

Treasury Report: Governance Regime Applying to PFA Companies

Date:	19 March 2012	Report No:	T2012/490
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note the contents of the paper.	Friday, 23 March 2012

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Derek Gill	Principal Economist, State Sector Management	Withheld under section 9(2)(a) of the Official Information Act	
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Minister of Finance's Office Actions (if required)

None.

Enclosure: No

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Executive Summary

The Crown Entities Act 2004 (CEA) and the Public Finance Act 1989 (PFA) are under review, inter alia, to allow for the *Better Public Services* priorities and initiatives to apply across the State Sector. The proposed omnibus amendment bill provides the opportunity to address a technical loophole in the public management regime, and ensure better alignment across the wider state.

The loophole arose when the CEA was developed and Schedule 4 of the PFA was created as a 'parking lot' for a range of very small public bodies such as Reserve Boards for whom the CEA was judged inapplicable. The schedule was never intended to be used as separate, specific organisational form so there is little specification of the governance regime that should apply. For example, the Minister's powers of direction using the Statement of Intent and the whole of government direction provisions of the CEA do not apply to Schedule 4 entities. These are the provisions that underpin achievement of the Better Public Service goals.

Six new companies have been added to Schedule 4 of the PFA since the CEA was passed in 2004 while the schedule of Crown entities companies in Schedule 2 of the CEA is essentially unaltered. This suggests that there is a risk of a proliferation of entities listed on Schedule 4 of the PFA that are outside the whole of government direction and other formal Ministerial Statement of Intent (SOI) direction powers.

There are three options to 'close the loophole':

1. Future-proof the CEA by amendments to allow for less than 100% ownership of Crown entity companies in the future; or
2. Extend the coverage of the CEA governance provisions such as the whole of government direction to apply to companies on Schedule 4 of the PFA; or
3. Use guidance to try and close off future use of Schedule 4 of the PFA.

In the course of developing this advice we have concluded that the second option is the most practical solution. Officials are currently preparing draft Cabinet papers and propose to include this option 2. The CEA paper will be part of the suite of draft Better Public Services Cabinet papers that state sector joint Ministers will be supplied with by 30 March 2012.

This report is provided as background for your discussion with the Minister of State Services and the Associate Minister of Finance on 19 March 2012.

Recommended Action

We recommend that you:

- a **Note** the contents of the paper.

Michele Lloyd
Manager, State Sector Management

Hon Bill English
Minister of Finance

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Purpose of Report

1. This report explores the policy options for applying a robust governance regime to companies listed on Schedule 4 of the PFA to allow for the *Better Public Services* priorities and initiatives to apply to these companies. It is a response to your request for more information on the options at the meeting of 13 March.

Background

2. Schedule 4 of the PFA includes a range of statutory entities including trusts, Reserve Boards etc as well as six active parent companies – Crown Fibre Holdings, Health Benefits, Learning State, Research and Education Advanced Network New Zealand, the Dispute Resolution Services Limited, and Crown Asset Management Limited. Crown entity companies include the eight Crown Research Institutes as well as New Zealand Venture Investment Fund Limited, Radio New Zealand and TVNZ.
3. Listing on Schedule 4 of the PFA requires that the Crown has a controlling interest such as a shareholding greater than 51%. The government also decides which parts of the CEA's accountability regime (eg. if the entity has to prepare a Statement of Service Performance, a full Statement of Intent) and which CEA financial provisions will apply in addition to basic requirements such as preparing financial accounts.
4. By contrast the CEA, while providing a robust accountability and governance regime, does not currently allow for less than 100% Crown ownership of parent companies or for shares in parents to be sold. In order to dilute 100% ownership in a parent Crown entity company, legislation is required to enable the removal of the Crown entity company from Schedule 2 of the CEA. The only companies currently under the CEA are those placed on the schedule when the legislation was passed.
5. The public management regime should be able to accommodate the future possibilities offered by majority or mixed ownership of parent companies and public-private partnerships. Accommodating less than 100% ownership in parent companies may be an increasingly important means of introducing public and private partners to bring in innovative practices or alternative ownership arrangements. For example Learning State Limited could potentially be merged with other Industry Training Organisations. In other cases the government may not wish to be a permanent 100% owner
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6. The CEA was not developed to accommodate less than 100% ownership of Crown entity companies. The PFA Schedule 4 allows for less than 100% ownership but does not provide a complete governance regime.

Analysis

7. There has been a growing use of Schedule 4 of the PFA for a range of government owned companies rather than these companies being included as Crown entity companies under the CEA. Six companies listed above have been added to Schedule 4 of the PFA in the last few years. Southern Response Earthquake Services Limited will be listed on Schedule 4 of the PFA shortly to take over the Canterbury earthquake liabilities of AMI Insurance Limited.

8. Schedule 4 of the PFA was created as a 'parking lot' for a range of very small public bodies such as Reserve Boards for whom the CEA was judged inapplicable. It was never intended to be used as a separate, specific organisational form so there is little specification of the governance regime that should apply. For example, the Minister's powers of direction using the SOI and the whole of government direction provisions of the CEA do not apply to Schedule 4 entities. These are the provisions that underpin achievement of the Better Public Service goals.
9. There are three broad options to close the loophole and improve alignment:
 - a) Amend the CEA to explicitly allow for less than 100% ownership of Crown entity companies; or
 - b) Amend the PFA by expanding the governance provisions such as the whole of government direction to apply to Schedule 4 companies (which is the most practical solution); or
 - c) Use guidance to try and close off future use of Schedule 4 and encourage the more active use of subsidiaries for disposal of assets.

Option 1 - Amend the Crown Entities Act to explicitly allow for less than 100% ownership of Crown entity companies

10. The first option involves future proofing the CEA and allows the CEA to accommodate a wider range of ownership options. Technically this would be relatively easy to achieve by:
 - amendment to s80 of the CEA *Restrictions relating to shares in Crown entity companies*, to allow share disposal;
 - removing the board's duty to the Minister (s 87 of the CEA) for less than 100% Crown owned companies. Removal of s87 duties does not mean forgoing much and is most likely to allow the board to operate in the most effective manner;
 - providing a protection of minority interests by introducing a provision akin to Section 7 of the State-Owned Enterprises Act 1986, which provides for the Crown and the SOE to contract to provide goods and services where the SOE would not otherwise do so; and
 - providing the power by Order in Council to transfer companies to and from Schedule 2 of the CEA and the addition of a new schedule (for majority owned Crown entity companies) following moves to less than 100% ownership.
11. Consideration could then be given to whether the existing companies on Schedule 4 of the PFA should become companies under the CEA or move to another organisational form. This would ensure that the whole of government direction and other formal Ministerial direction powers through the SOI, could apply to these entities.

Option 2 - Amend the Public Finance Act by expanding the governance provisions such as the whole of government direction to apply to Schedule 4 PFA companies (most practical solution)

12. The second option involves amending the PFA instead of amending the CEA. The advantage of this option is that it would create a clear line between Crown entity companies, under the CEA, where the Crown expects to remain a long term 100% owner of the parent and those listed on the PFA where majority ownership is possible. The PFA Schedule 4 currently allows for less than 100% ownership but does not provide a complete governance regime.

13. With the PFA amendment option, all the companies currently listed on the Schedule 4 could be moved onto a new schedule of the PFA with the existing Schedule 4 reserved for non-company entities. Most of the CEA companies governance provisions could be then applied to companies on the new schedule of the PFA by cross reference to the CEA. These could include the role of the Minister on the SOI, whole of government direction, etc.
14. The governance regime that would apply to companies under both options would be largely the same. The main point of difference is in the readability of the legislation. The PFA (in sections 45M and 45L) currently cross references sections of the CEA that apply to all or some Schedule 4 organisations. This list of cross references would need to be expanded.
15. This option has the presentational advantage of creating a clear line between 100% Crown entity companies, and those listed on the PFA where a wider range of majority ownership options are possible.

Option 3 - Use guidance to try and close off Schedule 4 to future use and encouraging the more active use of subsidiaries for bringing in private partners

16. Whereas Options 1 and 2 propose legislation to close a 'loophole' in the public governance framework, option 3 emphasises changes in practice. Under this option central agency guidance would emphasise that Schedule 4 of the PFA should not be used for permanent bodies but only for temporary bodies such as the Auckland Transition Agency. The guidance could also point to opportunities to more active use of company constitutions and more creative use of subsidiaries. Subsidiaries can bring in partners to introduce innovative practices.
17. In effect this option attempts to shut the gate on permanent new Schedule 4 PFA entities, while leaving the current agencies on the schedule outside of the CEA governance regime. The main advantage with this option is that it avoids the need to take up scarce House time on an issue that may shift attention away from the overall merits of the package of measures proposed in the Omnibus Bill to amend the PFA, the State Sector Act, and the CEA.
18. The main risk with this option is that guidance has not in the past proved very effective in changing practice. Over time there is a significant risk of a series of ad hoc decisions leading to a proliferation of entities listed on Schedule 4 without a well designed governance and accountability regime. The CEA was developed by successive administrations to avoid just these problems. The Controller and Auditor General's' 1998 report into the Tourism Board is instructive of the sort of problems that lead to the development of the CEA. This option is the least robust and is not recommended.

Risks

19. The main risk identified in this report is that if the government does nothing, more and more entities will be added to Schedule 4 of the PFA over time, and these entities activities will not be well integrated with the rest of the State Sector. The proposed omnibus amendment bill provides the opportunity to address a technical loophole in the public management regime and ensuring that the Better Public Services priorities and initiatives can apply. This report has also explored the implication of a move to majority ownership for companies under the CEA and the PFA 4th schedule companies. It suggests that the CEA company provisions provide a governance and accountability regime that can, with minor adaption, be applied to majority-owned companies either under the CEA or a new schedule in the PFA.

20. Allowing for majority-owned companies under the CEA may expose the government to the criticism that the Government is preparing to sell off Crown entity companies such as CRIs and TVNZ. Option 2 - Amending the PFA by expanding the governance provisions applying to Schedule 4 PFA companies - has the presentational advantage of creating a clear line between 100% Crown entity companies, and those listed on the PFA where a move to mixed ownership over time is already possible.