



# Occasional Paper No. 17

## Crown Entities: An Overview of SSC Developmental Work



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## Crown Entities: An Overview of SSC Development Work

### Summary

On 15 July 1999, the Minister of State Services announced the Crown Entities Initiative. The key points of the Initiative included:

- the need for clarification of the expectations of key players (Ministers, Departments, Boards etc);
- the need for provision of quality information on public sector ethos and practice through briefing and induction programmes and board appointment processes;
- the need to enhance oversight through better disclosure and monitoring processes; and
- the need to introduce legislation to address inconsistent governance arrangements.

Behind these announcements considerable development work had been undertaken by the State Services Commission (SSC). This paper provides an overview of this analysis undertaken by the SSC prior to the Minister's 15 July 1999 announcement. It is based on an address made by Derek Gill and Simon MacPherson on 16 July 1999, at Victoria University, Wellington, New Zealand.

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### Introduction

The work of the State Services Commission (SSC) on Crown entities has addressed four questions:

- What are Crown entities?
- When should these types of organisations be used?
- What governance and accountability regime would be most effective?
- What changes should be made to improve the status quo?

This paper is arranged around these four questions.

### Part A: What are Crown entities?

The State sector includes about 3000 organisations. Fewer than 50 of these are departments of State under the Public Finance Act 1989. An even smaller number (fewer than 20) are State Owned Enterprises under the State Owned Enterprises Act 1986. Most of the rest are classified as 'Crown entities'.

Thus, Crown entities is the name given to what essentially is a large residual category of state sector organisations that are neither departments nor State Owned Enterprises. The label 'Crown entities' does not describe a particular organisational form.

The notion of Crown entities is an artefact of the public management reforms in New Zealand in the 1980's. With the introduction of accrual accounting, the Government had to clarify what it actually "owned". A select committee reviewed a range of organisations, and those that passed certain tests were designated Crown entities and listed on the Fourth Schedule to the Public Finance Act 1989.

Each Crown entity is legally separate from the Crown, each has a Responsible Minister, and each must comply with some (predominantly financial) reporting obligations. Beyond that, Crown entities have little in common. As a result, there will be exceptions, perhaps many exceptions, to almost any statement made about Crown entities. For example, this paper will discuss boards, but while most Crown entities do have a board, some do not.

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<sup>1</sup> In addition there are some 48 statutory bodies such as the Reserve Bank and the Higher Salaries Commission, which the Crown in some sense 'owns', but which are not Crown entities listed in the Fourth Schedule of the Public Finance Act 1989.

<sup>2</sup> Plus caveats regarding subsidiaries, etc.

There are three key points to note about Crown entities in New Zealand:

- they are not new;
- their functions vary; and
- there is more diversity than unity.

### **Crown entities are not new**

The history of the State sector shows there always has been a large amount of Government activity performed by organisations that are not departments of State. Often these have been called *quangos*. The first wave of the public management reforms put some of these *quangos* that were trading organisations under the more disciplined, generic governance and accountability regime of the State Owned Enterprises Act 1986. The second wave of reform, implemented through the Public Finance Act 1989 and the State Sector Act 1988, brought greater clarity to departments. The *Crown Entities Initiative* announced on 15 July 1999 is the beginning of a third wave of reform to bring a more disciplined generic regime to the rest of the State sector.

### **Functions of Crown entities**

Government functions can be categorised as:

- policy making;
- regulation; and
- service delivery.

The Crown entity form is not suitable for an organisation if its primary function is to develop policy. Policy advice involves a degree of interaction with Ministers, which means the arm's-length relationship may be eroded and the role of the board may be undermined. Nevertheless, some Crown entities currently do have important policy development functions.

Regulation is the main function where legal separation from the Crown may be desirable. However, it does not necessarily follow that something that is a regulatory function must be carried out independently of a Minister – in fact Ministers themselves are often decision-makers in respect of some regulatory activities. Also, if a measure of independence is desirable this does not necessarily imply using an organisation outside the Crown. The relationship between a Minister and the department is structured in such a way as to preclude Ministers directing departments in respect of particular decisions (e.g. Serious Fraud Office, IRD and NZ Police).

Crown entities currently dominate government's service delivery. Constitutional considerations preclude the use of Crown entities in some sectors, e.g. Defence and Foreign Affairs. As a result, Crown entities are not the presumptive type of organisation for service delivery, but can be an appropriate form for service delivery functions when constitutional issues do not arise.

### More diversity than unity

The things Crown entities have in common are their separate legal identities, the fact they all have a Responsible Minister, and their financial reporting obligations under the Public Finance Act 1989. There is tremendous variation:

- *in what they do* – everything from quasi-judicial functions to commercial functions;
- *in their legal form* – companies, trusts, corporations sole, statutory corporations, other statutory bodies;
- *in their scope and size* – anything from Auckland Hospital, which has 5,000+ employees - through to entities with no employees (e.g. Road Safety Trust); and
- *in their relationship with the Responsible Minister* – this varies from extreme independence to a reasonably close degree of control.

The initial phase of the SSC's work aimed to make sense of this unity and diversity. Thereafter, the Commission's work focussed on two questions:

- *organisational design* – when should this type of organisation be used?; and
- *governance and accountability* – what sort of governance and accountability arrangements would best ensure these organisations were effective?

## Part B: Organisational design<sup>3</sup>

Governments have various ways of achieving their policy objectives, including regulation, taxes, transfers, subsidies, and the provision of services. Some ownership of organisations probably is necessary to allow effective decisions to be made about what policy objectives are to be pursued, and what means are used to achieve them. But beyond that, a government will have to choose whether or not to own the organisations through which its policy objectives are to be pursued, e.g. whether it provides services itself or contracts with others.

Thus, important though organisational design issues are, it must be acknowledged that they are subsidiary to some more fundamental issues. Once those more fundamental issues have been addressed, the simple, but key premise of organisational design choices is that “form follows function”. The first organisational design question is, should any particular function be undertaken by *inside* the legal Crown (by a Public Service department) or *outside* it (Crown entity, SOE or another sort of body).

If the answer to the first question is the latter and specifically ‘Crown entity’, the next question is ‘what sort of Crown entity?’ because Crown entities are not a uniform organisational form. Should it be a statutory corporation (e.g. a University), a company (e.g. hospitals) or a trust? And if a statutory corporation, should it have a close working relationship with the Minister

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<sup>3</sup> For a detailed discussion see: State Services Commission, *Organisational Design*, Occasional Paper No. 21, September 1999.

(similar to departments), should it be quite independent, or should it be somewhere in between?

In developing the framework for when this type of organisation should be used, the SSC developed three generic high level principles:

- effectiveness and efficiency;
- effective management of risks; and
- consistency with constitutional arrangements.

### **Effectiveness and efficiency**

Organisational design choices should be made to best achieve the Government's desired outcomes (i.e. effectiveness) and the least cost production of outputs (i.e. efficiency). Underneath those high level principles SSC has developed underpinning subsidiary propositions such as:

- If it is a commercial activity, use a commercial structure. In particular the SOE model is the presumptive form where profit is the primary objective, and the Crown Company model (akin to a private not-for-profit company) the preferred option if the primary goal is to maximise another objective.
- If the entity is charged with pursuing two or more significant and potentially conflicting objectives, then the presumptive form is a department.

### **Management of risk**

The second set of questions are around making organisational design choices that best manage contracting or other risks posed by the activities undertaken by Crown owned organisations. Our analysis suggests that if the contracting problems are significant, e.g. where it is difficult to specify, enforce and monitor contracts, then the departmental form is preferred. Similarly, where an entity exercises significant coercive power over citizens then the department is the preferred form. However where contracting is easier, but the SOE form is inappropriate, then there may be a case for a Crown entity (the Careers Service may be an example).

### **Constitutional considerations**

Finally organisational design choices should be made to best protect constitutional conventions and arrangements. The subsidiary propositions developed by the SSC distinguish between situations where the use of coercive power requires close Ministerial oversight and those where it can be managed at arm's-length. The case for independent Crown entities, where there is a need for independent and impartial decision making, is strongest where:

- the entity must act quasi - judicially for a significant part of its activities; or
- the Crown is subject to the entity's jurisdiction; or
- the entity has significant investigative functions.



A good example of an independent Crown Entity is the Commerce Commission – the antitrust regulatory body in New Zealand.

Regardless of the organisational design analysis, there is still a need for a robust governance and accountability regime. Part C of this paper will address those issues.

### **Part C: Governance and accountability regime**

There are three features of a high performing governance and accountability regime:

- clarity about the roles and responsibilities of, and relationships between, different parties;
- a quality governing body; and
- effective accountability arrangements.

#### **Clarity of roles and relationships**

One of the key lessons from the public sector management reforms in New Zealand, is the importance of being clear about the roles and responsibilities of different players. Prior to the *Crown Entities Initiative*, Ministers' roles and responsibilities were not well articulated. This is documented in the companion paper *Crown Entities: Roles of Ministers, Crown Entities and Departments*.<sup>4</sup> Moreover, some Ministers have received a high degree of support from the monitoring department, while others have received virtually none. As a result, clarifying the roles and responsibilities of Responsible Ministers and strengthening departmental monitoring and support was an important part of the package of guidance material approved for issuing on 23 August 1999.<sup>5</sup>

#### **Quality of governing bodies**

A quality board selection, induction and review process is a crucial governance lever. The companion paper *Crown Entities: Board Appointments and Inductions*<sup>6</sup> suggests that the Crown has not consistently employed good processes for making appointments. And in the absence of a robust induction process, new board members were often left unclear about the constitutional requirements of working in the State sector and about their roles and responsibilities. Accordingly, a briefing programme is to be rolled out for new Board members from October 1999.

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<sup>4</sup> State Services Commission, *Crown Entities: Roles of Ministers, Crown Entities and Departments*, Occasional Paper No. 18, September 1999.

<sup>5</sup> State Services Commission's website refers: <http://www.ssc.govt.nz>.

<sup>6</sup> State Services Commission, *Crown Entities: Review of Board Appointment and Induction*, Occasional Paper No. 19, September 1999.

### Effective accountability regime

There are a number of problems with current accountability instruments because the Public Finance Act 1989 sets out a financial reporting regime, not a comprehensive accountability regime. In some cases, legislation specific to an entity fills out the details, but the coverage is patchy, and there are significant inconsistencies. The companion paper *Crown Entities: Review of Statements of Intent*<sup>7</sup> suggests a mixed pattern in the use of statements of intent – the key accountability document from the Executive to the Legislature.

## Part D: Next steps

### So what are the next steps?

The Government's strategy to improve Crown entity performance has three key elements:

- improving governance and accountability arrangements within the existing legislative framework;
- articulating some organisational design principles to shape future use of different types of Crown entity; and
- addressing legislative gaps through a Crown Entities Bill.

On 15 July, the Minister of State Services announced the *Crown Entities Initiative*. In part this drew on the analysis set out in the companion papers. What the *Initiative* makes clear is that there is much that can be done within the current legislation to make the existing framework work better, that is improving governance and accountability arrangements. This includes: guidelines; strengthening the processes for the selection, briefing and induction of board members; clarifying roles and responsibilities, especially of Ministers and departments; and making better use of the existing accountability instruments.

In addition to this work, it is necessary to further articulate the criteria for when the Crown entity form should be used. This will in turn allow for a more consistent approach to be taken to governance and accountability arrangements of the various types of Crown entity.

While there are gaps that can be filled within the existing framework through guidance material, training and support etc, the legislative framework for Crown entities also needs addressing. This is the subject of development work involving the SSC and a range of other agencies. The results and conclusions of that work will be presented in future SSC Occasional Papers.

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<sup>7</sup> State Services Commission, *Crown Entities: Review of Statements of Intent*, Occasional Paper No. 20, September 1999.