occurs between the SOEs, shareholding Ministers and COMU. The timetable below outlines the key milestones in the business planning process.

Annual planning process

Timing	Action
October	<i>Setting expectations:</i> Shareholding Ministers send letter of expectation to board.
End January	<i>Setting expectations:</i> Board may respond with a strategic issues letter, which also outlines the key strategic issues facing the SOE and the board's

	responses to those issues.
January–May	<i>Consultation:</i> As required.
1 May	<i>Approval:</i> Board submits draft SCI and the SOE's underpinning business plan (for context) to the shareholding Ministers.
On or before 1 July, unless extension agreed	<i>Tabling:</i> Board submits final SCI to the shareholding Ministers for tabling in Parliament.

Shareholding Ministers' expectation is that the draft SCI will be delivered on 1 May each year. This is a month before the legislated deadline of 1 June to allow sufficient time for COMU to undertake a full analysis. It is also expected that SOEs will present a detailed business plan to support the SCI and to provide COMU with the context to analyse the SCI and provide advice to shareholding Ministers. It is important to note that the business plan is the responsibility of the board and shareholding Ministers cannot direct changes to it.

If there are any concerns relating to the SCI and its contents it is preferable that these are dealt with through the business planning process. Noting all the preparation and engagement that has already occurred, the draft SCI should not contain any surprises.

What we do

The aim is for each tabled SCI to be comprehensive and challenging, and clearly state the SOE's goals and scope, set challenging performance targets, both financial and non-

financial, and allow accountability to be publicly displayed. In analysing the draft SCI and business plan, COMU expects the documents to:

- ▶ have strategies that align with shareholder expectations
- ▶ focus on maximising shareholder value
- ▶ identify meaningful performance measures
- ▶ include risk management strategies
- ▶ show a clear capital structure, and
- ▶ meet the legislative requirements, as shown in the table below.

SCI requirements	
Section	Requirement
Section 14(2)(a)	Objectives of group
Section 14(2)(b)	Nature and scope of activities
Section 14(2)(c)	Ratio of consolidated shareholders' funds to total assets, and definitions
Section 14(2)(d)	Accounting policies
Section 14(2)(e)	Performance targets and measures
Section 14(2)(f)	Dividend policies
Section 14(2)(g)	Information to be provided to shareholders during the year
Section 14(2)(h)	Acquisition policies
Section 14(2)(i)	Any activities where the board seeks Crown compensation
Section 14(2)(j)	Such other matters the shareholding Ministers agree with the board
Section 14(3)	Current commercial valuation

Draft SCI to final SCI

The SOE board considers any comments on the draft SCI provided by shareholding Ministers not later than 14 days before the commencement of the financial year.

The SOE board then delivers a final SCI on or before the commencement of the financial year, unless an extension is granted by shareholding Ministers.

The shareholding Ministers must then table the final SCI within 12 sitting days of receipt.

How this supports shareholding Ministers

SCI development is the one stage in the year when shareholding Ministers have input into the strategic direction and financial intentions of an SOE. The engagement process, and analysis by COMU of the draft SCI, ensures that shareholding Ministers have the knowledge to participate in engagement, make decisions and comment on an SOE's strategy.



FINAL STATEMENT OF CORPORATE INTENT

A key board responsibility is strategic planning and advising of those plans so that the board can be held to account.

What it is

The *Statement of Corporate Intent* (SCI) is a broad and public performance agreement between shareholding Ministers and the board of a State-owned Enterprise (SOE). It presents the SOE's intentions over the next three years, but is primarily focused on the immediate financial year.

Section 14 of the State-Owned Enterprise Act 1986 (the SOE Act) requires that the SCI is delivered to shareholding Ministers on or before the commencement of the financial year (unless an extension has been granted by Ministers). Ministers then have 12 sitting days to table the SCI in Parliament.

It is preferable that concerns relating to strategy are dealt with earlier in the annual planning process and not at the point the final SCI is received. The substantive work is therefore undertaken by the Crown Ownership Monitoring Unit (COMU) during the Letter of Expectation, the strategic issues letter, business planning and draft Statement of Corporate Intent stages.

However, to ensure the SCI meets its statutory requirements, and any further expectations, shareholding Ministers have reserve powers under the SOE Act. Section 13 of the SOE Act allows shareholding Ministers to direct an SOE to include in, or omit from, an SCI any provision that relates to requirements set out in sections 14(2)(a) to (h). These powers are very rarely used and must be administered in regard to the principles of the SOE Act which makes boards directly responsible for the operations of the SOE.

What we do

Therefore, by the time the SCI has reached the stage of the delivery and tabling in Parliament COMU's job is largely process.

When the final SCI is delivered, COMU will check whether any comments by the Minister in the previous stages have been considered and/or incorporated, and that the requirements of the SOE Act are met before it is tabled. Those requirements are shown in the table below.

SCI requirements

Section	Requirement
Section 14(2)(a)	Objectives of group
Section 14(2)(b)	Nature and scope of activities
Section 14(2)(c)	Ratio of consolidated shareholders' funds to total assets, and definitions
Section 14(2)(d)	Accounting policies
Section 14(2)(e)	Performance targets and measures
Section 14(2)(f)	Dividend policies
Section 14(2)(g)	Information to be provided to shareholders during the year
Section 14(2)(h)	Acquisition policies
Section 14(2)(i)	Any activities where the board seeks Crown compensation
Section 14(2)(j)	Such other matters the shareholding Ministers agree with the board
Section 14(3)	Current commercial valuation

An example of other matters, under section 14(2)(j), is the inclusion of a standard set of financial performance metrics. These can be found here:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>

Other agreements may be set out in the Letter of Expectation.

How this supports shareholding Ministers

Shareholding Ministers are accountable to Parliament. This final check ensures that the SCI that is tabled by Ministers meets its statutory requirements, and any further expectations have been appropriately incorporated.



1ST QUARTER REPORT: 31 OCTOBER

Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) are required by the State-Owned Enterprise Act 1986. Other reports are agreed between shareholding Ministers and the board (for example, the 1st quarter report).

What it is

The 1st quarter report (July-September) provides an early insight into the board's view on an SOE's performance, in particular relative to its *Statement of Corporate Intent* targets, including key factors affecting it, industry trends and market economic conditions.

SOE quarterly reports are not released to the public so they can provide shareholding Ministers with key operational and strategic information.

The focus in the first quarter is on any significant variances to the budget and is an early indicator of a performance issue with an SOE. This has to be balanced against the financial information provided only covering the first three months of the financial year.

The quarterly report has two information streams:

- ▶ financial information is provided to the Crown Ownership Monitoring Unit (COMU) by the SOE via CFISnet (the Crown Financial Information System), and
- ▶ performance commentary, which is provided to COMU in hard copy by the SOE board.

Quarterly reports inform shareholding Ministers about:

- ▶ SOEs' performance against plan
- ▶ causes of major variances
- ▶ any potential issues
- ▶ major achievements, and
- ▶ provide a forward (year-end) view of key results.

Quarterly reports are also helpful to monitor:

- ▶ performance of business units and / or product lines
- ▶ progress of capital projects
- ▶ spend to date profitability of joint ventures, and
- ▶ success of acquisitions.

What we do

In analysing quarterly performance, COMU uses the financial performance measures that have been developed for SOEs. These can be found at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>. In summary, they cover:

- ▶ shareholder returns
- ▶ profitability, and
- ▶ liquidity.

COMU also assess non-financial performance, which is SOE specific. The analysis provides both a historical view of performance and a view of the impact of this on future performance.

The analysis of the quarterly reports also involves certain steps that are explained below:

- ▶ checking that the quarterly report provides all the required financial information and that the commentary fully and accurately explains any major variances to budget, potential developing issues, and highlights major achievements for the quarter in sufficient detail, and
- ▶ identifying anything which is unusual and/or unclear and if necessary seek clarification from the SOE.

How this supports shareholding Ministers

The key COMU output from this process is the *Performance Report to Cabinet*, which provides shareholding and other Ministers with a regular and systematic view of individual SOE performance and the aggregated performance of the Crown's portfolio. The process also alerts shareholding Ministers to issues the Ministers may wish to discuss with the chair.



PERFORMANCE REPORT TO CABINET: OCTOBER

What it is

Based on the quarterly information provided by all the Crown companies, the Crown Ownership Monitoring Unit (COMU) prepares a quarterly performance report to Cabinet. The primary focus of the report, due to their size, is the State-owned Enterprises (SOEs) group.

The 1st quarter Cabinet report is an early signal to both shareholding Ministers and Cabinet on SOE performance including which SOEs will require specific focus during the year, based on the early financial results.

What we do

The SOE quarterly reporting process to shareholding Ministers provides much of the data for the report to Cabinet.

COMU analysts prepare commentary from their analysis on:

- ▶ SOE performance against the budget in their *Statement of Corporate Intent* and the specific quarter's performance
- ▶ SOE performance against its previous year results
- ▶ key company achievements, issues and how we think the company is placed for achieving its full year targets, and
- ▶ SOE performance within the Crown company portfolio.

COMU also rates each SOE "on watch" if it is performing below expectation or has developing issues and summarises SOE management plans to address this.

COMU advisors usually have until around the 15th of the month to complete the analysis.

How this supports shareholding Ministers

Cabinet consideration of SOE performance utilises the collective forum to:

- ▶ inform all of Cabinet on SOE performance
- ▶ provide support and challenge to shareholding Ministers on that performance
- ▶ make linkages across the Government's priorities,
- ▶ provides an opportunity for early discussions of any upcoming board membership changes, and
- ▶ allows Cabinet to support shareholding Ministers in assessing COMU's monitoring performance.

INDEPENDENT VALUATION

Under the State-Owned Enterprises Act 1986, one of the principal objectives of a State-owned Enterprises (SOE) is to operate as a successful business. As part of the reporting of that success, the boards of SOEs are required to assess their estimate of the commercial value of the Crown's investment and disclose their estimates annually in their *Statement of Corporate Intent* (SCI).

To increase transparency of the value of the Crown's investment, the Crown Ownership Monitoring Unit (COMU) commissions independent commercial valuation reports (ICVRs).

What it is

ICVRs are part of a suite of COMU initiatives that increase the transparency of SOEs, and benefit shareholders, directors, stakeholders and the public. SOEs are not listed companies and therefore there is no observable market value of equity. The ICVR:

- ▶ is a proxy to measure capital gains and losses of the SOE
- ▶ provides a more comprehensive picture of SOE returns
- ▶ helps SOEs improve the quality of their own valuations, and
- ▶ making drivers of value more transparent.

By making the valuations public an ICVR can:

- ▶ increase public awareness of the value of the SOEs, and
- ▶ provide boards with a greater incentive to conduct robust commercial valuations themselves.

ICVRs are available at:

<http://www.comu.govt.nz/publications/information-releases/valuation-reports/>.

The Treasury engages investment banks whose equity analysts conduct valuations, based on public information.

The reports follow a similar format to those research reports produced by investment banks on the NZX-listed companies. These reports are designed to identify and examine the main drivers of company performance and, ultimately, value.

Since 2007, ICVRs have been prepared for Meridian Energy, Mighty River Power and Genesis Energy. In 2010, the coverage of the SOEs was expanded to six SOEs and now covers over 90% of the value of the portfolio.

Valuers are requested to prepare Discounted Cash Flow (DCF) valuations cross-checked against other valuation methodologies. This approach is consistent with the valuation methodology that SOE boards are expected to use when conducting their own commercial valuations.

Valuers only have access to publicly available information and are not provided the SOE's own detailed cash flow forecasts.

What we do

COMU reports to shareholding Ministers on the year-to-year change in commercial value of the SOE portfolio. This includes a comparison between the SOE's own commercial valuation and that of the ICVR. The valuations are also a useful input when reviewing an SOE's SCI, business plans, and capital structure.

ICVRs are published on the COMU website and included in the COMU *Annual Portfolio Report*.

It is likely that the IVCR and SOE's own commercial valuation will differ owing to the access of information and the variation in underlying assumptions. However, we would

expect that, over time, the difference between the SCI and independent valuations would converge as preparing independent valuations would incentivise boards to prepare more robust measures of commercial worth and improve the level of information about the company.

How this supports shareholding Ministers

This process assists shareholding Ministers to:

- ▶ understand the market value of their investment in the SOE, and
- ▶ engage with the board on matters relating to the SOE's commercial value.

The independent assessment and publication of the commercial valuation also supports shareholding Ministers' objective of increasing the transparency of the Crown's investments.



ANNUAL PUBLIC MEETING

Shareholding Ministers hold the shares in State-owned Enterprises (SOEs) on behalf of the public of New Zealand. SOEs are accountable to the public via the scrutiny of SOEs undertaken by shareholding Ministers and by Parliament. Public accountability can occur in other ways (eg, via an annual public meeting).

What it is

Annual public meetings are not a requirement of the Companies Act 1993, or of the State-Owned Enterprise Act 1986. However, shareholding Ministers encourage SOEs, particularly the larger ones, to hold at least one public meeting a year so that the SOE board can be:

- ▶ transparent about its performance
- ▶ accountable, and
- ▶ accessible.

The public meeting provides a valuable opportunity for the board and management to engage in free and frank discussion with the public about the company, its performance and its future prospects.

There is no specification for timing, format or content of these meetings. Each SOE adopts an approach that best suits the stakeholders and communities it serves.

What we do

Analysts from the Crown Ownership Monitoring Unit (COMU) usually attend the annual public meeting and reports back to shareholding Ministers on the discussion, and any issues arising from the meeting.

How this supports shareholding Ministers

Shareholding Ministers are using the lever of public engagement to increase pressure on SOEs to improve their performance.



ANNUAL MEETING OF SHAREHOLDERS BY 31 DECEMBER

What it is

An annual shareholders meeting is an agenda-based face-to-face meeting between the board and shareholders (or their proxies if they are unable to attend in person).

Section 120 of the Companies Act 1993 (the Act) requires all companies, including State-owned Enterprises (SOEs), to call an annual shareholder meeting each year, not later than six months after the company's balance date.

Section 122 of the Act permits companies to propose a resolution in lieu of a meeting, and in the past this has been used by some SOEs. All SOEs are now encouraged by shareholding Ministers to hold annual shareholder meetings.

The meeting enables:

- ▶ those accountable for running the company (the board) to formally present and comment on the year's results to the shareholding Ministers
- ▶ both parties to engage in a free and frank discussion about the company's results and its prospects, and
- ▶ shareholders to make decisions on resolutions put to the meeting. Some of these (eg, appointment of auditors) are decisions required by the Act, but other resolutions may be any matters on which the board seeks shareholder approval.

The annual shareholders meeting is not intended to be a public meeting, although SOEs are encouraged by shareholding Ministers to also hold public meetings at least once per year.

What we do

The SOE is responsible for setting the date, agenda and resolutions for the meeting. Generally, the agenda (including any resolutions), proxy form, minutes of previous meeting and annual report (if not already sent) are sent to shareholding Ministers and the Crown Ownership Monitoring Unit (COMU), giving sufficient notice to enable COMU to advise shareholding Ministers on any relevant matters.

How this supports shareholding Ministers

Shareholding Ministers engage with the chair of a board. Sometimes this engagement includes the chief executive.

The annual shareholders meeting provides a valuable opportunity for the full board to hear the shareholding Ministers' view, and to engage in free and frank discussion about the company, its performance and its future prospects.



2ND QUARTER REPORT: 31 JANUARY

Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) are required by the State-Owned Enterprise Act 1986. Other reports are agreed between shareholding Ministers and the board (for example, the 2nd quarter report).

What it is

The 2nd quarter report continues to provide an early insight into the board's view on an SOE's performance, in particular relative to its *Statement of Corporate Intent* targets, including key factors affecting it, industry trends and market economic conditions.

SOE quarterly reports are not released to the public so they can provide shareholding Ministers with key operational and strategic information.

As the 2nd quarter report covers the first six months of the financial year, it is a good indicator of how the remainder of the financial year will end. It also is an indicator of the publicly released half-yearly report that the SOE will produce a month later. It is also an early indicator should any key strategic or operational issues become prevalent.

The quarterly report has two information streams:

- ▶ financial information is provided to Crown Ownership Monitoring Unit (COMU) by the SOE via CFISnet (the Crown Financial Information System), and
- ▶ performance commentary, which is provided to COMU in hard copy by the SOE board.

Quarterly reports inform shareholding Ministers about:

- ▶ SOEs' performance against plan
- ▶ causes of major variances
- ▶ any potential issues
- ▶ major achievements, and
- ▶ provide a forward (year-end) view of key results.

Quarterly reports are also helpful to monitor:

- ▶ performance of business units and / or product lines
- ▶ progress of capital projects
- ▶ spend to date profitability of joint ventures, and
- ▶ success of acquisitions.

What we do

In analysing quarterly performance, COMU focuses on the financial metrics that have been developed for SOEs by COMU. These can be found at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>.

In summary, they cover:

- ▶ shareholder returns
- ▶ profitability, and
- ▶ liquidity.

We also assess non-financial performance, which is SOE specific. The analysis provides both a historical view of performance and a view of the impact of this on future performance.

The analysis of the quarterly reports also involves certain steps that are explained below:

- ▶ checking that the quarterly report provides all the required financial information and that the commentary fully and accurately explains any major variances to budget, potential developing issues, and highlights major achievements for the quarter in sufficient detail, and
- ▶ identifying anything which is unusual and/or unclear and if necessary seek clarification from the SOE.

How this supports shareholding Ministers

The key COMU output from this process is the *Performance Report to Cabinet*, which provides shareholding and other Ministers with a regular and systematic view of individual SOE performance and the aggregated performance of the Crown's portfolio. The process also alerts shareholding Ministers to issues the Ministers may wish to discuss with the chair.



PERFORMANCE REPORT TO CABINET: FEBRUARY

What it is

Based on the quarterly information provided by all the Crown companies, the Crown Ownership Monitoring Unit (COMU) prepares a quarterly performance report to Cabinet. The primary focus of the report, due to their size, is the State-owned Enterprises (SOEs) group.

The second quarter Cabinet report provides shareholding Ministers and Cabinet with a stronger indication on SOE performance, including an indication of the contents of the half-yearly report, which is tabled in the House of Representatives in March and if there is any risk to dividends.

What we do

The SOE quarterly reporting process to shareholding Ministers provides much of the data for the report to Cabinet.

COMU analysts prepare commentary from their analysis on:

- ▶ SOE performance against the budget in their *Statement of Corporate Intent* and the specific quarter's performance
- ▶ SOE performance against its previous year results
- ▶ key company achievements, issues and how we think the company is placed for achieving its full year targets, and
- ▶ SOE performance within the Crown company portfolio.

COMU also rates each SOE "on watch" if it is performing below expectation or has developing issues and summarises SOE management plans to address this.

COMU advisors usually have until around the 15th of the month to complete the analysis.

How this supports shareholding Ministers

Cabinet consideration of SOE performance utilises the collective forum to:

- ▶ inform all of Cabinet on SOE performance
- ▶ provide support and challenge to shareholding Ministers on that performance
- ▶ make linkages across the Government's priorities,
- ▶ provides an opportunity for early discussions of any upcoming board membership changes, and
- ▶ allows Cabinet to support shareholding Ministers in assessing COMU's monitoring performance.



HALF-YEAR DISCLOSURE

The information contained in this document is the same information in the documents headed *Full-Year Disclosure* and *Continuous Disclosures*.

In publicly listed companies, continuous disclosure rules require companies to provide timely advice to the market of events and developments that might impact value as they occur. Continuous disclosure is intended to:

- ▶ ensure investors have sufficient timely information to make informed decisions, and
- ▶ prevent unfair access to information and insider trading.

There are two types of disclosure:

- ▶ immediate disclosure of material information to the public when the company first becomes aware of its existence, and
- ▶ periodic disclosure, which requires a company to release a specific set of information about the company at regular intervals (eg, in half-year and annual reports).

What it is

The State-Owned Enterprises Act 1986 does not contain a continuous disclosure regime. However, on 1 January 2009, shareholding Ministers introduced a regime for the nine largest State-owned Enterprises (SOE)s to keep the public informed on matters that may have a material effect on an SOE's commercial value.

The continuous disclosure rules were designed to be as close as possible to the successful NZX continuous disclosure rules for listed companies, while recognising that SOE's shares are not publicly traded.

The rules require the following information to be made public:

- the fundamental terms of each material transaction entered into

- information that has a material impact on an SOE's estimate of current commercial value as shown in its *Statement of Corporate Intent*, and
- half-year and full-year financial results, plus a brief explanation, no later than 60 days after the end of the relevant period.

Material transactions are transactions with a consideration of 5% of the SOE's current commercial value or transactions with consideration of \$100 million or more, whichever is the lesser. The exception is KiwiRail, which has a threshold of \$50 million.

There are a number of circumstances where SOEs do not have to disclose material information, such as information about negotiations, or where the information is confidential.

The continuous disclosure rules do not have any formal legal authority, but shareholding Ministers expect SOEs to comply with them.

The rules can be found at:

<http://www.comu.govt.nz/resources/pdfs/disclosures/soe-discl-rules-dec09.pdf>

What we do

The Crown Ownership Monitoring Unit (COMU) manages the regime. SOEs are required to email continuous disclosure notices to COMU. The notices are then placed on the COMU website at: <http://www.comu.govt.nz/announcements/soe-disclosures/>.

How this supports shareholding Ministers

As shareholding Ministers already have access to this and other performance information, in itself the continuous disclosure regime does not increase the amount of monitoring information or

advice available. Shareholding Ministers are using transparency as a means to improve the financial performance of SOEs.

POST-INVESTMENT REVIEW

In their dividend decisions each year, boards make an explicit decision either to return available cash flow to the shareholders by way of dividends or to invest such surplus back into a company.

What it is

The post-investment review is a new initiative by the Crown Ownership Monitoring Unit (COMU) to review the performance of State-owned Enterprises' (SOEs') investments.

SOE boards were asked in early 2011 to undertake a baseline review of past investments that were initially commenced from 1 July 2007 onwards based on the following threshold criteria:

- ▶ For SOEs with a book value of equity <\$100 million: Transaction >\$5 million
- ▶ For SOEs with a book value of equity between \$100 million and \$1 billion: Transaction >5% of book value of equity
- ▶ SOEs with a book value of equity >\$1 billion: Transaction >\$50 million

First submissions were due to COMU on 31 May 2011. In future years, SOE boards are expected to provide to COMU on 28 February each year one report that provides all post-investment reviews performed in the previous calendar year.

What we do

COMU has provided SOEs with a template of information requirements, as shown below:

Review information requirements

Investment details:

- ▶ Investment (project name)
- ▶ Planned commissioning date
- ▶ Actual commissioning date
- ▶ Date of post-investment review
- ▶ Is this a first or second review?

- ▶ Brief description of investment

Comparison of actuals versus forecast:

Costs to commissioning

- ▶ Actual costs to commissioning date \$
- ▶ Budgeted costs to commissioning date \$
- ▶ Explanation of any material variance

Financials post-commissioning

- ▶ Table showing, by financial years a comparison of actual cash flow and outflows
- ▶ Latest view on net present value / IRR / payback period and impact on shareholder value of the investment compared with the projected business case
- ▶ Explanations for material variances in actuals versus forecasts
- ▶ Explanations for material variances in key value drivers and assumptions versus forecast

Conclusions and learnings:

- ▶ Overall, are the financial benefits and business objectives of the investment being achieved?
- ▶ If not, why, and what is being done to address this?
- ▶ Optionally, what, if any, lessons have been learned and how will any learnings be incorporated in future investment decisions?

On receipt of the SOE's post-investment review COMU:

- ▶ analyses submissions against the selection criteria and information requirements
- ▶ has internal discussions on findings
- ▶ has discussions with the SOE where necessary (eg, to seek clarification and provide feedback), and

- ▶ reports to relevant shareholding Ministers providing them with a portfolio overview of COMU's findings and any recommendations.

How this supports shareholding Ministers

The aim of this process is to give greater visibility to shareholding Ministers as to how successful past investments have been, and whether SOEs have a track record of making good investments.

HALF-YEARLY REPORT



Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) is required by the State-Owned Enterprise Act 1986, including the half-yearly report.

What it is

The half-yearly report is an important part of telling the SOE's performance story and provides a comparison against the SOE's operating intentions, which were formally set out in the SOE's statement of corporate intent.

Content and tabling

The SOE Act does not specify the information to be presented in half-yearly reports. The content is agreed by shareholding Ministers and an SOE board, and is specified in each SOE's *Statement of Corporate Intent* (SCI). An SOE's half-yearly report is expected to include the following:

- ▶ chair and/or CEO overview
- ▶ a profit and loss statement
- ▶ a statement of changes in equity
- ▶ a statement of financial position
- ▶ a statement of cash flows, and
- ▶ non-financial information, including key performance indicators and management plans.

SOEs are required to deliver their half-yearly report to shareholding Ministers within two months of the end of the first half of each financial year.

The SOE Act requires the responsible Minister to table each half-yearly report in the House of Representatives within 12 sitting days of receipt.

Once tabled, the half-yearly report for each individual SOE is made public.

What we do

The Crown Ownership Monitoring Unit (COMU) analysis performed during the half-yearly reporting process supplements that undertaken during the quarterly reporting process for the second quarter. The half-year reporting process enables us to know how well each SOE is performing against the budget in their respective SCI. The half-yearly reporting is also a valuable tool for COMU to learn more about each SOE in the portfolio.

COMU produces a single report that aggregates the key financial information and performance commentary prepared by analysts for each SOE. This assists with comparability of performance. For each SOE, the report:

- ▶ summarises the half-yearly performance
- ▶ briefly comments on key SOE achievements, issues and includes a view on how we think the SOE is placed for achieving its full-year targets
- ▶ notes if it is performing below expectation or has developing issues, and
- ▶ concludes on whether the report can be tabled and advises Ministers accordingly.

How this supports shareholding Ministers

Presenting the half-yearly report to Parliament reflects that the shareholding Ministers are (along with the board) accountable for SOE performance. COMU supports shareholding Ministers by:

- ▶ providing Ministers with analysis of the key performance highlights, issues and risks, and
- ▶ ensuring Ministers are well prepared to respond to issues that may arise from the report.

INTERIM DIVIDEND

The information contained in this document is the same information that is in the document headed *Final Dividend*.

Every State-owned Enterprises (SOE) has the principal objective to operate as a successful business. Being a successful business includes providing an appropriate return on the capital invested, including capital growth and/or income.

Dividends are the income portion of the capital return and distributed to the shareholder from the earnings of a business.

What it is

Dividends: Link with measuring performance

One of the key financial performance measures for the Crown Ownership Monitoring Unit (COMU), which includes dividends, is the total shareholder return (TSR). The TSR is included in the COMU *Annual Portfolio Report* (see <http://www.comu.govt.nz/publications/annual-portfolio-report/>). Typically, the TSR is measured as the sum of (including an adjustment for equity invested):

- ▶ dividends paid out to shareholders, and
- ▶ capital gains or losses, as measured by the annual change in the board's commercial valuation.

Although SOEs should seek to maximise the TSR, shareholding Ministers may have their own preferences, between income and growth. Usually, this preference is provided by shareholding Ministers in the SOE Letter of Expectation.

Dividend expectations

Generally, shareholding Ministers express a preference for cash now rather than a prospect of greater returns later, unless this return could be shown to be appreciably superior (given the certainty of cash now).

An SOE's *Statement of Corporate Intent* (SCI) must include a statement of the principles adopted in determining the annual dividend together with an estimate of the amount or policy to determine the amount that is intended to be distributed to the Crown (section 14(2)(f) of the State-Owned Enterprises Act 1986 [SOE Act] refers).

An SOE's annual report must state the dividend payable to the Crown by the SOE for the financial year to which the report relates [section 15(2)(b) of the SOE Act refers].

Ordinary dividends may be paid in two instalments:

- ▶ interim dividend – if any, is paid as soon as possible after the half-yearly report, and
- ▶ final dividend – is paid as soon as possible after the annual accounts are finalised.

SOEs may also pay special dividends, as seen fit by the board.

Dividend policy

SOEs' dividend policies are set by each SOE's board and are driven by returning income to the shareholder based on its optimal capital structure, profitability and the level of future capital expenditure. Shareholding Ministers expect SOEs to operate a dividend policy that:

- ▶ translates to payouts that are commensurate with an SOE's publicly listed peers
- ▶ gives an appropriate balance between dividends and re-investment in the SOE, and
- ▶ shows a degree of consistency and improvement over the years.

Although the dividend policy is the responsibility of the board, under section 13(b) of the SOE Act the

shareholding Ministers may by written notice to the board, determine the amount of the dividend payable by any SOE.

What we do

COMU has various roles:

- ▶ recommends to shareholding Ministers what focus a board's dividend policy and actual returns could have in the Ministers' annual letter of expectations
- ▶ discusses with the board shareholding Ministers' expectations on dividend policies and actual returns, and
- ▶ when reviewing the draft SCI, COMU undertakes independent analysis on possible dividends, and may provide alternative advice to shareholding Ministers.

How this supports shareholding Ministers

As the shareholder of significant companies, the Crown can expect to achieve a return on its investments. COMU assists shareholding Ministers in ensuring that appropriate dividend policies are maintained and appropriate dividends are received.

3RD QUARTER REPORT: 30 APRIL



Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) are required by the State-Owned Enterprise Act 1986. Other reports are agreed between shareholding Ministers and the board (eg, the 3rd quarter report).

What it is

The 3rd quarter report provides a good indicator of an SOE's performance, in particular relative to its *Statement of Corporate Intent* targets, including key factors affecting it, industry trends and market economic conditions.

SOE quarterly reports are not released to the public so they can provide shareholding Ministers with key operational and strategic information.

As the 3rd quarter report covers nine months of the financial year it is a good indicator of how the financial year will end. Any key strategic or operational issues should already be prevalent at this stage.

The quarterly report has two information streams:

- ▶ financial information is provided to Crown Ownership Monitoring Unit (COMU) by the SOE via CFISnet (the Crown Financial Information System), and
- ▶ performance commentary, which is provided to COMU in hard copy by the SOE board.

Quarterly reports inform shareholding Ministers about:

- ▶ SOEs' performance against plan
- ▶ causes of major variances

- ▶ any potential issues
- ▶ major achievements, and
- ▶ provide a forward (year-end) view of key results.

Quarterly reports are also helpful to monitor:

- ▶ performance of business units and / or product lines
- ▶ progress of capital projects
- ▶ spend to date profitability of joint ventures, and
- ▶ success of acquisitions.

What we do

In analysing quarterly performance, COMU focuses on the financial metrics that have been developed for SOEs by COMU. These can be found at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>.

In summary, they cover:

- ▶ shareholder returns
- ▶ profitability, and
- ▶ liquidity.

We also assess non-financial performance, which is SOE specific.

The analysis provides both a historical view of performance and a view of the impact of this on future performance.

The analysis of the quarterly reports also involves certain steps that are explained below:

- ▶ checking that the quarterly report provides all the required financial information and that the

commentary fully and accurately explains any major variances to budget, potential developing issues, and highlights major achievements for the quarter in sufficient detail, and

- ▶ identifying anything which is unusual and/or unclear and if necessary seek clarification from the SOE.

How this supports shareholding Ministers

The key COMU output from this process is the *Performance Report to Cabinet*, which provides shareholding and other Ministers with a regular and systematic view of individual SOE performance and the aggregated performance of the Crown's portfolio. The process also alerts shareholding Ministers to issues the Ministers may wish to discuss with the chair.



PERFORMANCE REPORT TO CABINET: MAY

What it is

Based on the quarterly information provided by all the Crown companies, the Crown Ownership Monitoring Unit (COMU) prepares a quarterly performance report to Cabinet. The primary focus of the report, due to their size, is the State-owned Enterprises (SOEs) group.

The third quarter Cabinet report provides a good indication of the end of year performance. At this stage we will also get an indication of the SOE's ability to meet its dividend forecasts.

What we do

The SOE quarterly reporting process to shareholding Ministers provides much of the data for the report to Cabinet.

COMU analysts prepare commentary from their analysis on:

- ▶ SOE performance against the budget in their *Statement of Corporate Intent* and the specific quarter's performance
- ▶ SOE performance against its previous year results
- ▶ key company achievements, issues and how we think the company is placed for achieving its full year targets, and
- ▶ SOE performance within the Crown company portfolio.

COMU also rates each SOE "on watch" if it is performing below expectation or has developing issues and summarises SOE management plans to address this.

COMU advisors usually have until around the 15th of the month to complete the analysis.

How this supports shareholding Ministers

Cabinet consideration of SOE performance utilises the collective forum to:

- ▶ inform all of Cabinet on SOE performance
- ▶ provide support and challenge to shareholding Ministers on that performance
- ▶ make linkages across the Government's priorities,
- ▶ provides an opportunity for early discussions of any upcoming board membership changes, and
- ▶ allows Cabinet to support shareholding Ministers in assessing COMU's monitoring performance.

4TH QUARTER REPORT: 31 JULY

Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) are required by the State-Owned Enterprise Act 1986. Other reports are agreed between shareholding Ministers and the board (eg, the 4th quarter report).

What it is

The 4th quarter report provides the full-year unaudited result for the SOE and therefore can test its performance in relation to its *Statement of Corporate Intent* targets, including key factors affecting it, industry trends and market economic conditions.

SOE quarterly reports are not released to the public so they can provide shareholding Ministers with key operational and strategic information.

As the 4th quarter report has unaudited results for the financial year, the advice in the report will provide shareholding Ministers with an early indication of what will be in the SOE's annual report. The 4th quarter report is also used as an information source for the Crown Ownership Monitoring Unit's (COMU's) *Annual Portfolio Report*.

The quarterly report has two information streams:

- ▶ financial information is provided to COMU by the SOE via CFISnet (the Crown Financial Information System), and
- ▶ performance commentary, which is provided to COMU in hard copy by the SOE board.

Quarterly reports inform shareholding Ministers about:

- ▶ SOEs' performance against plan
- ▶ causes of major variances
- ▶ any potential issues
- ▶ major achievements, and
- ▶ provide a forward (year-end) view of key results.

Quarterly reports are also helpful to monitor:

- ▶ performance of business units and / or product lines;
- ▶ progress of capital projects
- ▶ spend to date profitability of joint ventures, and
- ▶ success of acquisitions.

What we do

In analysing quarterly performance, COMU focuses on the financial metrics that have been developed for SOEs by COMU. These can be found at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>.

In summary, they cover:

- ▶ shareholder returns
- ▶ profitability, and
- ▶ liquidity.

We also assess non-financial performance, which is SOE specific.

The analysis provides both a historical view of performance and a view of the impact of this on future performance.

The analysis of the quarterly reports also involves certain steps that are explained below:

- ▶ checking that the quarterly report provides all the required financial information and that the commentary fully and accurately explains any major variances to budget, potential developing issues, and highlights major achievements for the quarter in sufficient detail, and
- ▶ identifying anything which is unusual and/or unclear and if necessary seek clarification from the SOE.

How this supports shareholding Ministers

The key COMU output from this process is the *Performance Report to Cabinet*, which provides shareholding and other Ministers with a regular and systematic view of individual SOE performance and the aggregated performance of the Crown's portfolio. The process also alerts shareholding Ministers to issues the Ministers may wish to discuss with the chair.



PERFORMANCE REPORT TO CABINET: AUGUST

What it is

Based on the quarterly information provided by all the Crown companies, the Crown Ownership Monitoring Unit (COMU) prepares a quarterly performance report to Cabinet. The primary focus of the report, due to their size, is the State-owned Enterprises (SOEs) group.

The fourth quarter report provides both shareholding Ministers and Cabinet with unaudited financial results for the full year and therefore the financial results that will be tabled in the SOEs' Annual Reports.

What we do

The SOE quarterly reporting process to shareholding Ministers provides much of the data for the report to Cabinet.

COMU analysts prepare commentary from their analysis on:

- ▶ SOE performance against the budget in their *Statement of Corporate Intent* and the specific quarter's performance
- ▶ SOE performance against its previous year results
- ▶ key company achievements, issues and how we think the company is placed for achieving its full year targets, and
- ▶ SOE performance within the Crown company portfolio.

COMU also rates each SOE "on watch" if it is performing below expectation or has developing issues and summarises SOE management plans to address this.

COMU advisors usually have until around the 15th of the month to complete the analysis.

How this supports shareholding Ministers

Cabinet consideration of SOE performance utilises the collective forum to:

- ▶ inform all of Cabinet on SOE performance
- ▶ provide support and challenge to shareholding Ministers on that performance
- ▶ make linkages across the Government's priorities,
- ▶ provides an opportunity for early discussions of any upcoming board membership changes, and
- ▶ allows Cabinet to support shareholding Ministers in assessing COMU's monitoring performance.



FULL-YEAR DISCLOSURE

The information contained in this document is the same information in the documents headed *Half-Year Disclosure* and *Continuous Disclosures*.

In publicly listed companies, continuous disclosure rules require companies to provide timely advice to the market of events and developments that might impact value as they occur. Continuous disclosure is intended to:

- ▶ ensure investors have sufficient timely information to make informed decisions, and
- ▶ prevent unfair access to information and insider trading.

There are two types of disclosure:

- ▶ immediate disclosure of material information to the public when the company first becomes aware of its existence, and
- ▶ periodic disclosure, which requires a company to release a specific set of information about the company at regular intervals (eg, in half-year and annual reports).

What it is

The State-Owned Enterprises Act 1986 does not contain a continuous disclosure regime. However, on 1 January 2009, shareholding Ministers introduced a regime for the nine largest State-owned Enterprises (SOE)s to keep the public informed on matters that may have a material effect on an SOE's commercial value.

The continuous disclosure rules were designed to be as close as possible to the successful NZX continuous disclosure rules for listed companies, while recognising that SOE's shares are not publicly traded.

The rules require the following information to be made public:

- the fundamental terms of each material transaction entered into

- information that has a material impact on an SOE's estimate of current commercial value as shown in its *Statement of Corporate Intent*, and
- half-year and full-year financial results, plus a brief explanation, no later than 60 days after the end of the relevant period.

Material transactions are transactions with a consideration of 5% of the SOE's current commercial value or transactions with consideration of \$100 million or more, whichever is the lesser. The exception is KiwiRail, which has a threshold of \$50 million.

There are a number of circumstances where SOEs do not have to disclose material information, such as information about negotiations, or where the information is confidential.

The continuous disclosure rules do not have any formal legal authority, but shareholding Ministers expect SOEs to comply with them.

The rules can be found at:

<http://www.comu.govt.nz/resources/pdfs/disclosures/soe-discl-rules-dec09.pdf>

What we do

The Crown Ownership Monitoring Unit (COMU) manages the regime. SOEs are required to email continuous disclosure notices to COMU. The notices are then placed on the COMU website at: <http://www.comu.govt.nz/announcements/soe-disclosures/>.

How this supports shareholding Ministers

As shareholding Ministers already have access to this and other performance information, in itself the continuous disclosure regime does not

increase the amount of monitoring information or advice available. Shareholding Ministers are using transparency as a means to improve the financial performance of SOEs.



ANNUAL REPORT

Agreed, formal reporting timeframes provide the basis for a clear accountability relationship between shareholding Ministers and the State-owned Enterprise (SOE) boards. Some of the reporting (which supports the principles of accountability and transparency) is required by the State-Owned Enterprise Act 1986, including the half-yearly report.

What it is

The annual report is an important part of telling the SOE's performance story and provides a comparison against the SOE's operating intentions, which were formally set out in the SOE's *Statement of Corporate Intent*. Annual reports bring together the financial and non-financial information. They are also used by select committees to scrutinise performance and provide a broad range of information to a diverse group of other users (eg, staff, monitoring agents, the media, financial markets and academic researchers.)

Content and tabling

The SOE Act requires:

- ▶ SOEs to provide consolidated audited financial statements within the annual report
- ▶ SOEs to deliver their annual reports to shareholding Ministers within three months of the end of each financial year, and
- ▶ the responsible Minister to table each annual report in the House of Representatives within 12 sitting days of receipt.

Section 211 of the Companies Act 1993 specifies what each annual report must contain.

Once tabled, the annual report for each individual SOE is made public.

What we do

The Crown Ownership Monitoring Unit (COMU) analysis undertaken during the annual reporting process supplements that undertaken during the quarterly reporting process for the fourth quarter.

The annual reporting process enables COMU to know how each SOE has performed against the budget. The annual report process is also a valuable mechanism for COMU to learn more about each SOE in the portfolio. The annual report is the key input to COMU's publicly available *Annual Portfolio Report*.

COMU produces a single report that aggregates the key financial information and performance commentary prepared by analysts for each SOE. This assists with comparability of performance.

The report includes:

- ▶ an exceptions based commentary on the annual performance, including COMU's view and any developing issues
- ▶ summary financial tables on key headline financial measures, and
- ▶ concludes on whether the report can be tabled.

How this supports shareholding Ministers

Presenting the annual report to Parliament reflects that the shareholding Ministers are (along with the board) accountable for SOE performance. COMU supports shareholding Ministers by:

- ▶ providing Ministers with analysis of the key performance highlights, issues and risks, and
- ▶ ensuring Ministers are well prepared to respond to issues that may arise from the report.

- ▶ providing some initial thoughts on any performance changes shareholding Ministers can discuss with the SOE's board at the annual general meeting.



FINAL DIVIDEND

The information contained in this document is the same information that is in the document headed *Interim Dividend*.

Every State-owned Enterprises (SOE) has the principal objective to operate as a successful business. Being a successful business includes providing an appropriate return on the capital invested, including capital growth and/or income.

Dividends are the income portion of the capital return and distributed to the shareholder from the earnings of a business.

What it is

Dividends: Link with measuring performance

One of the key financial performance measures for the Crown Ownership Monitoring Unit (COMU), which includes dividends, is the total shareholder return (TSR). The TSR is included in the COMU *Annual Portfolio Report* (see <http://www.comu.govt.nz/publications/annual-portfolio-report/>). Typically, the TSR is measured as the sum of (including an adjustment for equity invested):

- ▶ dividends paid out to shareholders, and
- ▶ capital gains or losses, as measured by the annual change in the board's commercial valuation.

Although SOEs should seek to maximise the TSR, the shareholding Ministers may have their own preferences, between income and growth. Typically, this preference is provided by the SOE Letter of Expectation.

Dividend expectations

Generally, shareholding Ministers express a preference for cash now rather than a prospect of greater returns later, unless this return could be shown to be appreciably superior (given the certainty of cash now).

An SOE's *Statement of Corporate Intent* (SCI) must include a statement of the principles adopted in determining the annual dividend together with an estimate of the amount or policy to determine the amount that is intended to be distributed to the Crown (section 14(2)(f) of the State-Owned Enterprises Act 1986 [SOE Act] refers).

An SOE's annual report must state the dividend payable to the Crown by the SOE for the financial year to which the report relates [section 15(2)(b) of the SOE Act refers].

Ordinary dividends may be paid in two instalments:

- ▶ interim dividend – if any, is paid as soon as possible after the half-yearly report, and
- ▶ final dividend – is paid as soon as possible after the annual accounts are finalised.

SOEs may also pay special dividends, as seen fit by the board.

Dividend policy

SOEs' dividend policies are set by each SOE's board and are driven by returning income to the shareholder based on its optimal capital structure, profitability and the level of future capital expenditure. Shareholding Ministers expect SOEs to operate a dividend policy that:

- ▶ translates to payouts that are commensurate with an SOE's publicly listed peers
- ▶ gives an appropriate balance between dividends and re-investment in the SOE, and
- ▶ shows a degree of consistency and improvement over the years.

Although the dividend policy is the responsibility of the board, under section 13(b) of the SOE Act the shareholding Ministers may by written notice to the board, determine the amount of the dividend payable by any SOE.

What we do

COMU has various roles:

- ▶ recommends to shareholding Ministers what focus a board's dividend policy and actual returns could have in the Ministers' annual letter of expectations
- ▶ discusses with the board shareholding Ministers' expectations on dividend policies and actual returns, and
- ▶ when reviewing the draft SCI, COMU undertakes independent analysis on possible dividends, and may provide alternative advice to shareholding Ministers.

How this supports shareholding Ministers

As the shareholder of significant companies, the Crown can expect to achieve a return on its investments. COMU assists shareholding Ministers in ensuring that appropriate dividend policies are maintained and appropriate dividends are received.



ANNUAL PORTFOLIO REPORT

Crown-owned commercial entities do not face the same market scrutiny as listed companies. The monitoring regime, as far as possible, seeks to replicate market disciplines, which includes transparency of performance, accountability and public scrutiny.

What it is

The *Annual Portfolio Report* (APR) is produced by the Crown Ownership Monitoring Unit (COMU) in October/November, following the publication of individual Crown companies' annual reports. It covers performance of the individual entities and performance of the entire commercial portfolio over a five-year view.

What we do

The APR is assembled once companies' audited annual financial results are provided to COMU in September each year. The project is led by COMU's Financial Analysis Unit and includes input from across COMU.

COMU only uses publicly available information but may use different methodologies than the companies to calculate various performance metrics.

The report has two main sections – one summarising performance at the portfolio level and the other providing individual company analysis.

The report is based on the financial performance measures and ratios that State-owned Enterprises (SOEs) have been instructed to report. These financial metrics can be found at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>

In summary, the ratios measure:

- ▶ shareholder returns

- ▶ profitability/efficiency, and
- ▶ leverage/solvency.

We analyse trend information and performance of each entity relative to its own plans and against time series. We compare with other entities such as publicly listed companies where information is available and relevant. Other relevant one-off topics will be included from time to time.

A number of other governments produce a similar report that illustrates the performance of the Crown's assets.

The APR is a COMU product. We share a near final draft with the main responsible Ministers to ensure "no surprises" and get any feedback Ministers may have.

The APR is available at:

<http://www.comu.govt.nz/publications/annual-portfolio-report/>

How this supports shareholding Ministers

The APR helps to stimulate public scrutiny and discussion of the performance of the Crown's portfolio. This can produce new ideas on what that performance should be and put pressure on individual SOEs to improve their performance.

BENCHMARKING



Benchmarking is an agreed best practice method for comparing a company's key performance metrics.

The State-Owned Enterprises Act 1986 (SOE Act) specifically anticipates that State-owned Enterprises (SOEs) will perform as well as similar companies not owned by the Crown. The best way to test this is to benchmark against a set group of measures.

What it is

Financial benchmarking is a means to compare a company's performance through agreeing a set of performance metrics and comparing these measures against agreed comparative companies.

Benchmarking provides a better understanding of SOE performance through comparing performance against:

- ▶ comparable companies
- ▶ past performance
- ▶ generic SOE measures, and
- ▶ its own shareholder value such as Economic Value Added (EVA) – given the issue with some SOEs finding comparable companies.

This benchmarking information is included in the SOE's accountability documents.

What we do

The Crown Ownership Monitoring Unit (COMU) has developed a set of financial metrics that it has agreed with the SOEs and uses this to assess performance of the portfolio. These metrics are available at:

<http://www.comu.govt.nz/publications/guidance/financial-performance-measures/>.

These metrics form the basis for all of COMU's financial analysis and measure shareholder return,

profitability and solvency. The metrics are calculated using publicly available information. COMU uses this as a basis for comparing performance against historical trends, other SOEs and, where appropriate, like companies not owned by the Crown. There are difficulties with selecting similar companies (eg, there is only one air traffic controller in New Zealand and overseas the majority are not necessarily companies with publicly available information). COMU then uses its judgement to select appropriate benchmarks.

Where appropriate, industry specific measures such as generator efficiency are also used as a means to measure performance.

Benchmarking is used in comparison with other measurements such as:

- ▶ valuation
- ▶ assessment of strategy, and
- ▶ performance measures.

The data and information gained from benchmarking feed into COMU's analysis when it considers regular reporting provided by the board on an SOE's performance.

How this supports shareholding Ministers

Benchmarking is a means to demonstrate to shareholding Ministers how the SOE is performing against a standard. In isolation, assessing an SOE's financial performance can ignore whether trends are good or bad in relation to how the wider sector is performing.

Shareholding Ministers can use this evidence to:

- ▶ understand how that specific company is performing, and
- ▶ challenge companies on their business plan and *Statement of Corporate Intent* targets through each business planning process and use it to assess current financial performance.



BOARD VALUATION OF SOE

Section 14(3) of the State-Owned Enterprises Act 1986 requires the *Statement of Corporate Intent* (SCI) to include the board's estimate of the current commercial value of the Crown's investment in the State-owned Enterprise (SOE) and its subsidiaries and a statement of the manner in which the value was assessed.

What it is

SOEs are not listed companies and therefore there is no observable market value of equity.

The commercial valuation in effect is used by shareholding Ministers as a proxy to measure capital gains and losses of the SOE and through publishing this in the SCI, it informs the public.

Commercial valuation is a forward looking measure, generally based on the net present value of future cash flows, thereby setting a standard for future performance, the achievement of which is required to maintain or increase value. Accordingly, it is important that such valuations are credible.

Board valuation and measuring performance

One of the key financial performance measures for the Crown Ownership Monitoring Unit (COMU) is the total shareholder return (TSR) which includes the commercial valuation. The TSR is included in the *COMU Annual Portfolio Report* (see: <http://www.comu.govt.nz/publications/annual-portfolio-report/>)

Typically, the TSR is measured as the sum of (including an adjustment for equity invested):

- ▶ dividends paid out to shareholders, and
- ▶ capital gains or losses, as measured by the annual change in the board's commercial valuation.

Methodology

An SOE's commercial valuation is dependent on business strategy and asset use, and more generally the circumstance relating to an SOE (ie, if those circumstances change radically then the valuation may change also).

As detailed in the *SOE Owners' Expectations Manual*

[\[http://www.comu.govt.nz/publications/guidance/owners-expectations-manual/\]](http://www.comu.govt.nz/publications/guidance/owners-expectations-manual/), shareholding Ministers expect the boards of each SOE to, if requested, fully explain and justify to shareholding Ministers the methodology used in the assessment and the basis of the assumptions made.

In general, shareholding Ministers prefer such valuations to be prepared using a discounted cash flow (DCF) methodology. However, it is recognised that this may not always be feasible and that alternative valuation methodologies may be more appropriate, particularly for small SOEs.

What we do

The valuations are included in each SOE's SCI, on the COMU website and in the *COMU Annual Portfolio Report*. They are a key input for assessing SOE financial performance.

COMU also commissions and publishes commercial valuation reports on some SOEs to increase the transparency of the value of the Crown's investment in the SOE portfolio, in addition to the SOE's own commercial valuation. Publication is intended to provide SOE boards with greater incentive to conduct robust commercial valuations themselves. For further information, refer to *Independent Valuation*.

How this supports shareholding Ministers

This assists shareholding Ministers in understanding the market value of their investment in the SOEs and what the value drivers are. This allows the responsible Minister to engage with the board on matters relating to the SOE's commercial value.



COMU ENGAGEMENT WITH BOARDS

The Crown Ownership Monitoring Unit's (COMU's) monitoring model is based on:

- ▶ the State-owned Enterprise (SOE) boards being at the centre of the monitoring model
- ▶ an “assess” relationship (as compared to an “assist” relationship) with the SOE board, and
- ▶ key interactions being with the board, rather than the executive of the SOE.

What it is

The board of an SOE is accountable for the conduct and performance of the SOE. Given that COMU's primary interest is in strategic/ownership issues rather than operational issues, our key interactions are with the board (most frequently, the chair) rather than with management. At the same time, in practical terms, access to time with the board/chair is likely to be limited.

Consequently:

- ▶ discussions with the board/chair will focus on strategic decisions/options (eg, growth and investment strategies, capital investment plans, longer term value creation by the entity, dividends etc), once advisors/analysts are sufficiently informed to engage in credible and substantial discussions with the board, and
- ▶ matters of a routine, cyclical or procedural nature (eg, information gathering, quarterly reporting, drafting of core documents) are likely to be channelled first through management.

What we do

It is worthwhile for COMU to meet with the chair approximately every quarter to maintain the relationship and to establish a pattern of official-

to-chair contact. Other meetings may be organised if specific issues arise or at key times of the year (eg, when the *Statement of Corporate Intent* is in its draft form). Officials also request to attend any meetings between shareholding Ministers and the board/chair.

How this supports shareholding Ministers

The model COMU works to allows Shareholding Ministers to focus on their role as it:

- ▶ clarifies COMU's role vis-a-vis the board's role
- ▶ allows COMU to routinely collect information, which has been endorsed by the board
- ▶ provides COMU with quick access to the chair on key issues, and
- ▶ prevents Shareholding Ministers and COMU from getting involved in areas that are outside the mandate.

Further information

For further information on COMU's monitoring model, refer to the paper *Improving the Effectiveness of COMU's Monitoring* available at the bottom of this link:

<http://www.comu.govt.nz/about-comu/our-role/>

COMU MEETINGS WITH SHAREHOLDING MINISTERS

What it is

This section provides the general approach for when the Crown Ownership Monitoring Unit (COMU) meets with shareholding Ministers. There are exceptions to this process (eg, if meetings are scheduled at short notice).

What we do

Meetings between the Minister and COMU

COMU has a weekly meeting with the Minister of State-Owned Enterprises and regularly meetings with other shareholding Ministers.

For the meeting with the Minister of State-Owned Enterprises there is:

- ▶ an agenda prepared in advance of this meeting. Topics may include director appointments, current issues in the portfolio and shareholder expectations, and
- ▶ a weekly *State of Play* report which briefly outlines from COMU's perspective current issues in the portfolio. The report also includes a list of upcoming reports and Cabinet papers and Official Information Act requests that COMU has under action. Aspects of this report are often discussed at the weekly meeting.

Meetings between the Minister and the boards and sometimes the SOE's executive

COMU generally attends meetings held between the Minister, and the board and executive.

For meetings that shareholding Ministers have with State-owned Enterprises (SOE) boards and executives, COMU will normally prepare a briefing report on issues that are likely to be discussed at the meeting, and COMU's view of those issues. To do this effectively requires some liaison with the SOE concerned. The

SOE may also choose to provide some written information in advance of the meeting for the Minister. These meetings usually take place at Parliament or in the SOE's boardroom.

How this supports shareholding Minister

Shareholding Ministers often need more than factual information, diagrams and reports to understand the performance of SOEs, issues, opportunities and risks. Meetings can quickly clarify concerns, solve issues, and identify new areas of work that shareholding Ministers would like to commission from COMU.

Face-to-face meetings can also assist in:

- ▶ forming constructive working relationships
- ▶ building long-term trust
- ▶ dealing with issues in real time, and
- ▶ understanding perspectives.



CONTINUOUS DISCLOSURES

The information contained in this document is the same information in the documents headed *Half-year Disclosure* and *Full-Year Disclosure*.

In publicly listed companies, continuous disclosure rules require companies to provide timely advice to the market of events and developments that might impact value as they occur. Continuous disclosure is intended to:

- ▶ ensure investors have sufficient timely information to make informed decisions, and
- ▶ prevent unfair access to information and insider trading.

There are two types of disclosure:

- ▶ immediate disclosure of material information to the public when the company first becomes aware of its existence, and
- ▶ periodic disclosure, which requires a company to release a specific set of information about the company at regular intervals (eg, in half-year and annual reports).

What it is

The State-Owned Enterprises Act 1986 does not contain a continuous disclosure regime. However, on 1 January 2009, shareholding Ministers introduced a regime for the nine largest State-owned Enterprises (SOE)s to keep the public informed on matters that may have a material effect on an SOE's commercial value.

The continuous disclosure rules were designed to be as close as possible to the successful NZX continuous disclosure rules for listed companies, while recognising that SOE's shares are not publicly traded.

The rules require the following information to be made public:

- the fundamental terms of each material transaction entered into

- information that has a material impact on an SOE's estimate of current commercial value as shown in its *Statement of Corporate Intent*, and
- half-year and full-year financial results, plus a brief explanation, no later than 60 days after the end of the relevant period.

Material transactions are transactions with a consideration of 5% of the SOE's current commercial value or transactions with consideration of \$100 million or more, whichever is the lesser. The exception is KiwiRail, which has a threshold of \$50 million.

There are a number of circumstances where SOEs do not have to disclose material information, such as information about negotiations, or where the information is confidential.

The continuous disclosure rules do not have any formal legal authority, but shareholding Ministers expect SOEs to comply with them.

The rules can be found at:

<http://www.comu.govt.nz/resources/pdfs/disclosures/soe-discl-rules-dec09.pdf>

What we do

The Crown Ownership Monitoring Unit (COMU) manages the regime. SOEs are required to email continuous disclosure notices to COMU. The notices are then placed on the COMU website at: <http://www.comu.govt.nz/announcements/soe-disclosures/>.

How this supports shareholding Ministers

As shareholding Ministers already have access to this and other performance information, in itself the continuous disclosure regime does not

increase the amount of monitoring information or advice available. Shareholding Ministers are using transparency as a means to improve the financial performance of SOEs.

ENVIRONMENTAL SCANNING



Environmental scanning is the acquisition and application of information pertaining to the external environment in which an organisation operates.

What it is

Environmental scanning involves the Crown Ownership Monitoring Unit (COMU) examining and understanding a State-owned Enterprise's (SOE's) immediate business environment, including competitors, suppliers and customers, as well as understanding the longer-term trends (industry, economic, regulatory, political) facing an SOE as shown in Figure 1.

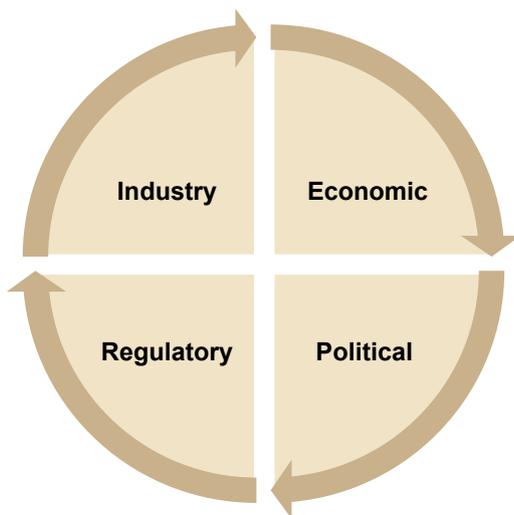


Figure 1: Basis of scanning – Longer-term trends

Environmental scanning is one of the fundamental components underpinning COMU's monitoring; it gives context to a performance and future potential needs. This context is essential in offering informed advice to shareholding Ministers. Furthermore, environmental scanning allows monitoring on a proactive, and not simply a reactive, basis.

What we do

A number of information sources are generally employed in scanning an SOE's environment. These include, but are not limited to:

- ▶ SOE updates or business plans
- ▶ market equity research reports on companies comparable to those monitored by COMU
- ▶ market research reports examining the industry in which the SOE operates
- ▶ economic reports and forecasts sourced both internally (within the Treasury) or externally (eg, the Reserve Bank of New Zealand, the New Zealand Institute of Economic Research Inc, Infometrics Ltd)
- ▶ research into the regulatory environment facing the SOE and industry, and
- ▶ media and RSS feeds (most commonly expanded as Really Simple Syndication or Really Simple Syndication) on items that mention an SOE.

Benchmarking is one specific element of environmental scanning that we undertake.

Conventionally there is no individual output produced as a result of undertaking environmental scanning; the information gathered is included implicitly when COMU reports on SOE performance.

When is it done?

Environmental scanning is a continuous process undertaken throughout the monitoring cycle. Additional scanning is likely to be undertaken in the strategy development and business planning stages of the monitoring cycle and offers insight into whether performance targets are likely to be achieved.

How this supports shareholding Ministers

Analysing the environment that SOEs operate within adds context and depth to the performance reports that Ministers receive from COMU.

Shareholding Ministers can use this evidence to understand how each specific SOE is performing through understanding its business environment.



LEGISLATIVE AND OTHER REVIEWS AS REQUIRED

The way in which public governance works is a mix of politics and policy, law and convention. Conducting reviews and altering settings and expectations is an essential part of having an effectively performing system.

What it is

Treasury administers various pieces of legislation including the State-Owned Enterprises Act 1986 (SOE Act). The Crown Ownership Monitoring Unit (COMU) is responsible for the SOE Act and for making recommendations to the Government about improving it.

COMU also undertakes reviews that are operational in nature, noting that on a day-to-day basis it is the State-owned Enterprise (SOE) board and management who are operating under the SOE Act.

What we do

Legislative reviews

To support legislative reviews, the Treasury's legal team operates a database that keeps records of issues with the legislation the Treasury administers. This information then feeds into the legislative review process.

As part of a regulatory review, COMU would review regulations and Orders in Council related to the SOE Act.

COMU also regularly provides input into Statutes Amendment Bills, which are designed as vehicles for technical, short and non-controversial amendments to legislation. This review process is coordinated by the Treasury's legal team, who work closely with the Ministry of Justice and the Cabinet Office.

Operational reviews

The SOE Act is primarily operationalised through the *Owners' Expectations Manual* (OEM) [<http://www.comu.govt.nz/publications/guidance/owners-expectations-manual/>].

COMU regularly reassesses and reviews how the SOE Act is operationalised, taking account of shareholding Ministers' priorities, how publicly listed companies are monitored and the changing corporate governance environment.

Operational reviews are either carried by COMU or through COMU engaging external experts.

How this supports shareholding Ministers

Some of the ways in which reviews support Ministers are that they can:

- ▶ provide a consolidated view of the current situation
- ▶ provide a basis for questioning and testing assumptions
- ▶ provide a better understanding of how the legislative landscape impacts on the performance of SOEs
- ▶ provide information on how other countries have responded to similar issues
- ▶ generate new ideas and approaches for improved performance, and
- ▶ provide a robust basis for policy recommendations.



MONITORING LOCAL AND INTERNATIONAL CORPORATE GOVERNANCE CHANGES

Corporate governance is generally considered to include the institutions, laws, policies, processes and practices, affecting the way a company is directed, administered or controlled.

What it is

The Crown Ownership Monitoring Unit (COMU) undertakes regular monitoring of changes in corporate governance practices and methodologies to ensure that its approach is aligned with best practice and is continually assessed against similar organisations.

What we do

COMU does this through sourcing information from a number of places, including:

- ▶ governance conferences and networks
- ▶ NZX – the NZX has a set of listing rules and procedures for all companies listed on the stock exchange. As company listing requirements change, and as appropriate, COMU will consider their relevance to State-owned Enterprises (SOEs)
- ▶ environmental scanning – COMU undertakes a specific media search for all media releases that have a reference to corporate governance
- ▶ OECD – the OECD has a secretariat specifically responsible for providing guidance on the best practice of corporate governance of SOEs. It does this through regular surveys, reports and meetings. The surveys cover OECD country practices and behaviour and are a useful tool for assessing New Zealand against like countries

- ▶ since 2007, COMU has partnered with Massey University's School of Business in the delivery of specialised governance training programmes, which include information on corporate governance research and analysis of current issues facing boards, and
- ▶ each COMU analyst is also expected to advise of any changes to practices occurring within the SOEs they monitor, and whether these could have wider application.

Should any changes or ways of doing things come to light that we consider would be worthwhile for the New Zealand model that we will assess those and report to shareholding Ministers advising of any:

- ▶ significant issues that have emerged
- ▶ proposed changes to the SOE model, and
- ▶ where further information will be sought.

How this supports shareholding Ministers

Being up to date with local and international governance changes ensures that the SOE model remains responsive to the changing environment.

MONITORING PLAN



The main purpose of monitoring State-owned Enterprises (SOEs) is to enable the Crown Ownership Monitoring Unit (COMU) to advise shareholding Ministers on SOE performance, and recommend how Ministers might respond to any issues, risk, and opportunities.

What it is

A monitoring plan defines which parts of a particular SOE's performance will be monitored, and how the monitoring will be undertaken. The benefits of having a monitoring plan are that it can:

- ▶ focus monitoring on what really matters over a particular period
- ▶ assist in setting shareholding Ministers' expectations of the SOE
- ▶ identify risks to performance targets
- ▶ assist monitors to plan topics for key engagements with boards, and between boards and Ministers, and
- ▶ provide a framework for the systematic collection of monitoring information.

What we do

COMU tends to write a monitoring plan when:

- ▶ a new company becomes subject to COMU monitoring
- ▶ a particular issue has arisen that requires extra focus by COMU, or
- ▶ an analyst is allocated a new SOE to monitor.

The monitoring plan is agreed with the relevant COMU manager. The plan is not specifically agreed with shareholding Ministers although, should a particular circumstance arise that

requires increased reporting and advice, COMU will likely advise the Minister.

What is in a monitoring plan depends on the specific situation. A monitoring plan should cover the objective(s) of the plan, the monitoring regime to be followed, including planned engagement with the SOE, and any reports that will be generated for shareholding Ministers.

Monitoring plans can include the annual list of events and deliverables (letter of expectation, business plan, *Statement of Corporate Intent*, etc) but these are generally standard and constant across SOEs. Care needs to be taken when including these, as they are a means to obtaining information for achieving the monitoring objectives, but in themselves are not the focus of the monitoring plan.

How this supports shareholding Ministers

Monitoring plans are a tool to ensure that COMU's monitoring aligns with shareholding Ministers' needs.

POLICY ADVICE



Policy development is an output of government that plays a key role in ensuring that resources are used effectively and efficiently.

The State-Owned Enterprises Act 1986 can be viewed as separating out ownership from the policy insofar as the objectives of State-owned Enterprises (SOEs) do not include a policy function. Policy advice is provided to shareholding Ministers via the Crown Ownership Monitoring Unit (COMU).

What it is

Specific policy issues arise from time to time relating to SOEs. (This is separate from business proposals from the SOEs.) The issues need to be considered on a case-by-case basis.

Examples of issues that have arisen in the past include:

- ▶ proposals to merge SOEs
- ▶ proposals to use SOE assets in a Treaty settlement, and
- ▶ the 2011 advice requested by the Government on the extension of the mixed ownership model to some SOEs.

What we do

Treasury has quality standards for policy advice, which can be viewed here:

<http://www.treasury.govt.nz/publications/abouttreasury/soi/2009-12/23.htm> This is used in COMU for planning and review purposes.

Our advice to Ministers is tailored to the particular issue being considered, and can include:

- ▶ the commercial impacts on the SOE or SOEs
- ▶ the wider impacts on the Crown's portfolio of assets

- ▶ the wider economic and fiscal considerations relevant to the issue, including consultation with the relevant policy team or teams within the Treasury, and other relevant government agencies
- ▶ a full assessment of the benefits, costs and risks of the issue and a description of why the issue requires action by shareholding Ministers or the Government, and
- ▶ options and/or recommendations.

If a policy change occurs, COMU reassesses its monitoring regime in light of that change as the regime needs to be fit for purpose.

As a rule, COMU will report to shareholding Ministers outlining the relevant considerations. That may be followed by shareholding Ministers discussing the issue with the board or boards of the SOEs, or taking a paper to Cabinet.

How this supports shareholding Ministers

Timely, objective, non-partisan, well-argued, robust policy advice assists shareholding Ministers to make informed decisions in light of their priorities.

Further information

Government departments developed *The Policy Development Toolkit*, which is available to departments and Crown entities via the Public Sector Intranet:

<https://psi.govt.nz/pdtoolkit/default.aspx>



REVIEW OF BUSINESS PROPOSALS

Companies make various investment decisions from acquisitions, to significant capital investments to agreeing long-term contracts. These decisions are usually supported by business proposals.

What is it

There are two reasons why the Crown Ownership Monitoring Unit (COMU) reviews some State-owned Enterprise's (SOE's) business proposals beyond a certain threshold for shareholding Ministers:

- ▶ the proposal requires shareholding Ministers' approval (ie, because the transaction meets the criteria for a major transaction threshold, or because there is a request for capital), or
- ▶ the proposal meets the consultation thresholds agreed between shareholding Ministers and SOEs. These thresholds are an example of the Government's "no surprises" policy in action. (Further information on the "no surprises" policy is available in the *Owners' Expectations Manual* [OEM] located at: <http://www.comu.govt.nz/publications/guidance/owners-expectations-manual/>). In these cases, consultation represents the opportunity for the board to be fully aware of the shareholders' views when the board makes major decisions. This is intended to support, not supersede, the authority of the board.

What we do

Critically assessing business proposals allows COMU to gain further insight into the operations of a company and to assess the ability of the company to meet its strategic objectives, achieve forecast returns and dividends, and how the management and board make decisions.

There is no one methodology for reviewing business cases. However, for all cases we assess:

- ▶ the link to strategy
- ▶ resource commitments
- ▶ source of funding
- ▶ Government/portfolio fit
- ▶ risk and returns, and
- ▶ alternatives.

In order to undertake an assessment of business proposal, we ask SOEs to submit a full and robust supporting business case. In the OEM we advise SOEs what we expect in this consultation stage, as follows:

- ▶ full explanation of the intended investment, demonstration of its link to the entity's purpose, core business and agreed strategy (as identified in the latest business plan or *Statement of Corporate Intent*)
- ▶ full assessment of the benefits, costs and risks of the proposal and a description of why the investment is considered necessary/priority
- ▶ full financial projections (financial performance, financial position and cash flow statements) to the same level of detail as the annual forecasted accounts in the business plan, and forecasted annually for an appropriate period for the type of investment (typically 10+ years)
- ▶ identification of forecasts of capital expenditure and funding (and sources of funding) over the projection period
- ▶ calculations not only identifying the expenses and returns for the project, but also identifying impacts for the whole of the SOE

- ▶ full identification of risks
- ▶ similar rigour applied to alternative scenarios (eg, status quo)
- ▶ full discounted cash flow (DCF) analysis leading to net present value (NPV) for each scenario. This should clearly identify all relevant assumptions, and
- ▶ the business case presented in a form that either conducts appropriate sensitivity analysis or enables officials to carry out such an analysis.

On receipt of a business proposal, the analysis undertaken by COMU is largely the same regardless of whether there is a formal decision required by shareholding Ministers or not.

What tools we use

The types of tools COMU uses to analyse a business proposal are:

- ▶ Full financial projections (financial performance, financial position and cash flow statements).
- ▶ Full discounted cash flow analysis leading to net present value for each scenario.
- ▶ Core business – Does the company's New Zealand core business remain focused?
- ▶ Scope of business – does the proposal expand the scope of the business?
- ▶ Is there a risk that value will be lost if the SOE does not go ahead with the proposal?
- ▶ Risk management – Is the expansion necessary to mitigate the level of risk associated with the existing activities?
- ▶ Governance structure/subsidiary – Is the expansion structured in a way to enhance the governance of the company?
- ▶ Risk mitigation – What risk management strategies are in place?
- ▶ Risk – Does the expansion significantly alter the risk profile of the Crown?

- ▶ Debt finance – Will the company take on new (private sector) debt for the expansion as opposed to withholding dividends (or capital injection)?
- ▶ Is it likely that declining a capital injection will encourage the SOE to hold back dividends in the future?
- ▶ Crown portfolio – Would the expansion fit well with the Crown's existing portfolio?

How this supports shareholding Ministers

This process provides shareholding Ministers with:

- ▶ information on what shareholding Ministers' role is (ie, approval or party to a consultation)
- ▶ an independent view (independent from the SOE), which is presented alongside the board's view, on whether the proposal is value enhancing for the shareholder
- ▶ a proposed letter for the chair of the SOE providing the Crown's view of the proposal, and
- ▶ where an approval or a capital injection is being sought, COMU provides the required formal documents and support to shareholding Ministers (eg, this could be a Cabinet paper).

Further information

The Government wants to improve the quality of analysis and decision-making around State sector capital proposals. The Treasury produces a guide targeted at departments and Crown agents on developing business cases that are proposing to undertake capital expenditure. The guidance is useful for any agency preparing a business case. The guide is available at:

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

SELECT COMMITTEE



State-owned Enterprises (SOEs) operate within a wider system than the Crown Ownership Monitoring Unit's (COMU's) monitoring of accountability and scrutiny [refer <http://www.comu.govt.nz/about-comu/our-role/>]. Part of that wider scrutiny involves select committees.

What they are

Select committees are one of the mechanisms through which Parliament can scrutinise and hold the Government to account. The Standing Orders of the House of Representatives gives select committees a wide range of powers. This includes the ability to require witnesses (including SOEs and officials) to appear before them, and give evidence. Appearing before select committees can occur any time during the SOE's annual performance cycle.

There are numerous reasons why an SOE would be called before a select committee. For example:

- ▶ **Financial review:** SOEs are regularly required to appear before the Finance and Expenditure Committee (or another select committee delegated by the Finance and Expenditure Committee) for a financial review. The key documents used for the financial review are the SOE's *Statement of Corporate Intent* and its annual report.
- ▶ **Legislation:** An SOE could be asked to advise a select committee on legislation under formation.
- ▶ **Submission:** An SOE may wish to make a submission on a Bill as a witness.
- ▶ **Petitions:** A select committee may receive a petition from private citizens regarding an SOE. The SOE may then be called in for a review.

- ▶ **Inquiries:** Every select committee has the power to launch an inquiry, and could call an SOE in to provide evidence.

Select committees report back to the House on their findings.

For whatever reason an SOE is required to appear, the SOE informs COMU and the shareholding Ministers' offices about its attendance and issues it plans to cover. This is in accordance with the "no surprises" policy.

What we do

If the select committee meeting is open to the public, COMU may attend the session.

Unless authority has been given by the shareholding Minister(s), COMU does not have an active involvement in any select committee meeting.

If COMU requested to appear before the select committee as a witness, the shareholding Ministers' offices are informed about the reason for appearance, and the likely coverage of issues.

How this supports shareholding Ministers

Following attendance at select committee, COMU advises the shareholding Ministers on:

- ▶ the topics covered by the select committee
- ▶ significant issues that emerged
- ▶ any further information that was sought by the select committee from the SOE, and
- ▶ any follow-up monitoring, or other activity, that will be undertaken by COMU.

Further information

Further information on select committees and officials roles and responsibilities is available at:

- ▶ State Services Commission's *Officials and Select Committees – Guidelines*
[<http://www.ssc.govt.nz/officials-and-select-committees-2007>]
- ▶ *Natural Justice Before Select Committees and Working with Select Committees* on the New Zealand Parliament website
[<http://www.parliament.nz/en-NZ/PubRes/About/Procedures>], and
- ▶ The Auditor-General has a direct relationship with the Finance and Expenditure Committee and provides assistance in its examination of entities' performance.



SHARING COMU EXPERTISE: MAGNET AND INGOA

One of the Crown Ownership Monitoring Unit's (COMU's) operating principles is that we share our knowledge with and learn from other governmental agencies undertaking monitoring roles, both in New Zealand and internationally. This supports COMU being a centre of expertise.

Some of the characteristics involved in being a centre of expertise are that COMU is:

- ▶ influential – connected, trusted, listened to
- ▶ in demand – sought out for advice and expertise, and
- ▶ adaptable – constantly learning and refreshing tools and techniques, innovative, nimble, able to move quickly and respond to demands and opportunities
- ▶ prepared to learn, grow and change - using external engagement and networking with public and private sector peers to inform, influence, gather intelligence and test strategies and tactics)

What they are

COMU is a member of two governmental organisations established as vehicles for the constant exchange of information and ideas on monitoring, appointments and governance.

The New Zealand forum is the [Monitoring, Appointments and Governance Network \[MAGNet\]](#). This link is only accessible to officials whose departments and Crown entities have chosen to be part of the Public Service Intranet.

While being a member of MAGNet gives COMU the opportunity to post information on the MAGNet site, attend workshops and forums, and locate contacts in other parts of the New Zealand Government, COMU is also a permanent member

of the planning group of MAGNet in the appointments and governance area.

The international forum is the [International Network of Government Ownership Agencies \[INGOA\]](#). Some of this website is accessible to non-members. The site allows for membership of more than one organisation from each country, and for multiple members from each organisation. To become a member, click here: [how to join](#)

While being a member of INGOA, which gives COMU the opportunity to post information on the INGOA website, attend forums (usually via video-conferencing) and locate contacts in other jurisdictions, COMU is currently the lead agency for INGOA.

Other ways we share our expertise

MAGNet and INGOA are only two ways in which we share our knowledge. COMU also:

- ▶ has increasing amounts of information on how COMU operates available on our website: www.comu.co.nz
- ▶ as a New Zealand Government central agency, works closely with the State Services Commission on appointment and governance issues (another part of the Treasury, the State Sector Management team, works with the Commission on monitoring and performance), and
- ▶ responds to queries on a range of issues related to monitoring, appointments and governance.

How this supports shareholding Ministers

Being prepared to share how COMU operates and learn from others improves the scope and depth of our advice to shareholding Ministers.