



ccmau

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

Protecting and enhancing shareholder value

Owner's Expectations Manual for State-Owned Enterprises

29 October 2007

CONTENT

1	Introduction	5
2	SOE Framework	7
3	Shareholder Roles and Responsibilities	11
4	SOE Reporting and Accountability	15
5	Social Responsibility	25
6	Financial Governance	27
7	Shareholder Consultation and Strategic Initiatives	33
8	Board Governance	39

1 INTRODUCTION

This manual outlines shareholding Ministers' expectations of the directors of state-owned enterprises (SOEs). 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 outlook letters sent by shareholding Ministers at the outset of the annual business planning round, which cover specific issues and expectations for individual SOEs.

The manual should be read in conjunction with relevant legislation such as the Companies Act 1993 (Companies Act) and the State-Owned Enterprises Act 1986 (SOE Act) which place certain obligations on SOEs. It should also be read in conjunction with other current expectations and ownership policies previously communicated to SOE boards.

The manual applies only to SOEs and not to Crown research institutes 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.ccm.au.govt.nz.

2 SOE FRAMEWORK

SOEs provide a significant contribution to the well-being of the New Zealand economy. They provide a range of services and products covering areas such as electricity generation and transmission, postal and meteorological services, control of air traffic movements and property valuation. Their performance is important to the Crown's overall fiscal and balance sheet position and its capacity to meet fiscal, social and other policy goals.

Crown company model

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

A key principle under the company model is the separation and maintenance of a clear division between the government's ownership, purchasing and regulatory interests.

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 SOE Act for SOEs).

SOE model

As part of the broader state sector reforms, SOEs were established as limited liability companies under and subject to the Companies Act. Until then, government departments generally undertook the trading activities that are now carried out by SOEs. Each SOE is also subject to the SOE Act. These Acts address the ownership, governance and public accountability arrangements for SOEs.

Under the SOE model:

- the principal objective of every SOE is to operate as a successful business and, to this end, to be:

- as profitable and efficient as comparable businesses that are not owned by the Crown
- a good employer
- an organisation that exhibits 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
- compensation is paid to each SOE for any non-commercial activities that the Crown requires it to undertake
- competitive neutrality is maintained between SOEs and the private sector.

SOE governance structure

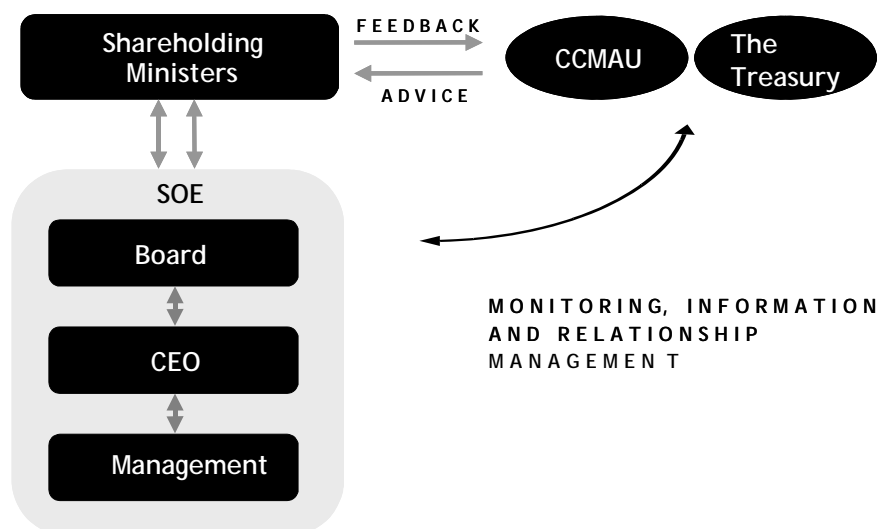
The Crown is the sole shareholder of each SOE and acts to protect its investment on behalf of the people of New Zealand.

Each SOE has two shareholding Ministers, the responsible Minister (in most cases the Minister for SOEs) 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 SOE. Directors of SOEs 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 or her to carry out the tasks of managing the company.

Officials at CCMAU and the Treasury monitor SOEs 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 SOE governance framework



Government ownership policy

One of the underlying principles of the SOE model as it was conceived in the 1980s was that government-owned trading entities would operate according to normal commercial disciplines. These would include capital market disciplines in the form of an option to privatise, and an understanding that the government would exercise this option wherever the public interest was adequately protected through regulatory or other mechanisms.

In considering the current portfolio of SOEs, it is the government's policy that an asset sale programme is not on the agenda. This is reflected in the government's long-term hold policy. The long-term hold policy has four overarching goals:

- to be clearer with SOE boards about shareholding Ministers' expectations of the companies
- to provide shareholding Ministers with a greater understanding of, and therefore confidence in, the performance of SOEs, through enhanced benchmarking
- to develop appropriate capital structures which impose financial disciplines on SOEs while ensuring they have sufficient capital to make operational investment decisions without recourse to the Crown
- to ensure that requests for capital are considered in line with the business needs of the SOE, while recognising the Crown's preference that major investments are considered relative to other demands for capital across the Crown by incorporating SOE requests for equity for significant investments into the normal budget process.

Part of this policy involves each SOE undergoing a long-term hold owner's review. The objective of each owner's review is, in general terms, to:

- provide advice to shareholding Ministers, for discussion between Ministers and the board, on any shareholder preferences regarding:
 - the content of the Statement of Corporate Intent (SCI) for the company's strategic purpose, scope of business, core business, consultation thresholds or investment strategy, in light of the company's strategic direction and investment profile
 - the company's capital structure, in light of its scope of business and core business, its investment profile, its risk profile and the credit-rating benchmark agreed by shareholding Ministers of BBB(flat) and the criteria for exceptions
- provide a better understanding of the company's performance through benchmarks for measuring performance against comparable companies and/or against the company's past performance, including a set of generic benchmarks for all SOEs
- provide information on the company's likely equity demands over time, given its planned investment profile and capital structure
- establish processes (such as, potentially, an in-depth strategic review) to look at particular aspects of the company's business where the initial review does not allow for sufficient depth or time to examine such issues.

The terms of reference for the long-term hold review will be agreed between shareholding Ministers and the board of the SOE.

Shareholding Ministers' expectations or preferences arising out of the review will be included in a Statement of Shareholder Preferences, which will be available to the board for its consideration. The Statement of Shareholder Preferences should be referred to by the board when developing its SCI in future business planning rounds.

The reviews are not a full examination of the strategic direction of the company. However, they may identify aspects of the company's direction, and make recommendations on issues to be examined outside of the review.

3 SHAREHOLDER ROLES AND RESPONSIBILITIES

Shareholding Ministers' role and responsibilities

Each SOE has two shareholding Ministers: the responsible Minister and the Minister of Finance.

The responsible Minister (normally the Minister for SOEs) generally takes the lead shareholder role, particularly in his/her capacity as the formal point of contact with boards. From time to time, the Minister for SOEs may delegate some of his/her responsibilities to an Associate Minister for SOEs.

The role of the Minister of Finance as an SOE 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 SOE Act, shareholding Ministers are responsible to the House of Representatives for the performance of the functions given to them under the Act or the constitutions of the SOEs.

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
- supporting the SOEs' medium- to long-term strategic direction
- tabling final versions of SCIs in the House of Representatives
- developing and communicating the government's ownership policies
- 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 reports in the House of Representatives
- taking decisions as shareholder (for example, approving a major transaction under the Companies Act, or other transactions if such approval is required under a company's 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 SOEs are set out in the Companies Act and the SOE Act.

Generally, shareholding Ministers have statutory powers to:

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

Before shareholding Ministers use their power to direct a board to alter the company's SCI, or to determine the level of dividend payable, they must have regard to Part I of the SOE Act and consult with the board. Within 12 sitting days of giving such a direction shareholding Ministers must lay a copy of the direction before the House of Representatives.

The monitoring function

As owner of SOEs, 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 SOE 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 SOE without empowering legislation.
- Unlike listed companies, SOEs do not have a share price that shareholding Ministers can use to monitor company performance.

For these reasons, it is important to monitor SOEs and receive timely and relevant information from them. The SOE Act, therefore, gives shareholding Ministers certain powers over and above those of ordinary shareholders, eg the power to require information relating to the affairs of a SOE to be provided to shareholding Ministers.

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 SOEs
- clear and focused board accountability
- independent advisors being familiar with and understanding the SOEs 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 SOEs from two main sources: CCMAU and the Treasury. This advice may be supplemented by input from other agencies when necessary.

Both CCMAU and the Treasury are required to develop and maintain a detailed knowledge of each SOE's operations and markets to enable them to assess whether individual SOEs are meeting shareholding Ministers' expectations.

Advisors focus on:

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

Advisors also contribute advice on general policy that affects SOEs in consultation with other departments, as appropriate. However, final decisions on all SOE 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, restructuring issues and capital structure
- analysing business cases presented by SOEs where they are required to consult with, or seek the approval of, shareholding Ministers
- advice relating to SOE performance and on whether SOEs are making an appropriate return on investment.

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

CCMAU's role

CCMAU advises the Minister for State Owned Enterprises and any Associate Minister for State Owned Enterprises. It has lead agency responsibility for:

- routinely monitoring SOEs financial and non-financial performance
- issue management, which includes advising shareholding Ministers on ministerial correspondence, requests under the Official Information Act 1982, parliamentary questions and other issues that may 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 SOEs 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 any 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 the impact of SOE performance 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 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 SOE 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 SOE REPORTING AND ACCOUNTABILITY

Part 3 (Accountability) of the SOE Act provides a comprehensive outline of SOE requirements with regard to its key accountability document – the SCI – and reporting performance to shareholding Ministers and the wider public, through Parliament.

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

The business planning process

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

Most SOEs have a 30 June financial year. The following outlines the key steps in the business planning round for SOEs with a 30 June balance date. A table of key reporting dates is set out on page 20.

Exchange of expectations statements

In or around December or 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 business planning round.

The board then sends a strategic issues letter to shareholding Ministers by the end of February, outlining the major issues the company expects to address during the business planning round.

Submission and review of business plan and draft SCI

Each SOE board provides shareholding Ministers with a draft SCI, supported by the company's business plan. The business plan enables shareholding Ministers and their advisors to assess the draft SCI.

The SOE Act requires the board of each SOE 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 SOEs provide their draft SCIs and

business plans at the start of May to allow time for meaningful review. If, for any reason, an SOE considers that it cannot meet this deadline, it should contact CCMAU as early as possible.

Sections 14(2) and (3) of the SOE Act set out the information to be contained in each SOE's SCI, including the objectives of the group, the nature and scope of its activities and the performance targets by which the group may be judged in relation to its objectives. Each SOE's SCI should clearly identify the information required by these sections of the SOE Act.

Shareholding Ministers expect the performance targets and measures in each SCI to be meaningful and related to the drivers of each SOE's performance.

Once the business plan and draft SCI are received, advisors prepare a report for shareholding Ministers outlining the key aspects of each SOE's future strategy. As part of this process, advisors will engage with the companies to clarify any questions arising out of the business plan and draft SCI. To facilitate the calculation of these indicators, it is expected that each SOE will submit with its business plan a full set of financial statements (including a profit and loss statement, statement of financial position and statement of cash flows) for the planning period.

Finalising, tabling and releasing SCIs

Under the SOE 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 must be delivered to shareholding Ministers for tabling.

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 12 sitting 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 SOE's SCI on the CCMAU website. SOEs are also encouraged to make their SCIs widely available.

The business plan is not a public document and is not tabled.

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

Key SCI content expectations

Objectives and nature and scope of activities

The board of each SOE is required to specify in the company's SCI the group's objectives, and the nature and scope of the activities to be undertaken.

The board of each SOE may wish to consider separately defining, in relation to the nature and scope of the activities to be undertaken by the group, the company's 'core business activities'.

In this context, shareholding Ministers consider that:

- the 'nature and scope of the activities to be undertaken by the group' defines the boundary outside of which the group may not carry out any business
- 'core business activities' represents the core business activities to be undertaken by the group in line with its core competencies
- any business activities to be undertaken by the group that are not core business activities will be within the nature and scope of the company's activities.

Ministers expect the board of each SOE to operate in such a way that it does not lose focus on the company's core business activities. This does not preclude expansion into non-core areas. Policy announcements in June 2006 encourage SOEs to diversify where they can demonstrate spill-over benefits that promote economic growth in New Zealand. Ministers will clarify such expectations with individual companies as part of the annual business planning round.

Financial and non-financial performance indicators

The SOE Act requires every SOE to operate as a successful business and, to this end, to be as profitable and efficient as comparable businesses not owned by the Crown, to be a good employer, and to exhibit a sense of social responsibility. Accordingly, shareholding Ministers expect SOEs to benchmark their performance against comparable businesses not owned by the Crown, either in New Zealand or overseas and to demonstrate achievement of the non-financial dimensions of operating as a successful business.

Shareholding Ministers expect SOEs to provide benchmarking information in their SCIs and regular quarterly, half-yearly, and annual reports. In particular, shareholding Ministers are interested in receiving information regarding the following areas of financial and non-financial performance:

- credit rating
- profitability
- service performance
- social responsibility
- commercial value

- other indicators that the board considers relevant or that shareholding Ministers advise from time to time.

Ministers are also interested in receiving other internal benchmarks that the board considers appropriate, e.g. comparison with different business segments.

Performance indicators (financial and non-financial) must:

- be meaningful to the SOE's business and the SOE Act
- be specific and measurable without ambiguity
- be timely and capable of being audited, where appropriate
- be within the SOE's responsibility or power to control
- be consistent with and influence, as appropriate, the SOE's purpose and principles of operation or business,
- respect commercial sensitivity, where appropriate
- encourage and reflect best practice
- where appropriate, ensure employee participation in, and ownership of, these indicators.

All SOEs should include in their SCIs a glossary of the terms used for financial performance indicators.

Estimate of current commercial value

Section 14(3) of the SOE Act requires the SCI of each SOE to include the board's estimate of the current commercial value of the Crown's investment in the SOE and its subsidiaries and a statement of the manner in which the value was assessed.

This is consistent with the expectation that the board has an ongoing fundamental understanding of company value; what value drivers are and the effect in terms of enterprise value.

Accordingly, shareholding Ministers expect the board of each SOE to comply with this requirement and provide an estimate of current commercial value of the Crown's investment in the SOE in the SCI. If requested, the board should be able to fully explain, and justify, to shareholding Ministers the methodology used for the assessment, and the basis for any assumptions made. In general, shareholding Ministers prefer such valuations to be prepared using a discounted cash flow (DCF) methodology. However, it is recognised that this may not always be feasible and that alternative valuation methodologies may be more appropriate, particularly for smaller SOEs. SOEs may wish to consider having their valuations carried out by or peer-reviewed by third parties with specialist valuation expertise.

Reporting to shareholders

Quarterly reports

While not required under the SOE Act, shareholding Ministers expect each SOE'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.

Shareholding Ministers expect the financial information and commentary in each SOE's quarterly report to fully and accurately summarise 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 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. SOEs 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 SOE's outlook for the rest of the financial year in terms of achieving its SCI targets, key opportunities, threats, and management plans.

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

Half-yearly reports

SOEs 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 SOE Act does not specify the information to be presented in half-yearly reports; rather, the content is specified in each SOE's SCI.

The responsible Minister is required to table each half-yearly report in the House of Representatives within 12 sitting days of receipt. Half-yearly reports should be made publicly available only once this has occurred.

Annual reports

SOEs are required to deliver their annual report to shareholding Ministers within three months of the end of each financial year (although shareholding Ministers' preference is that each SOE 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 and in section 15 of the SOE Act. Among other things, the annual report is required to contain information necessary to enable an informed assessment of the operation of the SOE, including a comparison of the performance of the SOE 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 clearly understand the nature and scope of the company's operations
- strive to meet current best-practice disclosure guidelines including those relating to governance practice.

The responsible Minister is required to table each annual report in the House of Representatives within 12 sitting days of receipt. Annual reports should not be made publicly available until after this has occurred.

Table of key reporting dates

The table below shows the key dates for the business planning round and regular reporting. The table relates to SOEs with a 30 June balance date. The deadlines will shift in accordance with any other balance date a SOE may have. For example, an SOE with a balance date of 30 September will be required to submit its annual report by 31 December.

Business planning round	
December/January	Shareholding Ministers send outlook letters to boards. The outlook letter details shareholding Ministers' expectations of, and information requirements for, the business planning round.
By 28 February	Boards submit strategic issues letter to shareholding Ministers, setting out the major strategic issues faced by the company.
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 the final SCI to shareholding Ministers.

Business planning round (continued)	
Within 12 sitting 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 quarterly reports 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 a half-yearly report to shareholding Ministers. Each report must include the information specified in the SCI.
Within 12 sitting days of receipt by shareholding Ministers	The responsible Minister tables the half-yearly report in the House of Representatives. Half-yearly reports should be made publicly available only once they have been tabled.
Annual report	
By 30 September	Boards deliver an annual report to shareholding Ministers
Within 12 sitting 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	<p>Each SOE is to hold an annual meeting no later than six 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:</p> <ul style="list-style-type: none"> • 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

SOEs are subject to the Official Information Act 1982. In handling requests made under this Act, SOEs are expected to respect the underlying principles 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.

'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 relating to SOEs that may be contentious or could 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 employees
- fraudulent acts by the company's directors or employees
- breaches of an SOE's corporate social responsibility obligations (refer to section 5)
- significant company restructuring
- large-scale redundancies
- industrial disputes
- significant acquisitions and divestments
- significant health and safety issues
- the release of significant information under the Official Information Act 1982
- imminent media coverage of any 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 that are 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 New Zealand 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

SOE boards and executives should be aware of the potential political implications of engaging with MPs, either through visits or briefings. Accordingly, SOEs should contact the Minister for SOEs office before agreeing to or organising any visits/briefings. SOEs are encouraged to set an agenda before any such meeting and to ensure that visitors adhere to that agenda.

Accountability

Select committees

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

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

- An SOE could be asked to advise a select committee on legislation under formation.
- An SOE may wish to make a submission on a bill as a witness.
- A select committee may receive a petition from private citizens regarding an SOE, which may then be called in for a review.
- Every select committee has the power to launch an inquiry, and could call an SOE in to provide evidence.

- In addition, SOEs are regularly required to appear before the Finance & Expenditure Committee (or another select committee delegated by the Finance & Expenditure Committee) for a financial review. Normally the chair and CEO of the SOE are expected to appear before the select committee. It is not usual for external legal representation to attend. SOEs 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 an SOE appears before a select committee. They also expect the boards and management of SOEs to be open and forthright in their dealings with select committees.

If the chair of an SOE 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 SOE'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 SOE 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* at <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 at <http://www.parliament.nz/en-NZ/PubRes/About/Procedures>.

5 SOCIAL RESPONSIBILITY

The SOE Act requires every SOE to operate as a successful business and, to this end, to be an organisation that exhibits 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, SOEs have corporate social responsibility (CSR) obligations that go beyond other companies.

There are a number of leading international frameworks available to provide guidance on how SOEs 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, SOEs 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 an SOE's obligation to act in a socially responsible manner.

SOE boards must report any such breaches to shareholding Ministers as soon as practicable after any breaches are brought to the board's 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 SOEs 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 SOE 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 SOE should assess its impact on the society and environment within which it operates, and adopt specific CSR programmes that are appropriate to that SOE's impact on the environment and its interfaces with society in general.

Shareholding Ministers expect each SOE 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

Financial targets

All SOEs are expected to add to shareholder value in their operations over the longer term, and meet short term financial targets specified in their SCI (see section 4).

The setting of appropriate financial targets aims to ensure that SOEs:

- are focussed on earning appropriate risk-adjusted rates of return over the business planning period
- replicate the disciplines exerted over private sector companies that result from share market trading and the threat of takeover
- operate in an environment that is competitively neutral with the private sector.

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

Performance against targets

If an SOE anticipates that it will not achieve 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 nature and extent depending on the circumstances at the time.

In cases of serious underperformance or financial distress by a SOE, shareholding Ministers have a number of options, including:

- seeking more detailed information from the SOE (eg monthly accounts and cash flow forecasts)
- working with the board with a view to improving its performance
- reviewing the membership of the board
- appointing a special advisor to the board
- liquidating or re-capitalising the SOE.

Such measures, particularly the latter, would only be taken in extreme circumstances and shareholding Ministers would consult with 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 an SOE.

Managing for value - value-based reporting (VBR)

A core expectation for SOE boards is that there is a continual focus on managing for value. As outlined in section 4 above under the heading 'Estimate of current commercial value', boards should understand the company's value drivers and monitor enterprise value constantly.

To support this, in addition to reporting under the requirements of generally accepted accounting practice (GAAP), Ministers also encourage the use of VBR. VBR represents a useful tool to assist both Ministers and boards to advance the objectives of SOEs. The most widely used form of VBR is Economic Value Added (EVA¹) performance measurement.

EVA is a useful additional measure of performance for any long-term owner of businesses, and it can be calculated from publicly available information. Using economic methodologies, EVA focuses on the changes in a company's economic value from a shareholder perspective. In light of the government's current long-term hold policy for SOEs, EVA can help measure the economic performance of those businesses over time. It is internationally recognised as a measure of performance and provides another dimension for boards and agencies like CCMAU, in assessing the performance of SOEs.

Put most simply, EVA is net operating profit minus an appropriate charge for the opportunity cost of all capital invested in an enterprise. The resulting EVA is therefore the profit (or loss) in excess of (or below) an investor's required return. A key benefit of EVA is that the system encourages a mindset in which managers recognise that all capital has a cost and therefore they should allocate capital to its most effective use.

While each SOE is required to be as profitable and efficient as comparable companies not owned by the Crown, a number of SOEs have no companies with which to compare their performance. EVA is a useful benchmarking tool in such cases. Some SOEs already use EVA for internal purposes and/or publish their EVA results, eg Airways Corporation, New Zealand Post and Transpower. Shareholding Ministers support and encourage this approach.

By providing decision-makers with additional information focusing on shareholder value, EVA should be able to contribute to improving overall performance over time.

¹ EVA is a registered trademark of Stern Stewart

Managing risks

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

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

Foreign exchange risk management

SOEs 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 management

Shareholders expect SOEs to minimise the level of surplus capital on their balance sheets, without adversely affecting their ability to meet objectives under the SOE Act. SOEs are expected to return surplus capital to the Crown so that it may be used for other government priorities.

Optimal capital structure

Each SOE should have a target optimal capital structure (ie the combination of financial liabilities and equity used to fund its assets). An optimal capital structure is one that, in light of economic, industry and company-specific factors, would provide for an appropriate credit rating, while at the same time imposing a discipline on the SOE to optimise efficiency.

To this end, the government has a credit rating benchmark policy whereby SOEs are expected to have a capital structure consistent with a BBB(flat) credit rating (unless the SOE can demonstrate good reasons for an alternative benchmark). This is to ensure that all SOEs have appropriate financial disciplines to manage capital efficiently at similar risk levels.

The application of this credit rating benchmark may involve moving to a higher gearing ratio. While there may be a number of ways to achieve this, shareholding Ministers have a general preference for SOEs to reach higher gearing through debt financed distributions (ie, special dividends) to shareholders. Shareholding Ministers recognise that for some SOEs, the timing of any repayment of a special dividend will depend on existing banking restrictions and future capital expenditure plans. Ministers expect Boards to use their best endeavours to negotiate prudent levels of borrowing to closer reflect shareholder preferences, and if necessary explore alternative banking arrangements. Shareholding Ministers additionally expect Boards to report on the likely timing for a change in gearing levels, to better align with the BBB(flat) benchmark.

Dividend policy

The level of estimated dividends (and forecast payout ratio) is set by the board after considering shareholding Ministers' comments through the SCI and business plan consultation process. It should aim to maintain, or progress toward, the company's optimal capital structure within defined and agreed timeframes.

The level of estimated dividends is driven by each SOE's desired capital structure, profitability, and the level of future capital expenditure as outlined in the business plan and SCI.

The proposed dividend payout ratio and estimated dividend payment should be included in the business plan for each year covered by the plan.

Ordinary dividends, if any, may be paid in two instalments: an interim dividend and a final dividend. Special dividends may be paid as seen fit.

Interim dividends, if any, are paid as soon as possible after the half-yearly report and final dividends, if any, as soon as possible after the annual accounts are finalised. The Treasury requests at least a week's notice of the actual date and amount before payment, which should be accompanied by a shareholder dividend payment statement. Shareholding Ministers may agree on variations to those dates, after consultation with the board.

SOE borrowing

Explicit disclaimer of Crown guarantees and loan covenants

For all SOE 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 SOE borrowings. The disclaimer aims to give a clear signal to third parties of the nature of the relationship between the Crown and SOEs.

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 SOEs, 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 long-term hold policy, the position on such clauses is as follows.

- It is acceptable to have loan provisions that require lenders to be informed whenever a SOE becomes aware that its ownership will change.
- Shareholding Ministers prefer SOEs 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 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 an SOE. Boards should bear this in mind when considering such mechanisms.

Tax planning

SOEs 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. SOEs 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 SOEs engaging in normal tax planning in accordance with tax law, they are not comfortable with companies leading the market in developing aggressive tax planning strategies.

Shareholding Ministers recognise that what might be considered aggressive may change over time and that there will always be an element of judgement involved. This is a judgment for SOEs, not shareholding Ministers, to make.

The principles that shareholding Ministers expect boards to adopt when considering tax planning are as follows.

- Final decisions regarding whether to proceed with any single, or series of related transactions are for individual SOE boards to consider, subject to the usual shareholder consultation requirements set out in each SOE's SCI, and thresholds specified in the Companies Act regarding major transactions.
- All transactions should be legal in all jurisdictions in which they have effect, and with respect to unusual or non-trivial tax issues have sign-off from professional tax advisors and appropriate tax authorities where possible (eg receiving a binding ruling on the transaction from IRD where appropriate). Moreover, the tax-planning component of transactions should not be aggressive from a New Zealand or international corporate perspective, which should be confirmed in professional tax advice received by an SOE.
- Ownership risks arising from the transactions should be remote.
- The normal expectations regarding the 'no surprises' policy and disclaimers on company financing still apply.
- Boards are fully accountable for their tax planning activities, and so need to be able to explain their decisions to all stakeholders, recognising the obligations imposed on

SOE directors through the SOE Act and other legislation, and shareholder expectations.

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 CONSULTATION AND STRATEGIC INITIATIVES

The board of each SOE is required to seek the approval of, and expected to consult with or inform, shareholding Ministers before certain transactions or strategic initiatives are entered into.

Consultation expectations and thresholds

It is important to distinguish between 'approval' and 'consultation'. In the SOE environment, most consultation with the shareholder is just that (unless the board is required to seek approval and/or an equity injection is required) and the responsibility for decision-making lies with the board.

Approval

Under the Companies Act, SOEs 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.

Consultation

Shareholding Ministers expect the board of each SOE to include in the company's SCI the matters on which they will be consulted before certain transactions or strategic initiatives are entered into.

Under section 14(2)(h) of the SOE Act, the board of each SOE is required to include in the SCI for the group the procedures to be followed before the group subscribes for, purchases, or otherwise acquires shares in any company or other organisation. Shareholding Ministers expect these procedures to include an obligation to consult with them where the acquisition exceeds a threshold that is agreed by shareholding Ministers and the board as part of the annual business planning round.

Under section 14(2)(j) of the SOE Act, the SCI should also include any other matters agreed by the shareholding Ministers and the board. Shareholding Ministers expect this to include an obligation to consult with them on matters such as the sale or other disposition of shares, the acquisition or sale of assets, and any capital investment, where

such transactions exceed a threshold agreed by shareholding Ministers and the board as part of the annual business planning round.

The board of each SOE may also wish to consider agreeing separate consultation thresholds with shareholding Ministers for transactions which relate to the SOE's core business activities, and for transactions which are not core business activities but which fall within the nature and scope of the SOE's activities as defined in its SCI.

In addition to the above, shareholding Ministers expect the board of each SOE to consult with them in relation to any proposed activity that falls outside the nature and scope of the SOE's activities as defined in its SCI, as this will require an amendment to the SCI.

Inform

Shareholding Ministers expect the board of each SOE to inform them, in advance, of any transaction that does not meet the consultation thresholds specified in the company's SCI, but which falls within the scope of the 'no surprises' policy.

Process for consultation

Shareholding Ministers are, on occasion, consulted on or asked to approve investment proposals. This usually arises either because the investments are major transactions under the Companies Act 1993, shareholding Ministers are being consulted by the board as required under the SCI, or shareholding Ministers are being asked to consider an equity injection.

The consultation process, as distinct from shareholder approval, is expected to be conducted in good faith and to involve the following steps.

- Based on advice from its management team, the board forms a view on the commercial merits of the proposal.
- The board advises Ministers of a relevant pending decision.
- The board provides information to Ministers.
- Reasonable time is given for Ministers' consideration, depending on the circumstances of the particular decision.
- The board considers Ministers' comments, with an open mind.
- The board proceeds to take the final decision for which it is responsible.

Shareholding Ministers will continue to assess investment proposals against the principles set out below:

- the business case for the proposal, including expected financial returns and risks, and the sensitivity and volatility of returns to various alternative scenarios
- the size of the proposal and fit with core business
- the company's track record of success in similar expansions

- whether the proposal can be funded from the company's balance sheet without recourse to new equity finance from the Crown.

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

In order to assess investment proposals, shareholding Ministers prefer that sufficient information be made available to allow them to make an informed assessment of the proposal. If investment approval is being sought during the business planning process, Ministers' views on the proposals should be explicitly sought, ie consultation should not be inferred from consultation on the business plan, and Ministers may still choose to consider the proposals outside of the planning process.

Diversification and expansion

Diversification supporting economic transformation

In June 2006, shareholding Ministers announced a change in policy for SOEs to encourage expansion into new businesses to help build New Zealand's wealth.

In general terms, shareholding Ministers have agreed to consider proposals from SOEs that broaden the nature and scope of their existing activities by diversifying their technological, product and market portfolios and that extend the time horizon over which they seek to capture a return on investments.

SOEs will be responsible for establishing how they can achieve this, and for preparing robust business plans that can preferably be funded off their own balance sheet and that meet the relevant criteria.

The relevant criteria include the following.

- Diversification must be based on an effective utilisation of existing core competencies and into adjacent technologies, products and markets.
- New activities should have a demonstrated potential to enhance the competitive competencies of other firms and industries, ie spillover benefits.
- Other than in very rare circumstances, the diversification should be able to be financed off the SOE's existing balance sheet.
- Any revised scope of business must be accompanied by robust evaluation processes using explicit performance indicators, leading to a clear exit route for ventures that are not meeting expectations.

SOEs are encouraged to consider options for diversification based on their existing core competencies. Each proposal will be considered on a case-by-case basis by shareholding Ministers, who will consider the proposal's strategic fit with the government's policy

framework, including the benefits to the economy as a whole and any Commerce Act implications.

Where an SOE has been through the long-term hold process, shareholding Ministers will also consider expansion proposals against the Statement of Shareholder Preferences.

Overseas expansions

Overall, shareholding Ministers have the following preferences for overseas expansions (and expansions generally).

- The SOE should not lose focus on its core business.
- Expansion should not significantly increase the risk profile of the SOE and/or the Crown.
- Expansion strategies should tend to develop and leverage from domestic activities rather than developing entirely new products and services for international markets.
- Overseas expansion should not put at risk the SOE's New Zealand operations or assets.
- The SOE should have some level of non-Crown private sector debt for expansion and should not seek total funding by the Crown, eg through withholding dividends.
- Overseas expansion should not create a risk that the New Zealand Government may be associated with and held accountable for poor company actions and behaviour overseas.

Subsidiaries

In relation to subsidiaries, shareholding Ministers expect that:

- the parent company will comply with any restrictions in its SCI relating to the acquisition or formation of subsidiaries
- the powers and functions 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 for SOEs (or the relevant responsible Minister) 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) will include information on the subsidiary's activities and performance.

Joint ventures

Boards of SOEs should only seek partnering solutions that allow them to retain substantive control over their business activities. In general, shareholding Ministers will not support joint ventures that result in Crown-owned assets and capabilities being transferred or diluted.

This concern about dilution of control also extends to financial and budgetary controls. Shareholding Ministers expect that any joint ventures entered into by the Board would be subject to at least the same level of financial budgeting and monitoring control as that which applies to SOEs 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 the 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 maximise 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, ie 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 chief executive 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 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 CCMAU's website (<http://www.ccm.au.govt.nz/pdfs/Fees-Guidelines-February-2004.pdf>) has comprehensive information on 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.

Directors: 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 responsible Minister for the particular board, and the process is managed by CCMAU.

Crown company directors 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 or 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, he/she will receive a letter from the responsible Minister at the same time as new board appointees are advised of their appointment. It is CCMAU's aim 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 1993 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 the shareholders, 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 the Minister 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 company 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, through the office of the responsible Minister. The chair and the deputy chair are also appointed by shareholding Ministers. Although the responsible Minister 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.

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 the responsible Minister. 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 interests, 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.

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 overarching 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 undertakes 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 no longer one prescribed process for evaluation. However, 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 the Minister along with the requested board fees in any year.