ccmau
CROWN COMPANY MONITORING ADVISORY UNIT
TE MATA AROTURUKI RAWA A TE KARAUNA

Protecting and enhancing shareholder value

Owner's Expectations Manual for Crown Research Institutes

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1 INTRODUCTION

This manual outlines shareholding Ministers' expectations of the directors of Crown research institutes (CRIs). It is designed to help boards to operate efficiently in their roles and to clarify their responsibilities. It also takes account of the particular expectations of board members in companies owned by the Crown, as opposed to private or publicly listed companies.

The manual is not intended to replace the annual Operating Framework for CRIs (attached in Annex 1) or outlook letters sent by shareholding Ministers at the outset of the annual business planning round. The Operating Framework outlines expectations regarding the role of CRIs in the science system and their particular activities such as, for example, collaboration and technology transfer. The Owner's Expectations Manual, on the other hand, does not focus on the operational activities of the CRIs but on the expectations placed on their boards with regard to governance, reporting and their role and responsibilities in general.

This manual and the Operating Framework should be read in conjunction with relevant legislation such as the Companies Act 1993 (Companies Act), the Crown Entities Act 2004 (CE Act) and the Crown Research Institutes Act 1992 (CRI Act), which place certain obligations on CRIs. This manual should also be read in conjunction with other current expectations and ownership policies previously communicated to CRI boards.

The manual applies only to CRIs and not to state-owned enterprises or other Crown entity companies.

The manual replaces the previous version of the Owner's Expectations Manual and will be updated periodically as processes, policies and shareholding Ministers' expectations change. It is also available on CCMAU's website at www.ccmau.govt.nz.

2 CRI FRAMEWORK

Crown company model

During the 1980s, the government began using the company model as part of its broader state sector reforms.

Under the company model, Crown-owned companies:

- operate at arm's length from the government (unlike departments, Crown-owned companies are not part of the Crown but are owned by the Crown)
- have independent boards that are accountable for the companies' performance
- are separate legal entities with directors who are responsible for overseeing the management of the business and affairs of the companies
- are subject to the financial reporting and other requirements applying to all companies, together with any relevant sector-specific legislation (including the CE Act and the CRI Act for CRIs).

CRI model

As part of reforms to the science sector, the CRIs were established in 1992 as limited liability companies under and subject to the Companies Act. Until then, government departments (principally the Department of Scientific and Industrial Research) undertook the activities that are now carried out by the CRIs.

Each CRI is also subject to the CE Act and the CRI Act. These Acts address the ownership, governance and public accountability arrangements for CRIs.

Under the CRI model:

- the purpose of each CRI is to undertake research
- each CRI, in fulfilling its purpose, is to operate in accordance with the following principles:
  - o the research that it undertakes should be undertaken for the benefit of New Zealand

- to pursue excellence in all its activities
- in carrying out its activities, to comply with any applicable ethical standards
- to promote and facilitate the application of its research and technological developments
- to be a good employer
- to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage those interests when able to do so
- to operate in a financially responsible manner so that it maintains its financial viability.

CRI governance structure

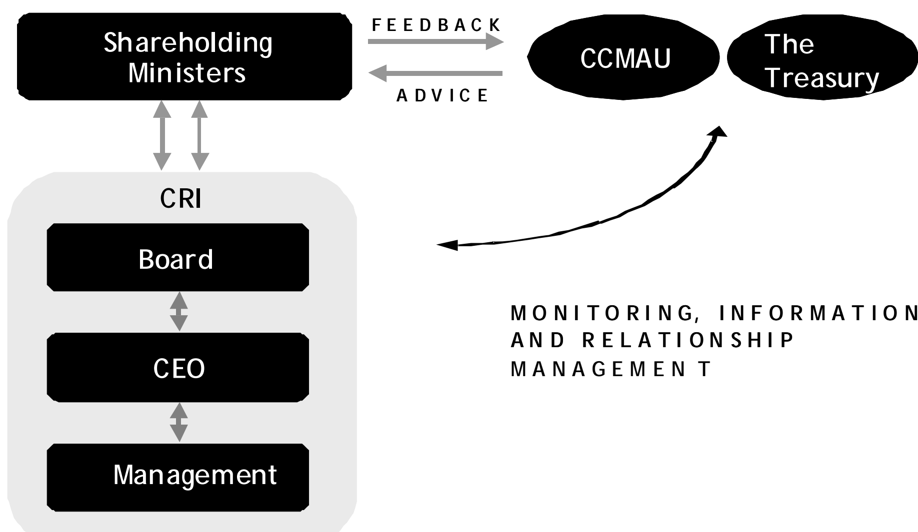
The Crown is the sole shareholder of each CRI and acts to protect its investment on behalf of the people of New Zealand.

Each CRI has two shareholding Ministers: the Minister of Research, Science & Technology and the Minister of Finance, each of whom holds 50% of the company's shares.

Shareholding Ministers appoint a board of directors to oversee the management of the business and affairs of each company. CRI directors are subject to a number of duties under the Companies Act, including the duty to act in the best interests of the company. The board generally delegates a number of its powers to the company's chief executive officer (CEO) to enable him/her to carry out the tasks of managing the company. However, the board generally remains ultimately responsible for the exercise of those powers.

Officials at CCMAU and the Treasury monitor CRIs on behalf of, and provide advice to, shareholding Ministers. The respective role of shareholding Ministers, boards, managers and officials is shown in Figure 1 below.

Figure 1 CRI governance structure



Role of the CRIs in the science system

The current government's agenda is to continue New Zealand's transformation to a high-value, knowledge-based economy. CRIs have a key role to play in achieving this objective.

The government sees CRIs as agents for transformation by creating the value that will create advantage for New Zealand. The importance of CRIs to New Zealand as repositories of nationally important skills and capabilities is the reason why the government will continue to own them. The government sees CRIs as part of New Zealand's national public research infrastructure and expects them to operate always with the delivery of New Zealand benefit at the forefront of their thinking.

A strong focus of the government's economic transformation agenda is the strengthening of links between CRIs, tertiary education institutes (TEIs) and firms. Such interconnectivity is seen as vital for the successful functioning of New Zealand's innovation system. There is an enduring expectation that CRIs will strengthen their research and commercialisation linkages with TEIs and deepen the quality of their engagements with industry stakeholders.

3 SHAREHOLDER ROLES AND RESPONSIBILITIES

Shareholding Ministers' role and responsibilities

Both shareholding Ministers, the Minister of Research, Science & Technology and the Minister of Finance, are 'responsible Ministers' in terms of section 10 of the CE Act.

The Minister of Research, Science & Technology generally takes the lead shareholder role, particularly in his/her capacity as the formal point of contact with boards.

The role of the Minister of Finance as a CRI shareholder reflects the importance of the sector to the Crown's economic and financial objectives. From time to time, the Minister of Finance may delegate some of his/her responsibilities to an Associate Minister of Finance.

Under the CE Act, the role of shareholding Ministers is to oversee and manage the Crown's interests in, and relationship with, CRIs and to exercise any statutory responsibilities given to them, including under the CE Act and the CRI Act.

In practice, shareholding Ministers' responsibilities include:

- appointing and removing directors (including chairs and deputy chairs)
- commenting on the content of draft SCIs and business plans, including any aspects that may be inconsistent with statutory requirements and the Operating Framework for CRIs
- supporting the CRIs' medium- to long-term strategic direction
- tabling final versions of SCIs in the House of Representatives
- developing and communicating the government's ownership policies, in particular through the Operating Framework for CRIs
- monitoring board performance and taking necessary remedial steps should boards fail to meet the targets in their SCIs and business plans
- consulting with boards as issues arise
- tabling annual and half-yearly financial reports in the House of Representatives

- taking decisions as a shareholder, eg approving a major transaction under the Companies Act or other transactions where such approval is required under a company's Statement of Corporate Intent (SCI)
- passing resolutions at annual meetings or special meetings, or agreeing to pass written resolutions in lieu of such meetings.

Shareholding Ministers' powers

Shareholding Ministers' statutory powers in relation to CRIs are set out in the Companies Act, the CE Act and the CRI Act.

Generally, shareholding Ministers have statutory powers to:

- exercise their rights as a shareholder under the Companies Act
- subject to the requirements of the CE Act and the CRI Act:
  - direct the board to alter certain provisions of the company's SCI
  - determine the level of dividend payable by the company in respect of any financial year or years
  - require additional information from the company.

Shareholding Ministers are required to exercise their powers in a manner that is consistent with the purpose, and principles of operation, of a CRI.

Ministerial directions

Shareholding Ministers have no power to direct CRIs to have regard or give effect to a government policy unless specifically provided in another Act (section 105 of the CE Act).

Section 15 of the CRI Act gives shareholding Ministers the power to direct a CRI to alter certain provisions of its SCI and/or determine the level of dividend payable by a CRI in respect of any financial year. Before giving such a direction shareholding Ministers are required to consult with the board of the CRI. They are also required to table notice of the direction in Parliament, and to publish it in the *Gazette* as soon as practical after giving the direction to the board. This ensures that shareholding Ministers are accountable to Parliament for the exercise of their statutory powers.

In addition, section 7(6) of the CRI Act requires directors of CRIs to have regard to any whole-of-government direction given under section 107 of the CE Act that relates to Crown entity companies. Section 107 allows the Ministers of Finance and State Services to direct jointly Crown entities to comply with specified requirements for the purpose of both supporting a whole-of-government approach and, either directly or indirectly, improving public services. Such directions may be given only to one or more categories of Crown entities, and not to individual Crown entities. Thus, CRIs would only be required to have regard to a whole-of-government direction that applies to all Crown entity companies.

Before giving a whole-of-government direction, the Ministers of Finance and State Services must consult with the entities to which the direction is proposed to apply and those persons that the Ministers consider are representative of the interests of persons likely to be substantially affected by the proposed direction. As soon as practicable after giving the direction, the Ministers must notify the entities to which the direction will apply and present the direction to the House of Representatives. The direction comes into force 15 sitting days after it is presented to the House of Representatives, unless the House resolves, in that period, to disapply the direction. As soon as possible after the direction comes into force the Ministers are required to publish it in the *Gazette* and on the internet.

The Prime Minister also has the ability under section 43 of the CRI Act to give directions to CRIs in times of national emergency.

The monitoring function

As owner of the CRIs, the government is obliged to manage its investments in the best interests of New Zealanders. The monitoring function is, therefore, central to ensuring that relevant legislation, ownership policies and shareholding Ministers’ expectations are clearly communicated and that CRI boards have appropriate regard to them.

The shareholding Ministers’ monitoring function is similar to that undertaken by equity holders in the case of private sector companies. However, shareholding Ministers face certain constraints, including the following, that are not faced by private sector equity holders.

- Shareholding Ministers cannot divest themselves of ownership of the CRI without empowering legislation.
- Unlike listed companies, CRIs do not have a share price that shareholding Ministers can use to monitor company performance.

For these reasons, it is important to monitor CRIs and receive timely and relevant information from them. The CE and CRI Acts, therefore, give shareholding Ministers certain powers over and above those of ordinary shareholders, eg the power to require information.

The success of this monitoring regime relies on:

- a common and clearly understood framework of accountability and governance
- the implementation of best-practice corporate governance policies and procedures by CRIs
- clear and focused board accountability
- independent advisors being familiar with and understanding the CRIs they monitor and the sectors in which they operate so that shareholding Ministers receive expert advice.

The roles of advisors

Shareholding Ministers receive ownership advice on CRIs from two main sources: CCMAU and the Treasury. This advice may be supplemented by input from other agencies on issues that affect the environment in which the CRIs operate, such as the research, science and technology portfolio.

Both CCMAU and the Treasury are required to develop and maintain a detailed knowledge of each CRI's operations and operating environments to assess whether individual CRIs are meeting shareholding Ministers' expectations.

Advisors focus on:

- the environment in which the CRIs operate
- protecting and enhancing shareholder value
- performance against financial and non-financial objectives
- establishing ownership objectives for individual CRIs and the CRIs as a whole
- developing ownership policy advice for shareholding Ministers.

Advisors also contribute advice on general policy that affects CRIs in consultation with other departments, as appropriate. However, final decisions on all CRI issues remain with shareholding Ministers or Cabinet.

CCMAU and the Treasury share some monitoring roles including:

- advising on strategic issues, ownership policy issues, investment and diversification opportunities, and capital structure
- analysing business cases presented by CRIs for significant and major transactions (where the CRIs are required to seek the approval of shareholding Ministers).

Each agency brings a different perspective to the monitoring role. These complementary roles are described below.

CCMAU's role

CCMAU advises the Minister of Research, Science & Technology. It has lead agency responsibility for:

- routinely monitoring the CRIs' financial and non-financial performance
- advising on restructuring issues, and the impact of wider innovation system policy positions on CRIs (in this latter role CCMAU has frequent interactions with the Ministry of Research, Science & Technology (MoRST), the Ministry of Economic Development, the Foundation for Research, Science & Technology (FRST) and other government agencies)

- issue management, which includes advising shareholding Ministers on ministerial correspondence, requests under the Official Information Act 1982 (OIA), parliamentary questions and other issues that arise.

CCMAU has sole responsibility for advising on board composition and performance and managing the director appointment process.

CCMAU is the daily point of contact with the CRIs and should be sent all routine reports (quarterly, half-yearly and annual reports) and other process-related documents.

The Treasury's role

The Treasury advises the Minister of Finance and Associate Ministers of Finance.

The Treasury manages the Crown's finances and is the government's principal advisor on economic and financial issues. Therefore, it focuses on both economic efficiency and the fiscal impact of CRI performance, ie the impact on the Crown's balance sheet, economic efficiency and welfare, and the regulatory/policy interface.

The Treasury may take the lead on issues relating to wider ownership and innovation system policy formation.

Relationship with officials

Boards, particularly chairs, are expected to work closely and cooperate with CCMAU and Treasury officials as the conduit of information and advice to shareholding Ministers. It is expected that a good working relationship will develop between CCMAU and the Treasury and CRI board members and senior managers.

Boards may wish to invite officials to be present during parts of board meetings or annual business planning sessions, if required, to discuss issues or to clarify shareholder expectations. Such invitations are entirely at the discretion of each board.

4 CRI REPORTING AND ACCOUNTABILITY

This section summarises reporting requirements under the CRI Act and outlines shareholding Ministers' other reporting requirements and how this works in practice. It also addresses CRIs' accountability to Parliament through select committees.

The business planning process

The business planning process, which culminates in boards submitting a final SCI, is critical in maintaining a strong and mutually supportive relationship between the shareholder and the company.

A table of key reporting dates in the business planning cycle is set out on page 21. The key steps are as follows.

Outline of expectations

In or around December/January of each year, shareholding Ministers send an outlook letter to each board to detail the information requirements, the timing, and any specific issues the company is expected to address during the planning round. Shareholding Ministers usually enclose with the outlook letter the annual Operating Framework for CRIs. This document outlines the general expectations for the CRIs and includes a company-specific addendum which outlines specific expectations for each CRI. The Operating Framework is a public document and is available on CCMAU's website and sent to relevant stakeholders.

Submission and review of business plan and draft SCI

Each CRI board then provides shareholding Ministers with a draft SCI supported by the company's business plan. Whereas the SCI is a 'high-level' document outlining in broad terms a CRI's plans for the next three years, the business plan document is expected to provide more comprehensive and detailed information on the CRI's three-year strategy with particular focus on the first 12 months.

The SCI is 'draft' at this stage in so far as it cannot be 'final' until shareholding Ministers have provided their support. Nevertheless, as far as the company is concerned, the SCI (and the business plan) sent to shareholding Ministers should be the board's final version.

The CRI Act requires the board of each CRI to deliver its draft SCI to shareholding Ministers at least one month before the start of each financial year (ie the end of May).

Shareholding Ministers' preference, however, is that CRIs provide their draft SCIs and business plans by the start of May to allow time for meaningful review. If, for any reason, a CRI considers that it cannot meet this deadline, it should contact CCMAU as early as possible.

Sections 16(2) and (3) of the CRI Act set out the information to be contained in each CRI's SCI, including the objectives of the group, the nature and scope of its activities, and the financial and non-financial performance targets (including the research application indicators) by which the company may be judged in relation to its objectives. Each CRI's SCI should clearly identify the information required by these sections of the CRI Act. SCIs should also contain information on intended use of CRI Capability Fund monies, in line with the CRIs' contract with MoRST.

Shareholding Ministers expect the performance targets and measures in each SCI to be meaningful and related to the drivers of each CRI's performance. In terms of non-financial performance, the CRIs are expected to set targets for the indicators listed in Annex 2 which refer to staff numbers and the performance of the CRIs in applying their research results and technologies. These activities are in line with section 5(1) of the CRI Act. CRI boards may also wish to include other targets that demonstrate their science excellence, good employer practices, or environmental performance.

Once the draft SCI and business plan are received, advisors prepare a report for shareholding Ministers outlining the key aspects of each CRI's future strategy. As part of this process, advisors will engage with each CRI to clarify any questions arising out of the business plan and draft SCI.

Finalising, tabling and releasing SCIs

Under the CRI Act, shareholding Ministers may comment on the draft SCI, which may include a request for further information or clarification on certain matters. This may be in the form of a letter or, if required, in a meeting between shareholding Ministers, advisors and the board. The comment may also include an extension to the date by which the final SCI is delivered to shareholding Ministers.

Boards are required to consider any comments by shareholding Ministers on the draft SCI no later than 14 days before the start of the financial year and deliver a final SCI to shareholding Ministers on or before the start of the financial year or such later date that shareholding Ministers have determined.

The responsible Minister is required to table the final SCI in the House of Representatives within five working days of its receipt. The SCI should be made publicly available only once this has occurred. Once tabled, CCMAU will place a PDF copy of each CRI's SCI on the CCMAU website. CRIs are encouraged to make their SCIs widely available.

The business plan is not a public document and is not tabled. Nevertheless, some CRIs choose to share their business plan or an abbreviated version of it with staff members and other stakeholders.

If the board of a CRI wishes to amend its SCI after it has been tabled, it must advise shareholding Ministers and consider any comments shareholding Ministers may have on the proposed modification(s). Section 16 of the CRI Act sets out the process for making amendments to an SCI during the year.

Reporting to shareholding Ministers

Quarterly reports

While not required under the CRI Act, shareholding Ministers expect each CRI's SCI to specify that quarterly reports will be provided to shareholding Ministers no later than the end of the month following each quarter. This is a standard reporting expectation that applies to all Crown-owned companies.

There are no set requirements for the content of quarterly reports although they are expected to provide information such as key science and business highlights and financial performance information. Shareholding Ministers expect the financial information and commentary in each CRI's quarterly report to summarise fully and accurately the company's performance against budget, identify the cause of major variances, signal any potential developing issues, and highlight major achievements for the quarter. This is expected to include:

- financial statements including a profit and loss statement, statement of financial position, and statement of cash flows
- non-financial information, especially key performance indicators for the business
- any other performance measures in the SCI that are not already covered.

This information should be provided on a current quarter and year-to-date basis with a comparison against budget for each. CRIs may also wish to provide data for the relevant period in the previous year.

Additionally, shareholding Ministers expect quarterly reports to include the following information:

- full-time equivalent staff numbers
- a clear statement of the CRI's outlook for the rest of the financial year in terms of achieving its SCI targets, key opportunities, threats, and management plans.

In each financial year's first-quarter report, CRIs are also required to present additional information on their subsidiaries and associate companies. This information should include a list of all subsidiaries and associates, their purpose or main business area, the CRI's percentage level of holding, and the amount of paid-up capital invested in the subsidiary/associate.

Quarterly reports are confidential to shareholding Ministers and their advisors and not made public, although Cabinet receives a summary report on each CRI's performance and outlook.

Half-yearly reports

CRIs are required to deliver their half-yearly report to shareholding Ministers within two months of the end of the first half of each financial year, ie by the end of February. The CRI Act does not specify the information to be presented in half-yearly reports; rather, the content is specified in each CRI's SCI.

The responsible Minister is required to table each half-yearly report in the House of Representatives within five working days of receipt. Half-yearly reports should be made publicly available only once this has occurred.

Annual reports

CRIs are required to deliver their annual report to shareholding Ministers within three months of the end of the financial year (although shareholding Ministers' preference is that each CRI will provide them with a draft version of the annual report before it is finalised). The required content is outlined in section 211 of the Companies Act, section 152 of the CE Act, and section 17 of the CRI Act. Among other things, the annual report is required to contain information necessary to enable an informed assessment of the operation of each CRI including a comparison of its performance with its SCI.

The annual report should provide a comprehensive report on the company's business so that members of the public are able to understand clearly the nature and scope of the company's operation. The annual report should also strive to meet current best-practice disclosure guidelines including those relating to governance practice (see section 8 for more detail). The annual reports are also expected to contain information on each CRI's use of CRI Capability Fund monies, in line with the CRIs' contract with MoRST, and performance against the research application indicators.

The responsible Minister is required to table each annual report in the House of Representatives within five working days of receipt. Annual reports should be made publicly available only once this has occurred.

Besides the information required by statute and that referred to in each CRI's SCI, the remaining content of the annual report is a decision for the board of each CRI. As Crown-owned organisations which receive significant public funding for their activities, there is a preference that the CRIs provide a sufficient level of information on their science and technology transfer activities and the impact of their activities on New Zealand's society, economy and environment.

Table of key reporting dates

The table below shows the key dates for the business planning round and regular reporting.

Business planning round	
December/January	Shareholding Ministers send outlook letters and the Operating Framework to boards. The outlook letter details shareholding Ministers' expectations of, and information requirements for, the business planning round. The Minister of Research, Science & Technology meets with boards (possibly with the Minister of Finance or his/her representative).
By end of April	Boards submit their business plan and draft SCI to shareholding Ministers.
By 16 June	Boards consider shareholding Ministers' comments (if any) on the business plan and draft SCI.
On or before 1 July (or such later date as shareholding Ministers determine)	Boards deliver their final SCI to shareholding Ministers.
Within 5 working days of receipt by shareholding Ministers	The responsible Minister tables the SCI in the House of Representatives. SCIs should be made publicly available only once they have been tabled.
Quarterly reports	
Within one month after the end of the quarter, ie 31 October 31 January 30 April 31 July	Boards deliver their quarterly report to shareholding Ministers. CCMAU prepares a report which is presented to Cabinet. Quarterly reports are not made public.

Half-yearly report	
By 28 February	Boards deliver their half-yearly report to shareholding Ministers. Each report must include the information specified in the SCI. Half-yearly reports should be made publicly available only once they have been tabled.
Within 5 working days	The responsible Minister tables the half-yearly report in the House of Representatives.
Annual report	
30 September	Boards deliver their annual report to shareholding Ministers.
Within 5 working days of receipt by shareholding Ministers	The responsible Minister tables the annual report in the House of Representatives. Annual reports should be made publicly available only once they have been tabled.
Annual meeting	
By 31 December	Each CRI is to hold an annual meeting no later than 6 months after its balance date and no more than 15 months may elapse between the date of one annual meeting and the next. An annual meeting does not need to be held if everything to be done at the meeting is dealt with by a written shareholder's resolution. Where relevant, resolutions are expected to note: • that shareholders have received the company's annual report for the most recent financial year • the appointment of the company's auditor • the board's decision (if any) as to the payment of a dividend. Shareholding Ministers should not be asked to confirm, approve or ratify the payment of any dividend as this is a decision for the board.

Other expectations

Provision of official information

CRIs are subject to the OIA. In handling requests made under this Act, the CRIs are expected to respect the underlying principle of, and comply fully with, the Act in terms of making information available to the public within the stated deadlines unless there is good reason for withholding information.

In general, as accountable Crown-owned organisations, the CRIs are expected to be open in their communication with the public and to respond in a timely and adequate manner to requests for information, provided that such information does not jeopardise a CRI's commercial position or in any other way harm its interests. It should be noted that members of the public who fail to receive an adequate response from a CRI may, in some cases, draw the issue to the attention of shareholding Ministers.

'No surprises' policy

Ministers expect boards to be sensitive to their interests. Boards must be mindful that Ministers are accountable to a wider audience and the affairs of the companies, positive and negative, can impact on the responsible Minister. This is referred to as the 'no surprises' policy, further detail of which is set out below. A failure to keep Ministers informed on significant issues at appropriate times can create situations that may divert attention from a company's day-to-day business.

Under the 'no surprises' policy, shareholding Ministers expect to be informed well in advance of any material or significant events, transactions and other issues that could be considered contentious or attract wide public interest, whether positive or negative. Examples of matters that could fall within the 'no surprises' policy include, but are not limited to:

- changes in CEOs
- potential/actual conflicts of interest by directors
- potential/actual litigation by or against the company, its directors, or staff
- fraudulent acts by the company's directors or employees
- breaches of a CRI's corporate social responsibility obligations (refer section 5)
- transactions that affect the ownership of intellectual property
- significant company restructuring
- large-scale redundancies
- industrial disputes
- significant health and safety issues

- the release of significant information under the OIA
- imminent media coverage of science or organisational activities that could attract critical comment or on which shareholding Ministers could be asked to express a view.

Shareholding Ministers expect boards to:

- understand wider government policy issues as part of their decision-making
- be aware that the Crown has interests wider than those of ordinary shareholders in private companies
- be aware of the potential implications of company-specific issues on the Crown and/or its balance sheet
- be sensitive to the demand for accountability placed on shareholding Ministers from both Parliament and taxpayers.

Shareholding Ministers' expectations in relation to the 'no surprises' policy are not intended to detract in any way from directors' statutory obligations.

Depending on the details or circumstances of the issue, communication can be by way of a telephone call, e-mail, letter or a meeting between the board and shareholding Ministers. Boards should advise of the details of the issue and what the board intends to do to respond. CCMAU is the first point of contact for most issues and will pass on relevant details to Ministers' offices.

Visits by MPs

There is an established protocol for visits by MPs to CRIs.

- Visits by electorate MPs are acceptable for genuine electorate duties.
- Similarly, visits by party spokespeople in the CRI, science or closely related portfolios are acceptable.

CRIs should always contact the Minister of Research, Science & Technology's office before agreeing to or organising any visits/briefings. CRIs are encouraged to set an agenda before any such meeting and to ensure that visitors adhere to that agenda. Visits by MPs (other than the CRI, science or related spokespeople) for general familiarisation or discussion purposes are not encouraged.

Accountability

Select committees

Select committees have wide powers to require people to appear before them and to give evidence. Among other roles, they play an important part in assessing the performance of CRIs.

There are several reasons for which a CRI may appear before a select committee.

- A CRI could be asked to advise a select committee on legislation under formation.
- A CRI may wish to make a submission on a bill as a witness.
- A select committee may receive a petition from private citizens regarding a CRI, which may then be called in for a review.
- Every select committee has the power to launch an inquiry, and could call a CRI in to provide evidence (an example could be 'the state of scientific research in New Zealand').
- In addition, CRIs are regularly required to appear before the Education & Science Committee (or another select committee delegated by the Finance & Expenditure Committee) for a financial review. Normally, the chair and CEO of the CRI are expected to appear before the Committee. It is not usual for external legal representation to attend. CRIs should view these financial reviews as opportunities, rather than impositions, to emphasise the importance of what they do.

Shareholding Ministers expect to be advised before any CRI appears before a select committee. They also expect the boards and management of CRIs to be open and forthright in their dealings with select committees.

If the chair of a CRI has concerns about providing information to a select committee, shareholding Ministers expect these concerns to be raised with the committee, rather than refusing to provide the information. If, notwithstanding the CRI's concerns, the select committee requires the information to be provided, the chair may request that the committee receive the information as private or secret evidence. Chairs are encouraged never to refuse to answer a question outright.

Shareholding Ministers expect CRI boards and management to be aware of, and to familiarise themselves with, the Standing Orders of the House of Representatives before appearing in front of select committees. Boards may wish to consider obtaining specific training in this regard. In particular, the Standing Orders provide rules relating to Parliamentary privilege. Parliamentary proceedings are subject to absolute privilege, to ensure that those participating in them, including witnesses before select committees, can do so without fear of external consequences. This protection, enshrined in the Bill of Rights 1688, is an essential element in ensuring that Parliament can exercise its powers freely on behalf of its electors. There must be no pressure placed on individuals to deter them, or action taken against them as a direct consequence of their giving evidence to a

select committee. Any such action might be regarded as contempt of the House, with potentially serious consequences for those involved.

Further information on select committees can be found in the State Services Commission's *Officials and Select Committees – Guidelines* (http://www.ssc.govt.nz/officials-and-select-committees-2007) and in the procedural guides *Natural justice before Select Committees* and *Working with Select Committees* on the New Zealand Parliament website (http://www.parliament.nz/en-NZ/PubRes/About/Procedures).

5 SOCIAL RESPONSIBILITY

The CRI Act requires every CRI to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so. Therefore, CRIs have corporate social responsibility (CSR) obligations that go beyond those of other companies.

There are a number of leading international frameworks available to provide guidance on how CRIs could approach CSR. These frameworks emphasise that CSR is not just about visible programmes, but is also more importantly about values and behaviours evident in an organisation's day-to-day operations. Accordingly, prescriptive approaches to CSR are unlikely to be successful, and it is recognised that one size does not fit all.

However, it is important to note that, in addition to having CSR programmes in place, CRIs have a fundamental obligation to behave in a socially responsible manner at all times. This obligation should, therefore, be reflected in all policies and be evidenced by company practices. To this end, shareholding Ministers are particularly sensitive to any breaches of a CRI's obligation to act in a socially responsible manner.

CRI boards must report any such breaches to shareholding Ministers as soon as practicable after any breaches are brought to the boards' attention. Likewise, breaches should also be disclosed in the companies' annual reports. Robust procedures and accountabilities should also be put in place to ensure details of any breaches are communicated to boards in a timely way.

The most effective and appropriate way to address the CSR obligations of CRIs is to integrate CSR into the existing business planning process, with officials providing guidance and monitoring input to help with the consistency and quality of CSR plans.

Such an approach puts CSR objectives on the same footing as financial objectives. Targets and objectives are set in the annual SCIs, and subsequently reported against to help ensure transparency and accountability for good CSR practices.

Under the CSR framework, the onus is on each CRI to look hard at the way it conducts its business, and put in place appropriate values and objectives and monitor performance against them. Complementary to this, each CRI should assess its impact on the society and environment within which it operates, and adopt specific CSR programmes that are appropriate to that CRI's impact on the environment and its interfaces with society in general.

Shareholding Ministers expect each CRI to have the following in place from the commencement of the 2008/09 financial year:

- specification of CSR values and behaviours, and how these are incorporated into the fabric of the company
- objectives and performance targets reflecting good social responsibility practice
- specific CSR programmes
- the reporting framework to be used.

6 FINANCIAL GOVERNANCE

The public funding component of CRI revenue is becoming increasingly devolved. Examples of this devolution include the CRI Capability Fund and recent moves toward the negotiation of some FRST funding contracts.

This places greater responsibility on CRI boards to set strategies and to ensure adequate management of their CRI's financial affairs and to make decisions about the allocation of funding where these decisions were once essentially dependent on the outcome of FRST funding rounds.

Financial targets

All CRIs are expected to add to shareholder value in their operations over the longer term and to meet the short-term financial targets specified in their SCI.

The expected target for each CRI is to make a net (post-tax) return equivalent to its cost of equity capital on average over time. Shareholding Ministers have adopted 9.0% as the cost of equity target.

The setting of appropriate financial targets aims to ensure that CRIs operate in a financially viable manner (in line with section 5(2) of the CRI Act and as discussed further in the Operating Framework).

This does not mean that the target needs to be achieved consistently every year as long as an appropriate average return is achieved over time.

Performance against targets

If a CRI anticipates that it will not meet its stated performance targets, shareholding Ministers expect advice from the board, including detail of the reasons for the expected shortfall. In general, this can be achieved through the quarterly reporting process. Where performance shortfalls are significant, however, shareholding Ministers expect more direct notification, including any remedial action proposed and to be kept aware of progress. In this instance, advisors may interact more frequently with the board, with the extent and nature of this closer monitoring depending on the circumstances at the time. Companies may be placed on 'monthly watch'. This would require the board to submit monthly reports and for the chair and/or senior managers to meet with officials to outline monthly progress against target and to explain any significant variances.

In cases of serious under-performance or financial distress by a CRI, shareholding Ministers have a number of options including:

- seeking more detailed information from the CRI
- working with the board with a view to improving its performance
- reviewing the membership of the board
- liquidating or re-capitalising the CRI.

Such measures, particularly the latter, would only be reverted to in extreme circumstances and shareholding Ministers would consult the board before taking such steps. Boards should not, in the absence of an express agreement to this effect from shareholding Ministers, assume that additional financial support will be provided by the Crown to a CRI.

Managing risks

Boards are responsible for managing risks and should, therefore, establish processes and practices within the CRI to manage all risks associated with its operations.

Boards should also keep shareholding Ministers informed of risk management strategies through their business plans and other reports when necessary.

Foreign exchange risk management

CRIs with exposure to foreign exchange risks should have policies and procedures for managing these risks and, if requested, report against these policies and procedures to shareholding Ministers.

Capital structure

Each CRI should have a target optimal capital structure (ie the combination of debt and equity used to fund its assets) in line with its business opportunities and risk/return profile. The onus is on boards to develop and propose an appropriate target capital structure. In the absence of an agreed capital structure, a 30% net gearing ratio with a three-times interest cover requirement will continue to operate as the default target.

Shareholding Ministers would expect the setting of a CRI's capital structure target to have undergone external review to ensure that it conforms to current best practice. In such a case, the board is expected to undertake an externally assessed capital structure review and present to shareholding Ministers the result of that review. The decision on what additional supporting information is provided is one for each board; it could be a copy of the capital structure review itself or a separate detailed summary of the review's key assumptions.

CRIs should not just set the target but actively manage to it within an acceptable margin should they exceed the target. CRIs are expected to re-evaluate their capital structure target whenever circumstances suggest it is necessary, such as following any major change to the CRI's risk profile. A CRI's capital structure should be reviewed by the CRI if its investment decisions and/or dividend policy have not led to, or are unlikely to lead to, an optimal capital structure within the timeframe forecast in the business plan.

Dividends and reinvestment

The level and timing of estimated dividends is agreed annually between the board and shareholding Ministers through the annual SCI. Proposed dividends should be identified for each of the three years covered by the SCI. The level and timing of estimated dividends is driven by the desired capital structure, the company's profitability and the level of reinvestment.

With regard to reinvestment, this should add value on an aggregate basis, ie the CRIs are not restrained from reinvesting into activities with low financial returns to them, provided that other reinvestment initiatives provide a compensating return that allows them to continue to meet company return targets on average and over time.

For the payment of dividends, the Treasury requires at least one week's notice of the actual date and amount before payment, which should be accompanied by a shareholder dividend payment statement.

CRI borrowing

CRIs are exempt from the restriction on borrowing contained in section 162 of the CE Act.

Explicit disclaimer of Crown guarantees and loan covenants

For all CRI financing not provided by the Crown, there must be a disclaimer associated with the contract that the Crown does not guarantee or financially support any CRI borrowings. The disclaimer aims to give a clear signal to third parties of the nature of the relationship between the Crown and a CRI.

Ownership review clauses

Some loan documents link the loan terms to the shareholder's identity, so that, if the control of the company changes, the lender reserves for itself the right to call up the loan. For CRIs, this would connect the terms of borrowing with the Crown, and could incorrectly give the appearance of an implicit Crown guarantee.

Notwithstanding the Crown's current ownership policy, the policy on such clauses is as follows.

- It is acceptable to have loan provisions that require lenders to be informed whenever a CRI becomes aware that its ownership will change.

- Shareholding Ministers prefer CRIs not to enter loan agreements that provide for a review of the loan at the lender's discretion, in the event of an ownership change.

- It is not acceptable to have loan provisions that involve a technical default at the lender's discretion in the event of an ownership change.

There are alternative mechanisms that can provide lenders with the comfort they desire without the drawbacks typically inherent in ownership change clauses. These range from covenants concerning the debt/equity ratio and interest coverage to lenders taking security over specific company assets. However, these mechanisms can place constraints on the company and must be designed to minimise the extent to which they frustrate any future restructuring of a CRI. Boards should bear this in mind when considering such mechanisms.

Tax planning

CRIs are expected to conduct their businesses on the same basis as comparable businesses not owned by the Crown, including normal prudent planning of their tax affairs. At the same time, CRIs are also required to act as good corporate citizens by exhibiting a sense of social responsibility where able to do so.

These objectives are not served by tax planning that is outside the spirit of the law. While shareholding Ministers are comfortable with CRIs engaging in normal tax planning in accordance with tax law, they are not comfortable with companies leading or seeking to lead the market in developing aggressive tax planning strategies.

When assessing performance, the government views dividend payments as if it were a domestic resident taxpayer. This means imputation credits are treated as if they have value in the hands of shareholders, and should be reserved for attachment to dividends.

7 SHAREHOLDER APPROVAL AND STRATEGIC INITIATIVES

Approval and notification thresholds

The board of each CRI is required to seek the approval of, and expected to notify, shareholding Ministers before entering into certain transactions or strategic initiatives.

Approval for major transactions

Under the Companies Act, CRIs may not enter into a 'major transaction' (as defined by that Act) unless it has been approved by a special resolution signed by shareholding Ministers, or is contingent on such approval.

Approval and notification for significant transactions

Shareholding Ministers expect the board of each CRI to include in its SCI other significant transactions above a certain threshold agreed by shareholding Ministers and the board for which the board will either seek prior approval or, in line with the 'no surprises' policy, provide advance notification to shareholding Ministers.

Process for seeking approval

Shareholding Ministers are, on occasion, asked to approve transactions above a certain threshold. This usually arises because the transactions are major transactions under the Companies Act, or shareholding Ministers are being asked for their approval as required under the company's SCI, or shareholding Ministers are being asked to consider an equity injection.

Boards are encouraged to enter into contracts for the transactions covered under this requirement subject to shareholder approval, and to seek shareholder approval well before the transaction is due to proceed. Generally, a minimum period of two weeks would be required for officials to analyse the business case and for shareholding Ministers to formulate their recommendation, although this depends on the complexity of the transaction. Boards are encouraged, however, to engage with officials early to determine the time required for the process and the information that may be required to allow an informed assessment of the transaction. Such information may include:

- expected financial and non-financial returns and risks
- the size of the proposal and fit with the CRI's core business

- the CRI's track record of success in similar transactions
- the CRI's proposed means of funding the transaction (in the case of a purchase) and how this would affect the CRI's or Crown's financial position
- in the case of technology transfer activities:
    - maximisation of spillover effects to New Zealand (such as job creation/retention and export growth)
    - ongoing earnings to New Zealand
    - anchoring any technology transferred within New Zealand.

If approval is being sought during the business planning process, shareholding Ministers' views on the transaction should be explicitly sought, ie approval should not be inferred from Ministers' support for the business plan.

With regard to the provision of new capital, this may be a decision for Cabinet which will consider its relative capital priorities across government. Shareholding Ministers, therefore, expect that any request for additional capital will demonstrate what shareholder value will be added, to assist them in prioritising demands on capital.

Shareholding Ministers expect CRIs to keep public comment on transactions that are yet to receive shareholder approval to a minimum to avoid giving stakeholders the impression that consent is a foregone conclusion.

Overseas activities

Shareholding Ministers are comfortable with CRIs engaging in activities overseas with the aim of extending science networks and/or generating income. Boards, however, should ensure that any proposed overseas activities:

- are consistent with the CRI's legislated operating principles, with particular emphasis on providing demonstrable benefits to New Zealand
- are broadly consistent with and encompass the expectations in the Operating Framework
- do not detract focus from the CRI's core business activities in New Zealand
- do not create undue risk for areas of core national science capability
- anticipate returns commensurate with risk.

'Demonstrable benefits to New Zealand' should include particular emphasis on, but are not limited to, the development of:

- intellectual property
- strategic scientific knowledge, resources and capability

- technology transfer.

These benefits should be able to be applied in New Zealand and/or offered to a CRI's local client groups.

A CRI's activities overseas should not create a risk that the New Zealand Government may be directly or indirectly associated with and held accountable for the CRI's overseas actions and behaviour. As CRIs may be perceived, however, to be acting on behalf of the New Zealand Government, they should always ensure that they act with high ethical standards.

Formation of subsidiaries

Under the CE Act, CRIs are required to notify shareholding Ministers before they acquire or form a subsidiary. Shareholding Ministers also expect that:

- the parent company will comply with any restrictions in its SCI relating to the acquisition or formation of subsidiaries
- the powers and function of each subsidiary will be treated in practice as if it is subject to the same statutory limitations as the parent company
- in establishing the governance arrangements for the subsidiary, the parent will act in accordance with any relevant provisions of its SCI and accepted best practice in the identification and appointment of directors
- the parent company will be accountable to the Minister of Research, Science & Technology for the subsidiary's activities and performance and will have appropriate financial controls, business planning and monitoring procedures in place
- public accountability documents for the parent company – SCIs, financial statements and annual reports – are required to cover the parent CRI's Crown entity subsidiaries.

Ownership

CRIs may wish to form joint ventures, partnerships or other similar associations with third parties. Such engagement with industry can be useful for the transfer of CRI technologies but should not affect a CRI's control over its **core** science activities and capabilities.

This concern about dilution of control also extends to financial and budgetary controls. Shareholding Ministers expect that any joint ventures entered into by CRI boards would be subject to at least the same level of financial budgeting and monitoring rigour as that which applies to CRIs and their subsidiaries.

8 BOARD GOVERNANCE

Governance framework

Crown company governance

The governance structure for all Crown companies is essentially the same. Shareholding Ministers appoint boards of directors to oversee the management of the companies and to appoint the company's CEO. This is carried out under the terms of the Companies Act, the relevant legislation under which the company operates, and the constitutions of each company. CCMAU advises shareholding Ministers on director appointments and monitors the performance of each board.

Directors' duties

The Companies Act sets out the legal duties of company directors, including the duty to act in good faith and in the best interests of the company, as set out in section 131 of the Companies Act.

Some of the other important directors' duties set out in the Companies Act include the duty to:

- exercise powers only for a proper purpose (section 133)
- comply with the Companies Act and the company's constitution (section 134)
- not agree to the company engaging in reckless trading (section 135)
- not agree to the company agreeing to incur an obligation that it cannot perform (section 136)
- exercise the care, diligence and skill of a reasonable director (section 137)
- comply with rules concerning transactions in which directors have a 'self-interest' (sections 139-144)
- comply with rules relating to the use and disclosure of company information (section 145).

The fundamental nature of a director's position in relation to a company is that of fiduciary. This is a relationship of high endeavour and trust and the obligations on a director are strict.

Failure to diligently and properly discharge their duties can result in personal liability for company directors. This applies as much to Crown company directors as it does to company directors in the private sector. The Crown's liability for Crown companies is limited in the same way as for other shareholders and there is no guarantee implied or otherwise that the Crown will meet the liabilities of a Crown company should it become insolvent. If a Crown company were to become insolvent and shareholding Ministers did not wish to make any further investment in that company's business, a receiver or liquidator would be appointed pursuant to the Companies Act. In the event of liquidation, the liquidator will endeavour to make such recoveries as are available for the benefit of the company's creditors, which could include claims against directors for reckless or insolvent trading or other breach of duty.

Role of the board

Under the Companies Act, the board of the company is responsible for managing, by or under its direction or supervision, the business and affairs of the company.

The role of the board of a Crown company differs in some respects from the board of a privately owned company. For example, all decisions relating to the operation of a Crown company must be made by or pursuant to the authority of the board in accordance with its SCI. Further, under the constitution of each Crown company, shareholding Ministers, rather than the board, appoint the chair and deputy chair and set directors' fees.

A Crown company board's responsibilities include:

- appointing a CEO and managing and monitoring the CEO's performance
- providing leadership and vision to the company in a way that will enhance shareholder value
- developing and reviewing company strategy
- monitoring the performance of senior management
- reviewing and approving the company's capital investments and distributions
- ensuring compliance with statutory requirements
- providing leadership in its relationships with key stakeholders including, where relevant, industry groups, Māori and staff
- preparing annually a draft SCI and delivering it to shareholding Ministers, considering shareholding Ministers' comments on the draft SCI, and submitting a final SCI for the responsible Minister to table in the House of Representatives
- developing annually a business plan and delivering it to shareholding Ministers at the same time as the draft SCI
- holding management responsible for meeting the performance measures/milestones in the SCI and business plan

- establishing appropriate governance structures (such as board committees and clear lines of responsibility and accountability between the board and management) to ensure the smooth, efficient and prudent management of the company
- reporting to shareholding Ministers in accordance with legislative requirements and the expectations set out in this manual.

In addition, the Companies Act requires each board, among other things, to:

- comply with the directors' duties set out in the Companies Act, including the duty to act in the best interests of the company
- provide an annual report and annual financial statements to the shareholder
- comply with the solvency requirements set out in the Companies Act
- hold annual meetings, except where the shareholder passes a written resolution in lieu of such meetings
- present special resolutions to the shareholder when necessary (for example, resolutions for the approval of 'major transactions' as this term is defined in section 129 of the Companies Act).

Role of the chair

The key requirements of the chair's role are to:

- provide effective leadership and direction to the board and company, consistent with the owner's expectations, to maximize shareholder value
- ensure effective accountability and governance of the company, consistent with the requirements of relevant legislation
- develop and maintain sound relationships with shareholding Ministers, their advisors and other stakeholders
- meet shareholding Ministers' expectations by ensuring a process is in place to undertake an annual performance review of the board as a whole, as well as of the chair and directors individually
- maintain an ongoing review of the board's membership profile, with regard to the skills needs of the board in relation to the successful governance of the company, as well as succession planning for both the chair and directors' roles
- actively observe the 'no surprises' policy (chairs are expected to advise shareholding Ministers and/or their advisors of any material event or circumstance that could affect shareholder value, cause embarrassment, or be of significant interest to Ministers)

- ensure that the company's governance arrangements and risk management policies are continually reviewed and updated to reflect current best practice
- provide the necessary guidance and support to other members of the board to ensure that they contribute effectively to the governance of the company (particular regard is to be given to the induction of and mentoring of new members)
- provide the necessary guidance and support to the CEO and his/her senior management team to ensure the company is managed effectively
- generally act in a manner consistent with the obligations of a director as required by the Companies Act and other legislation.

Role of the deputy chair

Most, but not all, boards will have one member of the board appointed by shareholding Ministers as deputy chair. Naturally, the principal role of the deputy chair is to act in situations where the chair cannot be present to fulfil one or more of his/her duties. The degree to which the deputy chair takes on the authority and responsibilities of the chair will depend on the circumstances and, particularly, on the length of the chair's absence. In situations where no formal deputy chair has been appointed, the chair and board will develop a procedure to select a director to act during the absence of the chair (in accordance with the company's constitution).

The deputy chair may be delegated by the board specific roles as required and in general will be expected to provide a level of leadership and mentoring as would be expected of a senior director. The deputy chair will often lead the board's periodic evaluation of the chair's performance, as well as taking a significant role in the board evaluation generally.

Boards should not assume that the deputy chair appointment will inevitably lead to a subsequent appointment as chair.

Board committees

Board committees (or sub-committees) exist to increase the overall effectiveness and efficiency of the board. These committees have no legal standing or distinction from the board itself, and all board members remain accountable for the decisions taken in any and all board committees. When a committee is established by a board, its terms of reference and its powers, duties, reporting procedures, membership and duration of office should be clearly recorded.

Board committees can be standing or ad hoc in nature, and might typically encompass such areas as audit (finance and risk) and remuneration. However, apart from the recommendation of an audit committee below, there is no prescribed or optimum number or type of committees, and boards should only set up new committees after serious consideration of the need for them and of the potential benefits to the governance of the particular company.

The establishment of an audit committee is particularly important. It is expected that such a committee will give the board assurance in terms of risk management and compliance, as well as to probe in greater detail the company's financial management, reporting and internal controls. Membership of an audit committee will include directors who are financially literate. Best practice dictates that the chair of the audit committee not be the chair of the board. The audit committee should meet at least three times a year and a statement to this effect should be recorded in the annual report.

Fees and expenses

The document *Directors' Fees and Reimbursement Guidelines*, posted on the CCMAU website at http://www.ccmau.govt.nz/pdfs/Fees-Guidelines-February-2004.pdf, provides comprehensive information on the shareholding Ministers' expectations with regard to the payment of directors' fees and expenses in Crown companies. Directors are also encouraged to refer to the Office of the Auditor-General's guidelines on controlling sensitive expenditure at http://www.oag.govt.nz/2007/sensitive-expenditure/.

In the setting of board fees for the year, no allowance is made for membership of committees. Ordinary fees are calculated to cover the full expected duties of a director, including any committee membership. However, the amount approved by the Minister in any one year for board fees is a global amount that the board can allocate as it considers appropriate. Therefore, specific fees can be ascribed to committee membership by a board if considered appropriate, as long as a proper process is applied to the allocation and the total amount paid in fees for the year does not exceed the amount specified by the Minister.

Director: appointment process, terms of appointment and succession planning

Directors are generally appointed to Crown company boards for a term of three years, and may be reappointed at the expiry of that term, subject to their contribution having been satisfactory and their skills continuing to be relevant to the board. In some circumstances directors may serve more than two terms, where a critical business need has been clearly demonstrated to Ministers. Each case is considered on its own merits. Directors need to be aware that the same process that was followed for their original appointment will be applied again if they are eligible and available for reappointment at the expiry of their term.

Shareholding Ministers are accountable to Parliament for the appointment of directors to the various Crown boards. Appointments are made by the Minister of Research, Science & Technology in the case of CRI boards, and the process is managed by CCMAU.

Directors of Crown companies hold office at the pleasure of shareholding Ministers and, accordingly, under the constitutions of the companies, may be removed at any time by notice in writing to the board of the company.

Shareholding Ministers, board chairs and CCMAU are continually reviewing board composition and skills requirements as well as term expiry dates and succession. In the

case of every expiry of a director's term, or vacancy arising for other reasons, this process will result in the development of a skills profile for every board. Following agreement by the responsible Minister, a specification will be prepared for each individual vacancy. The specification for the vacancy will be used by CCMAU to guide the search for suitable candidates for the responsible Minister's consideration for short-listing and for appointment.

If a director is to retire, he/she will receive a letter from the responsible Minister confirming that fact well in advance of the expiry of the term. If a director is being considered for reappointment, notification will be made by receipt of a letter from the responsible Minister, at the same time as for new appointees to boards for any particular appointment round. It is the aim of CCMAU to have all board appointees notified at least one month in advance of the commencement of the new term of office.

Conflicts of interest

Directors must disclose any relationships and/or matters that give rise to an actual or potential conflict of interest. Directors should refer to sections 139 to 149 of the Companies Act for further guidance on what may need to be disclosed. The board must have in place a process for disclosing and dealing with conflicts of interest, including the maintenance of an interest register, and should ensure that all board members are aware of the existence and nature of any disclosure of interest made.

Crown company constitutions provide that a director who is interested in a transaction may not vote on a matter relating to the transaction but may:

- vote on any matter which relates to the company indemnifying, or effecting insurance for, directors and employees of the company
- attend a meeting at which a matter relating to the transaction arises and be included among the directors for the purposes of determining the presence of a quorum
- sign a document relating to the transaction on behalf of the company
- do anything else as a director in relation to the transaction

as if the director were not interested in the transaction.

Relaxation of the rule prohibiting directors from voting on a matter in which they have an interest can only be exercised by the shareholding Ministers.

In addition, shareholding Ministers generally expect that directors who are interested in a transaction will absent themselves from deliberation on the matter, unless the board or committee resolves that this is not required.

Further information, including examples of conflicts of interest and guidance on how to manage them, can be found in the Office of the Auditor-General's publication entitled *Managing conflicts of interest: Guidance for public entities*.

Other issues to raise with shareholding Ministers

It is also possible that a director may be placed in a situation where, as a result of circumstances which are not related to a directorship of a particular company, continuing to act as a director of that company might nevertheless place the company or the shareholders in a position of embarrassment. A director who is placed in such a situation must take the initiative and raise the matter with shareholding Ministers, via the board chair. While there are no set criteria for such situations, examples of the types of issues the shareholders would expect to be advised on include:

- where legal proceedings have been, or are likely to be, brought against the director
- where the director has been, or is likely to be, subject to negative media or public scrutiny
- where the director is placed in a situation of actual or perceived conflict of interest
- any issue affecting the director's ability to contribute to the board, eg as a result of other time pressures, extended overseas travel (ie more than two months), illness etc
- where the director is appointed to any position as an employee of the Crown, or intends to undertake significant contract work for any Crown agency
- any other similar circumstance which may place the company or the shareholders in a position of embarrassment.

If any of the above circumstances arise the director concerned should, in the first instance, discuss the matter with the board chair, who will then advise shareholding Ministers if appropriate.

Board and director expectations

The board charter or code of practice

A board is expected to have a charter/code of practice to provide guidance to directors to assist them to carry out their duties and responsibilities effectively, and in accordance with the highest professional standards. A board charter should not be an exhaustive statement of obligations. If read in conjunction with the law applying to company directors and the constitution of the company, it should present a complete picture of the legal and ethical responsibilities imposed on directors, including any specific requirements arising from the business of the company and the wider sector in which it operates.

In 2004, the Securities Commission developed a set of Principles of Corporate Governance. They were written after consultation with a range of sectors and acknowledge that different types of entities can take different approaches to achieving consistently high standards of governance. While the Principles do not in themselves impose any legal obligations, they are supported by shareholding Ministers. It is expected that a company's board charter will at least cover the Securities Commission's Principles,

adapted as necessary to fit the Crown environment and the particular company's circumstances.

It is also expected that annual reports will report fully on the companies' corporate governance practices. The manner and style of such reporting is up to the CRI itself but it should at least provide a report that incorporates a reference to each of the Securities Commission Principles set out below and how the board has achieved those principles.

Securities Commission Principles of Corporate Governance

Shareholding Ministers expect the boards of Crown companies to comply with the Securities Commission Principles of Corporate Governance, including those set out below.

- Directors should observe and foster high ethical standards.
- There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively.
- The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.
- The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.
- The remuneration of directors and executives should be transparent, fair, and reasonable.
- The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.
- The board should ensure the quality and independence of the external audit process.
- The board should foster constructive relationships with shareholders that encourage them to engage with the entity.
- The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

Relationship with shareholding Ministers

The board is appointed by shareholding Ministers. The chair and the deputy chair are also appointed by shareholding Ministers. Although shareholding Ministers, in particular the Minister for Crown Research Institutes, may meet with the board as a whole from time to time, the usual conduit for informal communications is between the Minister and the chair, or through CCMAU.

Shareholding Ministers expect the board to be sensitive to their interests. Boards must be mindful that Ministers are accountable to a wider audience and the affairs of the

companies, positive and negative, can impact on Ministers. This is referred to as the 'no surprises' policy, further detail of which is set out in section 4 of this manual. A failure to keep Ministers informed on significant issues at appropriate times can create situations that may divert attention from a company's day-to day-business.

Consultancy services

Shareholding Ministers expect that no director on the board of a Crown company or subsidiary company will undertake consulting work for the company. This is not intended to preclude a director from undertaking assignments for the board that properly fall within the scope of a director's normal duties, but would preclude the director carrying out, for example, a consulting assignment that would normally be contracted to a third party.

In the event that an exception to this rule appears appropriate, the circumstances should be referred by the chair, in advance, to shareholding Ministers for approval.

Gifts, facilitation practices and bribes

Directors are solely remunerated for their contribution to the board through the fees they are paid. They should not seek to financially benefit in other ways from their position as a director.

No director, or any member of a director's immediate family, may accept gifts, entertainment, discounts, loans, commissions, or other favours from individuals or organisations, if they could influence, or be perceived as influencing, a business decision, or be considered to be extravagant or unduly frequent. This is especially important if the company or individual is soliciting business or information from the Crown company concerned.

Board attendance

The membership of a board of directors is structured so as to ensure that the competencies and skills necessary to conduct the board's affairs are present. Although all directors carry equal responsibilities, the appointment process has the aim of ensuring the necessary balance. As with most teams, the absence of a director can have a negative impact on board deliberations. It is, therefore, expected that boards will agree on a schedule of meeting dates at the commencement of the year, with the intention that directors manage their commitments to ensure attendance.

There has been a general convention that missing two or more meetings in a year, whether consecutive or not, should at least raise initial questions over a director's motivation and commitment to membership of the board. It is not intended to deny the board's authority to allow a leave of absence where a director demonstrates sufficient justification for missing one meeting. However, missing two or more meetings must raise doubt whether that director should continue on the board.

Partial attendance – if frequent - is more problematic. Not only is this disruptive to board discussions, it means that the director may lose continuity in board outcomes and again denies the full board the benefit of his/her expertise. Whether the partial attendance is in person or via electronic media, the outcome is perceived to be the same. Boards are encouraged to raise this as an issue with the shareholder, if a solution cannot be found.

If a director misses three meetings through a year this is to be regarded as a trigger for signalling concern to the responsible Minister. The Minister will communicate the concerns to the affected director and, unless extenuating circumstances can be demonstrated, will seek the director's resignation.

Directors standing for Parliament

The period before a general election has implications for the directors of Crown companies, particularly if they are selected as parliamentary candidates. Directors who have been selected to stand as a candidate in a parliamentary election should advise the chair of the board immediately and, equally, chairs need to advise shareholding Ministers, through CCMAU, as soon as any members of their boards have been identified as candidates.

In order to ensure that governance of a company is not distracted by a director's election activity, and to prevent the possibility of any conflicts of interest, real or perceived, arising during this time, Ministers have developed a protocol that they consider should be followed where a director is standing for Parliament.

Any Crown company director who is formally selected to stand as a candidate for election to Parliament, or placed on any political party's list, will be invited to stand down from his/her board position with effect from nomination day, or such earlier day as may be determined.

Particular care around political neutrality needs to be exercised at election times. This is a time when behaviours, relationships and expectations among employees of publicly owned entities, board members, Ministers and other Members of Parliament that would otherwise be unexceptional may be perceived as having greater significance. Chairs and boards should pay particular attention to the 'no surprises' expectation during an election.

Confidentiality and security of information

Access to information from and about a company is a fundamental requirement for a director to carry out his/her duties. It is equally fundamental that the director has a duty of care with regard to the use made of the documents and their security.

Board papers remain the property of the company and it is usual for them to be returned to the company on the retirement of the director. Directors must ensure the security of board papers while in their possession.

The following suggestions are offered in situations where board documents are provided to directors in electronic form. In agreeing to accept documents electronically, a director should certify that:

- if on an individual's personal computer, documents are electronically filed so that no unauthorised user can access the material either deliberately or inadvertently (this may require the director to seek technical advice on file storage to provide this certification)
- if received and stored via another organisation's IT system and server, the director has initiated the necessary steps to ensure internal file security and the means by which unauthorised access – deliberate or accidental - may be precluded or identified
- on resignation, confirmation by the director that the electronic versions of the documents have been deleted to the same extent as if physically destroyed.

Director induction and development

Director induction

Directors are appointed to boards for the contribution they are expected to make to the board and the company. They have been selected for the governance competencies and industry-relevant skills they hold. However, it must be recognised that even the most experienced new director will join with only a minimal appreciation of the company concerned and of the nature of governance in a Crown environment.

Shareholding Ministers expect that an appropriate induction plan will be put in place by the board for all new directors.

There are three parts to a director's induction by the board.

- The first part is a detailed introduction to the company, including its business components, the company's business strategy and the roles of key members of the management team. This may include visits to key sites of the company's operations. Equally important is that new directors receive an early understanding of the manner in which the board's business is conducted, together with the roles and responsibilities of board committees. The chair is responsible for setting up this induction programme, and a new director should expect a programme to be set in place within the first two months of his/her appointment.
- The new director should expect to be provided with a director's manual, or similar document, prior to the first meeting. The manual should, in addition to the over-arching business and governance policies and values of the company, include such detail as key contacts in the organisation.
- CCMAU will then provide a briefing on the sector in which new directors find themselves. Attendance at the CCMAU briefing, while strongly recommended, is not compulsory.

Board and director performance evaluation

The Crown requires that each board undertake periodic evaluation of its performance. The board evaluation is an important contribution to the process by which responsible Ministers consider the skills make-up of each board when they deliberate on appointments and reappointments. However, its prime function is as a basis for the mentoring of directors by chairs and fellow directors and it therefore forms a vital element in the seamless process of director induction and development.

There is a general requirement for Crown company boards to evaluate annually the performance of individual directors, the chair of the board and the board as a whole. Individual boards are able to develop processes for themselves that best meet their needs – provided that the minimum expectations (as set out below) are met. Boards may find it useful to have access to tools to assist them in this process and, therefore, default evaluation templates are available from CCMAU, if required. Shareholding Ministers expect that each board will have a process in place that meets the needs of the board and the minimum stated requirements. The key deliverables from this process will be:

- formal high level board feedback to CCMAU on overall board performance, key focus areas for continuing development, and assurance that the process has been appropriately implemented
- individual director performance assessments and development plans that will be implemented by the organisation (these plans are to be retained by the board and not shared with CCMAU)
- a board succession plan which is annually updated which advises the shareholder of gaps in current board composition and risks going forward as director rotation occurs.

Boards are not required to submit individual director or chair evaluation reports to CCMAU. However, CCMAU does require written confirmation that an appropriate process has taken place. CCMAU will confirm its requirements each year, but chairs should anticipate a minimum requirement to report that a suitable evaluation has been undertaken, briefly describing what that process was and what the high-level outcomes were – with particular reference to overall board performance. The advice should include commentary on any significant issues that chairs consider should be brought to the attention of shareholding Ministers or CCMAU.

Director development

As part of the performance assessment for individual directors, there should be a discussion and agreement between the chair and each director on areas of focus and development for the next 12 months (including situations where agreement is reached that nothing is required by way of formal training or development). As part of the annual fee-setting process, boards can propose an amount as an allowance for director training and development that can be submitted for approval by shareholding Ministers along with the requested board fees in any year.

ANNEX 1

2007 OPERATING FRAMEWORK FOR CRIS

Foreword

This is the seventh Operating Framework issued to CRIs. It is the cornerstone document through which shareholding Ministers communicate their expectations to CRI boards. It is a public document and I encourage CRI boards to circulate it to staff and other stakeholders.

During 2006, I have been pleased to see the CRIs making significant progress against most of the expectations outlined in the 2006 Operating Framework. This common understanding of expectations is reflected in the fact that this year's Operating Framework is essentially unchanged, other than a few minor updates. I am also pleased that during 2006 the CRIs have had valuable input into discussions around the development and implementation of a more stable funding system, and I welcome continued dialogue in this area.

CRI engagement with stakeholders has also developed further. This engagement includes not only the CRIs' various client bases but also the community in general. This latter engagement has varied from contributing to urban and regional economic development initiatives to communicating the value of science and science careers to young people. These activities are very much in line with shareholder expectations that the CRIs will play a broad transformative role in New Zealand's economy, society and environment and contribute to the government's economic transformation goals. Shareholding Ministers are keen to see this engagement continue in 2007 and, in particular, to respond to the many constructive points raised at the *Capitalising on Research* summit held in October 2006.

Finally, the 2007 Operating Framework continues the incorporation of an addendum specific to each CRI introduced in 2005. The CRIs are becoming more diverse over time and the addenda enable shareholding Ministers to provide clearer guidance on where their expectations for a particular company sit within the wider parameters of the generic Operating Framework.

Steve Maharey
Minister for Crown Research Institutes

Role of a CRI

CRIs are owned by the government and their role is to:

1. undertake excellent research, science and technology (RS&T) that aligns with the government's current social, economic and environmental priorities, in a manner that reflects best practice management and governance
2. engage with relevant industrial, environmental and social stakeholders to address current RS&T needs and agree longer-term research priorities, while regularly communicating to the public the set of stakeholders they are targeting
3. serve as a key repository of New Zealand's strategic scientific knowledge and RS&T skills of national importance
4. collaborate with other science organisations, to provide for New Zealand's current and future strategic science needs
5. ensure the development of knowledge, and its transfer to and uptake by end-users within the resources available to the CRI, in a way that maximises the overall benefit to New Zealand
6. promote awareness of the value of RS&T amongst all New Zealanders
7. continually develop the human capital of their organisation in ways that support and are aligned with the long-term interests of New Zealand's science and innovation system.

The role of a CRI does not include:

- necessarily being the sole provider of RS&T within New Zealand
- acting as a principal education provider
- maximising profit
- focusing on financial return at the expense of delivering on its other objectives and statutory purpose
- competing with or crowding out the private sector by holding a majority ownership interest in commercialisation ventures beyond the point where the CRI is the party that can add most value
- acting with complete academic freedom, without regard to the needs of stakeholders

- determining its own research priorities without regard to existing government research priorities and/or the needs of sector stakeholders
- deciding RS&T policy, although the CRIs are expected to have input to policy formation.

Owner's expectations of CRIs

A CRI's research and development capabilities, which are ultimately geared to ensure benefit to New Zealand, should always be underpinned by a successful business so that those capabilities can continue to be delivered over the long term.

A successful CRI will be able to demonstrate that it meets the following expectations.

A. CRIs fulfil their role by:

1. undertaking excellent research
2. engaging with relevant industrial, environmental & societal stakeholders
3. serving as a key repository of strategic scientific knowledge and skills
4. collaborating with other science organisations
5. ensuring the transfer of knowledge and its uptake by end-users
6. communicating the value of RS&T to all New Zealanders
7. developing the human capital of their organisation

B. CRIs demonstrate best practice management and governance by:

8. ensuring long-term financial viability
9. measuring and reporting financial and non-financial performance
10. exhibiting best practice governance
11. maintaining excellent and transparent practices
12. being socially, ethically and environmentally responsible
13. taking considered risks
14. setting and managing to a target capital structure

A. CRIs fulfil their role by:

1. Undertaking excellent research

Excellence in research is central to all CRI activities; undertaking excellent research ensures CRIs can deliver a quality of service that allows them to meet stakeholders' needs and collaborate with other high-quality science organisations, both domestically and abroad. CRIs should be undertaking excellent research that contributes toward improving New Zealand's economic, environmental and social development through transforming/creating industries or delivering improvements in well-being.

Undertaking excellent research will play a key role in CRIs' attracting, developing and retaining quality staff.

We expect that CRIs will continue to monitor themselves against the generally accepted measures of research excellence, including publication and patents, but also work with government agencies, including the Ministry of RS&T (MoRST) and the Foundation for RS&T (FRST), to improve the application of processes such as technical review.

2. Engaging with relevant industrial, environmental and societal stakeholders

CRIs should engage with stakeholders to help facilitate the government's industrial, environmental and social development objectives.

The government has the objective of transforming industry to create a high-productivity, high-wage and high-skill economy. It wants to see science and innovation raise productivity in, and add value to, both traditional and non-traditional industries. The government also seeks to improve the well-being of New Zealanders and improve the sustainability of New Zealand's environment. To contribute to this transformation and improvement, CRIs will need to build on existing knowledge, develop new knowledge, and use the full range of transfer mechanisms to ensure the knowledge is applied to the benefit of New Zealand.

As well as providing tactical RS&T solutions, CRIs are well placed to look over the horizon to identify new technology needs of their stakeholders through their direct engagement with RS&T end-users and their activity in research that will underpin future technology. Through ongoing and meaningful engagement with their stakeholders, CRIs should be much better able to identify areas of opportunity relevant to their stakeholders and to help stakeholders themselves identify areas of opportunity. It is only through identifying and taking advantage of new opportunities that stakeholders will build, maintain and enhance their competitive advantages.

MoRST is developing a suite of 'science roadmaps' that will help provide an overview of areas of scientific importance to the government and outline the desired directions for that area into the future. Roadmaps will also inform the government's broader RS&T policy objectives over time. CRIs will have an important role to play in contributing to the development of these roadmaps, including providing a researcher's and end-user's perspective to this process.

3. Serving as a key repository of New Zealand's strategic scientific knowledge and skills

The government owns CRIs to ensure that New Zealand maintains a critical mass and capability in strategic areas of science that are of long-term importance to New Zealand. This role is not duplicated in other publicly funded research organisations, such as tertiary education institutions. Maintaining this critical mass and capability is important to New Zealand's capacity to create the knowledge, products and processes that are core to achieving the aims of the government's economic transformation agenda and the government's social and environmental objectives.

CRIs' decision-making on the capabilities that they choose to develop and maintain should be aligned with the existing and future needs of their stakeholders, including both the public and private sector. CRIs should give regard to their capability development and maintenance strategies, including the production of a three year capability profile in their SCI, as part of their obligations associated with receiving monies from the CRI Capability Fund.

An important part of CRIs' repository role involves the curation of databases. The government is committed to increasing the availability of data for the generation of national benefit. CRIs have an important role in actively managing, disseminating significant science databases and curating data to appropriate standards, including standards for metadata that facilitate data sharing, for the benefit of New Zealand.

Shareholding Ministers expect that CRIs will have regard to the following principles in managing and disseminating data:

- data should be managed and disseminated in a way that will maximise benefit to New Zealand in the long run
- charges for access to data should normally reflect the costs of provision, including the cost of capital invested by the CRI
- on entering into contracts that involve the generation of new data, whether publicly or privately funded, the subsequent availability and application for national benefit should be actively considered and formally agreed
- data should be managed in a way that retains the quality and integrity of the data over time

- data should be publicised and made available except where:
    - prevented by contractual arrangements
    - release prejudices the objectives of a research programme
    - it can be demonstrated that greater national benefit is likely to accrue from alternative arrangements, or
    - it is not practicable to make data available.

To manage these expectations, shareholding Ministers expect that CRIs will develop and publish transparent data management policies that are regularly reviewed.

4. Collaborating with other science organisations

(i) Onshore

The small size of most research areas in New Zealand and the fragmented nature of individual sectors mean that collaboration between organisations is of greater importance in New Zealand than in many other countries.

CRIs are the only organisations tasked with maintaining a strategic view of their stakeholders' RS&T needs. It is expected that, as part of considering the knowledge, expertise and capability needs of their stakeholders, CRIs will identify and, where required, facilitate collaboration between themselves, other research organisations and end-users.

(ii) Offshore

Science and technology, both research and the application of that research, continue to internationalise. Whilst strong international collaboration at the investigator level is the norm, institutional and governmental collaboration are less advanced. CRIs need to ensure that they are well linked into RS&T developments offshore so that they are able to facilitate the identification and capture of relevant offshore expertise, knowledge and innovation for the benefit of their New Zealand stakeholders.

The government has a growing number of bilateral science agreements with other countries. Free trade agreements are also deepening New Zealand's linkages with international markets. CRIs should seek to ensure that they take full advantage of the opportunities that these arrangements offer so that the full potential benefit of any offshore engagement can deliver to their stakeholders. MoRST can assist CRIs in identifying these opportunities.

5. Ensuring the transfer of knowledge and its uptake by end-users

The government is committed to increasing the rate at which CRI research is applied to the benefit of New Zealand. The application of research is a broad concept that encompasses a variety of approaches that CRIs can use to translate knowledge into value for New Zealand. These approaches include direct dissemination, CRI-industry collaborations, and 'commercialisation' activities such as the sale or licensing of IP and spinning out commercial subsidiaries. Researcher mobility between collaborating organisations and staff exchanges or secondments with client firms are also a form of tacit knowledge flow. CRIs are encouraged to promote this activity.

CRIs are expected to bring an increased focus on New Zealand benefit to their commercialisation activities through developing commercialisation models that reward CRIs for their risk-taking, while ensuring that significant ongoing economic, environmental and societal benefit is delivered to New Zealand. The following criteria should guide all CRI technology transfer activities. CRIs should:

- partner effectively with industry as early as possible
- maximise wider benefits to New Zealand
- aim to ensure ongoing earnings to New Zealand
- aim to anchor within New Zealand any technology transferred
- consider wholly owned subsidiaries where industry partners are not immediately available, with a view to seeking such partnerships downstream as the business consolidates.

Where CRIs have developed a subsidiary to commercialise technology, shareholding Ministers expect that CRIs may well divest some, or all, of their ownership stake in cases where the research and scientific risks associated with the subsidiary decline and the business risks and capital requirements increase beyond the capacity of the CRI to deal effectively with them.

When considering the sale of equity in a commercialisation subsidiary, CRI boards would be expected to make an assessment of whether any recommended sale or partial sale of a commercialisation subsidiary is consistent with the criteria and divestment expectations above. Shareholding Ministers will separately circulate guidance to boards on information requirements for sale processes that require shareholder consent.

Shareholding Ministers appreciate that commercialisation brings with it many risks and understand that individual ventures may sometimes fail. It is considered important, however, that CRIs find ways to manage the risks associated with commercialisation so that core science capabilities are not jeopardised.

For the avoidance of doubt, shareholding Ministers are comfortable with CRIs' allowing an individual or a team to benefit materially from the financial success of a venture to which they have made an intellectual contribution.

6. Communicating the value of RS&T to all New Zealanders

Ministers have identified the need for New Zealanders to understand the value of RS&T to themselves and to the country. CRIs are expected to play a key role in the communications needed to achieve this goal, with MoRST coordinating this work across the sector. CRIs will be expected to work with other government agencies and science organisations to maximise the impact of this communication.

CRI communication activities should target audiences such as communities, schools and industry groups and may include engaging with the public on areas of science that may cause concern.

7. Developing the human capital of their organisation

Staff members and their representatives are important stakeholders. Shareholding Ministers expect that CRIs will enter into productive employment relationships and engage collaboratively with their staff members and the Public Service Association (PSA) in respect of their staff members represented by the PSA. The government and the PSA have entered into a partnership agreement built on the recognition of a common interest to develop a modern and innovative workplace. Shareholding Ministers expect that the CRIs will reflect the aims of this agreement through their principles of engagement, good faith, and respect for staff.

CRIs are expected to meet or exceed their statutory requirement to be a good employer, as defined by section 118 of the Crown Entities Act 2004. In addition, to deliver their role in the New Zealand science system, they are expected to have appropriate policies and procedures in place that create the environment required to attract, develop and retain the capabilities they need to undertake world-class R&D, and to reward their staff based on their performance. Consequently, shareholding Ministers encourage CRI boards to review their IP reward policies periodically to ensure they remain appropriate to their organisation.

Shareholding Ministers also see that CRIs have a role in continually developing their human capital in ways that support and are aligned with the long-term interests of New Zealand's wider science and innovation system. Shareholding Ministers expect CRIs to engage with their staff collectively to address issues relevant to human capital development affecting all CRI staff. This will include working in partnership to create a culture and to develop processes and policies that:

- ensure that science careers are attractive, stable and rewarding as evidenced by low staff turnover, good staff morale, and a high level of positive responses to staff satisfaction measures

- support the recruitment and retention of high-quality staff including the provision of salaries and working conditions that are competitive with other organisations and policies that reflect good employer practices and provide equal employment opportunities

- promote and support science excellence.

A successful CRI should be actively engaged with New Zealand and overseas science and education communities to ensure that it will be able to meet its staffing needs over the long term. There are currently several examples of CRIs closely engaged with universities to improve the flow and quality of graduate and post-graduate students from universities to CRIs, which Ministers support.

As major employers of scientists, CRIs also have a role in encouraging school students to consider careers in science. Such activities could include information for students and promotional activities highlighting career opportunities.

B. CRIs demonstrate best practice governance and management by:

8. Ensuring long-term financial viability

The board of a CRI exercises stewardship on behalf of the shareholder to ensure the company's ongoing health and financial viability. CRIs sustain capabilities in fields of strategic importance to New Zealand and are expected to do so for the long term. Shareholding Ministers' expectations regarding governance and financial performance are informed by this focus on long-term financial viability.

(i) Growth

A successful CRI will adopt strategies that will ensure long-term viability and maintain the ability to meet its debts as they fall due. To achieve this, CRIs need to generate sufficient operating surpluses that they can apply to enable investment in capital expenditure, to develop new products and services for future revenue, and to attract and retain suitable staff members, all of which, in turn, will contribute to future revenue generation and long-term viability.

A successful CRI is expected to maintain or grow its revenue in real terms so that, at the least, it can keep pace with the cost of undertaking R&D and with inflation generally. Growing revenue also allows CRIs to increase their R&D capability and capacity and/or increase rewards to staff in line with performance.

While revenue growth is essential to the long-term viability of CRIs, it should not be the overriding focus of a CRI. A successful CRI will grow sufficiently to ensure its long-term viability and extend its R&D capabilities over time while ensuring ongoing transfer of scientific knowledge and technology to the sectors with which it is aligned.

Shareholding Ministers are comfortable with commercial revenue growth that reflects an extension of a CRI's ability to serve its constituents, but uncomfortable if revenues are derived from competing with or crowding out the private sector.

(ii) Reinvesting with a capital mentality

In recent years, some CRIs have continually reinvested significant portions of their operating surpluses into research and/or development activities without any evidence to date of recovering those investments. This has contributed to a steady decline in the average return on equity for CRIs. Unless CRIs balance reinvestment against returns, they are living beyond their means and diluting their value, which could ultimately threaten their ongoing viability.

There is no inherent conflict in the expectation on CRIs to, amongst other things, be both financially viable and undertake research for the benefit of New Zealand. A CRI can deliver both on an *aggregate* basis. It is frequently the case that the greatest proportion of 'benefit' from CRI knowledge transfer is realised in the wider economy, and not as a financial return to the CRI. The CRIs are not restrained from reinvesting into activities with low financial returns to them, provided that other reinvestment initiatives provide a compensating return that allows them to continue to meet company return targets on average and over time.

Several CRIs continue to support otherwise unfunded capabilities through reinvestment. The CRI Capability Fund, rather than reinvestment, is intended to be used to maintain or enhance capabilities, in the short to medium term, where alternative funding is limited or unavailable.

(iii) Generating returns at the cost of equity capital

A successful CRI is expected to generate net profit after tax (NPAT) before dividends sufficient to reflect the cost of its equity capital on average over time. Shareholding Ministers consider that an appropriate cost of equity target for CRIs is 9.0%. Ministers are comfortable that additional profits can be reinvested by CRIs if done so with a capital mentality.

CRIs are expected to manage to their SCI NPAT targets, which may include scaling back reinvestment in operating items in the course of a year if the CRI forecasts that it will not meet its NPAT target.

9. Measuring and reporting financial and non-financial performance

There are tried and tested accounting and financial analysis practices for measuring financial performance, but the methodology for measuring the delivery of national benefit through RS&T is less well established. Shareholding Ministers consider it vital that CRIs improve their ability to demonstrate the value they add to New Zealand, both within formal performance monitoring frameworks and by CRIs' own efforts. An

example of the latter is Crop & Food Research's and HortResearch's involvement in the *Growing Futures* project.

The new research application indicators introduced in 2006 will provide a comprehensive overview of the CRIs' performance to shareholding Ministers and will highlight to the public the valuable contribution that the CRIs make to New Zealand's economy, society and environment. Shareholding Ministers look forward to the CRIs' reporting on these indicators.

There are two other areas where progress in developing measures is desired in the near future:

Science excellence - ownership monitoring of science excellence is seen as increasingly important as the funding system is further evolved. CCMAU has been asked to work with FRST, MoRST and CRIs during 2006/07 to ensure that measurement is aligned with sector best practice.

Knowledge creation – both CCMAU and MoRST share the Association of CRIs' interest in the developing field of intellectual capital (IC) measurement. If IC tools develop in a way that is seen to be relevant to CRI performance measurement, CCMAU will be asked to lead efforts to implement them in the CRI sector.

While CCMAU has been asked to play a lead role in developing new measures, the direct involvement of CRIs is vital to ensure that measures are aligned with CRIs' organisational and strategic interests.

10. Exhibiting best practice governance

Ministers expect CRI boards to implement governance standards that reflect accepted best practice in terms of ethical behaviour, strategy development, delegation, compliance and risk management, and the specific governance structures and protocols that are put in place. In setting strategy for the company, boards are expected to have high regard for the expectations of shareholding Ministers. Operating Frameworks, correspondence and the new Owner's Expectations Manual for CRIs, expected to be released in early 2007, will support and clarify expectations.

All boards are expected to have in place an annual process for evaluating board, chair and individual director performance. The outcomes of this process should be aligned with suitable professional development programmes for directors.

In calculating and paying directors' fees and reimbursing directors' expenses, boards are expected to pay particular attention to the Crown Company Directors' Fees and Reimbursement Guidelines issued in February 2004.

11. Maintaining excellent and transparent practices

CRIs need to develop and maintain excellent, transparent processes around budgeting, forecasting, capital allocation and risk management. This is particularly so in the case of revenue and profit forecasting as shareholding Ministers' support for the various initiatives outlined in each CRI's SCI relies on the company's ability to generate sufficient revenues and profit.

CRIs are also expected to maintain open and regular lines of communication with shareholding Ministers and their officials. This expectation includes the appropriate timeliness of response to shareholder requests for information and, in line with the 'no surprises' policy, proactive communication in advance of issues that are considered controversial or likely to be of wider public interest.

12. Being socially, ethically and environmentally responsible

CRIs are expected to be cognisant of the context in which they operate, particularly given public expectations that Crown-owned organisations will exhibit ethical and socially responsible behaviour. Consequently, CRIs are expected to consider the impact on their staff members, local communities and other stakeholders when undertaking major initiatives such as relocations or the divestment of business units. Appropriate consultation should be undertaken when deemed necessary.

In the course of their business, CRIs should be a model of ethical behaviour. For example, aggressive strategies to minimise tax obligations would not be acceptable. Similarly, when operating overseas, CRIs may be looked upon as representatives of the government and should behave in a manner in which they are seen to be beyond reproach.

CRIs are expected to consider the impact of their physical infrastructure and business activities on the environment and to adopt sustainability practices that seek, for example, to minimise waste, CO_2 emissions and energy use.

13. Taking considered risks

Boards are expected to take reasonable risks to meet their objectives and to take advantage of opportunities that arise. CRI boards should be fully aware that shareholding Ministers accept risk-taking as a natural part of a CRI's activities and that risk-taking may occasionally fail to produce returns.

Again, this highlights the need for CRIs to balance their risk-taking against adequate returns so that they can weather a percentage of failed research and/or development-related investments. Boards should also make sound capital rationing decisions and exit science and/or development projects if it becomes clear that they have little chance of success.

14. Setting and managing to a target capital structure

Most CRIs have either agreed with shareholding Ministers a capital structure appropriate to their risk/return profile or are on course to do so. Boards are expected to re-evaluate their optimal capital structure whenever circumstances suggest it is necessary, such as following any major change to the CRI's risk profile. Shareholding Ministers would expect that any capital structure review will have undergone external review to ensure that it conforms to current best practice. In the absence of an agreed capital structure, 30% net gearing with a three-times interest cover requirement will continue to operate as a default target. Therefore, the onus is on boards to demonstrate why any different capital structure target is appropriate.

CRIs should not just set the target but actively manage to it within an acceptable margin. Any CRI that consistently falls below or above its target would be expected to take action to re-align. Appropriate action would include planned expenditure to reduce the cash balance or the payment of a dividend where no commercially sound investment opportunities can be identified.

While the Crown's primary purpose in owning CRIs is not dividend flows, CRIs should have excellent capital allocation processes that are transparent to the shareholder. Where dividends are made, they will be retained within the wider innovation system.

ANNEX 2

NON-FINANCIAL PERFORMANCE INDICATORS

The following non-financial performance indicators are intended to measure the performance of the CRIs in applying their research results and technologies. The CRIs are expected to set targets in their SCIs against all these indicators (unless an indicator has a zero target) and to report progress in their annual reports.

Indicator	**Definition**
Commissioned reports to users	Reports for users commissioned under contract or other formal arrangement.
Presentations on technical information and research results	Papers, oral presentations, static displays and web presentations presented at a venue where users are present, eg a conference, workshop, training course, seminar, fieldday or hui.
Publications on technical information and research results	These publications are not peer-reviewed and aim to disseminate technical information and research results to users, such as: • papers in trade journals, magazines, series or books • conference papers and abstracts • research monographs or books • popular books/articles • web-based publications.
Peer-reviewed articles	A peer-reviewed journal article that requires a rigorous quality assurance by peers before publication.
Keynote and plenary presentations	A written or oral presentation delivered at a recognised forum where the CRI representative is invited and costs are paid in full or in part.
Patents granted - in New Zealand - overseas	Registration for the same item that covers more than one overseas country is counted once only.
Requests for information from databases and collections	This covers both 'nationally significant' databases and collections and others that a CRI may consider is significant.

Indicator	Definition
New or improved products, processes and services	'Products' are articles of substance produced by manufacture or other means (eg new plant cultivars, improved instrumentation, or new materials), or objects which otherwise embed information (e.g. software, plans, blueprints). 'Processes' comprise operational systems for supplying or realising products (eg frozen storage processes for food products, tests for diseases, substance extraction processes). 'Services' include the provision of technical support (eg advice, opinion) which should result in some substantive outcome (eg a problem resolved, decision-making criteria implemented).
Licensing arrangements entered into	Formal agreements whereby an outside party will further develop or commercialise a CRI's intellectual property (product, process, service etc.) and, in return, a CRI receives royalty income for units sold.
Joint ventures or formal associations	Incorporated or unincorporated joint ventures or associations with any other organisation for the explicit purpose of developing intellectual property or disseminating results. Evidence would include memoranda of understanding, contracts, formal written agreements etc.
Spin-out companies formed	Subsidiaries that a CRI establishes, wholly owned by the CRI, for the purposes of further development or commercialisation of intellectual property. The subsidiary is still dependent on the assignment of the CRI's technology.
Spin-off companies formed	Companies formed in which a CRI retains some degree of ownership for the purposes of further development or commercialisation of intellectual property or for continued access to market knowledge.

CRIs are also expected to set targets and report on the following staff indicators.

Total number of FTEs	The total number of staff members employed within a CRI (calculated as full-time equivalents), including fully owned subsidiaries but not including other companies in which the CRI has only part-ownership.
FTEs in research teams	Staff members directly involved in the production of specified research outputs.
FTEs in research support	Staff members whose work logistically supports research team outputs teams but whose work could not of itself be described as research, for example IT support staff, laboratory assistants, librarians, research report editors, general nursery and orchard staff, farm staff, ship crew and workshop staff.
Other FTEs	Staff members whose activities support the generic, non-research or infrastructural component of the CRI, for example management, business development, commercialisation, financial, HR, secretarial, stores, ground and building maintenance, marketing and communications/PR.