SETTING NEW STANDARDS OF GOVERNANCE FOR THE PUBLIC SECTOR

Governance and Accountability in the Public Sector Conference

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INTRODUCTION

Why are we interested in the theme of governance and accountability? The answer can be found both in specific recent events and in shifts in government policy.

On the events side, we can see evidence of a number of significant failures in governance – public, private and voluntary. High profile examples include:

- Enron - raising very real questions about the quality of corporate governance both in the United States and, with some of the knock on events, in Europe (eg major accounting irregularities at the Dutch food firm, Royal Ahold NV).
- Compelling evidence put forward by Joseph Healey, Head of Regional Investment Banking, ANZ Investment Bank, on the extent to which major New Zealand corporates have lost shareholder wealth.
- Government bail outs of significant New Zealand educational institutions – for example the Wairarapa and Wanganui polytechnics.
- Instances of failure of governance in voluntary sector organisations – for example the Northland health and social services provider Te Hau Ora O Te Taitokerau and the Pipi Foundation (associated with the ACT MP, Donna Awatere Huata).

Government policy initiatives include:

- The growing interest in triple (or quadruple) bottom line reporting, encouraged by the New Zealand Business Council for Sustainable Development and by the government (and now made compulsory for local government).
- Shifting government policy with an increased emphasis on working collaboratively and/or in partnership with regional and local interests.
- The response to the quite strong views contained in the first report of the State Sector Standards Board on governance in the state sector.

If we are to take an intelligent look at governance, the first thing we need to do is clarify what we mean by the term. Writing on governance has become an industry all of its own in recent years and one thing that anyone familiar with the literature and research will know is that the term takes on many different meanings. Most importantly, for our purposes, it quite clearly has different significances when used in respect of the private sector, the public sector, and the voluntary and community sector.

For the purposes of this paper, I have taken three authoritative statements relating, respectively, to the private sector, the state sector, and the voluntary and community sector to serve as a basis for understanding the term in the rest of this paper.

Private Sector Governance

November 2001 saw the publication of *"Beyond Compliance: Building a Governance Culture"*, the final report of the Joint Committee on Corporate Governance established by the Canadian Institute of Chartered Accountants, the Canadian Venture Exchange and the

Toronto Stock Exchange. That report sets out what the Committee regards as the objective of good governance:

> *"The objective of good governance is to promote strong, viable and competitive corporations. Boards of directors are stewards of the corporation's assets and their behaviour should be focused on adding value to those assets by working with management to build a successful corporation and enhance shareholder value.*
>
> *A committed, cohesive and effective board adds value, first and foremost, by selecting the right CEO for the company. Beyond this, the board contributes to value in a number of ways discussed below. These include assessing and approving the strategic direction of the company, ensuring that management has in place appropriate processes for risk assessment, management and internal control, monitoring performance against agreed benchmarks, and assuring the integrity of financial reports. When boards add value by fulfilling their responsibilities in these areas, it will result in greater transparency and understanding of a company's situation by its major stakeholders.*
>
> *In an increasingly globalized world economy, competition is intense and good corporate governance can make a difference to how Canadian companies are viewed. There are benefits to being recognized as a country where excellence in corporate governance receives a high priority; these benefits accrue to individual Canadian companies when operating abroad, as well as to the entire Canadian capital market as viewed by international investors."*

Here, clearly the objective is around shareholder value and maintaining a competitive edge in the global competition for investment capital.

State Sector Governance

The Australian National Audit Office is about to publish its *"Better Practice Guide on Public Sector Governance"*. In an address to the 2002 Business Planning Workshop of the Australian Communications Authority, Pat Barrett, the Australian Auditor General, set out the Office's thoughts on governance as follows:

> *"… the ANAO has chosen to use the term 'public sector governance' or simply 'governance' when discussing the governance of public sector bodies. I do not intend to debate the choice of particular terminology, important though that can be on occasions.*
>
> *I continue to consider public sector governance to encompass how an organisation is managed, its functional structures, its culture, its policies and strategies, and the ways in which it deals with its various stakeholders. In many ways, governance is a combination of legal and 'better practice' organisational structure and management requirements, aimed at facilitating accountability and improving performance.*
>
> *I note that some commentators treat governance quite narrowly, often focussing almost entirely on the operations of a board and its relationship with the CEO and with Ministers. I would like to emphasise that, while boards and the CEO are*

crucial, public sector governance also relies very heavily on the systems, processes, policies and strategies that direct operations, assure quality, monitor performance and manage their obligations to stakeholders. For example CAC agencies are directed through legislation such as the CAC Act 1997 and the Public Service Act 1999 and through more informal guidelines including Chief Executive's Instructions (CEIs) and Department of Finance and Administration Directions.

Having said that, guidelines, regulation, structures and systems can provide a robust and useful framework, but it is only through the actions and decisions of organisations and their staff that their benefits can be realised. It is those who govern who make the crucial decisions and direct the use of resources. They delegate authority to management. Importantly, they provide the 'tone at the top' that is essential for sound corporate governance. Whoever governs exercises ultimate authority within an organisation and is finally held accountable for overall organisational performance by stakeholders."

Note, as might be expected from an Auditor General but as is also appropriate in the public sector, an emphasis on governance as including systems – the much stronger interest that the "owner" in the public sector has in seeing through the corporate veil to the way in which resources are managed.

Voluntary and Community Sector Governance

In 2001 the Canadian Institute on Governance published *"Governance Dos and Don'ts*", lessons from 20 case studies on 20 Canadian non-profits. In writing of governance and good governance, the report states:

"Governance in the voluntary sector has been defined as "the processes and structures that an organization uses to direct and manage its general operations and program activities". It is defined for our purposes as "the structures, functions (responsibilities), processes (practices) and organizational traditions that the board of an organization uses to ensure accomplishment of the organizational mission. These determine how power is exercised, how decisions are taken, how stakeholders have their say and how decision-makers are held to account."

Governance itself has no normative content. Good governance is about both achieving desired results and achieving them in the right way; that is, in a way consistent with the normative values of democracy and social justice. This is particularly important in the voluntary sector where values play a very important role in determining both organizational purpose and style of operation.

Good governance, in the view of this author, is about vision (planning for the future), destination (setting goals and providing a general 'road map'), resources (securing the resources necessary to achieve the goals or reach the destination), monitoring (periodically ensuring that the organizational vehicle is well-maintained and progressing, within legal limits, toward its destination) and accountability (ensuring efficient use of resources; reporting progress and detours to stakeholders). This view is drawn from and supported by the normative literature on organizational governance.

> *Management, not governance, is about steering the organizational vehicle. It is about knowing the road map, examining alternate routes, selecting the course, ensuring efficient resource consumption and good vehicle maintenance, regularly assessing progress and travel conditions, adjusting course when advisable or necessary, and providing periodic travel reports to the crew, passengers and Board."*

Here the emphasis to note is on governance as a means for accomplishing the organisational mission – and the accompanying reference on values.

General

This conference is concerned primarily with public sector governance including both central and local government, with an occasional look at non government organisations (NGOs) and trusts as important partners in delivering the outcomes now sought by the public sector.

Governance, within the private, the public or the voluntary/community sector, is about structures, functions, processes and systems. But it is much more than that. Good corporate governance is not just conformance – having the right systems in place and doing the right things at the right time. It is about how to enable the performance hoped for from the organisation. Thus:

- In the speech cited above, the Australian Auditor General notes that:

  > *"Poor governance often involves inflexible, mechanistic approaches that provide an image of compliance (such as simple 'tick a box' approaches for instance to satisfy the auditors) with little real commitment to the principles of accountability, successful integration of the governance elements, and full disclosures aimed at improving transparency and performance."*

- In an article in the Harvard Business Review for September 2002, *"What Makes Great Boards Great"*, Jeffrey Sonnenfeld looks at the boards of failed companies such as Enron, Tyco and Worldcom. He notes:

  > *"A close examination of those boards reveals no broad pattern of incompetence or corruption. In fact, the boards followed most of the accepted standards for board operations: members showed up for meetings; they had lots of personal money invested in the company; audit committees, compensation committees, and codes of ethics were in place; the boards weren't too small, too big, too old, or too young. Finally, while some companies have had problems with director independence because of the number of insiders on their boards, this was not true of all the failed boards, and board make-up was generally the same for companies with failed boards and those with well managed ones."*

- The Independent for 26 March 2003 carried an article *"The Success of Any Company Depends Mainly on its Board"* by Colin Coulson-Thomas, Head of the Centre for Competitiveness at the University of Luton and Britain's first Professor of Competitiveness. He is blunt and to the point: *"Winning boards are distinguished by the attitudes and conduct of their members. Corporate governance arrangements are often a symptom rather than a cause of board effectiveness."* and *"Winning boards display*

the will to win and are driven to succeed. Their actions demonstrate commitment. They anticipate events, confront realities, take a longer term view and provide strategic leadership." In contrast, *"Directors of losing companies are preoccupied with their own status and remuneration. They confuse the roles of director, manager and shareholder. They concentrate on the internal, policing and stewardship aspects of corporate governance"* and *"Losers also react, imitate and copy. They jump on bandwagons and adopt 'me-too' approaches. They fall for fads, embrace panaceas and search for single solutions."*

From each of these quotations there is a sense that corporate governance as formal structures, processes, reporting requirements and so on is merely the form; that the substance of good corporate governance is more subtle – a function of performance, commitment and the values that people bring to their governance role.

In the rest of this paper I will cover the following topics:

- Are our governance practices tight enough?
- Tracking expenditure and funding – issues relating to NGOs and trusts in each sector.
- Reforming the public sector – how recent reforms have impacted the need for greater governance and control of funding and performance. (I will place a greater emphasis on local than central government in this theme.)
- Differentiating between ministerial, board, stakeholder and senior officer accountability for key outcomes.
- Interpreting the government's expectations of intent and key objectives for each sector. (This coverage will be brief – other presentations will cover this area in more detail.)

ARE OUR GOVERNANCE PRACTICES TIGHT ENOUGH?

I want to begin this section by picking up a theme that I partly developed in the introduction – the role of values and mission.

The question (set for me by the conference organisers) of whether current practices are tight enough is an ideal question for considering the underlying assumptions of our public sector governance practices. Its implication is that governance is about control – of ensuring that people don't "get away with it" or, at the very least, that you strike as good a balance as you can between monitoring and compliance costs on the one hand and whatever it is that they may "get away with" on the other.

Our public sector governance practices are firmly embedded in that body of economics known as public choice theory, with its strong emphasis on agent/principal and transaction costs theories.

Agent/principal theory recognises that, of necessity, substantial organisations will be managed by people other than the owners. The immediate question this raises is how the owner ensures that the manager's incentives are aligned with those of the owner.

Transaction costs theory recognises that the process of aligning incentives is not costless. We operate in a world of bounded rationality – information has its cost – and we are continually balancing the costs of controlling relationships (whether internally or externally through contracting) against the presumed benefits.

One of the leading writers on transactions cost theory, Oliver Williamson, identified two key conditions that organisational design needed to confront: a behavioural condition that he terms "opportunism" and the cognitive condition "bounded rationality" (which we have already discussed). Opportunism he defines as *"self interest seeking with guile".* It *"refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate or otherwise confuse"* (Williamson, 1985).

It is useful to consider the implications of that view for the governance of public sector organisations. The focus is on governance as control, both control by the owners over those who exercise governance in the organisation and, through them, over individuals within the organisation itself.

The emphasis is on minimising the extent to which the governors, and those whom they govern, can depart in any way from the intent of the owner (the government or minister) on whose behalf governance is exercised. Most importantly, it presumes that if they can they will – that the core problem for owners is that managers cannot be trusted.

We then need to consider what kind of conduct such an approach encourages. Arguably, one of compliance – of developing means for restricting managers to undertaking those activities, and only those activities, that the owner has prescribed.

There is an inherent difficulty with this approach. As the Prime Minister herself observed in the foreword to *"Growing an Innovative New Zealand"*, the document setting out the government's growth and innovation strategy "*We need to become a more innovative, more confident, more flexible economy which is able to compete successfully on the international scene".*

A similar statement can be found in the foreword by Steve Maharey, the Minister of Tertiary Education, in the government's tertiary strategy for 2002-2007. He concluded his foreword with the statement:

> *"We will need to balance a tertiary education system that has very successfully encouraged high levels of participation with the development of niche areas of specialisation and world-class capability. These challenges are also exciting opportunities to be innovative and to improve education outcomes. By working together, by focusing firmly on the future needs of New Zealand, and by learning from our mistakes, we can create a superb and dynamic tertiary education system which will be the envy of other small nations and which will help us to secure the economic growth we need and the prosperous, confident nation and distinctive culture to which we aspire.*"

Implicit in both of these statements is a recognition that we need managers who are innovative and able to think "outside the box" – to act in ways that, by definition, the owner would not have anticipated. If we are to have such managers and they are to have the confidence needed to reach their potential, then we require governance and accountability

arrangements (and an organisational culture) supportive of innovation – that is based on trust rather than distrust.

Support for this comes from a new way of looking at issues of organisational structure which is revisiting the essentially uni-dimensional approach of public choice theory by drawing on inputs from a range of social sciences.

One example of this is work being done at the ESRC Centre for Business Research at the University of Cambridge. In a recent paper, *"Theorising Corporate Governance: New Organisational Alternatives"*, Simon Leamount reviews new thinking coming out of an organisational approach to corporate governance. He observes that:

> *"Social sciences carry a special responsibility because of the process of the double hermeneutic: its theories affect the agents who are its subject matter. By assuming the worst, this theory can bring out the worst in economic behavior. By assuming opportunism and establishing it as his base case, Williamson is blind to forces that work to confirm or discredit the validity of his assumptions ... In the process, his theory is likely to encourage the very behavior that it takes for granted and seeks so hard to control."*

He then provides a useful critique of the conventional economist approach to organisational design:

> *" … to some extent or another, almost all current approaches to corporate governance ('economic' and 'organizational') ultimately focus on hierarchical controls such as fiat, incentives or monitoring mechanisms (Williamson 1996) which are aimed at attenuating the potentially opportunistic or utility-maximizing behaviour of company managers. Recently though, some organizational researchers have put forward ideas that as social organizations, the governance of firms might also usefully be explored in terms of non-hierarchical or social controls, which includes, for example, trust (Tyler and Kramer 1996; Lane and Bachman 2001) and the responsibilities and obligations that are engendered in everyday socio-economic interactions."*

> *"New institutional economists have recognized organizational trust for some time as an issue with implications for the way that companies are governed, and have attempted to extend and amend their theories to account for the phenomenon (Williamson 1993; Bromiley and Cummings 1995). The underlying assumptions of their approach to trust is that humans are self-interested and opportunistic; therefore the concern of transaction costs economics is to understand the constraints and sanctioning mechanisms that exist to enforce trustworthiness. In this view, it is generally assumed that trust is possible only in very small groups where there is repeated interaction, and is explained principally through calculation and hierarchical controls that proscribe individual self-interested behaviour (Varian 1990; Stiglitz 1993). Emerging notions of trust in the organizational literature, by contrast, propose that the economist's conceptualization is limited, and building on insights from other disciplines including psychology, sociology, political science and socio-biology aim to challenge the dominance of the 'rational choice' economic model of individual motivation (Rousseau, Sitkin et al 1998; Tyler and Kramer 1996)"*

Research of the type being undertaken at the Centre for Business Research at the University of Cambridge, at INSEAD in France and at the Danish Research Unit for Industrial Dynamics at the Copenhagen Business School invites a significant reappraisal of the way corporate governance has developed in recent years. It is particularly timely as governments respond to perceived failures in corporate governance in both the private and public sectors. Currently:

- The United States Government is implementing the Sarbanes-Oxley Act, its legislative response to Enron and other scandals. CEOs and CFOs now have to certify the correctness of their financial statements. From September of this year they will be required to certify the adequacy of the company's internal controls and the company's auditors will also have to attest to their adequacy.
- In the United Kingdom, the government has welcomed the Higgs Report (commissioned by the Secretary of State for Trade and Industry) which proposes a strengthening of the role of independent directors in the boards of listed companies including a new definition of "independent director" and a requirement that at least half the members of a board meet the new test as would all members of the audit and remuneration committees and a majority of the nomination committee. Although currently legislation is not intended as a backup to the Higgs recommendations, there is a clear message that the UK Government expects these new standards to be taken as a benchmark.
- The New Zealand Government is in the middle of its Review of the Centre, which includes potentially major changes in governance of Crown entities as well as for core government departments.

In one sense, all of this activity can be seen as a variation on the theme of the "knee jerk response". We have a problem, it looks as though the governance wasn't working effectively, so we need to tighten our governance requirements. The question we need to ask is whether all this is actually addressing the right problem. For example, if this paper were mainly about private sector governance, we would be looking at quite strong critiques of the idea of the "independent director" as necessarily the solution, at the impact of incentive schemes, at the role of institutional shareholders, and how (or whether it is possible) to inculcate a strong sense of business ethics in corporate leaders. We need to recognise that simply piling compliance cost on top of compliance cost may not be the best or only solution.

Obviously, rules do matter. Control and reporting systems are important, and it is essential that they convey quality information to people who need it. Equally important is the way in which we structure governing bodies.

My concern is that we need also to have regard to the underlying culture that informs what we do. As the Canadian paper on NGO governance cited above notes, values are central. As the Australian Auditor General emphasised, one of the things that matters in public sector organisations is the "tone at the top".

Ironically, with a government that has shown a strong antithesis to its predecessors' enthusiasm for a market-based approach, we still approach matters of public sector governance squarely within the principles of public choice theory as applied in the days of the Lange/Douglas Labour Government. Although we have moved structurally to create forms that look as though they provide a substantial degree of autonomy, we have done so

within an accountability framework whose underlying premise is one of distrust. We appear also to have created a strong imbalance between the purchase and ownership interests of the Crown. In relative terms, the purchase interest reigns supreme, with the governance interest – for example in the long-term capability of its organisations or in a "whole of government" approach – largely suppressed. One obvious consequence of this is the growing problem of capability in the public sector. Typically, the government's purchase role operates to minimise the potential for investment in capability development and government agencies, all too often, see recruiting from another agency as their "first best" means of increasing their own capability.

Of perhaps greatest concern, whether it is within core government departments themselves, in Crown entities, or in trusts and NGOs that may be contracted by the Crown, we face an unresolved conflict between our accountability culture and the conditions that promote innovative and dynamic management. I return to this theme later in this paper and close this part by suggesting that the issue is not so much one of tightening controls as one of realigning controls with the objectives the government is now setting for the public sector.

TRACKING EXPENDITURE AND FUNDING – ISSUES RELATING TO NGOS AND TRUSTS

In this section I want to be comparatively brief, simply highlighting what seem to me to be some key issues, namely:

- Capability.
- What do we mean by public money?
- Accountability

Capability

This is a crucial issue. As government places more and more weight on working through arm's length entities of various kinds, so it needs to pay more attention to capability. It is not sufficient to have very well specified requirements around the purchase side. It is also necessary to consider the capability of the arm's length entities through which government, or government entities, seek to pursue the outcomes they want. Specifically, do those entities have the governance capability needed to oversee the effective delivery of the services for which they are contracted?

In this respect, it is important to remember that purchase monitoring and accountability is essentially after the event. Prospective monitoring and accountability, which is what is really needed to ensure that an organisation is well steered, concentrating on the right things and putting the right resources in place, is the role of the governance body.

The experience of Child, Youth and Family and the Ministry of Health with Te Hau Ora O Te Taitokerau is instructive. It is clear with hindsight (and from reports I have read, should have been clear with foresight) that the board of this trust lacked the understanding of good governance, and the processes needed to support it, required to discharge their role. There has been much public criticism of them. In their defence, the question can be asked what

was government and its agencies expecting in passing over such significant responsibilities without either providing the board with the support it so clearly needed or ensuring that would be available?

My concern is that this may not be an isolated instance. With the emphasis now coming through on devolution, the demands on governance skills, in a society that is manifestly short of them, will increase dramatically. It is simply counterproductive to government's own objectives to proceed on the assumption that there will be good people available, often at a voluntary or highly discounted rate, to carry out the critical role of governance. Government needs to revisit this issue and ensure that it invests appropriately both in training and support, and in remuneration.

What Do We Mean By Public Money?

The example I want to use here is the recent public fracas surrounding certain expenditures claimed to have been made by the Pipi Foundation, an educational trust associated with the ACT MP Donna Awatere Huata. Well nigh universally, these expenditures were attacked as a misuse of public monies. From my perspective, that looks like a fundamental misunderstanding of the issue.

The Pipi Foundation was contracted to the Ministry of Education to deliver educational programmes. I have not seen the documents involved but assume that the Ministry of Education took the trouble to specify the outputs it required. The monies paid to the Foundation, provided that it had delivered the contracted outputs, became the money of the Foundation and ceased to be public monies.

It may be that the claimed expenditures took place and were unwise or improper. Provided that the contracted outputs were actually delivered, then no misapplication of public money was involved. Instead, the question of inappropriate or unwise expenditure is one of whether the expenditure was consistent with the purpose and objectives of the trust and whether the decision to undertake that expenditure was made through an acceptable due process within the trust structure – essentially a matter for the Attorney General in her role as the one public official who has the power to call charitable trusts to account.

A possible response to this analysis is that it is somewhat hair splitting – that surely the whole purpose of the Pipi Foundation was to deliver services to improve the reading skills of school children and that, in the broad sense, therefore all of its assets were public and should have been dealt with accordingly. In terms of broad public perception, that may be a fair criticism. In terms of addressing the issues, it would miss the point. If the Foundation had diverted monies from delivering the required outputs to apparently low priority expenditure for the benefit of trustees, then that would be a misuse of public money and remedies would arise at least under the contract with the Ministry and possibly through other means. If the Foundation had met its contractual commitments, then we are looking at a very different set of issues – the quality of governance and the mission (and incentives) of the organisation itself. It is important to distinguish the two.

Accountability

We have an extraordinarily disparate and inconsistent approach to accountability for organisations that spend public money or deliver services at a regional or local level.

Under the Local Government Act 2002, councils now face very detailed accountability requirements, both prospective and retrospective. Councils are now required to:

- Base their forward planning on identified community outcomes.
- In the course of decision-making in relation to a matter, give consideration to the views and preferences of persons likely to be affected by or have an interest in the matter and to do so at each of four stages: when the problems and objectives are defined; when the reasonably practical options for achieving an objective are identified; when those options are assessed and proposals developed; and when those proposals are adopted.

Other organisations, whose decisions may have at least as significant an impact on communities face very differing requirements:

- Gaming trusts, which collectively are now the single largest source of discretionary funding in New Zealand's communities, face no obligation to allow any community input into determining their objectives, their distribution policies or in monitoring the effectiveness of what they do.
- Community trusts (ex Trustbank) and energy trusts between them hold very substantial community wealth. The totals are hard to estimate but would be at least in the range $5 billion to $7 billion. Community trusts face no prospective accountability requirements. Retrospectively, they are simply required to publish audited accounts and lists of donations. The community has no right to be involved in determining the purposes for which those trusts apply their income or capital (although it should be noted that, in practice, community trusts are increasingly recognising the importance of engaging with their communities). Energy trusts, as a matter of law, are private trusts. Most (but not all) are elected but under a mandate that must be seen as relatively weak given the lack of public information – they are simply required to produce audited annual accounts.
- There are no standards regarding public accountability of the many trusts and other NGOs that now play an increasingly significant part in service delivery within their communities – other than the accountability requirements embedded in their purchase contracts with their government funder(s).

REFORMING THE PUBLIC SECTOR – HOW RECENT REFORMS HAVE IMPACTED THE NEED FOR GREATER GOVERNANCE AND CONTROL OF FUNDING AND PERFORMANCE

This is a conference topic in itself. As I noted in the introduction, this section will deal primarily with local government.

The Local Government Act 2002 is a very misunderstood piece of legislation. Most people outside local government believe that, as a result of its passing, we have moved from a situation in which local government was controlled by a highly prescriptive piece of legislation

to one under which it has “powers of general competence” – the legal ability to do virtually whatever it wishes.

This widespread view is wrong both as regards the previous Act and the present Act. Large parts of the previous Act were indeed quite prescriptive. However, that Act also contained one very important part that was virtually the equivalent of a power of general competence for a local authority to undertake or fund almost any kind of activity it wished *“to maintain and promote the general well-being of the public”* and *“encourage the development of such services, facilities, amenities and programmes as it considers necessary to provide for the recreation, amusement, and instruction of the public, and the provision or improvement or development or maintenance of amenities for the public”.*

The new Act, although cast in terms of powers of general competence, in some major respects is far more restrictive. A primary example is that councils are forbidden either to privatise water or wastewater services or use them as security for borrowing. Coupled with this are restrictions on contracting out management that are so tight as to be well nigh a ban on doing so. These provisions are a contrast with previous legislation under which councils had wide ranging discretion to engage the private sector in water and wastewater services.

More importantly, the new Act reflects a different view of the purpose of local government and the role of individual councils. Essentially, local authorities now have a statutory responsibility to *“enable democratic local decision-making and action by, and on behalf of, communities and to promote the social, economic, environmental and cultural well-being of communities, in the present and for the future”.*

The new Act reflects what appears to be a quite ambivalent approach by central government to local government. One the one hand, central government now clearly sees local government as an essential partner in pursuing the major social and economic outcomes government itself wishes to realise. On the other hand, it seems to reflect a profound distrust of local government. This appears not just from specific prohibitions such as those dealing with water and wastewater services, but also in the quite extraordinarily detailed and prescriptive accountability and reporting requirements.

Finally, and perhaps most importantly, the Act significantly enhances the importance of regional councils. Under previous legislation they were largely restricted to environmental management and regulatory activities. Under the new Act they have the same broad range of responsibilities as territorial local authorities. It is this particular reform that has the greatest implications for governance and the way in which services are delivered.

Most major social services have a local, a regional, a national and an international perspective to them. This includes things like economic development, health, social welfare, housing and education. A review of recent research and practice in each of these areas suggests that, increasingly, the most important of these dimensions is the regional one, as typically it is at the regional level that the great majority of impacts are internalised.

What this highlights is the importance of connectivity at a regional level – between central government agencies and instruments of regional governance, the most important of which will increasingly be the regional council.

What this suggests is that the major response need in terms of governance is how to develop the institutions for regional level collaboration between central government and regional governance. Establishing the first regional network of agencies is a current priority for the Review of the Centre. It will need to include clarity on matters such as:

- Central government/regional governance collaboration and partnership.
- Funding.
- Defining requirements for performance, recognising that regional councils will be driven by the Local Government Act emphasis on basing their planning on identified community priorities.

This will be the major challenge. Other issues of improving governance such as building the capability of the core public service and the culture of a collaborative sector will also remain important. All in all, a time of continuing major change in public sector governance, hopefully based on a clear understanding of the objectives the process is intended to serve and the values that should inform it.

DIFFERENTIATING BETWEEN MINISTERIAL, BOARD, STAKEHOLDER AND SENIOR OFFICER ACCOUNTABILITY FOR KEY OUTCOMES

Outcome responsibility has been a sensitive issue in the New Zealand public sector. The original concept of the Public Finance Act 1989 was that ministers would be responsible for outcomes and that the role of public servants was to deliver outputs, purchased by the minister to achieve his or her outcomes.

That was a model that quickly ran into difficulty. Ministers showed a reluctance to be held accountable for outcomes, partly for political reasons (not wanting to be pinned down too closely) and partly for the quite sensible reason that ministers were aware that much of what contributed to the delivery of outcomes was undertaken not by themselves but by public servants or others, often operating with a degree of discretion that the minister could not effectively control.

Treasury, for its part, took the view that it was not appropriate to hold public servants accountable for outcomes. One reason amongst others was that outcomes were seen as being multi-causal, thus making it difficult to establish a clear accountability linkage.

During that period, my firm became closely involved on behalf of one central government department which took the view that it should have a measure of outcome accountability – partly because of the particular tasks being set for it by government. In advising that department on its options, we looked at practice elsewhere and found that, despite the difficulty of the debate in New Zealand, there were parts of the world where common sense seemed to have prevailed.

We were particularly attracted to an approach put forward by the Auditor General of Canada and the Treasury Board Secretariat looking at public sector accountability. Their reasonable approach was that public servants did influence outcomes in a number of different ways, depending on the circumstances of the particular programme or programmes they were involved with, and that they ought to be held accountable accordingly. In their advisory role,

public servants could play a major influence in a minister's or ministers' decision on what outcomes they should seek to pursue and in advising the minister or ministers what outputs ought to be purchased for that purpose. Often, they would also have a very major impact on outcomes in the way in which they actually delivered services. Income support is an obvious example – how does the public servant at the counter treat the applicant for a benefit – in exercise of the discretion that, increasingly under a case management approach, is held at the counter.

Sensibly, the Canadians decided that although the principal outcome responsibility remained with ministers, public servants should be held accountable for:

- The quality and relevance of the advice that they gave in the selection both of outcomes and of the means used to achieve them.
- The impact of the way in which they delivered services on the achievement of government's outcomes.

The Canadians also concluded that, although it was ministers who remained accountable to parliament for outcomes, public servants should be answerable to parliament, not for the outcomes themselves but for the advice they have given ministers.

The New Zealand public sector seems, largely, to have got beyond the difficulties of the 1990s. Now, instead of taking the view that public servants have no outcome responsibility, we have shifted to recognising intervention logic as a key component in public sector policy formulation. This is the purely common sense view that, if an official cannot explain why he or she thinks that a particular policy initiative is appropriate to deliver a particular set of outcomes, and cannot explain how you might recognise progress towards those outcomes as the initiative unfolds, then perhaps the policy ought not be adopted.

New Zealand's public sector, though, has real difficulties ahead of it in dealing with the different accountabilities of ministers, boards, stakeholders and senior officers. In recent times my firm has been required to look quite closely at the governance and accountability of Crown Research Institutes (CRIs), especially in the context of the present government's growth and innovation framework.

There is a clear expectation that CRIs will play a central part in a research and development driven growth strategy for the New Zealand economy. CRIs are responsible for a major part of New Zealand's publicly delivered research and development activity. They employ – and often provide the only or the principal career option for - much of New Zealand's scientific talent.

Structurally, they operate as companies under a statute that requires them to undertake research for the benefit of New Zealand but also requires them to maintain financial viability which is defined as *"the activities of the Crown Research Institute generate, on the basis of generally accepted accounting principles, an adequate rate of return on shareholders' funds".*

Strictly speaking, that statutory requirement is one that obliges CRIs to generate a market-determined rate of return on investment within each reporting period. That is easiest done when producing relatively predictable outputs that are sold into relatively predictable markets. In the research environment, that requirement applies best to commercial consultancy –

product development, materials testing, etc. CRIs, operating with an expectation of innovation, need a different imperative. Consider the following extract from a recent INSEAD working paper *"The Theory of Innovative Enterprise"*. Its author has this to say of resource allocation in the innovative enterprise:

> *"Innovative resource allocation is strategic and, therefore, interpretative and experiential, so decision-makers must have control of resources if they are to commit them to a developmental process in accordance with their evaluation of the problems and possibilities of alternative learning strategies. They also require control to keep resources committed to the innovative strategy until the learning process has generated the higher quality, lower cost products that enable the investment strategy to reap returns. Thus, inherent in the process of innovation, in the need to commit resources to undertake it and the uncertainty of returns from innovative investments, is a need for control of resources by the decision-makers who shape the innovative process."*

For CRIs, the tension is compounded by the way in which they receive funding. CRI boards, typically, will develop a strategic plan and business plan at a "whole of organisation" level. They are not, however, free to allocate resources to support that business plan. Instead, a significant portion of funding (still, on average, around 50% of total revenue) comes from the Foundation for Research, Science and Technology (FRST) which will make its own judgements regarding the appropriateness of particular CRI projects or programmes. The practical effect is to remove from the CRI board the responsibility for delivering on the strategic plan and transfer it to a series of FRST reference groups whose focus is on part of the CRI's work and resource only, and which typically will have little understanding of the organisational impacts of decision-making.

This includes the impact on capability, probably the key reason why governments retain ownership of CRIs. Successive reflections on why government owns CRIs have each led to the conclusion that the real reason is to maintain a critical mass of scientific skill, and yet the means we have chosen for funding CRIs is almost deliberately structured so that the impact on capability cannot be taken into account. As a consequence, there is increasing evidence that capability within CRIs is under threat.

Against that background, let me look briefly at each of the four accountability dimensions, drawing some general lessons for the public sector.

Ministerial

The minister's roles include appointment of the board and signalling to that board government's expectations of its performance – through letters of expectation, the statement of corporate intent process, and other instruments available to the minister.

The board appointment process, as currently managed, does not appear consistent with government's expectations that CRIs should play a central role in research driven economic growth (something which may need to include CRIs playing a significant role in commercialisation of the research they undertake). There is little evidence that boards are appointed to ensure that CRIs have, consistently, the quality and capability of leadership they need. There are concerns in the sector that, too often, CRIs are seen as an opportunity to

give new directors experience or to satisfy government's concerns for ethnic, geographic or gender balance.

Innovation is inherently an multi-year process but ministerial levers for signalling to boards what is required of them are still driven by a short-term focus – including, recently, a requirement for CRIs to pay dividends almost regardless of the impact on their requirements for investment.

The generic lessons are:

- Appointments of directors to government controlled entities should first and foremost be focused on the contribution those people can make to achieving government's objectives for the entities. Directorates are not sinecures to be used in satisfying concerns about political balance, representation or the like. Especially in companies that are operating in highly challenging environments – as CRIs do – government risks seriously compromising its objectives unless it ensures that the best possible people are put in those positions and treated in a way that makes it clear to them how significant the role is. (The custom of discounting public sector director's fees to recognise an element of "public service" may have a superficial appeal on grounds of equity or political acceptability. It risks, however, downgrading the role of the director and his or her input in a way that carries very substantial costs with it.)
- Government entities should be tasked by ministers, and performance measured, not on a procrustean 12-month principle, but over a cycle that reflects the dynamics of the business that the government entity is in. For a multi-year business such as innovation, tasking and performance measurement should be on a multi-year basis.

Board

We need to remember the role of the board of directors when considering what their accountability should be. Whether it is the private sector role of being stewards of assets focused on adding value, the state sector role of exercising ultimate authority within an organisation – the "tone at the top" - or the voluntary/community role of achieving desired results and achieving them in the right way, we need to recognise the central role of the board. It requires:

- That the board itself is a capable board – made up of people with the right combination of skills, experience, personal qualities and standing to provide the leadership required.
- That the board has the discretion, within the framework set by government, to exercise its skills and experience.

This is particularly the case for boards such as those of CRIs, but also of other Crown entities (especially in the education sector) that operate within a purchase framework. With New Zealand's strong emphasis on what I term an accountability culture (by which I mean a culture of distrust leading to rule specification designed to constrain conduct), there is a very real risk of transferring key parts of board responsibility away from the board to the officials who drive the purchase process. This is certainly the case within CRIs. It is clearly an issue in much of the education sector – with strong constraints on the ways in which schools may go about undertaking their activity – but hopefully will be avoided in the tertiary sector.

The generic lesson is that, currently, we operate an arm's length purchase process concentrating on outputs. We have an alternative available of taking a relational contracting approach, based on building up relationships of trust and understanding between purchaser and provider, a relationship that assumes a commonality of objectives. (Obviously somewhat different issues arise for entities such as SOEs, which generate a commercial income, but the principles of ensuring alignment between government's objectives for the organisation and the instruments of governance it employs remain the same.)

Stakeholders

I am attracted to the concept of stakeholder accountability. Involving the people on whose behalf public sector activity is undertaken has a certain attractiveness about it, especially in a country under significant fiscal pressure.

Stakeholder accountability is really a way of responding intelligently to the fact that, in any democratic political process, inevitably interest groups will be demanding that government (or local government) give priority to their priorities – whether it is welfare for business, additional health care funding to provide elective surgery for older New Zealanders, increased resources for tertiary education, more investment in low income housing, or whatever.

Stakeholder accountability takes a different approach for vested interest groups of whatever kind. It is based on two assumptions:

- Stakeholders do have valuable knowledge that can be used in making resource allocation decisions.
- Stakeholders should carry some responsibility for decisions in areas of interest to them.

This requires a different approach from the current fashion for increased consultation. Stakeholder consultation and stakeholder accountability are two quite different things. Stakeholder consultation allows people to seek to influence a public process in their favour without any responsibility for the outcomes. To put it crudely, it allows them to try and influence the lolly scramble in their favour.

In contrast, stakeholder accountability is based on the premise that stakeholders should carry some of the consequences for the decisions resulting from their representations. Part of the purpose is to create processes of engagement through which stakeholders can understand that resources are, quite genuinely, limited and that additional government expenditure in one area inevitably means a combination of less in another and/or increased taxes. It is the process of making it clear there is no free lunch.

It is not a process to which we are accustomed. The closest example I have personally been aware of in New Zealand is some of the community health groups that operated under the former Central Regional Health Authority (CHG). CHGs were community groups used by the CRHA as a sounding board for the decisions it was taking in setting priorities for health care.

Of their very nature, CHGs represented a spectrum of health services consumers rather than a single interest group based on age, ethnicity, or medical condition. Before they were abolished (in those days we were increasingly focused on centralising decision-making), some of the CHGs had begun to get to grips with the central problem of social services

spending – how to make trade-offs within limited resources. In other words, they were showing signs of beginning to take responsibility for the consequences of the representations they were making.

We are a long way from any meaningful approach to stakeholder accountability but it is a concept that seems well worth pursuing – and one that is likely to become increasingly attractive to public officials as they wrestle with the alternative of ever increasing consultation with its incentives to pursue self-interest rather than the collective interest.

Senior Officers

Here, accountability will vary depending on the nature of the public sector organisation within which the person is a “senior officer”. Within entities structured on a corporate basis (most Crown entities, other arm’s length public bodies), the accountabilities are the conventional ones of implementing the objectives set by the board. Rather than focus on that, I want to say a word about the "whole of government” component of senior officer accountability.

Several years ago I undertook a project for the Border Control Review Team, exploring the issue of agent/principal relationships within Border Control Services. Essentially, what I was looking at was the relationship between the Customs Department, in its border control activity, and those ministries and departments whose own outputs and outcomes were dependent on Border Control Services. As examples, these included:

- The Ministry of Health, with its concern for the protection of public health.
- The Ministry of Agriculture and Forestry, with biosecurity responsibilities.
- The Immigration Department, with its interest that only those persons entitled to enter New Zealand actually did so.
- The (now) Ministry of Economic Development, with its tariff responsibilities.
- And about a score of other agencies.

Reflecting the quasi autonomous role of individual chief executives, some of these departments had been advising Customs that, in the relationship between them, they were the principal and Customs the agent, with the implication that Customs was required to do their bidding. Customs, for its part, was seeking within limited resources to balance the differing interests of all of those parts of government affected by the operation of Border Control.

The project was somewhat arcane in the sense of the theoretical underpinnings on which it drew, but relatively simple in terms of the outcome. What we had was a situation in which a series of government agencies was each arguing as though its interests and those of its minister should be the principal interest to which Customs responded. Applying an agent/principal approach to this led not, as those agencies had hoped, to the view that they should control Customs activities, but to the rather more sensible view that the principal was government and all of the parties, Customs and the ministries and departments with which it worked, were agents. To put it another way, the so-called “silo” approach was simply inappropriate.

More recently, much rhetoric has been directed to the death of the silo. Personally, I had taken much encouragement from this until a recent experience in the head office reception area of a client department. Amongst those sitting waiting were two individuals who, from their conversation, were clearly senior IT managers from government departments. Both were clearly involved in the e-government initiative and the discussion concerned a recent presentation on an aspect of that initiative. The one who had been at it was being asked by the other what had happened. The response was a scornful description of a presentation from someone who had suggested that there was scope within the way in which the initiative was developing for departments to write code that could be of assistance to other departments – something that seemed to me to be a perfectly natural expression of the kind of “whole of government, collaborative” approach we are now to expect from government agencies. Instead, the shared view of the two persons whose loud voices were broadcasting their views widely, was how naïve this presenter was. One went on to say, with vigorous agreement from the other, that if he did that kind of thing his chief executive would be irate and, as a first response, conclude that his unit must be over funded. Any concept of a “whole of government” approach was clearly absent from their thinking. The forcefulness of their comments also suggests that it was probably absent from the culture of their departments as well.

I give this example as it seems to me still to be the single most important issue in terms of senior officers within the public sector. It is also the example that illustrates the continuing imbalance within the public sector between the focus on governance of the sector and purchase, from autonomous agencies within the sector, of the outputs required by government. A purely purchase approach can operate at a micro level and on a department by department basis. A governance approach cannot. By its very nature, a governance approach must start with the overarching objectives of the “owner” which include optimising the owner’s interests across its portfolio of activities and ensuring that the capability remains in place to deliver on that portfolio not just now but in the future.

This is a matter that does require a culture change but, also, requires a revisiting of the instruments of governance determining the relationship between ministers and chief executives, and between departments and the entities with which they contract.

INTERPRETING THE GOVERNMENT’S EXPECTATIONS OF INTENT AND KEY OBJECTIVES FOR EACH SECTOR

This, clearly, is still work in progress. At this conference, others will be addressing aspects of that. I simply note the importance of ensuring that statements of intent take a whole of government approach and that the “vital few outcomes” that are their central feature are firmly based on this.

CONCLUSION

There is no doubt that New Zealand’s public sector faces some very real challenges in the area of governance and accountability. If there is one message I want to leave people with from this paper, it is the importance of focusing on the purpose of governance. It is not simply a set of compliance instruments designed to ensure a close alignment between government’s requirements (official’s perceptions?) of the activities that government

agencies and entities should be undertaking. Rather, it is the means through which to empower government organisations and those with whom they have contractual or other relationships for achieving government's outcomes to do so in innovative and value-adding ways. This requires an approach to governance and accountability based on trust rather than, as seems embedded in the present system, distrust.

The change may not be fundamental in terms of the instruments of governance or the processes of accountability. It may, though, prove to be quite far reaching in terms of culture change, particularly in giving people the "space" they need. This challenge will be particularly demanding in areas such as research and development, economic growth, and the development of collaborative arrangements between the centre and regions/localities. In each of these instances, to generate the value we are looking for (increased economic growth; better social outcomes) we are looking at performance which is:

- Best measured over a multi year than a single year reporting period.
- Difficult to forecast and thus requiring significant discretion.
- Strongly reliant on people voluntarily making the commitment to deliver their best rather than simply meeting required compliance standards.

It will also be important for government to recognise that, alongside the question of what kind of governance is the separate one of capability. Without significant investment in developing capable governance, it is unlikely that we will get the outcomes we seek.

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