



Occasional Paper No. 18

Crown Entities: Roles of Ministers, Crown Entities and Departments



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Derek Gill, Branch Manager
Strategic Development Branch
State Services Commission
Email: derek.gill@ssc.govt.nz
Facsimile: +64 4 495 6699

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Crown Entities: Roles of Ministers, Crown Entities and Departments

Summary

This paper forms part of the background work undertaken by the State Services Commission (SSC) during the 1998/99 financial year on Crown entities. It discusses the roles and powers of Responsible Ministers in relation to Crown entities, and the support they can receive in discharging their responsibilities. In addition, the relationship between the Minister and the governing body of the Crown entity is discussed as this is central importance to the governance and accountability arrangements of Crown entities. The paper concludes that the roles and powers of the Responsible Ministers and their relationship with Crown entities are not currently well articulated in legislation and varies from entity to entity depending on the nature of the entity. As such there is a clear need to better articulate the Minister's role, and provide better advice on the instrument of influence available to them. The paper also includes a separate Appendix that discusses the role of departments in relation to Crown entities

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Introduction

This paper discusses the role of Responsible Ministers in relation to Crown entities, and the support they can receive in discharging their responsibilities.

Crown entities play an important role in our system of government. Much of the activity of central government is carried out by non-departmental organisations outside the legal Crown. Most such organisations are either Crown entities or State Owned Enterprises (SOEs). Crown entities are a large group of quite disparate agencies which share certain reporting and accountability requirements under the Public Finance Act 1989. Crown entities do not form one homogeneous group of entities. They come in a number of different legal forms, and undertake quite different functions. The Public Finance Act provisions which relate to Crown entities are mainly concerned with external reporting requirements, and the key features of their governance arrangements are provided by the different legislation under which most are established.

All Crown entities have a Responsible Minister. The relationship between the Minister and the governing body of the Crown entity is of central importance to the governance and accountability arrangements of a Crown entity. It is the major way that the Government's interest and risks are managed and is the point of leverage that the Government has to exercise influence over Crown entities. The nature of this relationship and of the Minister's role varies considerably from entity to entity. Some entities have a considerable degree of independence from their Responsible Minister, others do not. The Government usually has policy and purchase (and sometime regulatory) interests in a Crown entity as well as an ownership interest.

The relationship between the Minister and Crown entity is in principle quite different to that between a Minister and a department. Departments are part of the legal Crown, and have a close relationship with their Minister, which provides the Minister with extensive powers to direct the department. Departments also share a common statutory framework which clearly sets out their responsibilities to the Minister, and the Government of the day, and expectations about how public servants will behave.

The role of the Responsible Minister

The nature of the role and powers of the Responsible Minister, and of the relationship between the Minister and Crown entity is not well articulated in legislation or elsewhere and varies from entity to entity depending on the nature of the entity. The Audit Office came to a similar conclusion¹. The Public Finance Act refers only to responsibility in respect of financial performance. However the Minister's role will, in general, at least encompass:

- general oversight of the entity, its legislation, and the policy area in which it operates. This will include ensuring that the entity complies with obvious legal requirements such as producing an annual report and other accountability documents, accounting to the House of Representatives for the entity, and taking action where serious failure seems indicated; and

¹ *Report of the Office of the Controller and Auditor General on Governance Issues in Crown Entities*, November 1996

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- appointing or recommending the appointment of the governing body², and deciding whether to reappoint or dismiss a board member.

In addition, depending on the nature of the entity the Responsible Minister may be required to:

- inform the entity of the Government's expectations;
- agree the terms of a purchase agreement;
- make an input into a statement of intent;
- agree the content of other accountability documents;
- inform the board as to Government policy where this is appropriate;
- direct the board where this is appropriate;
- take part in decisions about capital injections or withdrawals by the Crown, or in relation to investment or borrowing by the entity;
- decide on the nature of any regulations that will be made which will affect the entity; and
- monitor the performance of the entity.

The Responsible Minister's role encompasses informal elements (such as political leadership and relationship management) as well as the formal ones. The formal elements and the associated levers of influence are very important in terms of ensuring that the Government's interests and risks are managed properly. The Responsible Minister has a difficult job, and is relatively exposed, in discharging his or her role in a manner that is consistent with the logic of how the entity has been set up because:

- the Minister cannot rely (as is the case with departments), on a general power to informally direct the entity, and Crown entities are not, as a matter of course required to give effect to Government policy;
- departments are clearly obliged to serve the interests of the Government as a whole. There is not necessarily any similar obligation on Crown entities, which in formal terms usually relate solely to their Minister, and are not bound into Cabinet processes;
- departments have standard governance arrangements and a standard monitoring regime;
- the central agencies – Department of the Prime Minister and Cabinet (DPMC), Treasury and the State Services Commission (SSC) - do not play the same role in relation to Crown entities that they do in relation to departments (e.g. the monitoring arrangements of the point above); and

² There are some entities where the Crown does not appoint the board (e.g. School Boards of Trustees)

- there is a lack of general guidance available to Ministers on how various instruments function. For instance, there is no statement on the role of Ministers in relation to Crown entities, no guidelines on Statements of Intent, and only limited guidance available on appointment processes.³ Central agencies will need to work on advice on purchase agreements between Crown entities and Ministers once the Statute Amendments Bill has been passed.⁴

There is some evidence that Ministers are not using all their formal levers of control over Crown entities. A recent survey of the Statements of Intent of Crown entities has found that many do not comply with their statutory obligations.⁵

The work on improving strategic management – Strategic Result Area (SRA) Networks - raises some issues about the roles of the Ministers in relation to Crown entities⁶. An obvious issue is the extent to which SRA Networks should also encompass Crown entities and how Ministers can exercise influence, where that is appropriate.

Crown entities also throw the role of the lead Minister of an SRA Network and the lead agency into sharp relief. This is because they are not all obliged to follow Government policy as a matter of course (and are in practical terms not bound into the Cabinet decision making process). Nor are they explicitly bound into the collective interest of the Government. This is particularly significant where responsibility for policy rests with a Minister other than the Responsible Minister e.g. Housing. The Minister responsible for housing policy is different from the two Responsible Ministers for Housing New Zealand Ltd, which is one of the key instruments of the Government's housing policy.

³ Guidelines on the role of Ministers and board appointments were released as part of the *Crown Entities Initiative*, approved by Cabinet on 23 August 1999. Guidelines on Statements of Intent were released in June 1999.

⁴ There is a proposed amendment which clarifies certain things in relation to "purchase".

⁵ State Services Commission, *Crown Entities: Review of Statements of Intent*, Occasional Paper No. 20, September 1999.

⁶ See: State Services Commission, *A Better Focus on Outcomes through SRA Networks*, Occasional Paper No. 3, October 1998.

Possible sources of support for Responsible Ministers

It is open to the Responsible Minister to seek assistance to carry out his or her role, and he or she may seek that assistance from a number of sources:

- their office;
- their department; and
- any other advisors e.g. Crown Company Monitoring Advisory Unit (CCMAU).⁷

The Audit Report on Crown entities recommended that “All Responsible Ministers consider the merits of using appropriately skilled advisors to help them discharge their Crown entity responsibilities”.⁸

In the absence of any other advisor or agent, the Minister’s portfolio department is an obvious source of support. At present there is no satisfactory description of the role of a department in relation to Crown entities⁹ although there are some scattered obligations on departments (e.g. Treasury sets out some expectations for monitoring in its expectations or relationship letter to departments). In part this is because a department’s role is dependent on the nature of the Minister’s role, and his or her preferences, to define the department’s supporting role. There is no reason for the Minister to be obliged to make use of their department’s support, as opposed to another advisor (unless there are statutory or Cabinet requirements to do so).

Issues in relation to support available to Ministers

There seem to be a range of issues in terms of the support available to the Responsible Minister:

- no clear statement of what a Minister is responsible for, or how this varies according to the nature of the entity;
- a lack of general guidance to Ministers on the nature of the instruments of influence available;

⁷ For example, while CCMAU provides shareholding Ministers with ownership support in respect of most Crown companies (including SOEs) it is the Health Funding Authority and Foundation of Research, Science and Technology that manage the Crown’s purchase interest in HHSs and Crown Research Institutes respectively.

⁸ *Report of the Controller and Auditor-General on Governance Issues in Crown Entities*, November 1996, p. 19.

⁹ *Guidance for Government Departments in Relation to Crown Entities* was released as part of the Crown Entities Initiative, 23 August 1999.

- the evidence available, both anecdotal and empirical¹⁰, suggests an enormous variation in the level of support given to a Minister. Audit found that Ministers had no support from any advisors in two out of the six Crown entities they examined. Our own examination of the Estimates reveals that some Votes make no mention of the Minister purchasing any support at all from their department or any other advisor yet the portfolios contain significant and important Crown entities. On the other hand some Votes have output classes devoted to the purchase of a departmental role in supporting the Minister's duties in relation to Crown entities;
- there is no agreed position of what constitutes quality monitoring of Crown entity performance; and
- a lack of clarity around the role of departments, and in turn a lack of clarity about the relationship between a department and other advisors supporting a Minister in relation to Crown entities.

Many departments are currently putting significant effort in trying to define their role in relation to Crown entities and the quality of the support they should provide to their Minister.

The attached paper (see Appendix 1) endeavours to set out a basic description of a department's role in relation to Crown entities.

The content of this paper would not come as a surprise to most departments which deal with Crown entities, although they may not currently conform to all the expectations.

Conclusion

Responsible Ministers have a difficult job in relation to Crown entities. The support they receive is uneven. There is a need to better articulate the Minister's role, and provide better advice on the instruments of influence available to them. A clearer description of departments' responsibilities which does not unreasonably constrain Ministers' freedom to use other advisors for support is required.

This conclusion is predicated on retaining the existing governance arrangements over Crown entities. A more radical approach would be to give one agency responsibility for monitoring all or the most important Crown entities. If a statement on departmental responsibilities was adopted, consideration would need to be given to how the role of the department could be monitored.

¹⁰ *Report of the Controller and Auditor-General on Governance Issues in Crown Entities*, November 1996. *Departmental Responsibilities in Relation to Crown Entities - Information from the 1996/97 Estimates*, SSC internal paper, 1998.

Appendix 1: The role of Government departments in relation to Crown entities

Introduction

Many functions of government are carried out by a large number of quite disparate organisations that come under the rubric of the term Crown entity. Crown entities are outside the legal Crown, and legal persons in their own right, and are generally established under a particular statute. All Crown entities have a Responsible Minister.¹¹ They do, however, have quite different governance arrangements to those of departments, being at arms length from the Minister, and governed by a board which appoints a chief executive. The logic of having a function delivered by a Crown entity is that the board is given responsibility for running the organisation.

Ministers' relationship with the board of the Crown entities is the major way that the Government's interests and risks are managed. Ministers generally have fewer levers of control over Crown entities than they do over departments. The mechanisms available to them to exercise control or influence over a Crown entity depend very much on the particular institutional arrangements that apply to each entity.

In statutory terms Crown entities generally relate to their Minister, not the Minister's department. Crown entities are separate from and not under the direct control of departments. The Public Finance Act is clear that a departmental chief executive:

- shall not be responsible for the outputs or financial performance of a Crown entity or a State enterprise...even though such Crown entity or State Enterprise be wholly or partly funded through a Vote administered by the department (s34).

A department is dependent on its Minister for authority in relation to Crown entities (e.g. under the Public Finance Act 1989 (s45B) a Minister can require whatever information he or she considers necessary from the governing body of a Crown entity. The department has no such right). A department only can exercise influence over Crown entities through the support it provides to its Minister.

In assisting their Minister discharge his or her role in relation to Crown entities, departments may have significant responsibilities. The extent of these responsibilities will vary according to the role and preferences of the Minister and the nature of the entity or entities. This paper discusses the standard types of support that a department could be expected to provide their Minister. There may be additional expectations which apply in some circumstances because of Ministerial preferences.

¹¹ Crown companies usually have two shareholding Ministers, both of whom are viewed as Responsible Ministers.

Role of the Minister in relation to Crown entities in a Minister's portfolio

Any description of the role of a department must start with the functions and duties of the Minister with regard to the Crown entity, since they will largely determine the department's role. The Public Finance Act defines the Responsible Minister in terms of ownership, but the Responsible Minister is usually also the portfolio Minister, responsible for the Crown's policy and purchase interests in the entity as well.

The nature of the role and powers of the Minister, and of the relationship between the Minister and Crown entity, is not well articulated in legislation or elsewhere, but in general terms it involves ensuring that:

- the Government (and Parliament's) policy objectives are being advanced;
- the Government's interests and risks are properly managed; and
- there is proper accountability and control of public organisations that spend public money and exercise public powers.

What this means in practice will vary a great deal from entity to entity, depending on the nature and size of the entity and the related levers of control that the Minister has. The Minister may have a variety of formal levers of influence but the extent varies considerably from entity to entity. At one extreme are entities over which the Minister has extensive control, and which can be thought of as largely being agents of Government policy. At the other extreme are entities over which the Minister has little control. There are some entities, for example, where the Minister has little formal power, other than the right to require information. The levers of control available to the Minister should be exercised in a way that respects the role of the governing body, which is responsible for running the organisation.

In addition to the levers of control, the Minister also has policy initiative to promote amendments to legislation that apply to Crown entities.

Standard departmental responsibilities

Departmental support of Ministers in relation to Crown entities needs to be tailored to the nature of particular Crown entities and the relevant legislation. The following are standard functions that departments may be expected to do to support their Minister. Some may need to be tailored to the circumstances of a particular organisation. Some are basic requirements in the absence of a statement from the Minister to the contrary. The application of others will depend on the preferences of the Minister.

Policy advice

Initial briefing

As part of its Post Election briefing¹² or following a portfolio change a department would be expected, as a matter of course, to advise its Minister on the nature of any Crown entities within the Minister's portfolio¹³ including:

- the Minister's responsibilities, and the actions and processes needed to discharge those responsibilities, including statutory duties and powers, Cabinet requirements and Parliamentary expectations;
- the level of support the department usually provides or is able to provide to the Minister and other possible sources of advice and administrative support; and
- any major or urgent matters associated with Crown entities for which the Minister is responsible.

General awareness

To fulfil the above requirements a department would need to have a good general understanding of the relevant Crown entities, specific legislation under which the Crown entity was established and, any other pertinent legislation (particularly the Public Finance Act).

A department would need to maintain a general understanding of a Crown entity's corporate objectives, strategic direction and operating scope, and be able to provide independent advice to the Minister on such matters, without interfering in the business of the governing body.

The Minister needs to be kept informed of any significant developments in the Minister's portfolio, including those relating to a Crown entity. Where a department has knowledge regarding the operation of a Crown entity which presents risks to the Government (e.g. the failure to meet basic legal obligations of tabling appropriate documents in Parliament), the Minister should be advised.

Other advice

Departments may also be required to provide:

- "first" and "second" opinion advice. "First" opinion advice is likely to concern broad strategic direction, policy and purchase advice. "Second" opinion advice involves commenting on proposals and advice presented to the Minister by the Crown entity; and/or
- advice on legislation, regulations and management of process leading to legislation and regulations.

¹² Now known as Briefing to the Incoming Minister.

¹³ Cabinet Office Manual, 2.59-60. State Services Commissioner *Public Servants, Political Parties and Elections*, paras 35-42.

Assistance with appointments and induction of governing bodies

The governing bodies of Crown entities are usually appointed by Ministers or by the Governor-General on the advice of Ministers (although there are some significant exceptions to this such as school boards of trustees). These appointments are very important in terms of the effective operation of such bodies, and the proper management of the Crown's interests and risks, and departments should regard them in these terms.

Where Ministers require assistance departments should be in a position to provide it. Guidance material is available, particularly in the relevant Cabinet Office Circulars¹⁴ (these are consolidated in the *Administration of Statutory Bodies and Other Committees*, produced by the SSC¹⁵). The departmental officers responsible for dealing with these appointments should be suitably experienced and senior. The Ministry of Women's Affairs, Te Puni Kokiri and CCMAU offer nomination services for appointments.

The level of support required by Ministers may vary, but it is advisable that departments have systems in place to provide, at a minimum, assistance and advice suggested in the guidance material. As good practice this would include: a bring up system that alerts the department to an upcoming appointment well in advance (preferably 6 months); information on the nature of the organisation and position; the department's view of the type of person required for the position; the possibility of reappointment; the Cabinet requirements associated with the appointment process; and the support that the department can provide to the Minister. This support may include having the ability to run the appointment process, unless the Minister prefers to do this out of his or her own office.

The department may find it desirable to also record the information sent to appointees, as this could become important in the event of any future dispute as to the extent or adequacy of a person's briefing or appointment.

It has become standard practice in appointments to Crown companies for appointees to boards and offices to be asked to return to the appointing Minister or supporting agency written acknowledgement of their understanding of the terms and conditions of appointment, including acknowledgement of their duties and responsibilities in relation to conflicts of interests.

Other forms of assistance which could be available depending on Ministerial preference are:

- advice on selection;
- ensuring appropriate induction material and briefings are available to new appointees (these could include Institute of Directors seminars on the being a director, for example);
- ensuring that Cabinet requirements are followed in appointments; and
- guidance and advice on Fees and Travelling Allowances.

¹⁴ Cabinet Office Circulars place particular obligations on departments in respect of appointments for Crown entities such as the requirement to maintain a database of appointments and advise on upcoming appointments.

¹⁵ This folder has been replaced by *Board Appointment and Induction Guidelines*, issued by the State Services Commission, 23 August 1999.

Setting performance expectations and accountability

Ministers have a variety of mechanisms available to them to exercise formal control and influence over Crown entities for which they are responsible. These may include ex ante and ex post accountability documents, as well as powers to direct the entity, and appoint the governing body. Care should be taken when departments give advice to the Ministers on the use of these instruments that they take proper account of the responsibilities of the governing body for running the entity.

Depending on the nature of the entity the Minister may be responsible for both the Crown's purchase and ownership interests in the entity. This may require the Minister to negotiate the contents of an entity's Statement of Intent, purchase agreement, or other accountability document, and then assess its performance against those documents. The Minister may require assistance to discharge these responsibilities, which implies that the Minister may look to the department to provide purchase and ownership advice.

Performance monitoring

It is possible that Ministers may require minimal monitoring of legal obligations (statutory compliance, reporting against appropriations) or may request more intensive performance monitoring. The extent of monitoring expected of a department should be clarified with the Minister, possibly in performance agreement discussions.

Ways in which departments are able to support the Minister in this area include:

- assisting the Minister to negotiate expected performance through the purchase agreement, statement of intent, and any other ex ante accountability document;
- monitoring performance and giving feedback to the Minister on the Crown entity's performance (for compliance with statutory provisions, contractual obligations, and achievement of objectives); and
- providing the Minister with relevant advice and support to assist the Minister accounting to Parliament for the actions and performance of that Crown entity, where this is appropriate.

Financial and ownership monitoring

Generally, a Minister could expect to receive advice on any fiscal difficulties emerging or irregularities which could lead to ownership as well as purchase risks. To be well placed to provide this advice departments would need a monitoring regime that can give early warning of any significant threats to an entity's operational effectiveness or viability, as well as track the entity's performance against financial projections in the business plan and the performance indicators set out in the Statement of Intent or related accountability documents. This does raise the issue of sanctions and incentives which may require further exploration at some stage. The monitoring would also enable the department to notify the Minister that;

- the Crown entity is able to comply with the applicable provisions of the Public Finance Act (including coverage of the activities and performance of all Crown entity subsidiaries and any other bodies substantially owned or controlled by other Crown entities);

- the Crown entity, except in unusual circumstances, has finalised and tabled any Statement of Intent by the start of the financial period to which it relates;
- the Crown entity's governing body has consulted the Minister on corporate objectives, strategic direction, and any other initiatives that might have significant implications for the Crown's ownership interest in the entity, including changes to operational scope, and major investment or divestment plans; and
- the Crown entity had sought advice on capital injections, where relevant.

Treasury expects that departments will certify whether a Crown entity has a purchase agreement in place.

Reviews of Crown entities

Departments may be required to assist their Minister in reviewing a Crown entity. This might occur at the initiative of the Minister or, in some cases, there may be explicit legislative requirements for Crown entities to be reviewed.

Departments also should be able to assist their Minister if remedial action is required (e.g. if there was ever a perception of significance performance failure or risk) such as the need to take action to replace members of the governing body, commission a review, propose restructuring or a change of strategy.

Keeping Crown entities informed

It is important that the department maintains a good professional working relationship with its Crown entities. Crown entities are part of the wider system of government, and departments should be aware of the need to keep them informed of matters that affect them. These could include relevant Cabinet and Ministerial policy decisions, important Government and Parliamentary processes (e.g. Budget process) relevant legislative change or proposed legislative change, relevant collective interest issues and decisions, and any other major issues which may affect the Crown entity.

A department may need to consult with a Crown entity as part of the policy advice process and should ensure that the entity's views are accurately represented. In addition, Crown entities may seek advice or assistance from the department on policy and other matters.

A Memorandum of Understanding between a department and a Crown entity may be valuable to make it clear what services a department performs on behalf of the Minister or to assist the Minister in carrying out his or her functions.

While it is important for departments to maintain good relations with Crown entities in the Minister's portfolio, departments need to remember that they are acting in support of the Minister.

Specific statutory obligations on departments

Some departments have specific statutory responsibilities in respect of Crown entities e.g. some departmental chief executives hold statutory positions in Crown entities.

Other Ministers and departments

In some cases, more than one Minister will have a portfolio interest in a Crown entity. One example of this is where the Responsible Minister is a different Minister to the purchase or portfolio Minister. This may be true of some Crown-owned companies, which also usually have two shareholding Ministers, one of whom is the Minister of Finance. In such a case, a department (working to a Responsible Minister) would need to establish an understanding with CCMAU and the Treasury (working to the Minister of Finance) about co-ordination of their contacts with Crown entities, and mutual obligations to keep each other informed about policy advice.

Other Ministers may have particular rights or responsibilities in relation to another Minister's Crown entity, and in such cases departments may need to give advice on each Minister's role. For example; the Attorney-General must be consulted over the appointment of any lawyer to the Commerce Commission; some Crown entities must seek the Minister of Finance's agreement to borrowing; and some may be required by that Minister to pay a surplus to the Crown under s16 of the Public Finance Act 1989.

Central agencies (Treasury and SSC) may also have an interest in Crown entities (e.g. some Crown entities are obliged to consult with the SSC on terms and conditions of engagement, matters concerning industrial relations, and Fees and Travelling allowances). The SSC would also have an interest in any situation where advice proposed machinery of government changes for particular Crown entities or raised ownership questions. Similarly, Treasury has an interest regarding capital injections and withdrawals, borrowing and guarantees.

There are also a number of basic responsibilities, which operate because of Cabinet, SSC or Treasury circulars or expectations, irrespective of Ministerial preference (e.g. purchase agreements are a binding legal and administrative requirement and Treasury's expectation is that departments will certify that a purchase agreement is in place for Crown entities funded by way of a non-departmental output class).

Other advisers

The Minister may receive support from an adviser other than his or her portfolio department, such as a specialist monitoring agency like CCMAU. In such cases a range of functions will fall under the ambit of the specialist agency. This is likely to alter the Minister's requirements of the portfolio department. In this situation, it will be important to clarify the nature of each agency's respective responsibilities with respect to Crown entities to ensure full coverage and monitoring of key risks.

The existence of a specialist body does not remove the basic obligation from a department to provide Ministers with free and frank advice around a Crown entity including emerging risks.