

# The Treasury

## Expectations for Investment and Asset Management in the State Services Information Release

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### Cabinet Document Details

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Chair, Cabinet Economic Development Committee (DEV)

## **Expectations for Investment and Asset Management in the State Services**

### **Proposal**

1. This paper seeks Cabinet approval to replace Cabinet Office circular CO(15)5 *Investment Management and Asset performance in the State Services* with a new circular that reflects the Government's policy and expectations for the management of capital assets and investments.

### **Executive Summary**

2. For over 20 years, successive governments have set out in Cabinet Office circulars their expectations about the way departments and most Crown entities will manage capital assets and investments. The current circular was published in mid-2015.
3. Cabinet expectations add an important operational and system dimension to the financial management and stewardship responsibilities set out in law, including the Public Finance Act, the State Sector Act and the Crown Entities Act.
4. It is timely to update and replace the current circular to reflect two important changes in policy and practice under this Government. The first of those is the establishment of the New Zealand Infrastructure Commission, Te Waihanga (NZIC). The circular helps Ministers and agencies understand the NZIC infrastructure strategy and investment support roles alongside those of other system leaders.
5. The second important change is the Government's intention to apply a wellbeing approach to all its activity including its investments. The new circular places much more emphasis on the importance of delivering intergenerational value from government assets and investments, as well as clarifying expectations for how agencies should work together on investments.
6. In addition to accommodating those changes the new circular has been streamlined in several respects, for example by removing some detailed content and making this available to agencies on the Treasury or State Services Commission (SSC) websites.
7. While these changes future-proof the new circular to some extent, it may still be necessary to take a more fundamental look at the circular within 12-18 months depending on, for example, the outcome of changes in relevant state sector legislation or the Treasury's public finance system work programme.
8. Subject to Cabinet agreement, the new circular will take effect on 1 October 2019, or on a date to be determined by the Minister of Finance taking account of the establishment date for the NZIC.

## Background

9. Government departments, Crown entities and Schedule 4A companies manage an estimated \$133 billion worth of property plant and equipment assets and software assets, equal to 39% of total assets on the Governments forecast balance sheet at June 2019. In that financial year, these agencies planned to spend over \$8.0 billion on capital expenditure, equal to 78% of total government capital expenditure in 2018/19.<sup>1</sup>
10. The quality, quantity and composition of these assets and new investments have significant implications for New Zealand's economic performance, public services and resilience. That means the quality of investment management is vital to maintaining New Zealanders' wellbeing now and in the future, and it explains why the Government is committed to ensuring investment management and asset performance practices are fit-for-purpose.
11. The existing Cabinet Office circular on investment and asset management was published in 2015. Its scope covers capital expenditure, asset disposals, lease arrangements, "software-as-a service" type of procurements, and asset performance. It sets out Cabinet's broad expectations for how the system should work as well as specific requirements to ensure the system works effectively.
12. The circular has a wide reach as it applies to all departments, Schedule 4A companies and most types of Crown entities.<sup>2</sup> The circular does not apply to State-owned enterprises or mixed-ownership model companies.
13. The existing circular has generally worked well but it now needs to be updated to reflect the establishment of the NZIC and to convey new system-wide expectations for investment and asset management practice, particularly on the wellbeing approach.

## Comment

### *Recognising the roles of the NZIC in the investment system*

14. The new circular recognises the roles of the NZIC in the investment management system. Cabinet has previously agreed that the NZIC will have important roles in promoting a strategic and co-ordinated approach to the delivery of current and proposed infrastructure projects.<sup>3</sup>
15. The new circular echoes the requirements set out in the Government Procurement Rules that come into effect on 1 October 2019. Rule 64 explains that agencies that are developing any proposals for investments in infrastructure with whole of life costs in excess of \$50 million must consult with the NZIC early in the development process and must follow the NZIC's published procurement guidance.<sup>4</sup>

1 According to the 2019 Budget Economic and Fiscal Update.

2 Crown agents, Autonomous Crown entities, Independent Crown entities and Crown entity companies, including Crown Research Institutes. The scope does not include Universities, Tertiary Education Institutions, School Boards of Trustees, Offices of Parliament, or the Reserve Bank.

3 Infrastructure is defined in the new circular and in Government Procurement Rules as "fixed, long-lived structures that facilitate economic performance and wellbeing".

4 Whole of life costs is an economic concept that requires the agency to consider the downstream economic costs as well as the initial economic costs of the investment proposal.

16. The circular also makes clear Cabinet's expectation that:
  - 16.1 agencies should evaluate innovative and non-traditional approaches to procurement and alternative financing arrangements, and follow the NZIC guidance on those matters, and
  - 16.2 Cabinet must be involved in approving any innovative or non-traditional approaches to procurement, alternative financing arrangements or Public Private Partnership (PPP) investment proposals.<sup>5</sup>
17. These general policies will apply to all sectors, noting that Government policy precludes initiating the use of new PPPs in the health, education and corrections sectors.

*Reinforcing the Government's wellbeing approach*

18. The update provides an opportunity to convey the Government's wellbeing approach through Cabinet's investment management expectations. The circular addresses this in two ways:
  - 18.1 by making the purpose of the policy (and the investment system) more explicitly focused on delivering intergenerational value over time, and
  - 18.2 by refreshing system expectations to reflect the way the Government wants the system to work in future.
19. The current circular has three system objectives: optimising value, running an efficient system and setting up investments for success. In 2015 these objectives needed equal emphasis given the breadth of changes to the system at that time.
20. However, the wellbeing approach and the Treasury's living standards work have changed the way we think about value, and it is appropriate to reinforce this broader approach to value in the circular.
21. Accordingly, the circular makes clear that the primary objective of the investment management system is:

*"to optimise value from new and existing investments for current and future generations of New Zealanders"*

<sup>5</sup> Public Private Partnership (PPP) refers to a form of procurement based on a long-term contract for the delivery of a service, where the service involves the construction of a new asset or enhancing an existing asset. The project is privately financed on a non-recourse basis and full legal ownership is retained by the Crown.

22. The new circular states that value means the net fiscal, economic and wellbeing benefits of an investment proposal over its life cycle. In the investment system context value should take account of five performance dimensions:<sup>6</sup>
- 22.1 Effectiveness – the extent to which the asset or investment delivers the required level of service in support of the Government’s wellbeing priorities.
- 22.2 Efficiency – the extent to which the asset or investment makes best use of resources to deliver the required level of service, while minimising negative impacts.
- 22.3 Sustainability – the extent to which the asset or investment is able to deliver required levels of service for present and future New Zealanders.
- 22.4 Resilience – the extent to which the asset or investment can participate in, absorb, accommodate, or recover from the effects of an event in a timely and efficient manner.
- 22.5 Adaptability – the extent to which an asset or the investment can respond to long term *trends, new technologies or changes in the way services need to be delivered.*
23. While seeking best value from its assets and new investments, the Government still expects agencies (and the investment management system as a whole) to work in an efficient and effective way.
24. The high-level system expectations emphasise good investment management practice. They also reflect the Government’s expectations about the way agencies should work together when developing and delivering investments. The new circular includes two particular system expectations of all parties covered by the circular, linked to the Government’s wellbeing approach:

*“parties work across government to develop, assess, and implement investments that improve wellbeing for New Zealanders”; and*

*“parties consider the needs of present and future generations of New Zealanders.”*

#### *Updates for changes in system governance roles*

25. Role clarity is important for the efficient operation of the investment management system. The current circular (CO(15)5) assigns system roles to Cabinet, the Treasury, and to an ad hoc group of investment ministers. The Government prefers to conduct its business through standing Cabinet committees rather than ad hoc committees and so the new circular removes references to investment ministers.
26. Currently, some of the system roles are being performed by a Cabinet committee, some by the Treasury by default, and some others are not being done at all. The new circular makes clear that system governance, investment strategy and performance oversight roles will be performed by Cabinet committees, while the Treasury will take over administrative roles related to standards setting and good practices.
27. In this respect the circular affirms the Treasury’s system leadership role, including for example the requirement that the Treasury will report on the performance of the system, review the system rules and processes and ensure guidance materials are fit for purpose.

<sup>6</sup> The Treasury defined and applied the five dimensions in its 2018 Investment Statement.

28. I consider this allocation of investment system roles makes appropriate use of Cabinet committee time and Treasury system stewardship capability. I intend to use the Government Administration and Expenditure Review Committee (GOV) to maintain a focus on this aspect of public finance system performance. This provides an appropriate forum for a series of discussions (and decisions when necessary) to shape strategic choices and follow up on the impact of investment decisions and system changes over time.

*Minor updates to clarify expectations and improve system administration*

29. Most of the other operational policy expectations in the circular are working as intended, are still appropriate and therefore should remain in place for the time being. In particular, I propose to make no changes to the general approval thresholds for departmental or Crown entity investments.
30. The new circular makes clear that Crown entity subsidiary companies are covered by the circular. This reflects current practice and corrects an omission in CO(15)5.
31. Some aspects of the circular have been future-proofed to a degree by, for example, removing some of the detailed content on long-term investment plans and on functional leadership roles. Specific Cabinet requirements will still be available to agencies on the Treasury or SSC websites.
32. This presentational change does not affect the Cabinet-approved mandates of functional leads. It simply makes it easier to update such material on websites compared with issuing a new circular, when or if Cabinet should agree to make changes in strategic planning and reporting expectations or changes in functional leadership roles.
33. In a similar vein, the circular includes small but important changes to clarify expectations relating to asset management and project assurance plans, and brings them into line with current practice.

*Scope for future updates*

34. It may be necessary to take a more fundamental look at the circular within 12-18 months, depending on the outcome of changes to state sector legislation, the Treasury's public finance system work programme and lessons from the Treasury's ongoing stewardship of the investment management system.

**Process for publishing the new circular**

35. Subject to Cabinet agreement, the new circular will come into effect on 1 October 2019. That aligns with the expected establishment date of the NZIC and the date when the new Government Procurement Rules will come into effect.
36. There is a small risk that the final form of the new circular needs to be amended to reflect policy changes that may arise between Cabinet approval of the new circular and the proposed go-live date. The New Zealand Infrastructure Commission Bill is due to have its third reading shortly.
37. I recommend Cabinet delegate authority to the Minister of Finance to make any necessary or minor changes to the circular that arise during this period.

## **Consultation**

38. The Treasury consulted with 24 investment-intensive departments and Crown entities, including Housing New Zealand, NZ Transport agency, ACC and 8 District Health Boards. It informed all other agencies affected by the circular.
39. Consultation with affected agencies revealed there is general support for the policy changes set out in the new circular. Agencies can see the alignment between the new circular and other system changes already underway.
40. A number of agencies indicated that they need further details on how the new arrangements between, for example, the Treasury, the NZIC and the Government Procurement functional leader will work in practice. Those parties are working together and with agencies to ensure the operating procedures are clear, workable and understood. There is a related need to ensure that key information websites are up to date so that Cabinet's intentions can be conveyed efficiently.
41. Several agencies expressed support for a comprehensive review of the policy settings in 12-18 months' time and offered suggestions for further improvements to the current system.

[33]

## **Financial Implications**

43. This paper has no financial implications.

## **Legislative Implications**

44. There are no legislative implications.

## **Regulatory Impact Analysis**

45. Regulatory impact analysis requirements do not apply.

## **Human Rights, Gender Implications and Disability Perspectives**

46. This paper has no human rights, gender or disability implications.

## **Publicity**

47. This paper invites Cabinet to delegate to the Minister of Finance authority to determine when the new circular will be published on the Cabinet Office website.

## **Proactive Release**

48. I propose to release this paper proactively in full at the same time as the new circular is published.

## Recommendations

49. The Minister of Finance recommends that the Cabinet Economic Development Committee (DEV):
1. **agree** to update and replace Cabinet Office circular CO(15)5 with the attached new Cabinet Office circular entitled *Investment Management and Asset Performance in the State Services*, that sets out Cabinet's updated expectations for the management of investments and assets;
  2. **agree** that the new circular will have the same scope and reach as CO(15)5 in terms of the types of agencies (including Crown entity subsidiary companies), the types of investments that are subject to this policy and the general approval thresholds for investment decisions;
  3. **agree** that the new circular be updated to reflect the following changes in Government investment management policy and practice:
    - i the establishment of the New Zealand Infrastructure Commission, Te Waihanga (NZIC), particularly its procurement-related advisory roles;
    - ii the practical application of the Government's wellbeing approach;
    - iii the preference to use standing Cabinet committees for system governance rather than an ad hoc group of investment ministers; and
    - iv that Cabinet must be involved in approving any innovative or non-traditional approaches to procurement, alternative financing arrangements or Public Private Partnership investment proposals.
  4. **note** that in other respects, the new circular conveys the same expectations as CO(15)5, modified only to clarify roles and future-proof aspects of the circular.
  5. **agree** that the new circular will be effective from 1 October 2019, or on a date to be determined by the Minister of Finance taking account of the start date for the NZIC; and
  6. **authorise** the Minister of Finance to:
    - i make any necessary changes to the circular between the date of Cabinet approval of the circular and the effective date of the new circular to ensure it conveys Government policy; and
    - v make administrative changes over time to maintain the currency of the circular, provided these are consistent with the intent of the circular.

[33]

Hon Grant Robertson  
Minister of Finance  
Date: