THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Proposed Reform of the Public Finance Act 1989

Date:	16 December 2011	**Report No:**	T2011/2449

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Agree** to recommendations	Friday, 23 December 2011
Associate Minister of Finance (Hon Dr Jonathan Coleman)	**Note** the recommendations	Friday, 23 December 2011

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Andrew McLoughlin	Senior Analyst, State Sector Management, Treasury	Withheld under section 9(2)(a) of the Official Information Act		✓
Michele Lloyd	Manager, State Sector Management, Treasury	Withheld under section 9(2)(a) of the Official Information Act		

Minister of Finance's Office Actions (if required)

None.

Enclosure: **No**

16 December 2011 ST-2-2-0

Treasury Report: Proposed Reform of the Public Finance Act 1989

Executive Summary

This report summarises our near final proposals for reform of the Public Finance Act 1989 (PFA), and seeks your agreement to the package of proposals to be developed for Cabinet approval in the first half of 2012. The final proposals for changes to the PFA will depend on decisions taken on the report from the Better Public Services Advisory Group.

This report is being provided now, ahead of Cabinet papers in relation to the Better Public Services Advisory Group's report, in order to seek your views on the proposals for reform of the PFA in time to develop final proposals for progression in a 2012 Bill. This report should be read in conjunction with the joint Treasury and State Services Commission (SSC) report discussing changes to the State Sector Act 1988 (SSA) and PFA to accommodate alternative organisational forms (T2011/2514 refers).

The review of the PFA is one of several initiatives to enable more collective, strategic and effective management of government resources. The overall goal is to focus the central government sector on continuous improvement and on improving the information provided to Parliament. The objectives of the PFA review are:

- to make changes to the Act in line with the work of the Better Public Services Advisory Group;
- to generate better quality information that meets the strategic management needs of managers and their Ministers and the accountability needs of Parliament;
- to reduce the compliance costs involved in producing that information;
- to remove unnecessary barriers to different ways of working and innovation within the executive branch of government;
- to improve clarity around departmental chief executives' responsibilities for strategic financial management and stewardship; and
- to protect and strengthen the principles of parliamentary authority and accountability to Parliament.

We are proposing changes to the Act in the following 4 areas:

- modifying the types of appropriations, in particular to allow an output expense appropriation to be for a purpose or a result;
- enabling alternative administrative units within the legal Crown to administer and be accountable for appropriations (T2011/2514 refers);
- specifying the strategic financial management and stewardship responsibilities of departmental chief executives rather than signalling them by way of reporting requirements; and
- stripping back the reporting requirements specified in the Act to those required for accountability to Parliament, leaving the reporting required to manage within the executive branch of government to be specified in other ways.

At the same time as developing the legislative reform proposals, Treasury, SSC, DPMC and the Office of the Controller and Auditor General will also need to develop their own capacity and capability to provide a high level of support across the sector.

Further policy development work, consultation and testing is required in relation to some areas of reform discussed in this report. In order to introduce legislation in May 2012, to be enacted before the end of 2012, policy decisions will need to be made by the end of February 2012. This timeline allows very little time for consultation, particularly given the Better Public Services Advisory Group's report is not yet available to departments, which raises the risk of proposals being unworkable in practice or unacceptable to some stakeholders.

An alternative timeline would be for policy decisions to be made later in the first half of 2012, and for a Bill to be enacted by April 2013. This would not enable the changes to be implemented in the documents presented with Budget 2013. However, provided the amounts of imprest supply in the Imprest Supply Acts for 2013/14 were sufficiently large, the Better Public Services changes that require legislation could be implemented on a targeted basis to apply to selected areas for the whole of 2013/14 using Imprest Supply and the 2013/14 Supplementary Estimates.

As was undertaken with the Public Finance (State Sector Management) Bill in 2004, Ministers may wish to undertake pre-introduction consultation on the content of the Bill with other parliamentary parties. In addition, as required by Standing Orders (S.O.) there will be a need to obtain the agreement of the Business Committee to the Bill being introduced as an omnibus Bill [S.O.260] and, given the recent change to Standing Orders, consultation with the Business Committee on the structure of the Bill [S.O.297]. Further, section 18 of the PFA requires consultation with the Finance and Expenditure Select Committee (FEC) in the event of a proposal to significantly change the format or content of the Estimates, the Information Supporting the Estimates, or the Supplementary Estimates (possibly best done at the same time as FEC is considering the Bill).

Recommended Action

We recommend that you:

a **Note** that, if you agree to the recommendations below, we will further develop the proposed changes for reform of the PFA for submission to Cabinet in the first half of 2012.

Appropriations

Supporting a results focus

b **Note** that the Act currently provides that an output expense appropriation can be either for a single class of outputs or, if the Minister of Finance agrees, a multi-class output expense appropriation (MCOA).

c Agree to add a third option to enable an output expense appropriation to be for a specified purpose, provided that the Minister of Finance agrees, that the purpose is tightly specified, and that progress to achieving that purpose can be specified in a measurable way.

Agree / Disagree

Multi-class output appropriations

d **Agree** in relation to MCOAs:

i. to allow performance information for an MCOA to be at the appropriation level and not necessarily at the level of the component output classes as is currently required; and

ii. to review EXG Min (07) 1/1 to remove the requirement that proposed MCOAs in excess of $50 million need to be referred to ECC and to remove the default 10% limit on transferring resources between the component output classes of an MCOA without joint ministerial approval.

Agree / Disagree

Facilitating shared services arrangements

e **Agree** to widen the provision for department-to-department appropriations (section 20 of the Act) to enable it to be used where a department incurs expenses in providing shared services on behalf of other departments.

Agree / Disagree

Scrutiny and control of departmental capital expenditure

f **Note** that the permanent legislative authority (PLA) for departmental capital expenditure in section 24(1) of the Act does not impose a limit on departments' ability to incur capital expenditure and the net assets provisions in sections 22 and 23 of the Act do not enable effective scrutiny or control over departmental capital.

g **Direct** officials to develop solutions to these problems so as to enable appropriate control by Parliament over departmental capital and to ensure Ministers can limit departmental capital expenditure.

Direct / Disagree

Departmental reporting to Parliament

h **Note** that the detailed reporting requirements currently specified in the PFA attempt to cover not only the reporting required for Parliament but also the more detailed reporting needed by Ministers, and also to signal the financial management competencies required of departmental chief executives and their departments.

i Agree that the reporting requirements specified in the PFA should be limited to the reporting required for Parliament.

Agree / Disagree

j **Note** that recommendation (i) means that the more detailed reporting required within the Executive will need to be specified in other ways such as Treasury Instructions, circulars or guidance, or possibly Cabinet Office Circulars.

k **Agree** that service performance reporting be based on appropriations and comprise reporting on what has been delivered and/or the results that have been achieved.

Agree / Disagree

l **Agree** that the requirements for the Annual Report be changed so it reports on past performance and future strategy, and that departments no longer prepare a Statement of Intent.

Agree / Disagree

m **Note** that, to give more tailored and meaningful reporting to Parliament, the following changes to the PFA are indicated, subject to further consultation and testing:

i. the Information Supporting the Estimates to provide for each output expense appropriation information on:

- the evidence which will be used to demonstrate what has been achieved and/or delivered as a result of the appropriation;
- who will report on the appropriation at the end of the year; and
- in which document the reporting will appear.

ii. annual reporting to include for each output expense appropriation information on what has been achieved and/or what has been delivered as a result of the appropriation and the resources that have been used;

iii. the content of the Annual Report to include:

- information on the department's future strategy, covering at least a three year period, including how the agency will manage its capability; and
- the department's projected financial statement for the current year and associated assumptions.

iv. enable the Minister of Finance to exempt from performance reporting output classes which are insignificant; and

v. remove the requirement for departments to provide that portion of the information on future operating intentions currently provided in departmental Statements of Intent.

Agree / Disagree

n **Note** that Treasury and Office of the Controller and Auditor General will work with the External Reporting Board to facilitate the further evolution of Generally Accepted Accounting Practice (GAAP) to support more tailored reporting.

o **Note** that further development of the changes to the departmental reporting framework proposed in this report is required.

p **Direct** officials to consult with stakeholders in early 2012 in order to fully develop the departmental reporting proposals.

Direct / Disagree

Chief executives' strategic financial management and stewardship responsibilities

q **Agree** that the strategic financial management and stewardship responsibilities of a departmental chief executive, including those in relation to non-departmental appropriations administered by the department, should be specified directly in legislation rather than signalled indirectly by way of reporting requirements.

Agree / Disagree

r **Note** that an initial formulation of the strategic financial management and stewardship responsibilities of a departmental chief executive proposed to be included in legislation is:

i. ensuring that the services intended to be provided or results intended to be achieved from departmental appropriations administered by the department are provided or achieved in an efficient way;

ii. ensuring that the assets and liabilities held by the department and the non-departmental assets and liabilities administered by the department are managed efficiently and sustainably;

iii. monitoring whether the services intended to be provided or results intended to be achieved from non-departmental appropriations administered by the department are provided or achieved in an efficient way and, where this is not the case, advising the Minister responsible for each such appropriation, recommending remedial action; and

iv. monitoring and advising on the longer term strategy for, sustainability of, and capability to be achieved from, the appropriations administered by the department.

s **Note** that the strategic financial management and stewardship responsibilities of departmental chief executives will, with necessary modifications, need to apply to the proposed alternative administrative units within the legal Crown, particularly those that are to be responsible for administering appropriations.

A bigger role for central agencies

t **Note** that a sizable central agency commitment will be required to handle the implementation, monitoring and support phases of both the Better Public Services work and legislative reform, involving the central agencies devoting sufficient resources and working closely together to ensure the reform of the State Sector Act 1988 and the Public Finance Act 1989 beds down in as seamless a manner as possible.

Crown Entities

u **Note** that:

i. changes to the Crown Entities Act 2004 are needed in light of the proposed changes to the reporting framework for departments;

ii. as Crown entities are separate legal entities from the Crown, the Crown Entities Act needs to provide for the more formal relationship between Ministers and Crown entities;

iii. other changes to the Crown Entities Act (e.g. changes to the responsibilities of boards in relation to strategic financial management) may be desirable but require further investigation and consultation.

v **Direct** officials to consult with chief executives and chief financial officers of Crown entities in early 2012 in order to further develop the proposals with respect to Crown entities.

Direct / Disagree

Technical and drafting issues

w **Note** that officials will be considering a number of technical and drafting issues with respect to the Public Finance Act and the Crown Entities Act and will report to you in the first half of 2012 with specific proposals.

Michele Lloyd
Manager, State Sector Management

Hon Bill English
Minister of Finance

Treasury Report: Proposed Reform of the Public Finance Act 1989

Purpose of Report

1. This report summarises progress to date on the review of the Public Finance Act 1989 (PFA) and seeks your agreement to the package of proposals to be developed for Cabinet approval in the first half of 2012. This report should be read in conjunction with the joint Treasury and State Services Commission (SSC) report on changes to the State Sector Act 1988 (SSA) and PFA to accommodate alternative organisational forms (T2011/2514 refers). A paper on implementation options for the delivery of state sector reform initiatives (including changes to the PFA) is due to be provided to Cabinet in January 2012.

2. The review of the PFA is being carried out in two parts. The first covers the fiscal responsibility provisions in Part 2 of the Act. You have already received a report on this part (T2011/2420 refers). The part of the PFA review discussed in this report covers the rest of the Act, particularly Parts 1 (appropriations) and 4 (relating to reporting requirements).

Background

3. The review of the PFA is one of several initiatives to enable more collective, strategic and effective management of government resources. The overall goal is to focus the central government sector on continuous improvement and on improving the information provided to Parliament.

4. Initiatives so far include:

   - Four-year Budget Plans and triennial Statements of Intent (SOIs) for government departments (a longer term, more strategic focus and reduced annual compliance costs);
   - shared services initiatives (reducing cost and improving effectiveness through collaboration);
   - sectoral strategies (improved effectiveness through collaboration and strategic focus);
   - capital asset management (better management of investments and resources); and
   - the work of the Better Public Services Advisory Group (which brings a lot of these themes together).

5. Creating a focus on continuous performance improvement requires good information on financial and non-financial performance. The production and reporting of this information is currently prescribed by the PFA and Crown Entities Act 2004 (CEA). Agencies, commentators, Ministers, and the Auditor General have expressed concerns about some of the requirements in these Acts, particularly regarding the quality of the information produced by agencies, the cost of meeting the reporting requirements, and that the focus on detailed annual reporting by each agency inhibits cross-agency initiatives.

6. Following the meeting between the Auditor-General and the Cabinet Expenditure Control Committee (ECC) in August 2011, the Treasury, SSC, and the Office of the Controller and Auditor General (OAG) have been working together on ways in which the legislation could be changed to support more effective collective management of government resources, while preserving appropriate parliamentary control of government spending and accountability.

7. A point that needs highlighting at the outset is that, although legislative reform is needed to enable a number of the changes sought, it will not change behaviour or capability on its own. Much of what is proposed here is about removing impediments and simplifying requirements to facilitate more effective management of resources within the Executive. Practical gains will be made by developing the central government sector's internal systems and capability for managing organisational performance.

Aims

8. This part of the PFA review has two aims:

- to ensure the PFA can accommodate the potential changes discussed by the Better Public Services Advisory Group; and
- to generally improve the legislation to ensure it is flexible and fit-for-purpose over time, to achieve the following objectives:
    - to generate better quality information that meets the strategic management needs of managers and their Ministers and the accountability needs of Parliament;
    - to reduce the compliance costs involved in producing that information;
    - to remove unnecessary barriers to different ways of working and innovation within the executive branch of government;
    - to improve clarity around departmental chief executives' responsibilities for strategic financial management and stewardship; and
    - to protect and strengthen the principles of parliamentary authority and accountability to Parliament.

What scope is there for change?

9. We are seeking to change the legislation to support more effective collective management of government resources while preserving appropriate parliamentary control of government spending and accountability. The core principles and the room for change that we have identified are summarised in the following table:

Core principle	Scope for change
Appropriations	
Parliament gives spending authority to the Crown as a whole	There is scope to explore different ways of allocating administrative responsibility for funds within the Crown: an appropriation doesn't intrinsically have to be just for the work of a particular department
The authority must be at a level of detail that gives meaningful control	Most appropriations are currently for "a class of outputs", but there may be other ways of describing the scope (e.g. purpose or activity) to provide sufficient control while focusing on particular government objectives
Parliament must be provided with good information in support of the requested appropriation on what the money is for and how it will be monitored	The current system requires the information supporting the estimates and an SOI for each organisation. There is scope to explore how to simplify the information provided. In particular, there is a question about the usefulness of the SOI
Reporting to Parliament	
The Crown must report back to Parliament on its use of public funds	The principle is a whole of government one – there is scope to change who reports on which areas so long as the information is still provided in an easily understood and accessible form, and there is a responsible Minister to answer questions
Reporting should be on financial and non-financial performance	Both sets of information are important, but we need to explore how to connect the two better, and how to get more meaningful information on what has been achieved
The information reported should be prepared in accordance with independently set standards (GAAP) and audited	Both are desirable if the information is to have credibility, but there is a need to ensure that the GAAP and audit disciplines support good quality information
Parliament also needs reports from, and the chance to scrutinise, individual central government organisations from a "stewardship/ownership" perspective	There may be scope to reconsider the focus of financial reviews and make them more meaningful

Managing within the Executive	
In constitutional terms the Crown is a single organisation governed by Ministers, and departments are responsible to Ministers	There is scope to explore more use of internal management levers rather than legislation to change systems, behaviour and information flows, and to vary levels of responsibility for decision-making as well as organisational structures
Chief executives (CEs) take primary responsibility for departmental management (including financial management) on behalf of Ministers	There is scope to expand and clarify expectations on what this role involves and what CEs should be doing, both through greater legislative prescription and more detailed subordinate instructions or expectations (e.g. Treasury Instructions; Cabinet Office Circulars etc)
The relationship with Crown entities	
Arms length from Ministers	The SOI at present doubles as a forecasting and planning document and a mechanism for Ministers to exercise formal influence over the direction of a Crown entity. There may be better ways of achieving both
Reporting to Parliament	Given Crown entities are generally separate legal entities from the Crown, details of the relationship between Ministers and Crown entities need to be specified in legislation. Further work is needed to determine the extent to which the changes being proposed for departments can be applied to Crown entities
The entity manages its own organisational resources	Ministers cannot direct Crown entities in the same way as departments on standards of management, but there may be other ways of better communicating expectations on management of public resources and performance

Proposed changes to appropriations (Part 1 of the PFA)

10. Consideration of reform of the PFA needs to start with changes to how appropriations are made, because the way in which spending is authorised drives a lot of the accounting, managing and reporting activity. The discipline of separate appropriations for each department and each class of outputs encourages transparency about cost allocation, as well as improving accountability, but this discipline can make it administratively cumbersome for departments to work collaboratively and flexibly. The aim of reforms here is to remove those administrative barriers to sensible ways of working, while preserving transparency and accountability.

Appropriating for results

11. Aggregating outputs by 'purpose' would facilitate a focus on results, as discussed by the Better Public Services Advisory Group. We recommend that the aggregation of outputs by 'purpose' (as well as 'similarity of output') be allowed where Ministers wish to delegate to a department (or other organisational form), Crown entity or third party the authority to select the outputs to be delivered to achieve a specific, measurable result or purpose (supported by clear and verifiable performance measures).

Multi-class output appropriations

12. We recommend that changes be made to multi-class output appropriations (MCOAs) so they can be used more often as a tool for flexibility in how funding is managed. In particular:

- Change the requirements under EXG Min (07) 1/1:
  - To remove the requirement that MCOAs in excess of $50 million must be referred to ECC; and
  - To raise the current 10% limit with respect to the amount of funding that can be transferred between output classes in a MCOA without joint Ministerial approval.
- Performance information should be allowed to be reported at the appropriation level, rather than being required at the level of the component output classes (legislative change).

Department to department appropriations

13. There is currently a lack of clarity about the ability of one department to incur output expenses on behalf of one or more other departments under the PFA. We recommend changing the PFA and related Treasury guidance regarding department-to-department appropriations to make it easier for departments to collaborate on shared outputs or goods and services. Specifically, section 20 of the PFA should be widened to allow departments to incur expenses in providing shared services on behalf of other departments.

Scrutiny and control of capital

14. Parliament and Ministers have distinct roles in relation to capital expenditure. As part of its constitutional role of scrutinising and authorising public spending, Parliament needs to be able to scrutinise and authorise capital expenditure, while Ministers want to ensure that all capital expenditure, whether departmental or non-departmental, is consistent with the government's overall investment strategy and that the Crown's capital is being used to best effect.

15. The existing net assets provisions require Parliament to confirm in an Appropriation Act departments' projected net assets for each financial year. This does not provide Parliament with an adequate opportunity to scrutinise and authorise either capital expenditure or changes in departments' capital (net asset holdings). The permanent legislative authority (PLA) for departmental capital expenditure in section 24(1) of the Act means Parliament does not have the same opportunity to scrutinise and authorise departmental capital expenditure as it does with non-departmental capital expenditure and both departmental and non-departmental expenses, all of which are the subject of annual or multi-year appropriations. From the perspective of Ministers, the PLA does not impose a limit on the amount of capital expenditure departments can incur and there is a sense that some departmental capital expenditure occurs 'under the radar'.

16. The existing provisions in the Act relating to departmental capital (net asset holdings) and departmental capital expenditure do not work for either Parliament or Ministers. In addition the net assets provisions are cumbersome and compliance intensive to operate.

17. Officials will develop solutions to these problems so as to enable appropriate control by Parliament over departmental capital and to ensure Ministers can limit departmental capital expenditure.

Reporting to Parliament (Part 4 of the PFA)

18. The PFA currently specifies the planning and performance information that must be presented to Parliament on each appropriation and by each department. The level of detail in the reporting requirements has created a compliance burden on agencies and has had limited success in promoting quality strategic planning. We recommend that the reporting requirements be simplified, to reduce compliance costs and facilitate different ways of working, which will, in turn, support improved performance.

19. It is important to note at this point that further development of the reporting framework proposed in this report is required. Subject to your agreement with the nature and direction of this work, further development and consultation will enable a refined set of proposals to be produced in the first half of 2012.

Management within the Executive

20. The need for Ministers and management teams to engage in strategic thinking and management of their organisations should be tackled directly as a matter of internal management of the Executive. It does not need a legislated process. Instead, Cabinet and/or Ministers can simply decide how they want to run the machinery of the Executive and define for themselves the disciplines that they want their chief executives and senior management teams to follow in supporting them. This can be done through such devices as Cabinet decisions and circulars, ministerial letters of expectation, or Treasury Instructions. Keeping the requirements at this level, rather than legislating a process, has the advantage of flexibility and will let Ministers develop the systems over time.

Link all service performance information to appropriations

21. We propose that all performance reporting be tied to appropriations, and that, for each appropriation, information would be provided on what has been achieved and/or what has been delivered. This allows the integration of current entity level reporting (on impacts, outcomes, and cost effectiveness) and appropriation reporting on service delivery.

22. It also allows for the most meaningful measures for each appropriation to be selected as follows, supporting a move towards a 'result focus' where this is applicable:

- Where impacts or outcomes aren't meaningful (for example, in the case of the Parliamentary Counsel Office), an agency would not need to report against these but solely against output measures.
- Where measures of results (what has been achieved) are available, an agency would report on these, supplemented by reporting on key output measures. For example under the Welfare Working Group's recommendations, reporting would focus on the reduction in benefit dependency and in the amount of the future actuarial liability, but output reporting would still be required on whether the right amount is being paid on time to people who are eligible for benefits.

23. In both situations, particularly the latter, we envisage more selective reporting of output based service delivery information. This change has the potential to enable more tailored and meaningful reporting, by better enabling agencies to report on performance in the way that is most meaningful given the purpose of the appropriation and the nature of the activities being funded.

24. Under current legislation:

- Service performance reporting is required on all departmental output expenses, no matter how small the amount involved.
- Service performance reporting is required on all Crown entity output expenses unless the Minister of Finance exempts a class of outputs under section 143 of the Crown Entities Act.
- For outputs funded from an appropriation and provided by an entity not required to report to Parliament (for example, a non-government organisation), the Minister responsible for the appropriation is required by section 32A of the PFA to report to Parliament on the service performance achieved from that appropriation, but only if the amount involved is above a threshold (currently $5m) specified in criteria agreed with the Finance and Expenditure Committee.

25. We are exploring applying the criteria used for reports under section 32A to reporting on departmental output expenses to enable reduced and no reporting on output appropriations that are genuinely insignificant.

26. As reporting is driven by the appropriations that are sought from and made by Parliament, these changes in reporting are in part dependent on ongoing review of output expense appropriations (and component output classes of MCOAs) to ensure appropriate levels of aggregation.

27. Realising the potential for legislative change to lead to more tailored and meaningful reporting will require significant improvement in capability and focused work on identifying the most relevant measures of performance, with Treasury and the SSC, in consultation with the OAG working collaboratively with agencies. Treasury and the OAG will also need to work alongside the External Reporting Board to encourage GAAP to evolve in a way that supports the new approach to reporting.

28. Further, to facilitate greater flexibility in reporting in line with more collaborative approaches, we also propose that for each appropriation the Information Supporting the Estimates would, in addition to identifying the measures against which performance would be reported at the end of the year, identify who will report and where the reporting will occur.

Remove the requirement for departments to produce information on future operating intentions

29. Sections 38 – 40 of the PFA require information on departments' future operating intentions to be provided. This information is usually presented as a SOI. Departmental SOIs currently serve several functions: a statement to Parliament of the operating intentions of the department; a framework for reporting on performance at the end of the year; and a mechanism to ensure each department engages in strategic planning and management discussions with their Minister.

30. The SOI has not been very successful as a device for promoting strategic management within departments and strategic engagement with Ministers. Instead it has tended to become part of a production process of generic organisational information, abstract discussions of the intervention logic connecting outputs and outcomes, and a great deal of detailed measurement of different aspects of performance. This is not always the case: some organisations have managed to do this well and use the disciplines of the SOI and reporting processes effectively. But most agencies have struggled and it is easy to slip back into a 'tick-box' mode rather than meaningful engagement with respect to the organisation's performance.

31. In our view, the information that the SOI currently provides to Parliament can be provided in other ways, either in the Information Supporting the Estimates, by having annual reports looking forward as well as back, or through generally available information on each organisation. We therefore propose that the SOI as a document for departments should be abandoned.

Change to the information required in the annual report

32. To address the need for better quality strategic planning and management while continuing to provide Parliament with information on a department's strategy and capability, we recommend that:

- the SSA be amended to make explicit that chief executives are responsible for the medium and long term management of their department, including for strategic planning (linking to financial responsibilities of chief executives in the PFA, discussed below) (this recommendation is being made by SSC); and

- the information required in the Annual Report include information on the department's future strategy for the current and next two years (an Annual Report tabled in October 2013 would review the year to June 2013, and provide information on future strategy for the three years beginning 1 July 2013).

Strategic financial management and stewardship responsibilities of chief executives

33. Responsibilities of chief executives for financial management are either specified indirectly or not specified at all. Setting out these responsibilities specifically, rather than indirectly through reporting requirements, has the potential to improve accountability for financial management, provide the appropriate incentives for better performance, and reduce compliance costs associated with indirect reporting requirements.

34. The PFA currently makes departmental chief executives responsible for the financial management and financial performance of their department and for ensuring that the department complies with the reporting requirements imposed by the PFA or any other Act. Much of the behaviour sought regarding strategic financial management is signalled through the detailed specification of reporting requirements in the PFA.

35. The PFA specifies what a departmental chief executive is not responsible for in relation to Crown entities, PFA Schedule 4 organisations or State Owned Enterprises that are funded through a Vote administered by the department, but does not indicate what a departmental chief executive's responsibilities are in relation to non-departmental appropriations administered by the department.

36. We recommend that the strategic financial management and stewardship responsibilities of a departmental chief executive, including those in relation to non-departmental appropriations administered by the department, should be specified directly in legislation rather than signalled indirectly by way of the reporting requirements.

37. The following is an initial formation of the strategic financial management and stewardship responsibilities of a departmental chief executive:

    - Ensuring that the services intended to be provided or results intended to be achieved from departmental appropriations administered by the department are provided or achieved in an efficient way.
    - Ensuring that the assets and liabilities held by the department and the non-departmental assets and liabilities administered by the department are managed efficiently and sustainably.
    - Monitoring whether the services intended to be provided or results intended to be achieved from non-departmental appropriations administered by the department are provided or achieved in an efficient way and, where this is not the case, advising the Minister responsible for each such appropriation, recommending remedial action.

- Monitoring and advising on the longer term strategy for, sustainability of, and capability to be achieved from, the appropriations administered by the department.

38. The strategic financial management and stewardship responsibilities of departmental chief executives will, with necessary modifications, need to apply in relation to the proposed alternative administrative units within the legal Crown that are to be responsible for administering appropriations (T2011/2514 refers).

A bigger support role for central agencies

39. Treasury and SSC will need to build their capability to support the implementation of the changes proposed to the SSA and PFA. The legislative changes proposed are largely about removing barriers and enabling different ways of working. Treasury and SSC will need to support agencies to implement the changes, and provide ongoing monitoring and support.

40. Implementing the changes to legislation will involve:

    - changing cultures and behaviours and building capability (prior to any organisational change);
    - developing guidance and instructions on how to operationalise the changes; and
    - consulting stakeholders.

41. Ongoing monitoring and support involves engagement and assistance from central agencies on improving agencies' service delivery and performance reporting systems. As discussed by the Better Public Services Advisory Group, for Treasury this could mean playing more of a role as the "chief financial officer" for the whole of the state sector.

42. One of the lessons from previous reforms is that without central support, individual agencies may struggle to make changes on their own. Recent experience with "centres of excellence" within central government in areas such as IT and procurement is reasonably positive. We suggest taking the same approach in relation to lifting the game in financial and performance management across the sector.

43. Treasury and SSC will need to develop their own capability to advise Ministers on the development of systems for stronger strategic financial management across the state sector.

Crown entities

44. The proposed changes to the reporting requirements in the PFA have implications for Crown entities' reporting requirements, set out in the CEA. The issues around Crown entities are, however, more complex given that they are separate legal entities from the Crown and the legislative framework needs to provide for the more formal relationship between the Crown entities and Ministers. Further, while the CEA generally sets out the governance, operation, and reporting obligations of Crown entities, each Crown entity's own Act may modify or negate the application of the CEA.

45. We are yet to work through Crown entities changes in detail, but in broad terms:

- The changes to how appropriations are specified will have limited effect on Crown entities given that they do not directly receive or administer appropriations.
- We envisage that Crown entity reporting on service performance would, as for departments, be specified in terms of what has been achieved and/or delivered by the expenditure.
- The SOI as a document and prescribed process for interaction with Ministers is more important in the Crown entity context because of the arms-length relationship. Rather than abandoning it completely, we are looking at ways in which it can be simplified (and compliance costs reduced).
- We see greater potential to apply a differential reporting approach in respect of Crown entities, especially given the very different sizes and natures of these entities. Providing the capacity to tailor reporting to the nature of the organisation and its work should make reporting much simpler for many Crown entities.
- The work to specify more precisely the quality of strategic and financial management expected within departments should also be able to benefit Crown entities, while respecting their autonomy. As shown by the work on state sector procurement, for example, most Crown entities are willing participants in whole of government initiatives that improve performance and reduce costs.

46. Other changes to the CEA may also be desirable (e.g. changes to the responsibilities of Boards in relation to strategic financial management) and will require further investigation. Officials aim to report to you with proposals in the first half of 2012 and in order to do so seek your permission to consult with chief executives and CFOs of Crown entities in early 2012.

Other technical and drafting matters

47. There are a number of technical and drafting issues in relation to the PFA and CEA that may be appropriate to address alongside the more substantive reforms. These matters fall into two broad categories:

- Detailed wording changes, such as references to "departments", that will need to be made to accommodate alternative organisational forms within the legal Crown (T2011/2514 refers); and
- Changes to remedy technical problems that have been identified in practice.

48. Two examples where the current requirements create unnecessary compliance costs with respect to Crown entities are summarised below:

- Many Crown entities have subsidiaries that are non-active companies. The general law on financial reporting allows non-active companies not to produce accounts or have them audited, but the specific provisions of the CEA override this and mean that public sector non-active companies must produce accounts each year (showing no activity) and have them audited. The CEA should be amended to let the general exemption apply.
- Some legislation requires a Crown entity to produce separate financial statements for the group and parent (and have them audited), even if there is no material difference because the subsidiaries in the group are small. This creates additional cost. In some sectors only group statements are required. We will be looking further at ways to rationalise and standardise the reporting requirements for groups and subsidiaries.

49. Officials will be considering these and other technical and drafting issues further and will report to you in the first half of 2012 with specific proposals.

Consultation

50. We have consulted with the OAG, SSC, Parliamentary Counsel Office, and a chief executive who was a member of the Better Public Services Advisory Group. In the development of some of these proposals we also had a preliminary discussion with a group of departmental CFOs.

51. We were not able to consult more widely on the full range of these proposals prior to this report as the Better Public Services Advisory Group Report has not yet been released. Subject to your agreement, we aim to develop and test the proposals further with chief financial officers and the Senior Executives Group as soon as possible in early 2012.

Next steps

52. The state sector reform package being developed is highly interconnected. Accordingly, the SSA and PFA reforms should be progressed as a package.

53. Further policy development work, consultation and testing is required in relation to some areas of reform discussed in this report. In order to introduce the legislation in May 2012, to be enacted before the end of 2012, policy decisions will need to be made by the end of February 2012. This timeline allows very little time for consultation, particularly given the Better Public Services Advisory Group's report is not yet available to departments, which correspondingly raises the risk of proposals being unworkable in practice or unacceptable to some stakeholders.

54. The implications of two alternative enactment dates are as follows:

- By the end of 2012: this is the latest the legislation could be enacted for the changes to be implemented in the documents presented with Budget 2013 and apply generally to 2013/14. Implementation on this timeline would be very tight and entails significant policy and implementation risks.
- By the end of April 2013: this would allow final policy decisions to be made a few months later than the end of February 2012 but would not enable the changes to be implemented in the documents presented with Budget 2013 and to apply generally to 2013/14. However, provided the amount of imprest supply in the Imprest Supply Acts for 2013/14 were sufficiently large, the Better Public Services changes that require legislation could be implemented on a targeted basis to apply to selected areas for the whole of 2013/14 using imprest supply and the 2013/14 Supplementary Estimates.

55. Officials will set out an integrated reform implementation timetable in a Cabinet paper scheduled to be provided for the first Cabinet meeting in January 2012.

56. A number of aspects of the Better Public Services Advisory Group's report do not require legislation to be implemented. For those aspects that do require legislative change, interim non-legislative options are available until legislative amendments are passed.

57. Not all the further work needs to be completed prior to policy decisions about the legislative changes required. What needs to be completed before then is the work required to ensure that there is a robust basis for those policy decisions, including for example, consultation and road-testing the design of the reporting model.

58. As was undertaken with the Public Finance (State Sector Management) Bill in 2004, Ministers may wish to undertake pre-introduction consultation on the content of the Bill with other parliamentary parties. In addition, as required by Standing Orders (S.O.) there will be a need to obtain the agreement of the Business Committee to the Bill being introduced as an omnibus Bill [S.O.260] and, given the recent change to Standing Orders, consultation with the Business Committee on the structure of the Bill [S.O.297]. Further, section 18 of the PFA requires consultation with the Finance and Expenditure Select Committee (FEC) in the event of a proposal to significantly change the format or content of the Estimates, the Information Supporting the Estimates, or the Supplementary Estimates (possibly best done at the same time as FEC is considering the Bill).