# Report of the Crown Company Monitoring and Advisory Unit Review Team:

## Phase II – Scope, Form and Location

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# REPORT OF THE CCMAU REVIEW TEAM:

# PHASE II - SCOPE, FORM AND LOCATION

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## Purpose of Report

1. This report makes recommendations of the scope, form and location of CCMAU, following the transfer of the health ownership monitoring unit from CCMAU to the Ministry of Health.

2. The report is in four parts:

   - The first outlines a framework for making decisions on who is optimally placed to monitor the Crown's ownership interest in Crown entities.

   - The second is a "bottom up" entity specific analysis, examining entities where there is a prima facie case that CCMAU could optimally monitor the Crown's ownership interest.

   - The third examines the configuration of ownership monitoring across the public sector, and makes some recommendations from this "top down" perspective.

   - The fourth outlines a framework for making decisions on the optimal form and location of CCMAU and outlines the trade-offs the various options require.

3. The review has been conducted by a team of officials from Treasury and SSC. CCMAU has participated fully in discussions on its form and location. Both CCMAU and the current monitoring departments have had the opportunity to contribute to the framework and to discussions on optimal ownership monitoring arrangements for the specific entities under consideration. Where the views of either CCMAU or the current monitoring department differ from the Review Team, that is reflected in this report.

## Scope of CCMAU – The Framework

4. Typically the Crown owns entities because it has a purchase/public policy interest, and ownership is a convenient means for mitigating the market failure. Thus, the Crown usually differs from a classical private sector 'for profit' owner, whose principal objective is to maximise financial or economic value.

5. Four key criteria structure the framework for making decisions on optimal arrangements for monitoring the ownership interest in Crown entities:

- Is the ownership interest material?
- Are the ownership and purchase/other interests sufficiently well defined and separable from each other to make separate ownership monitoring valuable?
- Is there value monitoring the entity specific interest separately from the Crown's balance sheet interest?
- Do the benefits of monitoring aspects of the ownership interest centrally outweigh the costs?

These criteria operate as filters, so that if, say, the ownership interest in an entity is not easily separable from the purchase interest, that entity is excluded. The other criteria then become irrelevant.

***Materiality***

6. Before a decision is taken to monitor an entity's ownership performance, it is necessary to show that the benefits of monitoring outweigh the costs. For every entity under consideration, there must be a material ownership interest.

***Purchase/Other vs. Ownership***

7. The Government has multi-faceted interests in the organisations it owns, including purchase and ownership interests. In very general terms, a purchaser is interested in getting the right output at the right price. An owner is interested in the organisational health, viability, effectiveness, strategic alignment and integrity of the entities it owns, as well as maximising their value (whether value is measured financially or not).

8. Separate ownership monitoring can add considerable value through specialist business analysts concentrating on the underlying viability and capability of the monitored organisations. There can also be value separating this ownership monitoring out from the responsible department to mitigate the risk that Ministers will not be exposed to key ownership issues that arise out of conflict with funding or policy issues. In many cases the Crown has significant investments at stake, which are well worth protecting.

9. Two key complications emerge in the Government context:

- The Government's key interest is usually a public policy one in most cases, it buys outputs and owns entities to achieve some social, environmental, regulatory or economic goals.
- There is often no market either for the provision or the purchase of the good or service. In such cases the Government is likely to own the entity that will supply the services required. As a result, Government as owner is interested both in input efficiency and long-term capability, which converges with its interests as purchaser in ensuring ongoing service delivery at the lowest possible price. This is particularly so where the Crown has a direct purchase or funding relationship with the entity – as is the case with most departments and many Crown entities.

10. Since the Government has a variety of interests in Crown entities, which are not always easily separated from each other, decisions on who should monitor the entity from an ownership perspective rely on judgments on how the Government can best protect its overall interests. If monitoring responsibilities are not separated when they should be, there may be conflicts of interest and value destruction. On the other hand, if monitoring responsibilities are separated unnecessarily there may be duplication, loss of synergies and potential for confusion that is unlikely to provide Ministers with value for money. In that case, ownership monitors will find themselves asking the same questions as other monitors – e.g. is this entity producing this output in a cost effective manner, and can it continue to do so in the future?

**CCMAU Comment**

11. CCMAU believes that the Government's separate interests can always be defined sufficiently to justify separate monitoring. Therefore, CCMAU considers there is usually real benefit in separating out the ownership monitoring function because it provides greater clarity and transparency over the differences in the Government's interests. It is recognised as best practice that separate institutional monitoring of the ownership and purchase interests avoids conflicts of interest and ensures full transparency and hence robust accountability. It is noteworthy that in the current health sector context, the Minister has continued to insist and rely upon separate ownership monitoring from the Ministry of Health because the separation provides better value enhancements than integration – integration has more risk of value destruction.

12. CCMAU further observes that for some entities there is currently no well-defined purchase contract with the Government. This, however, is not to say that the two interests are inseparable: rather, it implies that the existing purchase arrangements require improving. By transferring the ownership monitoring to CCMAU, those policy/funding departments would be encouraged to develop better output definition and improve the Crown's purchasing arrangements with the entity. At the same time there would be an enhanced ownership monitoring focus from CCMAU because the inherent conflict of interest of a policy/funding department doing the ownership monitoring would have been removed.

### Entity Specific Interest vs. Crown Balance Sheet Interest

13. As well as its specific interest in individual entities the Government also has an interest in its overall financial position. At times, it may need to make trade-offs between the entity specific interest and its overall balance sheet interest.

14. The Treasury monitors the Crown's balance sheet. As a result, it has an interest in the performance of every entity, at least to the extent that it impacts on the Crown's overall financial position.

15. If the Government's main interest in an organisation is the impact that its performance has on the Crown balance sheet, and the entity specific interest is small, then monitoring the entity specific interest separately from the Crown balance sheet interest is unlikely to add much value and could create unhelpful confusion of roles.

### Do The Benefits Of Centralised Monitoring Outweigh The Costs?

16. Specialist ownership monitors require general business analysis and performance monitoring skills. In order to assess if an organisation is operating efficiently and if it has an appropriate level of capability to operate now and in the future, knowledge of the sector the business operates in is also required.

17. Just as there is value in having specialist social policy advisors working together, there is value in having business analysts working together. This allows them to feed off each other's skills, knowledge and experience. The Review Team consider that organisational buy-in to monitoring excellence is a pre-requisite for good ownership monitoring. It is easier to create this buy-in in a specialist monitoring

agency, because management face fewer distractions and are likely to be more focussed on developing as a centre of monitoring excellence.

18. One of the benefits of centralising ownership monitoring is that it creates an opportunity for a centre of excellence to develop. However, the monitoring unit's owner must be prepared to make the investment required to create that centre of excellence. A centre of excellence would not only monitor its portfolio of entities, it could also provide monitoring leadership, and develop and share best practice with other monitors and monitoring units within the public sector. Experience could be shared through monitoring networks.

19. Decisions on optimal monitoring arrangements for Crown entities require Ministers to make judgments on a case by case basis, since they often have multiple interests in the entities they are responsible for. Ultimately, Ministers need to consider whether they want integrated or separate streams of advice from officials on entity performance from different perspectives. An integrated advice structure carries a higher risk of conflicts of interest for the monitor however, with the result that differences arising from the purchase and ownership perspectives may be filtered before they reach Ministers.

20. Transition costs may also be an issue. If staff do not transfer with the function, it may take time to build up familiarity and relationships. However, the Review Team considers that transition costs will typically not be a determinative issue unless there is little to choose between transfer or not.

## Scope of CCMAU – Entity Specific Issues

21. The Review identified ten entities, or groups of entities, for consideration for monitoring by CCMAU. They were: (current monitors in parentheses)

- Earthquake Commission – (Treasury)
- Government Superannuation Fund New Zealand – (proposed new entity)
- Public Trust Office – (Treasury)
- New Zealand Lotteries Commission - (Department of Internal Affairs)

- New Zealand Fire Service Commission - (Department of Internal Affairs)
- New Zealand Symphony Orchestra Ltd - (Ministry for Culture and Heritage)
- Museum of New Zealand Te Papa Tongarewa - (Ministry for Culture and Heritage)
- Tertiary Education Institutions - (Ministry of Education)
- Learning Media Ltd - (Ministry of Education)
- Accident Compensation Corporation – (Department of Labour)
- Housing New Zealand Corporation (proposed new entity)

***Earthquake Commission (EQC)***

22. EQC insures all New Zealanders with house and contents insurance against earthquake damage. EQC has various financial instruments, and has the power to re-insure. It has an unlimited guarantee from the Crown. The Crown does not have an explicit purchase interest in EQC – rather, New Zealanders who choose to purchase contents insurance do. The Crown has a significant ownership interest in EQC however.

23. EQC could potentially manage a significant amount of the Crown's balance sheet, and puts a larger part at risk. Its asset management, its premium levels, and its pay-out policies have potentially a huge effect on the Crown balance sheet. A significant ownership interest exists. The nature of this interest is such that it is not sufficiently separable from the Crown balance sheet interest. Therefore EQC is excluded by criterion iii.. The Review Team does not consider that monitoring by CCMAU would add value over and above Treasury. We also consider that Treasury is better placed to manage this risk on behalf of the Crown. (CCMAU agrees.)

***Government Superannuation Fund New Zealand (GSFNZ)***

24. GSFNZ, which is due to be created as a Crown entity in 2001, will manage the GSF assets and operations. The Crown bears the unfunded liability, and is the effective economic owner of the assets.

25. The Crown will have no significant purchase interest in GSFNZ. The ownership interest is significant i.e. the efficient management of the fund to minimise the impact of the unfunded liability (net of assets) on

the Crown. This interest is the Crown's balance sheet interest. Since GSFNZ has discretion only within the investment parameters set by the Government, the entity specific ownership interest is small however.

26. Since the entity specific ownership interest is small and not usefully separated from the balance sheet, the Review Team does not consider there would be any benefit in CCMAU monitoring it separately from Treasury. Thus GSFNZ is excluded by criterion i. and iii. (CCMAU agrees.)

***Public Trust (PTO)***

27. The Public Trust has three main areas of business:

- retail trustee services – e.g. wills, estate administration, insurance products
- corporate trustee services – prudential oversight of managed funds
- funds management.

At present, it is a department under the State Sector Act (1988).[1] Following decisions taken by Cabinet in July 2000, it will become a Crown entity from 1 July 2001.[2]

28. The Crown has a purchase interest in the Public Trust - bearing the cost of statutory public policy obligations such as the provision of free wills and acting as trustee of last resort. This cost is to be made explicit from July 2001 via appropriations and an output agreement. The Crown also has an entity specific ownership interest in the efficient management of the organisation, and in its financial viability. This ownership interest is heightened by the statutory guarantee of the Public Trust's common fund, which contains trust, estate and agency money. The purchase/public policy and ownership interests are distinct, and it is likely there would be value in monitoring the interests separately. (Criterion ii.)

29. Since PTO's bottom line impacts the Crown balance sheet, the Government has a Crown balance sheet interest in the Public Trust. The Crown balance sheet interest is likely to be narrower than the entity specific interest, and separable from it. (Criterion iii.)

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[1] But not under the Public Finance Act (1989).
[2] See CAB (00) M 24/1D.

30. The Review Team considers that the key skills required for monitoring the Public Trust are business analysis skills, together with trustee and finance industry knowledge. We consider that CCMAU is best placed to build up and maintain the sectoral knowledge. As such we consider that CCMAU should be responsible for monitoring the entity specific ownership interest in the Public Trust, while Treasury would continue to focus its monitoring on the impact on the Crown balance sheet (consistent with the recently revised SOE protocols). CCMAU agrees. We further suggest these new arrangements be progressed as soon as is practicable in order to minimise transition risks.

***New Zealand Lotteries Commission***

31. The Lotteries Commission has a statutory monopoly with the power to administer various gaming activities. Its surplus is paid to the Lottery Grants Board for distribution to community and charitable groups.

32. The Crown has no explicit purchase interest in the Lotteries Commission, although it has a strong regulatory interest as the Lotteries Commission is the only organisation that is able to pay people to sell lottery products. The Lotteries Commission is required to behave in a socially responsible manner, and not to exploit its monopoly position excessively. As such the Crown has a public policy interest in mitigating the social costs of gaming. The ownership interest is really in the organisational efficiency of the Commission so that it can maximise its revenue subject to regulatory and public policy constraints. The Review Team considers that, although the regulatory and policy environments set some constraints on the Lotteries Commission's performance, there is a genuinely separable ownership interest that it would be valuable to monitor separately. (Criterion ii.)

33. All Commission revenue comes from third parties and dividends do not flow to the Crown, so its performance does not directly impact on the Crown balance sheet. Thus, the entity specific interest is clearly separable from the Crown balance sheet interest. (Criterion iii.)

34. Some understanding of the sector is required to monitor the Lotteries Commission, such as awareness of the social implications of its business activities. Interaction between ownership monitors and policy/regulatory advisors will be desirable in some circumstances, but we see no reason why this cannot be maintained across agencies, nor why CCMAU could not maintain adequate sectoral knowledge. We consider that the key skills required will be business analysis skills and

that CCMAU is the best source of these. The Review Team considers that the benefits of separate monitoring (avoidance of conflicts of interest and better ownership monitoring) outweigh the costs (possible loss of synergies).(Criterion iv.)

35. The only significant transitional issue is the possible impact of the review of the gaming sector. However, some entity will still have to administer various games on the Crown's behalf, and as long as there is an effective separation between the lottery games business, and the community funding arm, CCMAU is likely to be best placed to monitor the Crown's ownership interest in the operation of the lotteries business. (Criterion iv.)

36. The Review Team considers that responsibility for monitoring the ownership interest in the Lotteries Commission should be transferred to CCMAU. CCMAU agrees.

**DIA Comment**

37. The Department of Internal Affairs considers that the Government's regulatory and public policy interests in the Lotteries Commission makes it significantly different from most entities that CCMAU monitors. DIA considers that these interests impact on the ownership environment to such an extent that separating responsibility for monitoring the ownership interest is difficult.

38. DIA notes that the gaming review could have significant implications for the sector and that it would be more sensible to make decisions on monitoring at the end of the review. They also note that there are significant synergies with the rest of the DIA Crown entity monitoring unit, so that separating responsibility for monitoring the Lotteries Commission would be counter-productive, and may impede the development of a centre of excellence in the monitoring of Crown entities with significant social policy obligations

***New Zealand Fire Service Commission***

39. The New Zealand Fire Service Commission aims to prevent and to mitigate the harms of fire. It is the employer of the Fire Service. Services are funded almost entirely through a levy on house and contents insurance. The Crown has a $181 million investment in the Commission, to go with its significant public policy interest in fire prevention.

40. The Commission is fully third-party funded, but the Government has the ability to set performance measures for it through formal directives and the Statement of Intent. Since the Commission's revenue is collected primarily from a levy, its expenditure is not effectively scrutinised by levy payers or their representatives. As a result, the Government has a key regulatory interest in it, which it exercises by setting the levy and controlling its revenue and expenditure.[3] This regulatory interest is equivalent to a purchase interest exercised by the Government on behalf of levy payers. The Government is effectively directly purchasing fire fighting capability and prevention services from the Fire Service Commission via a specific tax. As noted in the proposed Crown entity reforms, the Fire Service Commission is to be classified as a Crown agent.

41. The ownership interest in the Fire Commission is material but for monitoring purposes can not usefully be separated from its regulatory/quasi-purchase interest. As a result, the Review Team consider that the Fire Services Commission is excluded by criterion ii. from consideration for monitoring by a specialist ownership monitor such as CCMAU. We recommend the Department of Internal Affairs continue to monitor the Crown's interests in the Fire Service Commission. CCMAU agrees.

42. CCMAU is prepared, however, to assist the Department of Internal Affairs in establishing a more rigorous ownership monitoring regime of the Fire Service. This would be consistent with the Review Team's recommendations that there needs to be better networking between monitoring departments, and that CCMAU can play a leadership role in this by further developing itself as a centre of ownership monitoring excellence which other government departments could draw upon (see paragraph 84 below). The Review Team considers that Ministers could establish a better ownership monitoring regime for the Fire Service, and suggests that Ministers ask CCMAU to work with DIA, under a formal arrangement, for a period of up to one year, to assist DIA upgrade its monitoring capability.

### *New Zealand Symphony Orchestra Ltd (NZSO)*

43. The NZSO is a Crown owned company, but most of its revenue comes from the Crown (around 70%). Although it has artistic independence, the level of Crown funding and some key operational performance measures are decided directly by the Government – for example, it is

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[3] Its expenditure is controlled under section 45 of the Fire Service Act (1975).

required to play a certain number of concerts per year, and play a certain number in the regions.

44. The Government's key ownership interests in the NZSO are in its efficient operation, and in its ability to maintain its artistic credibility and financial viability over the long term. As a purchaser, the Government cares about maximising the quality of its performance, now and in the future, at least cost. Because there is no arms-length purchase contract, the Government as both owner and purchaser has merging interests in ongoing quality at least cost. Although approaching the overall interest from different perspectives is valuable, we do not consider that the purchase interest is sufficiently well defined and separable from the ownership interest to justify separating responsibility for monitoring them because it would lead to unnecessary duplication.

45. Therefore, the Review Team considers that the NZSO is excluded by criterion ii. As a result, we recommend that the responsibility for monitoring the NZSO Ltd should remain with the Ministry for Culture and Heritage.

### CCMAU Comment

46. CCMAU considers that transferring the ownership monitoring function would enable the Ministry to develop better output definition for the NZSO and improve the Government's purchase arrangement with the company. This separation would help provide clarity and transparency from the short term purchase/funding perspective and from the Government's long-term ownership objectives of retaining a world class cultural asset.

47. CCMAU therefore disagrees with the conclusion of the Review Team. NZSO is a financially fragile organisation, demonstrated by its financial challenges in the mid-1990s and by its frequent requirement for funding injections from the Government. For this situation to improve, the company needs to adopt a more business-like approach, and a strong ownership monitor will be required to both encourage and scrutinise its progress.

### *Museum of New Zealand Te Papa Tongarewa*

48. The Government purchases museum services from Te Papa, provides a significant part of its revenue (over 50%), and has some decision rights over its service performance measures. The Government has a sizable interest in Te Papa's collections and buildings. However, this

interest is not primarily financial but cultural, and for philosophical reasons it delegates decisions about managing that cultural interest to the board, although the Government retains that interest and residual levers to manage it.

49. The Government has an ownership interest in the efficient management of its operations, and the effective care of its cultural assets. The first is tied closely to its purchase interest in getting the right output at least cost for ongoing viability. The second is closely tied to its public policy interest in preserving and promoting New Zealand's cultural heritage. Like the NZSO, while there is value in examining the performance of Te Papa from both ownership and public policy/purchase perspectives, we do not consider that the separate interests are sufficiently well defined or separable to justify separate monitoring. Both ownership and purchase monitors would be examining Te Papa's cost-effectiveness and long-run capability.

50. Therefore, the Review Team considers Te Papa is excluded by criterion ii. Consequently, we recommend that responsibility for monitoring Te Papa should remain with the Ministry for Culture and Heritage.

### CCMAU Comment

51. CCMAU disagrees that the Government's separate interests cannot be defined to justify separate monitoring. On the contrary, CCMAU considers there would be real benefit in transferring the ownership monitoring function because it would provide greater clarity and transparency over the differences in the Government's interests. The Crown is not the only source of revenue for Te Papa – it raises significant revenue itself from various commercial activities. It is clear however that currently there is no well-defined purchase contract between Te Papa and the Government. By transferring the ownership monitoring to CCMAU, the Ministry would be able to concentrate on the purchase contract and better output definition, while at the same time there would be an enhanced ownership monitoring focus from CCMAU.

### *Tertiary Education Institutions (TEIs)*

52. The Tertiary Ownership Monitoring Unit (TOMU) of the Ministry of Education monitors all 38 publicly owned TEIs, and several education Crown entities. TOMU is separated from the policy/funding units by a "Chinese Wall", but it still reports directly to the tertiary group manager. This means that conflicting advice from the Ministry's tertiary policy/funding units and TOMU are mediated by the tertiary

group manager, rather than by Ministers (as would occur if the ownership monitoring was in a separate organisation). In CCMAU's view, there is a major conflict of interest in this arrangement."

53. Since students make purchase decisions, the ownership interest can be monitored separately from the purchase interest. (Criterion ii.)

54. It is also clear that there is a material entity specific ownership interest apart from the Crown balance sheet interest. That entity specific ownership interest encompasses:

- the Crown's public policy interest in the capability of TEIs for teaching and research; and
- the Crown's financial interest in TEIs' ongoing viability. (Criterion iii)

55. Although there is value in monitoring the entity specific ownership interest separately, other factors need to be considered. The Government does have different interests as funder from its interests as owner, but its policy interests have key linkages with its ownership and funder interests. There are both benefits and costs to co-locating the policy unit with the ownership monitoring unit.

***Benefits of Retaining Responsibility for Monitoring TEIs in the Ministry of Education***

- TEIs have unusual governance arrangements – Ministers do not appoint a majority of the boards, even though the Crown is effectively the economic owner of the assets. As a result, the Government has fewer levers for directly influencing TEI performance. The Review Team considers that the Ministry of Education, with a wider variety of relationships with TEIs, may be better placed to pull the few levers that exist than CCMAU. We note that this relationship between policy and monitoring units could be maintained across agencies, but it may be more difficult. CCMAU, on the other hand, considers that having two organisations pulling the available levers may be equally if not more effective than one.
- Information sharing between the policy and monitoring units is likely to improve both the policy and monitoring processes, since policy issues have ownership ramifications and vice-versa. The Review Team considers that this interaction will occur more easily within one department than between departments.

***Benefits of Transferring Responsibility for Monitoring TEIs to CCMAU***

- Against this, Ministers have to balance a conflict of interest if fair and neutral ownership advice were to be compromised by its implications for the Ministry's other advice. As a result, Ministers might not have the best possible information with which to make decisions.

- The Review Team also considers that CCMAU may provide better ownership monitoring advice because of its focus on ownership monitoring. Transferring a significant block of monitoring responsibilities, such as for TEIs, could also be significant enough to materially improve CCMAU's capability, though TEIs inherently non-commercial governance arrangements may limit the economies of scope that result.

56. If Ministers were to decide to transfer monitoring responsibility for TEIs from the Ministry to CCMAU, transition issues would also need to be considered. There could potentially be a marginal loss in quality in the short-term if some staff chose not to transfer. There would also be implications for monitoring arrangements for the other entities that TOMU monitors at present. It would be inappropriate for CCMAU to monitor some of these entities (e.g. NZQA), so there would likely be a drop in the quality of the monitoring of those education Crown entities if the Ministry lost TOMU.

57. This is a fine judgment. The TEIs meet criteria i. – iii. for being monitored by CCMAU, and in our view monitoring the TEIs from CCMAU is a feasible option. Feasible but not compelling. Ministers need to balance the benefits of avoidance of conflict of interest in monitoring the TEIs and potentially a stronger CCMAU long term, against the loss of leverage from the separation in a sector where Crown levers are few and far between. This at a time when Ministers may want to exert greater leverage than has traditionally been the case. The Review Team considers there is not a determinative case either way, and on that basis does not recommend any change from the status quo.

**Ministry of Education Comment**

58. The Ministry of Education agrees with the recommendation, but further notes that the Ministry does have effective systems in place to manage any potential conflict of interest. This includes divisional managers separately signing up respective advice to the Minister and, if required, personally appearing before the Minister to defend that advice. The

Ministry also considers that, in locating TEI ownership monitoring in a separate and specialised unit that is focussed solely on ownership monitoring in the tertiary sector environment, it has already achieved the benefits associated with centralised monitoring which CCMAU might offer, as well as maximising the synergies possible from co-location with policy advice.

**CCMAU Comment**

59. CCMAU considers that TEIs also meet criterion iv. There is a contradiction in the finding that the Ministry of Education currently has erected a “Chinese Wall” between TOMU and the policy/funding units, and the finding that there are benefits in co-location of those functions through information sharing between them, and that the Ministry is better placed to pull levers using both its policy and monitoring hats. If there is a genuine “Chinese Wall” in place, then transferring the monitoring function to CCMAU should not greatly affect the Ministry’s policy/funding advice. However, if there is no wall and information sharing and interaction does occur, then the Ministry has a serious conflict of interest: it is in the position of monitoring and advising on the effects of some of its own policy and funding advice and decisions. In both cases, in CCMAU’s view, the balance of the analysis of the criteria indicates that a separation out and transfer of the ownership monitoring function is desirable.

60. There is a further benefit from transferring TEI monitoring to CCMAU, alluded to in paragraph 55, derived from providing CCMAU with a greater mass from which to build up as a centre of excellence in ownership monitoring. A transfer of TOMU would increase CCMAU’s size by around 25 - 30%, and would certainly provide greater mass for growth in organisational quality. It is also worth noting that the loss of TOMU would not have a corresponding disadvantage on the Ministry’s critical mass.

61. CCMAU therefore concludes that the TEIs meet all four of the Review Team’s transfer criteria, and that moreover the addition of TOMU would bolster CCMAU’s ability to act as a centre of ownership monitoring excellence.

***Learning Media Ltd***

62. Learning Media Ltd is an educational publisher. The primary purchaser of its products is the Ministry of Education, although other customers now comprise 30% of Learning Media’s revenue, with this projected to increase to 50% over the next three years. At present, the Ministry of

Education has formal responsibility, with the Treasury, for monitoring Learning Media Ltd. However, in practice CCMAU has managed the board appointment process for over five years, and this year the Minister of Education has asked CCMAU to assist in the business planning round and undertake the routine quarterly monitoring.

63. The Crown has an investment of around $2.7 million in Learning Media. It also has an interest in maintaining its capability to deliver the products that its core customers want. Thus, it is clear that the ownership interest in Learning Media Ltd is material. (Criterion i.) It is also clear that this interest in the financial performance and organisational health of Learning Media is different from the Crown's balance sheet interest, and there is likely to be value monitoring it separately from the balance sheet interest. (Criterion iii.)

64. The Crown purchases products on behalf of New Zealand schools in a contestable market. The Ministry of Education purchases from other publishers as well as Learning Media. Learning Media however has a level of intellectual capital and capability related to the New Zealand Curriculum and the teaching and learning needs in New Zealand schools which surpasses other providers and is critical to the Ministry's strategy for supporting teaching and learning in schools.

65. As owner of Learning Media, the Crown is interested in:

- the ongoing capability of Learning Media to meet the Minister of Education's needs to ensure schools are able to teach effectively; and
- Learning Media generating an adequate return on the capital the Crown has invested in it.

The Review Team considers that the ownership interest and the purchase interest in Learning Media are sufficiently easily defined and separable to make separate monitoring of the interests worthwhile. (Criterion ii.) We note that a key part of monitoring Learning Media's organisational capability is ensuring that Learning Media is aligned to meet the Government's educational goals. CCMAU would need to invest some resource in understanding the relationship of Learning Media to the overall education learning and support strategy. Nevertheless, we do not consider that this requires skills over and above those of a business analyst – any monitor wants to be assured that a company, in a competitive market, is able to meet the needs of its customers.

66. We see no reason why CCMAU could not maintain skills and knowledge to monitor Learning Media. CCMAU would bring a greater depth of monitoring skills, and it would avoid the significant conflict of interest the Ministry faces at present as both purchaser and ownership monitor. Since CCMAU already has significant involvement in Learning Media, there are unlikely to be transitional costs, although there may be some funding implications. As such, we consider that the benefits of monitoring the ownership interest centrally outweigh the cost. (Criterion iv.)

67. We recommend that Ministers transfer formal responsibility for monitoring Learning Media to CCMAU. The Ministry of Education agrees.

***Accident Compensation Corporation (ACC)***

68. The Government has a variety of interests that it wishes to monitor in ACC:

- a direct purchase interest, for the Minister of Accident Insurance, in respect of the Non Earners' Account;
- a custodial interest in ACC's performance on behalf of motor vehicle owners, earners, self-employed and employers (for residual claims);
- a regulatory interest in ACC's compliance with the Accident Insurance Act 1998, and implementation of Government policy; and
- an ownership interest in the ACC and its performance as a Crown entity.

69. The actual assets owned and used by the ACC are small, and are substantially dominated by the net assets and liabilities associated with the Accounts managed by the Corporation. While the net assets and liabilities are recorded in the Crown Accounts, the Corporation in effect acts as a trustee as the schemes are generally fully funded from non-Crown revenues.

70. Controllable changes in the liabilities of the scheme reflect a variety of factors but significantly include both the extent to which ACC's performance is best practice (where Department of Labour negotiates a performance agreement, in effect on behalf of premium payers) as well as changes to the regulatory regime - many of which arise from learning about what matters for scheme performance.

71. The Review Team considers that effective delivery against the Crown interests in this area require strong interlinkages and that any classical ownership interest is either small or difficult to distinguish. As such the Review Team considers that ACC is excluded by criterion ii. The costs of identifying a separate ownership interest and transferring such responsibility to CCMAU would outweigh any potential benefits.

**CCMAU Comment**

72. CCMAU disagrees with this conclusion. ACC currently is responsible for managing an asset base of over $3.3 billion, with net liabilities of $3.5 billion. It has a clearly identifiable ownership interest, just as any other insurance company has. A small percentage change in the management of its ownership interest could generate significant benefits and savings. The net cost-benefit of improving ownership monitoring of the ACC would therefore be beneficial. CCMAU considers that this is more likely to occur in a specialist ownership monitor than in a small unit within a larger policy department with a significant conflict of interest.

***Housing New Zealand Corporation (HNZC)***

73. The Review Team also considered the optimal monitoring arrangements for the proposed new housing Crown entity Housing New Zealand Corporation, based on the role and structure of the entity as laid out in POL (00) M25/7.

74. Although we do not intend to make formal recommendations to Chief Executives on monitoring HNZC, we do lay out the reasons that lead us to support one option. We have conveyed our thinking to officials working on the Housing restructuring.

75. The Crown will have a variety of interests in HNZC, including:

- a public policy interest in the provision of housing to those in need;
- a purchase interest in the provision of policy advice and the administration of social assistance;
- a funder interest in the administration of Income-Related Rents and the Accommodation Supplement; and
- an ownership interest in the management of a portfolio of rental properties and financial assets, including mortgages.

76. Since the portfolio of rental properties is valued at more than four billion dollars, the ownership interest is clearly material. (Criterion i.)

77. It is also clear that the Crown has an entity specific interest in HNZC apart from the Crown wide interest, since the entity has considerable discretion over the way that it manages its assets. (Criterion iii.)

78. We consider that the key issue is whether the ownership interest can be adequately separated from the Crown's other interests. HNZC will have a variety of levers available to achieve the Government's housing objectives, and the ways in which it uses each of these levers will impact on its organisational performance. As a result, the Review Team considers that there will be a lack of clarity about what the Crown's ownership interest will be in HNZC, and so rigorous monitoring of the ownership interest, in isolation, may lead to outcomes contrary to the Government's overall interest.

79. For example, given the mechanics of the income related rents policy, HNZC can maximise the return on HNZ's equity (a clear ownership interest) by placing its lowest income tenants in its highest rental accommodation, and so maximising the rent supplement to the detriment of the Crown's purchase interest. A monitor of the ownership interest in isolation would be pleased by this result even though it would be a relatively inefficient way of managing the Crown's overall delivery of housing assistance. As a result, we do not consider that the various interests are sufficiently well-defined and separable to make separate ownership monitoring valuable. (Criterion ii.)

80. The potential for perverse incentives on the new HNZC led the Review Team to acknowledge that the purchase interest monitoring must be at least as strong as the ownership side. The Review Team considered that this is most likely at present to develop if the monitoring is integrated in an agency that is largely focussed on the overall performance of HNZC. This is more likely to happen, in the Review Team's opinion, within the Ministry of Housing than elsewhere. There was a concern that, given the small size involved, if the Ministry of Housing were responsible only for monitoring HNZC's purchase and policy performance, then it is unlikely that a strong purchase and policy monitoring capability would develop to counterbalance the ownership monitoring. By integrating all monitoring within the Ministry, however, the Review Team considers that it has a better chance of growing sufficient critical mass to be an effective monitor.

81. As a result, we consider that the costs of centralising the ownership monitoring of HNZC in CCMAU outweigh the benefits. (Criterion iv.) We note though, that at present the Ministry of Housing does not have any monitoring capability. Accordingly, it would be desirable for CCMAU to offer support to the Ministry of Housing in establishing its systems, and that the board appointment and governance processes should be managed on an ongoing basis by CCMAU on behalf of the Minister of Housing. As there will be an initial vacuum, the Review Team considers that CCMAU should assist the Ministry in its monitoring role for the first year of HNZC so that the Ministry build its capability. In practice, this is likely to mean that CCMAU continues to perform some of the monitoring functions over this period.

## Ownership Monitoring Across the State Sector

82. Apart from the TEIs the Review Team was able to come to a clear view on whether entities should or should not be monitored by CCMAU. With the TEIs we were not convinced either way and in the absence of a compelling case for change ended up with the status quo.

83. In the process of conducting this review, the Review Team made several observations about the nature and standard of monitoring in the public sector:

- The quality of Crown entity ownership monitoring across the public sector is variable.
- Quality is not necessarily directly and consistently related to size – some small units seem to be very effective, e.g. the monitoring unit in the Ministry of Culture and Heritage. However, size is more of a determinant when it comes to sustainability simply because a large unit is likely to be better placed to absorb staff changes and to retain institutional memory.
- The key determinant of quality ownership monitoring appears to be organisational commitment to quality ownership monitoring.
- Monitoring entities across the state sector would benefit from a more active network of monitors, assisting each other with technology transfer, and through better performers assisting poorer performers.

84. In light of these observations we reaffirm our view from phase one that, in the absence of CCMAU taking on significant additional

functions, there are some risks to the cost and quality of CCMAU's advice but it would continue to be effective.

85. The Ministry of Culture and Heritage monitoring unit is a good example of monitoring done well from a smaller base than CCMAU currently has. However, while an ownership monitoring unit can function effectively with few people, a bigger unit, better able to attract and retain strong management and staff, would inevitably be better placed to develop as a genuine centre of excellence, with the added benefit of increasing the independence and transparency of ownership monitoring advice.

86. We were also convinced that there is opportunity for better ownership monitoring across departments through better networking of monitors. Such a network could evolve with existing players maintaining their current responsibilities, but is more likely to evolve with a strong leader with a designated responsibility. CCMAU is the obvious candidate for this leadership role.

87. CCMAU's eventual size and resourcing will dictate the extent of the leadership role it can play in improving monitoring across other departments. While obviously a bigger unit would be more able to respond to that demand, CCMAU will move positively to assist and share expertise with other monitors even at its current size. This may be possible with a realignment of some of the surplus corporate resources which have arisen as a result of the transfer of the health monitoring function.

## Form and Location of CCMAU

### Form

88. As part of the Review, the Review Team was asked to consider CCMAU's form and location. At present, it is a semi-autonomous body (SAB) attached to the Treasury.

89. The role of CCMAU is that of a contracted advisor to shareholding Ministers. CCMAU's core objective is to provide advice to enable shareholding Ministers to hold Crown company boards accountable for their performance in maintaining and enhancing shareholder value, however 'value' is defined by the owner.

90. CCMAU monitors and advises on a wide range of issues, from ongoing financial viability to the internal health of the organisation. Essentially,

the Unit covers everything that contributes to the ability of the Crown company to deliver its goods and services in future years, in addition to monitoring the organisation's current performance. As part of this, it advises shareholding Ministers on the selection, appointment and performance of the directors of those Crown companies.

91. CCMAU's role requires it to develop and maintain a detailed knowledge of all the Crown companies monitored by CCMAU, including their operations and their markets.

92. In light of the Review Team's findings on scope we anticipate CCMAU will be a unit consisting of 14-17 staff. If TOMU were to transfer CCMAU would have a staff complement of 24-27 staff.

93. The Review Team considered four alternative forms for CCMAU: Crown Entity; separate department; semi-autonomous body and disaggregation into Treasury and SSC.

**Crown Entity**

94. We concluded CCMAU should not be a Crown Entity as its primary function is monitoring based policy advice and there is no need for it to be legally separate from the Crown.

**Separate Department**

95. The advantage of a separate department over a semi-autonomous body is that there is likely to be a greater degree of independence, with external perceptions that its autonomy has been enhanced. This means:

- Avoidance of any perception that CCMAU's advice could be tainted by influence from its parent department.
- Greater freedom to establish own culture.

The Review Team does not consider that there are any other advantages.

96. The disadvantages of a separate department are that a new small department would exacerbate state sector coordination difficulties that have in part been generated by a proliferation of small departments in the past.

97. This increase in 'whole of government' co-ordination costs would affect central agencies, Te Puni Kokiri and CCMAU. For example, SSC would have additional roles monitoring CCMAU's performance and appointing and reviewing the chief executive's performance. Departments also have greater reporting requirements than semi-autonomous bodies on the ownership side, so CCMAU would be required to produce departmental financial statements, a Departmental Forecast Report, and an Annual Report. Treasury would have to monitor an additional department's financial ownership performance.

98. Higher overhead costs in CCMAU could be off-set to a large degree by shared services arrangements.

99. CCMAU, SSC and Treasury consider a separate department would be more of an option if CCMAU reached a minimum size of around 30 policy staff. If CCMAU reaches a size of around 30, all three agencies consider that further work should be done to review the merits of establishing CCMAU as a separate department.

**Semi-Autonomous Body**

100. The advantages and disadvantages of a semi-autonomous body are:

*Advantages*

- Allows for provision of advice, independent of views of parent department, and the development of a separate culture and focus.
- Parent department can look after some corporate reporting requirements and provide support to offset lack of management depth due to small size of unit.
- Fewer 'whole of government' coordination issues.
- Lower cost than separate department.

*Disadvantages*

- Perception that advice of CCMAU tainted by influence of parent agency.
- CCMAU is vulnerable due to its dependence on its host for some support and services, and to the fact that its head is the parent's employee

101. The key differences between a department and a semi-autonomous body are that:

- the head of a SAB is appointed by the Chief Executive of the parent department, while the Chief Executive of a department is appointed by the State Services Commissioner under section 35 of the State Sector Act; and
- a semi-autonomous body has different accountability requirements.

102. CCMAU, SSC and Treasury consider a semi-autonomous body remains the most appropriate form for CCMAU provided it remains smaller than 30 FTEs. Concerns that CCMAU's advice could be tainted by the influence of the parent could be partially addressed by formalising a requirement for the parent department Chief Executive to involve independent parties in the performance review of the CCMAU Executive Director. The roles of the Executive Director and the Chief Executive should continue to be clearly understood. The parent's interest is in the strategic and financial direction of the SAB, its organisational health and long-term capability. It does not extend to operational matters.

## Location

103. With respect to location we considered attaching CCMAU to Treasury, SSC and the Department of Internal Affairs.

104. Treasury and CCMAU support the status quo. The benefits of attachment to the Treasury are:

- Good fit with the kind of ownership monitoring Treasury already does of departments and Crown companies.
- Good cultural fit between "commercial" CCMAU and "economic and financial" Treasury.
- No transitional costs. CCMAU note that there would be significant staff losses in key areas if they were transferred to the SSC.

105. There is a risk of the Executive Director being in conflict with his employer if he tenders advice that conflicts with that of the Secretary of the Treasury. The Review Team and CCMAU note that this conflict can continue to be managed through separate, direct purchase agreements with Ministers, through documenting respective obligations in the employment contract and job description and

through the suggested external input into the review of performance. The Review Team also notes that the same potential conflict would occur with SSC, although possibly less frequently.

106. The benefits of relocation to SSC are:

- There are synergies between CCMAU's and SSC's ownership monitoring roles, particularly non-financial aspects of ownership.
- There are also synergies with SSC's emerging role in the broader state sector particularly if CCMAU's role in non company board appointments was expanded as part of the Crown Entity Reform.
- Location in SSC poses fewer risks of conflicts of interest as CCMAU is an alternative source of advice to the Treasury on Crown companies.

107. SSC's view is that by relocating CCMAU the Government has a strategic opportunity to start to reposition its relationship with companies in the broader state sector. If Minister wishes Crown companies to maintain their principal focus on financial performance, then Treasury remains the logical host, particularly given the risk of further CCMAU staff losses. If, on the other hand Minister wants to develop a wider ownership relationship with the Crown companies, then SSC would be a better longer term host.

108. Treasury and CCMAU consider that maintaining a strong commercial focus is critical to ensuring good performance. Ministers have taken steps recently, using the Standards Board, to convey the Government's expectations to company boards in a way that is consistent with the legal environment the companies work within. Companies are inherently different from the rest of the state sector, and they are constrained by a well-developed legal framework. For these reasons, company boards need to retain sufficient independence from Ministers to exercise the functions required of them by the Companies Act and the SOE Act (1986). If CCMAU is transferred to SSC, Ministers may send signals to boards that make it harder to recruit high-quality directors. This may also have implications for the Government's credibility with the wider commercial and financial sector.

109. The Review Team does not consider that the Department of Internal Affairs is a logical place for CCMAU since there are few synergies between the roles of the two agencies. We do not consider that the Department would be best placed to nurture CCMAU's capability.

### Disaggregate CCMAU into SSC and Treasury

110. If CCMAU is disaggregated, we consider that the most sensible option is to transfer the ownership monitoring unit into the Treasury, and transfer the appointments unit into SSC as a shared services centre.

*Advantages*

- Marginally lower cost.
- Avoid potential for duplication.

*Disadvantages*

- Ministers will receive advice from Treasury and companies only.
- It may be harder to maintain a focused monitoring culture in a multi-function department than in a specialist monitoring agency.
- Greater distance between monitoring and appointments function would reduce the effectiveness of both activities.
- Possible loss of staff and institutional experience.

111. We consider that the synergies between the governance and monitoring functions outweigh lower costs, so this option was discarded.

### Conclusions

112. The Review Team and CCMAU recommend that CCMAU remain as a semi-autonomous body, provided it is smaller than 30 FTEs. If it gets bigger than that, further work should be done to examine the costs and benefits of establishing it as a separate department.

113. Treasury and CCMAU recommend that CCMAU remain attached to Treasury. SSC recommends transferring CCMAU to SSC if the Government wants to reposition its relationships with companies in the broader state sector.

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