

**Wellington City Council**

Review of Council Controlled Organisations

June 2006

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We reserve the right, but are under no obligation, to revise or amend our report if any additional information (particularly as regards the assumptions we have relied upon) which exists on the date of our report, but was not drawn to our attention during its preparation, subsequently comes to light.

## Glossary of Terms

CCMAU	Crown Company Monitoring Advisory Unit
CCO	Council Controlled Organisation
CCOP sub-Committee	Council Controlled Organisations Performance sub-Committee
CEO	Chief Executive Officer
Council	Wellington City Council
KPI	Key Performance Indicator
LGOIMA	Local Government Official Information and Meetings Act
PWB	Positively Wellington Business
PWT	Positively Wellington Tourism
SOE	State Owned Enterprise
Sol	Statement of Intent
WCCL	Wellington Cable Car Limited
WRST	Wellington Regional Stadium Trust
WWL	Wellington Waterfront Limited

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# 1 Executive Summary

1.1 Council Controlled Organisations (CCOs) have a role to play in contributing to the Council's economic, social, cultural and environmental objectives. There have been concerns expressed within Council that some of the CCOs are operating in ways that are not fully aligned or consistent with the Council's objectives.

1.2 In light of these concerns, this review has been initiated by Council. Its objectives are to:

- determine the most appropriate model(s) for carrying out the activities currently undertaken by CCOs; and
- identify areas where reporting to, and monitoring by, the Council needs to be amended and enhanced.

1.3 This has required the review to consider the advantages and disadvantages of the CCO model and assess whether it remains appropriate, whether it needs to be modified, whether it should be replaced with another model and, lastly, whether functions undertaken by CCOs should be brought back within the Council itself.

1.4 In addressing these requirements, the review has assessed the way in which the CCO model currently works. A number of issues have been identified which potentially constrain the contribution of the CCOs to Council objectives. Among the more important of the issues identified are the following.

- CCOs do not necessarily have a clear view of Council's objectives. In some cases, this is a matter of communication. In others, it is a function of having multiple councils as owners and in most cases, it is a function of the fact that Council, of itself, has a complex array of objectives.
- Some CCOs are operating in a manner that suggests a greater degree of autonomy than is either envisaged by the Council and/or is appropriate recognising the financial, operating and reputation risks accruing to the Council as owner. There is a balance to be struck between autonomy and accountability and the balance is not optimal in all instances.
- CCOs have to deal with many parts of Council and, as a consequence, have many levels and lines of communication with Council. The potential for confusing and conflicting messages is considerable with significant potential for undermining effective accountability.
- The contribution of CCOs is critically dependent on the quality of the governing boards. On the whole, we consider that the Council is fortunate in having attracted high calibre people from outside of Council to participate on CCO Boards. However, there is scope for making more of the capability that exists through enhancing appointment and induction processes.
- Effective accountability rests on a relatively limited number of formal mechanisms. The Statement of Intent (Sol) is key among these. The scope and content of CCO Sols falls well short of the standard that is typically found across agencies of central government. The processes surrounding Sol development including the

roles played by Letters of Expectation and the CCO Performance Committee can be modified to further strengthen the Sol as a key accountability tool.

- Similarly, there are issues with the quality of performance reports which are another part of the formal accountability machinery. There is a need to ensure that the performance reports reflect the appropriate content, are provided according to a realistic timeframe reflecting the business cycle of the entity in question and leverage off the information used by CCO Boards to manage and hold the management of the CCO accountable.
- The CCO Unit needs to play a key role on behalf as the Council as owner, but there are indications that the role is not as well developed, or understood, as it could be.

1.5 While these issues serve to weaken the effectiveness of the CCO model, they do not invalidate the model. We have identified several steps for strengthening the CCO model including:

- making better use of letters of appointment and reviewing CCO deeds and constitutions;
- modifying Board appointment processes and policies;
- strengthening Board induction processes;
- realigning the scope of Sols along the lines of the requirements under the Public Finance and Crown Entities Acts;
- establishing an advisory group attached to the CCO Performance sub-committee;
- changing the process by which draft Sols are considered and approved;
- reviewing performance measures and re-focusing performance reporting;
- suggestions regarding the role of the CCO Unit; and
- better communicating roles and responsibilities (and streamlining communication channels as part of this).

1.6 Implementing these changes will further build on the inherent strengths of the CCO model.

1.7 The review does not recommend that the CCO model be rejected. Structure is only one part of the framework for organisational performance. The issues that lie behind this review are not inherently structural in nature. Rather, they have more to do with:

- processes and systems that do not:
  - adequately support aligning CCOs with Council objectives;
  - foster the best incentives for performance;
  - provide for effective accountability;

- CCOs that do not necessarily have a clear view of Council's views in relation to mission, vision and values;
- current arrangements that do not necessarily capture the full value of existing capabilities or provide opportunities to bring additional capabilities (e.g. the advisory group); and
- the quality and attitudes of the people involved in the relationship. There is potential for a lack of alignment and understanding between the Board and management of the CCOs with respect to Council objectives and a lack of understanding on the part of Council as to what is an appropriate and sustainable level of autonomy for the entities.

1.8 Moreover, most, if not all, of all of the reasons for establishing CCOs continue to be relevant including :

- the ability to attract external funding and specialist resources;
- providing greater focus and operational flexibility; and
- allowing for the situation of two or more Councils as owners.

1.9 For these reasons, the review does not advocate bringing CCO functions back within Council. If such an action was envisaged it would be for reasons of policy and or philosophy as opposed to performance.

1.10 The review has also considered whether the CCOs should be modified either in terms of a different organisational form, or merged in some fashion. Three of the CCOs are companies and the other seven are incorporated charitable trusts. Both organisational forms are tried and tested and provide effective overarching governance frameworks. While the Local Government Act allows for a wide range of possible organisational forms, the review does not see any compelling reasons to depart from the forms that are currently in use.

1.11 Furthermore, there does not appear to be a strong case for merging the CCOs in some form. Three types of integration have been considered:

- clusters of CCOs based around shared outcomes;
- separating asset ownership from service provision; and
- use of holding structures.

1.12 The relatively distinct nature of the functions performed by each of the CCOs means that the scope for efficiencies by joining them together in some way is somewhat limited.

1.13 In summary, the review favours retaining the current portfolio of CCOs that has been the focus of this review, but recommends a number of measures for strengthening governance and accountability arrangements. In addition, we have provided a list of criteria to assist with future considerations regarding the establishment of CCOs.

## 2 Introduction

2.1 The Council has a number of Council Organisations that contribute to the economic, social, cultural and environmental well being of the city and, in many cases, wider region. This review concerns nine Council Controlled Organisations (CCOs)<sup>1</sup> and the Wellington Regional Stadium Trust.<sup>2</sup> For the sake of simplicity, we refer to all of these organisations as CCOs for the purposes of this review. The portfolio of CCOs comprises a mix of Trusts and Companies. Both organisational forms are legally separate from the Council and operate at arm's-length from the Council.

### Context

2.2 The ten entities that are included in this review collectively represent a significant part of overall Council activity. In total, the revenues associated with the CCOs sum to \$53 million and have combined assets of approximately \$257 million (FY 05).

2.3 While the financial aspects of the CCOs are significant, their wider economic, social, cultural and environmental impacts are even greater. There is a diverse range of activities undertaken by the CCOs including:

- managing infrastructure that is integral to the overall functioning of the City and region (Capacity and Wellington Cable Car Limited);
- promoting economic activity (Positively Wellington Business and Positively Wellington Tourism);
- promoting events, arts and culture (Wellington Stadium Trust, St James Theatre Trust and the Museums Trust); and
- developing, promoting and maintaining assets for the enjoyment of the community (Wellington Waterfront Limited, Basin Reserve Trust and the Zoo Trust).

2.4 Reflecting their span of activities, the CCOs collectively have a significant part to play in contributing to, and the achievement of, Council objectives. Council is, therefore, keen to ensure that the CCOs operate in ways that maximise their contribution to Council objectives.

2.5 By way of background to this review, there had been concerns expressed within Council that some CCOs are operating in ways that are not fully consistent with the Council's objectives. Examples of the types of issue giving rise to such concerns include:

- CCOs taking significant decisions without appropriate regard to, or consultation with, Council;

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<sup>1</sup> Capacity, Wellington Cable Car Limited, Wellington Waterfront Limited, Positively Wellington Tourism, Positively Wellington Business, St James Theatre Trust, Wellington Museums Trust, Wellington Zoo Trust and Basin Reserve Trust.

<sup>2</sup> Wellington Regional Stadium Trust (WRST) is a charitable trust established by the Wellington City Council and Greater Wellington Regional Council and is registered under the Charitable Trust Act 1957.



- Council feeling marginalised;
- Council being on the receiving end of adverse events, but CCOs taking all of the credit for positive outcomes; and
- CCO board members adopting a position of independence from Council that does not reflect an appropriate balance between autonomy and accountability.

2.6 Concerns in these, and other, respects have caused some within Council to question the merits of the CCO model with some advocating the transfer of functions back within Council. Rather than reacting to these concerns through structural solution, the need for more fundamental review of the CCO model has been identified. This is reflected in the objectives and terms of reference for the review.

### **Objectives**

2.7 The objectives for the review are to:

- determine the most appropriate model(s) for carrying out the activities currently undertaken by CCOs; and
- identify areas where reporting to, and monitoring by, the Council needs to be amended and enhanced.

### **Terms of Reference**

2.8 In support of these objectives, the scope of the review, as reflected in its terms of reference is quite wide-ranging. In assessing the appropriateness of the generic CCO model, the terms of reference require that consideration be given to four options:

- retain the CCO model as is;
- retain but amend and enhance the CCO model;
- reject the CCO model in favour of an alternative; and
- reject the CCO model and bring the activities undertaken by CCOs back within the Council itself.

2.9 The terms of reference require that various matters be addressed as part of the consideration given to the four options. These include consideration of:

- the generic rationale for establishing a CCO and whether this is still appropriate;
- the advantages and disadvantages of the CCO model, alternatives to that model, and the risks involved;
- models used elsewhere;
- whether some CCOs could be merged to create efficiencies through greater scale, alignment and capability; and
- the criteria that should be applied when considering whether or not to establish a CCO.

2.10 Clearly, it does not automatically follow that if the CCO model is appropriate in one context, it will be the most appropriate choice in other contexts. Accordingly, the terms of reference has also required entity-specific consideration of the appropriateness of the CCO model. To this end, the review has considered the specific reasons for establishing each CCO and whether these still have currency. A significant part of the review has also focussed on ways in which the functioning of the CCO model can be enhanced. Specific areas for focus in this regard, as required by the terms of reference, have included:

- monitoring and reporting arrangements;
- selection and appointment of Board members;
- processes for accountability between a CCO Board and the Council;
- roles and responsibilities; and
- funding issues.

### **Scope**

2.11 It is important to note that the review has not sought, or been required, to assess the performance of the CCOs. This is part of the ongoing role of the CCO Unit and is not part of the terms of reference for this review. Further, the review has limited its focus to the ten CCOs noted earlier and their interactions with the various arms of Council. The Council has multiple interests in the CCOs reflecting the wide array of activities that they are involved in and the multiple outcomes (economic, social, cultural and environmental), to which these activities contribute.

2.12 The overarching focus of this review has been on the governance and accountability arrangements pertaining to CCOs (i.e. the arrangements that exist between the Council as “owner” of these entities rather than the purchase interest that the Council has in the entities). The scope of the review has not extended to assessing whether the level of service/outputs provided by CCOs is optimal. Further, the review has not been required to assess the option of sourcing services provided by CCOs from other third party suppliers not owned by the Council.

### **Approach**

2.13 The approach to the review has involved a process of gathering information (through reviewing documentation and interviews), evaluating that information in light of good governance and related practices and identifying opportunities for change and enhancement.

2.14 As part of the information gathering phase, the review has:

- examined the specific reasons for the establishment of each CCO and considered if this remains relevant within the legal framework under which each operates;
- scoped the nature of concerns with existing arrangements to ensure that we have a clear understanding of the nature of the problems and issues; and
- considered the future roles and functions for the CCOs and assessed what implications, if any, changes in these may have for the CCO model and its application.

2.15 The evaluation phase has split into two distinct parts. The first, and more intensive, part of the evaluation phase has focused on enhancing the functioning of the CCO model. In this regard, we have reviewed and assessed the mechanisms by which the CCO model is implemented including:

- board selection and appointment processes;
- board induction processes;
- board evaluation processes;
- the processes through which Council expectations are communicated to CCOs;
- the specification of expectations in operating, financial and other terms;
- relationship protocols and processes;
- delegations;
- processes for preparing and agreeing business plans, Statements of Intent and, if any, service agreements;
- arrangements by which:
  - roles and responsibilities of CCOs and the Council are defined;
  - the activities of CCOs are aligned with the interests and objectives of Council;
  - Council can influence the direction of CCOs;
  - Council can review the roles and functions of CCOs;
- reporting and accountability arrangements (from both purchase and ownership perspectives); and
- governance and monitoring arrangements.

2.16 The processes, policies and arrangements in these areas have been compared and contrasted with best practices. The first part of the evaluation is contained in sections three and four of this report.

2.17 The second part of the evaluation (covered in sections five and six of this report) assesses the advantages and disadvantages of effecting structural change to the existing CCO model. This includes the option of bringing CCO functions back within Council as well as the option of amalgamating or merging CCOs in some form. It also includes consideration of organisational forms other than trusts or companies (which are the existing organisational forms for the ten CCOs that form part of this review).

## 3 Assessment of Existing Arrangements

3.1 As part of the review, we have met with relevant personnel from Council and from each of the ten CCOs that are within scope. The purpose of these meetings has been to gain, first-hand, an appreciation of how the CCO model is working in practice. By obtaining an understanding of the issues arising with current arrangements, we have been able to form a view as to the appropriateness of the existing model, whether consideration needs to be given to adopting a different model, or whether it is more a case of refining and enhancing the operation of the existing model so as to better align with, and contribute to Council objectives.

3.2 What follows is our assessment of a range of issues and concerns stemming from the existing model most of which relate directly to issues surrounding good governance and effective accountability.

### Objectives

3.3 The Council has an “ownership” interest in CCOs essentially because the functions they perform contribute to the outcomes that the Council wants to see for Wellington. It follows, therefore, that from a Council perspective, the ultimate success of the CCOs (individually and collectively) depends on aligning the activities of the CCOs with Council’s objectives (i.e. doing the right things) and ensuring that those activities are undertaken in a cost and risk effective manner (i.e. doing the right things well).

3.4 Aligning the activities of the CCOs with the objectives of Council requires that Council have a clear set of objectives, that these are appropriately communicated and that they are understood by the CCOs. Council has a complex range of objectives that span economic, social cultural and environmental dimensions. This is reflected in the array of CCOs in the Council’s portfolio and the span of activities undertaken by the CCOs. This situation gives rise to some issues from a CCO perspective.

- Where objectives are multi-dimensional and complex, there is a higher than normal premium attaching to the need for clear articulation of those objectives. In the first instance, CCOs derive their mandate from Trust deeds (in the case of Trusts) and constitutions (in the case of Council Controlled Trading Organisations registered under the Companies Act). However, these documents do not describe objectives in other than fairly generic terms. Accordingly, if the Council is to have the opportunity to provide strategic guidance and direction to CCOs, the general description and definition given to objectives in trust deeds and constitutions needs to be supplemented by other means. Key among these mechanisms is the annual Sol process but, as discussed below, this is not working as effectively as it needs to.
- In addition to this, alignment of CCO actions with Council objectives also rests heavily on the behaviours of the CCO governing Board. In this respect, there are issues also with the mechanisms by which the focus of Board members is aligned with Council interests including, in particular through the appointment and induction process.

- The multi-faceted nature of Council also means that different arms of Council have an interest in the activities of CCOs. This gives rise to multiple channels through which there is communication and interaction between CCOs and Council. Multiple channels of communication give rise to the risk of conflicting messages and signals including with respect to objectives. Mixed signals regarding objectives risks undermining the accountability of CCOs to Council. Accordingly, there is an issue around the existing multiple channels of communication and the mechanism for ensuring that consistency of message is achieved.
- For three of the CCOs (Capacity, Positively Wellington Business and the Wellington Regional Stadium Trust) there is an added complication regarding objectives in that these entities have more than one owner.<sup>3</sup> Where the interests of multiple owners diverge, there needs to be a mechanism for reconciling the difference. It is not the role of the CCO to try and reconcile different interests between its owners. The owners need to do this for themselves.
- More generally, due to the complex and multi-dimensional objectives of Council(s), there is the potential for objectives to be in conflict with one another. Trade-offs need to be made. Mechanisms for considering the trade-offs and prioritising need to exist both within Council and within CCOs.

3.5 Council also has a range of reasons as to why it has established CCOs (instead of undertaking the activities within Council). It is important to ensure that these reasons are understood by CCOs (and Council) and that they remain relevant.

### Autonomy and Accountability

3.6 The CCOs within the scope of this review are all wholly owned by the Council (with the exception of Capacity, the Wellington Regional Stadium Trust and Positively Wellington Business) and exist by virtue of decisions taken by Council. In short, they are entities of Council, but with their own legal status. The separate legal status and governance arrangements surrounding the CCOs mean that they are at one arm's-length from Council.

3.7 Based on discussions with various Council personnel, it is clear that there are concerns regarding the degree to which some of the CCOs appear to be operating independently of Council. The concerns include CCOs that are:

- pursuing objectives that are not shared by, or agreed with, Council. It needs to be noted, however, that issues surrounding the clarity and articulation of Council objectives may be contributing to this concern;
- seeking to extend the nature and scope of activities beyond that envisaged or desired by Council;
- adopting values and vision that do not adequately align with those of Council;

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<sup>3</sup> Capacity is owned jointly by the Wellington City Council and Hutt City Council. PWB is owned by the Wellington City Council, Hutt City Council, Upper Hutt City Council, Porirua City Council and the Kapiti District Council. The Wellington Regional Stadium Trust has the City and Regional Councils as settlers.

- taking decisions with significant implications for the CCO and Council without observing appropriate consultation and communication protocols;
- branding their organisation in a way which does not adequately acknowledge the links (ownership, purchase and/or funding) that exist with Council;
- arranging and conducting events that do not pay sufficient, or any, recognition to the Council as owner, funder, sponsor etc; and
- failing to comply with statutory and other deadlines in relation to accountability documentation.

3.8 The issues underlying these concerns reflect a combination of behaviour and cultural issues along with weaknesses in the way the CCO model is working. Some of those weaknesses revolve around issues to do with the Board appointment and induction processes, the SOI process and the performance monitoring process. When working well, these are mechanisms through which the appropriate balance between autonomy and accountability can be managed.

3.9 Notwithstanding the issues surrounding process in these areas, processes in themselves are unlikely to be the only reasons behind the concerns that exist with respect to perceived imbalances between autonomy and accountability. Part of the explanation for imbalance also stems from behavioural and cultural differences between CCO board members and Council. CCO board members need to be continually mindful that being on the board of a CCO is not the same as being the director of a commercial company (which is the background of many CCO board members). While governance requirements and principles are the same, CCOs are different because:

- they are part of Council;
- their objective is not strictly, or even predominantly, commercial. As noted above, the objectives for CCOs involve a more complicated mix of commercial, social, cultural and environmental objectives;
- they have only one owner (or a small number of owners in the case of three of the CCOs) as opposed to large numbers of diverse and unrelated shareholders as the case with large listed companies;
- the relationship between the board and the Council is generally much closer than that which exists between shareholders and the Board in a listed company; and
- although independent, their financial capacity to borrow and maintain solvency is effectively underwritten by the Council. While appropriate legal safeguards are in place, the nature of the relationship between the owner/funder and the CCOs creates a contingent liability to the Council in terms of the moral hazard arising from the relationship.

3.10 While the competencies gained as the director of a commercial company are undoubtedly useful in the context of being a CCO board member, there are other skill sets and behaviours required to be an effective CCO board member. Critical among these is the onus on CCO members to recognise that the CCO will be subject to much more direct oversight and influence by the owner than would be true in a listed company setting. Behaviours and culture need to adjust accordingly. There is a need for an understanding of the operating dynamics and modus operandi of a Council-owned entity. The need to recognise ambiguity, an often lack of clear specification and broader social/non commercial aspects of decision making, is critical.

3.11 In our view the induction processes need to be strengthened to address these issues.

### Communication Channels

3.12 CCOs have commented, as part of the review, that they have to deal with multiple layers of communication with Council. This includes regular meetings with the Mayor/CEO, regular meetings with the CCO Unit, performance reporting meetings with the CCOP sub-committee, interaction with various other council committees (relevant to the activities of the CCO) and interaction with various Council officers. Each layer of interaction spurs its own communication channel. The issues this gives rise to are:

- high transaction costs;
- risk of conflicting messages (Council not speaking with one voice on matters affecting the CCO);
- risk of discouraging the desired alignment between CCOs and Council because of frustrations around communications;
- risk of undermining effective accountability;
- the boundary between formal and informal communications tends to get blurred; and
- ineffective co-ordination across the channels which risks messages/information falling through the cracks.

### Board Appointments and Induction

3.13 The contribution made by CCOs depends in part on having high quality individuals appointed to the governing boards. The Council has a policy on Board appointments that was approved in June 2003. There are several issues arising from the policy and its implementation.

3.14 The policy provides for the appointment of Councillors to the Boards of CCOs. Although this approach is adopted across many Local Authorities it is generally seen as being inconsistent with good corporate governance practices because of the inherent conflicts of interest that such appointments can give rise to.

3.15 We are aware of the view that councillor directors/trustees can potentially add value through bringing a council voice to the governing body, providing a local community perspective and helping to ensure that the objectives of the board are aligned with those of the Council. However, in our view, there are other mechanisms for achieving these ends without placing councillors in the awkward position of having to act in the best interests of the CCO while at the same time performing their duties as councillors. In the case of Capacity as a first step in its establishment and operationalisation it was agreed that the majority (four out of six) directors would be councillors (two each from the Council and Hutt City Council). We note that the process is underway to reduce the number of Councillors to two. At present however if the Council members have to stand-aside on an issue being considered by the Board of Capacity, because of conflict with their Councillor responsibilities, it leaves the Board without a quorum.

3.16 We note that the Council's policy on Board appointments also provides for the option of appointing council officers to boards. This also has the potential to blur accountabilities and is an issue has been commented on from time to time by the Controller and Auditor-General.<sup>4</sup> In practice, only one of the CCOs within the brief of this review has council officers as Board members.<sup>5</sup>

3.17 The Council's policy on Board appointments recognises that the net needs to be cast widely to identify potential board appointees. This is an important element of getting the best people for the job. However, the policy is silent on the opportunities that should be given to potential appointees to assess the appropriateness of taking up the offer of a board position; in effect, potential appointees should be given a more structured opportunity to undertake due diligence. Just as the Council needs to be satisfied that it has the best person for the job, the potential appointee also needs to satisfy him or herself that the role is appropriate for them and that they can make an effective contribution to the CCO.

3.18 Based on discussions with various Chairs, the impression gained is that those approached to sit on the Board of the CCO have little formal opportunity to undertake due diligence prior to accepting their appointment. In some respects, they are entering the role with less than full information reflecting more of a commitment to undertake public service and contribute to the Council/City.

3.19 The situation is not assisted by the further observation that letters of appointment are not used as fully as they could be to communicate Council's expectations of board appointees. As we understand it, the letters currently set out the terms of appointment, but are relatively silent in terms of setting out the reasons why the Council owns the CCO, the contribution that the Council expects the CCO to make and code of conduct expected of board members. The limited information provided to Board members is further perpetuated by the very limited induction and orientation provided upon appointment. Induction and orientation needs to occur at two broad levels:

- induction around the role of a CCO board member. As noted above, experienced commercial directors do not automatically have the understanding of Council and Council processes. To be fully effective in the CCO context, they need this; and
- induction around the CCO itself and the sector it operates within.

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<sup>4</sup> For example, refer to Controller and Auditor-General (2001) Local Authority Governance of Subsidiary Entities.

<sup>5</sup> Basin Reserve Trust



## Sol and Business Plan Process

3.20 The process for developing and agreeing the Sol is a key mechanism through which the Council can seek to provide guidance around strategic direction to a CCO and through which the CCO can express its goals and commitments to Council objectives. Used well, the Sol can be a powerful tool for aligning the CCO with Council objectives, for providing focus for the CCO and for adding value. Used poorly, the Sol risks being viewed as just a compliance requirement.

### Letters of Expectation

3.21 In the last two years, the Council has taken steps to initiate the annual Sol process with a Letter of Expectations. The Letter of Expectations is commonly used, at central government level, for SOEs and, increasingly, Crown entities and the wider public sector. It is a useful means by which the owner can signal issues of concern, areas for particular focus in the Sol and timetable governing the Sol's development. Based on a reading of some of the Council's Letters of Expectations, the following points can be noted:

- The Letters need to be timely. They should be provided to the CCO at the start of the annual planning round. Last year, Letters of Expectation were provided in late April (i.e. after draft Sols are due by 1 March). This year, they were sent to CCOs in early March. Even this timing is too late. The late timing of the Letters means that they do not inform CCO planning early enough. Ideally, the letters should be available by late-October or November at the latest.
- The Letters need to be meaningful and pitched at a strategic level. Some of the letters reviewed have been rather generic in nature and have not been as focussed and purposeful as they could be.
- Where there are two or more councils that jointly own a CCO, the Letter of Expectations needs to be developed by all councils. Clearly it is not sensible or appropriate for one owner to signal expectations if the expectations conflict with those of the other owner.

### Sol Process

3.22 CCOs are required to provide a draft Sol by 1 March each year. The drafts are considered by the CCO Unit which then provides advice to the CCOP sub-committee. The sub-committee is invited to confirm any issues that it wishes to draw to the attention of the Strategy and Policy Committee. There are two aspects of this process which serve to limit its usefulness.

3.23 A major concern raised by CCOs regarding process is the fact that meetings with the CCOP sub-committee to discuss the draft Sols are held in public. Discussions regarding the Sol typically involve sensitive matters including commercially confidential matters, staffing and resource matters, issues around strategic direction, strategy, business arrangements with third parties and so on. Holding discussions in public serves to limit the free and frank expression of views on key issues affecting the Sol. This is not in the interests of Council or the CCOs. There is a need to find a mechanism for conducting discussions that does not inhibit the candour that needs to exist between the CCO and its owner while at the same time not diminishing the need for transparency, and wider accountability, of CCOs to Council and the wider public.

3.24 The second issue concerns the roles of the CCOP sub-committee and Strategy and Policy Committee. The CCOP sub-committee's role is essentially advisory. It considers draft Sols prepared by CCOs and makes recommendations to the Strategy and Policy Committee (firstly in terms of issues that the sub-committee considers that the CCO needs to give further consideration to and then in terms of approving the Sol). Having both committees involved appears to involve some duplication of effort. Options for streamlining the consideration of Sols need to be considered (and the same point applies in the context of monitoring quarterly and other performance reports as discussed below).

### **Sol Content**

3.25 The requirements for Sols are prescribed in the Local Government Act 2002. The requirements in the Act are modelled on those for SOEs under the State Owned Enterprises Act. The requirements under the Local Government Act (and SOE Act) should be interpreted as defining the minimum that is required. The minimum does not, and, in our view, should not, also define the maximum.

3.26 Based on a review of Sols for each of the 10 CCOs within the scope of the review, several observations can be made.

- The Sols are generally quite short documents (less than 10 pages). While they generally comply with legislative requirements in terms of the various headings that need to be covered, the discussion under each heading is brief and not overly informative or useful from an accountability perspective. The Sols give the impression of being compliance documents rather than something that the CCO is using of itself to help guide and steer the organisation.
- The key areas of weakness, in terms of lack of information, are around:
  - describing how the CCO contributes to wider Council objectives and outcomes;
  - as part of this, articulating the links between what the CCOs do and the outcomes these activities contribute to;
  - a heavy focus in some Sols on financial matters at the expense of wider considerations;
  - performance and other measures;
  - putting the CCO into some sort of strategic context (why they exist and matters of a strategic nature in the environment surrounding the CCO); and
  - issues affecting long term sustainability and capability of the CCO and how the CCO is proposing to address these.
- The Sols, rightly, focus on the Council's ownership interest in the CCO. However, for many CCOs it can be argued that the purchase interest is at least as important as the ownership interest. There is a case for bringing more closely together discussion around both ownership and purchase dimensions. A parallel can be drawn with Crown entities, for example, where Statements of Intent also include Statements of Forecast Service Performance.

- Following on from this last point, the multi-dimensional nature of the interest that Council has in CCOs means that the heavily ownership-focused nature of the Sol requirements under the LGA may not be the best reference point to look to. Better options from the perspective of best accountability practices might be the scope of matters that have to be included in Sols under the Public Finance Amendment Act 2004 and/or the Crown Entities Act 2004.

## **Business Plans**

3.27 Sols are supported by CCO business plans. There are important distinctions between the two documents. Business plans are the material of the CCOs; not the Council. Moreover, business plans are not a formal part of the accountability of the CCO to the Council. Reflecting these considerations, it would not be appropriate for Council to approve CCO business plans. To do so would imply intervention by Council in how the CCOs operate which runs counter to the need to hold CCOs accountable against objectives and outcomes.

3.28 While we understand that the Council (or its committees) does not formally approve business plans, we nevertheless note that the Trust Deeds of some, but not all, of the CCO Trusts contain clauses requiring business plans to be submitted for approval. There is a need to address the inconsistency and, more particularly, re-cast the Deeds so that it is clear that Council approves Sols, but not business plans.

## **Performance Monitoring**

### **Quarterly Reporting**

3.29 CCOs are required to report their performance quarterly. Reports are submitted to the CCO Unit who then forward these, together with supporting analysis and commentary to the CCOP sub-committee. The sub-Committee considers the quarterly reports and advice from the CCO unit and then submits recommendations to the Strategy and Policy Committee. The recommendations focus on the issues that the sub-committee considers should be brought to the attention of the Strategy and Performance Committee.

3.30 Consistent with the comments made above in relation to Sols, it is not clear what value is added by having quarterly reports considered by two committees. There is scope for streamlining arrangements in this regard.

3.31 Meetings of the CCOP sub-committee, at which quarterly reports are considered and discussed, are held in public. As with the meetings held in relation to Sols, the public nature of the meetings impedes free and frank discussion around CCO performance. In addition to limiting the discussion held at the CCOP sub-committee meeting, the public nature of the meetings is also influencing the scope of issues raised by the CCO unit in its advice to the sub-committee. It is not in the Council's best interests to impede (albeit unintentionally) the flow of advice from its officials to the sub-committee. The risk is that if matters are not raised, officials (and/or the CCOs) will be exposed to the criticism that relevant information was not drawn to the sub-committee's attention. In turn, this has the potential to undermine the effective accountability of the CCO. Moreover, if matters are not raised, they will not receive the due attention required for development of effective solutions. In short, holding meetings in public has the potential to frustrate, rather than enhance, accountability and good performance.

3.32 For most of the CCOs, reporting performance on a quarterly basis is an appropriate frequency. However, for one or two of the CCOs, the nature of the business is such that, arguably, six monthly reporting would suffice. This is an issue that the CCO Unit might wish to revisit from time to time as a check that the frequency of reporting is appropriate to the circumstances of each CCO.

3.33 The content of CCO quarterly reports is quite variable between the CCOs. Most CCOs report against KPIs but, as noted above in the context of Sols there are issues regarding the appropriateness of many of the KPIs. Most CCOs provide variance reporting but the quality of analysis is variable. Some do not provide good analysis of why the variance has arisen, what the CCO is doing to address the variance and/or what the implications are for year-end outturn (or beyond). We do not advocate more reporting; rather, the quality of reporting can be enhanced.

## Audit

3.34 Two issues have been raised by Council officers in relation to audit. The first of the issues relates to internal audit. The question was raised as to whether each of the CCOs has an internal audit manager and whether each of the CCO Boards has an audit committee. Good governance practices generally see both (and particularly the role of internal audit) as being highly desirable. The size of the entity can, however, have a bearing on whether or not a separate audit sub-committee of the Board is established.

3.35 Our understanding is that internal audit and audit sub-committees are the exception, rather than the rule, among the CCOs reviewed. This should be addressed. If a CCO chooses not to have either or both of an internal function and/or an audit sub-committee, then it would be normal practice for the reasons for this to be explained in the annual report of the entity. Further, it would also be normal practice to explain what steps had been taken to achieve the purposes of internal audit even if there is not a separate internal audit function.

3.36 The second issue raised relates to external audit and whether or not the findings of external auditors (i.e. management letters) should be made available to the Council as parent. External auditors report to the entity they are auditing; not their parent organisation. This is the case for all subsidiary/parent relationships where the subsidiary has its own external auditors. The onus should be on the CCO to raise with Council, any matters stemming from the external audit that would be of material interest to the Council as owner. We understand that this is the arrangement in place now for CCOs, although we have not sought to assess how well it is observed in practice. The same point also applies to internal audit. If internal audit identifies an issue that is of material interest to the Council as owner, the onus should be on the Board of the CCO to draw this to the attention of the Council (through the CCO Unit).

## Role of the CCO Unit

3.37 The CCO unit plays a key role on behalf of the Council as owner. It needs to be a primary point of contact between Council and the CCOs. Accordingly, the role, and how it is performed, needs to be carefully defined and, moreover, the role needs to be more widely understood by the CCOs.

3.38 The purposes of the CCO unit (as reflected in the role description for the Director of CCOs) include:

- to ensure clarity regarding the role and expectations of CCOs in relation to Council;

- to ensure systems are in place so that problems are brought to the attention of Council in a timely manner; and
- to service the CCOP sub-committee.

3.39 Responsibilities are described in relation to, among other matters:

- monitoring;
- strategic management, business planning and financial management; and
- relationship management.

3.40 While the role description is appropriate as far as it goes, there are some aspects of the role that are not documented (even though they may be being undertaken in practice). Based on our first hand experience of undertaking monitoring roles in other contexts, the aspects that are missing from the role description include the following.

- Under relationship management, there is no mention of fostering and maintaining relationships with the CCOs themselves. Instead the focus is limited to Council and external parties (including other councils, community groups and individuals). Building effective relationships with the CCOs is a key part of the role. The CCO Unit needs to maintain the confidence of the CCOs if it is to be truly effective. In this regard, it is worth recording comments made by the CCOs that they consider the relationship with the CCO Unit is a good one, but that this has not always been the case to the same extent.
- There is no reference to assisting with the appointments process. In reality, however, part of the role of the CCO unit includes maintaining a database of current, and potential, board members as well as establishing systems so that when vacancies are impending, steps are taken to fill them in a timely manner.
- There is relatively little emphasis given to the valuable role that the CCO Unit can play in terms of assisting CCOs to work as part of the overall Council machinery. As noted above, some CCOs are perceived to operate too independently of Council. By the same token, Council has multiple parts and multiple interests in CCOs. The CCO Unit can play a key role by maintaining awareness of issues within Council that potentially bear upon the CCO, helping to ensure awareness of these by the CCO and providing advice to the CCO as to the considerations it might need to have regard to in order to work through the issues affecting it. Some of this role verges on being advisory in nature. Care needs to be taken to ensure that, in undertaking this role, the CCO Unit does not transgress into areas that should remain the responsibility of the CCO and/or to ensure that the accountability of the CCO is not compromised.

3.41 We consider that these roles deserve explicit recognition and, moreover, we suggest that there would be benefits in compiling the roles and responsibilities into a Charter for the CCO Unit. The charter could be used to assist in ensuring that other arms of Council and the CCOs understand the mandate and role of the Unit and to provide an overarching point of reference from which to cascade job descriptions.

3.42 Multiple tiers and channels of communication between CCOs and Council exist as discussed above. Indications are that the CCO Unit is not always made aware of communications (particularly informal) that are occurring between Council and CCOs. This makes the role of the CCO Unit more difficult to discharge. The CCO Unit needs to be aware of communications between Council and CCOs. Moreover, there are benefits to both Council and CCOs if the CCO Unit is made aware of impending discussions as it is likely to have perspectives and/or information that helps to inform those discussions.

## 4 Options for Enhancing the CCO Model

4.1 The trust and company form models that are used as the basis for the CCOs owned by the Council are both well established models that are used by other Councils and, moreover, are recognised organisational forms that are used in a wide variety of contexts and which have proven to be effective from a governance and accountability perspective. That said, however, there are several issues concerning the functioning of these models as discussed in the previous section. Below, suggestions are offered for addressing these issues with the objective of enhancing the operation of the CCO model.

### Clarifying Objectives and Expectations

4.2 In the previous section, concerns around the clarity and relevance of objectives were raised along with concerns regarding the means by which these are communicated to the CCOs. There are three opportunities to reinforce the Council's objectives with respect to each of the CCOs and, as part of this, ensure that the message is effectively communicated to the CCOs.

4.3 Firstly, it is considered timely to review the deeds, constitutions and, as appropriate, funding deeds that are the foundation stones for each of the CCOs. Many of the CCOs and the associated deeds and constitutions, were put in place in the mid-1990s. Over time, Council objectives shift and change. Accordingly, it makes sense to review the deeds and constitutions from time to time to ensure that they retain currency with Council aims and objectives.

4.4 The Board is a key organ of each of the CCOs. The role of the Board in terms of setting CCO strategic direction is obviously pivotal in terms of aligning the intent and actions of the CCO with the objectives of Council. It follows, therefore, that it is imperative that board members have a clear understanding of the Council's objectives in respect of the CCOs.

4.5 There is an opportunity to make better use of the Letters of Appointment in this respect. Consistent with good practices<sup>6</sup>, the Letters should at a minimum set out:

- roles and responsibilities;
- the authority under which the appointment is made;
- term of the appointment and conditions attaching to the appointment (including fees and termination procedures);
- legislation relevant to the Board;
- training and development opportunities (including induction arrangements)
- key and or critical issues affecting the entity requiring particular attention.

4.6 In addition, the Letters can go beyond these minimum requirements to also:

- reiterate Council's objectives for the CCO;

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<sup>6</sup> See for example the Cabinet Office Circular on appointments to Crown bodies (CO (99) 12)

- outline the Council's expectations of the board member in relation to his/her role and behaviours (and indicate the mechanisms beyond the Letter through which expectations are communicated);
- emphasise the good governance principles that the Council expects its CCOs to observe;
- indicate the communication protocols that the Council expects the CCO to observe in relation to its dealings with Council (e.g. no surprises); and
- set out the role of the CCO Unit.

4.7 Letters of Appointment should be formally acknowledged by board members with a signed acceptance retained on file.

4.8 The third opportunity for reinforcing and communicating Council's objectives with respect to CCOs is in the context of the annual Sol process. As an input to the planning round of each CCO, the CCO Unit should be considering the objectives and strategic priorities for each CCO and communicating these via the Letter of Expectations. This can then be followed up through discussions with the CCO as part of the normal process of dialogue that should be occurring with respect to Sol development.

4.9 Where the Wellington City Council is a joint owner of a CCO alongside other territorial authorities, early in the planning round, there should be a meeting with the other joint owners to discuss and agree objectives regarding the jointly-owned CCO. The outcome of these discussions should be reflected in the Letter of Expectations.

### Strengthening Accountability

4.10 Clarity of objectives is a necessary but not sufficient condition for effective accountability. Objectives need to be translated into sensible business plans, a comprehensive Sol and reported against through quarterly, half-yearly and annual reports.

### Letter of Expectations

4.11 As noted above, the Letter of Expectations is one part of the planning process. The content and timing of the Letter can be improved. In terms of timing, the Letter needs to inform the planning process undertaken by each of the CCOs. This implies being in a position to send the Letters by late-October or November at the latest. The content of the Letters needs to address issues that are of concern to the Council in relation to the CCO and the matters, of a strategic nature, that the Council would like the CCO to pay specific attention to as part of its draft Sol.

### SOIs

4.12 Based on a review of current Sols, there are opportunities to enhance their scope and content. While the existing Sols meet minimum legislative requirements, they do not capture the full extent of the multi-dimensional interest that Councils have in CCOs. In particular, the Sols tend to have too heavy a focus on financial matters and not enough attention on the wider interests that Council has in its CCOs. In this regard, the requirements on Crown entities, in terms of their Sol, offer a richer and potentially more relevant benchmark to guide CCO Sols.



4.13 The requirements that stem from the Crown Entities Act over and above those required under the Local Government Act include greater emphasis on:

- describing the background to the entity (i.e. why it was established), and the strategic and operating environment within which it is operating;
- being much more explicit as to the impacts, outcomes or objectives that the entity is seeking to achieve and contribute to;
- how the entity intends to perform its functions and conduct its operations to achieve those impacts, outcomes or objectives (and in this regard, goes beyond simply stating the nature and scope of activities);
- how the entity proposes to manage the organisational health and the capability of the entity (consistent with greater emphasis given to organisational sustainability); and
- describing the services to be provided, and measures by which service performance may be assessed, through provision of a statement of forecast service performance.

4.14 In short, the Sol requirements contained in the Crown Entities Act go beyond the narrower and predominantly ownership focus of the requirements of the Local Government Act (which are, in turn, modelled on the requirements under the SOE Act).

4.15 By following the Crown Entities Act model, Council would obtain through the Sol a much richer picture of each CCO and how the CCO contributes to the Council's objectives and, hence, a better basis for effective accountability. Moreover, the enhanced Sol should, at least in theory, align better with the scope of CCO business and strategic plans and, in this regard, become a more useful strategic management tool from the CCOs' perspectives.

4.16 The process by which draft Sols are considered also needs to be modified. In particular, there needs to be an opportunity for free and frank exchange of views between the Council and the CCOs without having to air those views in public. It is Council policy for meetings of the CCOPs committee to be held in public consistent with the requirements of the Local Government Official Information and Meetings Act (LGOIMA). Moreover, as a matter of practicality, the CCOP sub-committee has a relatively short amount of time available to it to discuss draft Sols with each of the CCOs. The current meeting format tends to encourage a more passive response to discussion than the robust assessments and challenging of views that is desirable. For these reasons, the meeting at which the CCOP sub-committee considers draft Sols is not an appropriate forum for the free and frank exchange of views.

4.17 We consider that the discussion around draft Sols should take place in the first instance with the CCO Unit since this is a core part of its brief. Beyond this, we understand that it has been the practice within Council for pre-meetings of Committees to take place. The pre-meetings are not held in public and accordingly, they provide an opportunity for free and frank discussion on agenda items prior to the Committee meeting proper. It would seem desirable to utilise the pre-meeting format for the CCOP sub-committee.

4.18 In addition, however, it is suggested that an advisory group attached to the CCOP sub-committee be established. The role of the proposed advisory group is discussed further below, but part of its role would be to provide advice, alongside that of the CCO unit to the sub-committee on CCO draft Sols.

4.19 Under current arrangements, the CCOP sub-committee does not approve Sols but, instead, considers them and then refers them to the Strategy and Policy Committee for approval. This seems to add an unnecessary layer of review. Increasing the clarity of CCO alignment with Council objectives and requirements through enhanced Letter of Expectation and Board appointment processes, coupled with strengthened Sols, will provide Council with greater assurance regarding the contribution of CCOs to Council objectives and lessen the need to have the extra layer of Council scrutiny of Sols.

4.20 If the advice to the CCOPs sub-committee is strengthened, this would seem to further diminish the need for the extra referral to the Strategy and Policy Committee (except in unusual circumstances such as, for example, a decision to wind-up a CCO or merge it with another CCO).

4.21 We suggest that the sub-committee could have its terms of reference amended to give it the power to approve Sols. Reflecting its status, we understand that there would still be a need for the sub-committee to refer its decisions to the Strategy and Policy Committee for noting (because the Strategy and Policy Committee is a full committee of Council). An alternative would be to turn the CCOP sub-committee into a full committee which would then not necessitate referral through to the Strategy and Policy Committee.

### **Performance Measures**

4.22 Although not within the brief of this review, we note that for at least two of the CCOs, the performance measures do not appear to be particularly well aligned with objectives and/or focused on the contribution that is attributable to the CCOs (as opposed to factors outside of the control and influence of the CCO). In these cases, if the performance measures reported in the Sol are the same as those that the governing board relies on, then there more fundamental issues to work through because:

- the measures would not of themselves provide the Board with any meaningful insights regarding the contribution being made by the CCOs to Council objectives; and
- the measures risk becoming the focus of attention (because what gets measured gets managed) and, hence, risk driving CCO activity in directions that are not consistent with desired objectives.

### **Quarterly Reporting**

4.23 In addition to issues surrounding the relevance of some of the existing performance measures, there are also issues around the frequency of reporting and style of reporting that occurs quarterly. As noted in section three, there are differences in the standard of reporting among CCOs.

4.24 We suggest that there is an opportunity to undertake a small project to review the nature and scope of current reporting by CCOs. This would involve working with the CCOs to make the reports more focused and informative. The objective is not to extend the scope of reporting; rather, it is to re-shape the reporting to better inform Council about the contribution that the CCOs are making to Council objectives. A useful test in this regard is ensuring that what is reported to Council should reflect what the Board itself requires for effective governance of the organisation.

### **Board Performance Assessment**

4.25 It is part of accepted corporate governance practice that the Chair of a board should review, at least annually, the performance of board members against agreed and documented expectations and standards. We understand that formal Board performance evaluation is not commonplace among the ten CCOs. One or two undertake relatively informal assessments, some used to undertake assessments but have not undertaken them for some time and others have never undertaken them.

4.26 It is reasonable for Council to expect the Chairs to undertake such an evaluation. This should be made clear in the Letter of Appointment. Further, we would expect the Chair to discuss the outcome of the evaluation with Council representatives. The nature of these discussions is such that they would be held with the CEO, Mayor and CCO Unit Director (involved either directly or informed of the discussion that takes place). It would be normal for the outcome of Chair/board member discussions to then feed into expectations that are agreed annually between the Chair and board members for the year ahead.

### **Appointing the Best CCO Trustees and Directors**

4.27 Because of the potential for conflict of interest, we question whether the practice of appointing councillors to CCO boards is fully consistent with good governance practices. It is recommended that the policy be reviewed. If provision for the appointment of councillors is to be maintained, then we suggest that the policy needs to be strengthened to set out clearly:

- policies in relation to the definition of conflicts of interest;
- policies regarding the steps for managing conflicts of interest; and
- that the fiduciary responsibilities of Councillors/Officials on boards relate to the CCO and not to the Council.

4.28 The Council's policy on director/trustee appointments sets out in general terms, various competencies that are sought. These are sound as far as they go, but would benefit from some enhancement. In particular, missing from the current list are requirements in relation to:

- Technical competencies (financial, legal, experience/training as a director)
- Strategic leadership (a key role for any board is to set strategic direction for the organisation)
- Knowledge of local government (legislation, institutional arrangements, conventions etc)

4.29 While it is not expected that every director/trustee will possess all of these competencies and attributes, each Board needs to have an appropriate mix of them and this needs to be stated in the appointments policy.

4.30 Candidates identified for appointment to the board of a CCO should be given the opportunity to undertake due diligence in relation to the entity prior to accepting their appointment. The benefits of doing this include the following.

- The candidates are better prepared to contribute in their role.
- It is a mechanism for checking against possible conflicts of interest.
- It gives the potential appointee the opportunity to assess for themselves the “fit” with the entity and the other Board members
- It helps to avoid surprises.

4.31 It is recommended that the CCO Unit develop a brief guide as to how the due diligence process could work in practice (including, for example, what opportunities would be given to meet informally with incumbents directors, what information could be provided on a confidential basis to the potential appointee and so on).

4.32 Once the decision to appoint a new director/trustee has been taken, there is a need for somewhat greater rigour around the appointment process than exists now with the objective of better ensuring alignment with Council objectives. This can be achieved through use of the Letter of Appointment followed by implementation of a structured induction process.

4.33 In addition to setting out the terms of appointment (term and remuneration), the Letter of Appointment can usefully describe:

- roles and responsibilities;
- corporate governance principles including, in particular, the need to avoid conflicts of interest;
- requirements in relation to confidentiality;
- requirements in relation to interaction with the media;
- expectations regarding the use of Board committees (e.g. audit committee);
- expectations regarding the commitment expected of directors in order to effectively discharge their duties; and
- requirements and expectations regarding interaction with Council.

4.34 Appointees should be required to acknowledge their understanding and acceptance of these requirements by signing the Letter of Appointment.

## Roles and Responsibilities

### CCO Unit

4.35 Based on discussions with the CCOs, there are indications that there is not necessarily a common understanding of the role of the Unit. We suggest that there would be advantages in formally documenting the role (for example into a charter) and then communicating this both within Council and with the CCOs. The description of the CCO Unit's roles and responsibilities should, in our view, cover the various matters discussed in section 3 above (paragraphs 3.34- 3.36 refer). In terms of responsibilities this would require the CCO Unit to:

- ensure clarity regarding the role and expectations of CCOs and to seek to align these with Council objectives;
- maintain effective systems for monitoring CCO performance and drawing issues to the attention of Council in a manner that is timely and avoids surprises;
- provide advice to, and service the requirements of, the CCO Performance sub-committee (and wider Council as required) that enables effective decision making by Council in relation to CCOs; and
- be a principal point of connection between the CCOs and Council.

4.36 The roles that need to be undertaken in order to discharge these responsibilities are essentially threefold:

- CCO performance monitoring and advice;
- Connection point between Councils and CCOs; and
- CCO Board selection, appointments and induction processes.

#### *CCO Performance Monitoring and Advice*

4.37 First and foremost, the Unit's role is to monitor the performance of the CCOs (individually and as a portfolio) and to advise Council on the extent to which the CCOs are aligned with, and contribute to, the achievement of Council objectives. The monitoring role should not be interpreted as focussing solely on financial performance. The interests of Council in CCOs are in part financial, but there are also economic, social, cultural and environmental objectives that the CCOs contribute to.

4.38 The role of the Unit is to advise on the degree of alignment with and contribution with this complex objective function. To draw an analogy with central Government, we do not see the role of the CCO Unit mirroring that of CCMAU with respect to SOEs where the predominant focus is that of ownership monitoring. Rather, we see closer parallels being drawn with those Government ministries that have responsibility for monitoring a wide range of Crown entities where the Crown's interests are not exclusively, or even predominantly, ownership, but rather involve a complex mix of purchase and ownership objectives.

Some examples include:

Ministry of Transport	➤ Various Transport safety agencies
	➤ Transit New Zealand
Ministry of Economic Development	➤ Commerce Commission
	➤ Securities Commission
	➤ Trade and Enterprise NZ
Department of Labour	➤ Accident Compensation Corporation
Department of Building and Housing	➤ Housing NZ Corporation
Ministry of Education	➤ NZ Qualifications Authority
	➤ Tertiary Education Commission
Ministry of Health	➤ District Health Boards

4.39 The monitor's role includes analysis and advice in relation to business plans/Sol, quarterly, half-yearly and annual reports as well as day-to-day issues that inevitably arise in connection with CCOs. The monitor's role implicitly involves representing a view of the Council's interests; in short, the CCO Unit is the face of Council from the perspective of the CCOs.

#### *Connection Point Between Council and CCOs*

4.40 A second key role for the CCO Unit is to be a key point of connection between Council and the CCOs. This is very much a two-way street. The CCO Unit needs to be alert to activities within CCOs and the implications this might have for Council. Equally, however, it also needs to be aware of activities with Council and the implications this might have for CCOs. The CCO Unit should operate in a way that encourages the CCOs to look for advice from the Unit regarding issues that might affect CCOs and assist with how best to raise and discuss issues that affect Council. In this regard, the role of the Unit involves maintaining a cross-council view of issues as they relate to CCOs. The CCO unit needs to discharge this role in a manner that does not compromise its primary responsibility to provide independent advice in relation to the performance of CCOs.

#### *Board Selection, Appointment and Induction Processes*

4.41 A third key role for the CCO Unit is to assist Council with the board selection and appointments process. Assisting with the selection process should involve:

- Maintaining systems for anticipating board vacancies as they arise and the competencies that need to be brought to the position
- Maintaining a database and other information sources relating to potential board candidates
- Assisting with the search process
- Preparing letters of appointment for successful candidates.

4.42 Beyond appointment, the CCO Unit should also assist with the induction process for new appointees. As discussed earlier, new appointees are not necessarily well-versed in the Council, local government machinery and institutional arrangements generally. Filling this information gap is something that the CCO Unit would be well placed to assist with.

4.43 To undertake these roles effectively, it is important that they be understood throughout Council. One of the concerns noted in section three is that the CCO Unit is not always as well integrated into Council communications with CCOs as it needs to be. There is an onus on the CCO Unit and other parts of Council to ensure that the Unit is aware of matters affecting the CCOs. This point needs to be reinforced across Council.

### **Proposed Advisory Group**

4.44 The CCOP sub-committee and Strategy and Policy Committee play important roles in terms of scrutinising the performance of CCOs including consideration of CCO Sols and quarterly and annual reports. However, the role of the CCOP sub-committee is constrained to an extent by the fact that meetings are generally held in public. This serves to constrain the free and frank expression of views that needs to take place in the context of the Sols and performance reports.

4.45 To address this, while retaining the decision-making role performed by the Council's committees, it is suggested that consideration be given to establishing an Advisory Group. This group would be attached to the CCOP sub-committee.

4.46 The Advisory Group would comprise a small number of senior and experienced people who collectively bring recognised credentials in the business community and experience of working in a local government environment augmented by industry specialists and Council Portfolio spokesperson as required. Their credentials would be not unlike those of many of the existing chairs of the CCOs. In this respect, it is intended that the advisory group would bring a set of experiences that are unlikely to held be among CCO Unit personnel.

4.47 The roles of the Advisory Group would be to:

- assist with the process of assessing CCO Sols and performance reports;
- provide advice to the Council through the CCOP sub-committee in conjunction with the advice from the CCO Unit (separate reports are not envisaged);
- provide support for the CCO Unit;
- provide a somewhat less formal avenue through which the CCOs can raise and discuss issues; and
- assist with the appointments process by, for example, drawing on their business and other contacts to add names to the database of potential board members, acting as a sounding board as part of the short-listing process and contributing to the induction process.

4.48 Reflecting this brief, we would see the Advisory Group's role supplementing that of the CCO Unit. The overriding objective would be for the Advisory Group to both work with Council Officers and specialist resource to ensure that the best perspective and advice is brought to bear on the strategic alignment, Sol structure and performance monitoring of the CCOs.

4.49 Establishing the Advisory Group would have the following advantages:

- it would create a forum where key commercial and operating issues can be discussed in a free and frank manner;

- it would strengthen the advice provided to Council and in doing so provide the CCOP sub-committee with a better basis for decision making with respect to Sols; and
- it would provide the opportunity to devote more time, than the CCOP sub-committee is currently able to, to robust consideration and discussion over CCO Sols and performance reports.

### **CCOP and Strategy and Policy Committees**

4.50 Consistent with the comments in the preceding paragraph, we consider that establishing the Advisory Group would also create scope for streamlining Council decision-making processes by conferring on the CCOP sub-committee rights to approve draft Sols submitted by CCOs. By strengthening the processes for aligning CCOs with Council objectives (through the measures discussed in this section of the report), there is greater opportunity to reduce the extent of scrutiny by multiple Council committees. We understand that the CCOP sub-committee is not deemed to be a full committee of Council and, accordingly, its decisions would still need to be referred to Strategy and Policy Committee for noting (as opposed to approval as occurs now).

4.51 If it chose to do so, Council could still reserve some decision making rights for the Strategy and Policy Committee. These rights might include, for example, matters that raise strategic or important policy matters such as decisions:

- regarding disestablishing existing CCOs and establishing new CCOs;
- to merge or separate CCOs; and
- that materially changes the nature and scope of CCO activity.

### **Communications**

4.52 The risks created by multiple tiers and channels of communication between Council and CCOs need to be managed. The CCO Unit can play a key role in this regard in terms of providing a focal point for the interface between Council and the CCOs. This does not imply that all communication needs to be channelled through the CCO Unit. Rather, there is a need to ensure that CCO communications initiated by, and received by, the various arms of Council have a degree of co-ordination and that there is good awareness of what the various parties are communicating about. This can be achieved by adopting a protocol that applies across Council and which requires that communications affecting CCOs (in other than a trivial sense) are drawn to the attention of the CCO Unit. The CCO Unit could prepare a scheme of expected communication opportunities and proactively monitor the outcome of these.



## 5 Is the CCO Model Still Valid?

5.1 The concerns and frustrations that Council has been expressing in relation to CCOs have raised the issue of whether or not some or all of the functions undertaken by the CCOs should be brought back within the Council. This is an understandable reaction when there are perceptions that CCOs are operating too autonomously and without sufficient regard to Council and its objectives.

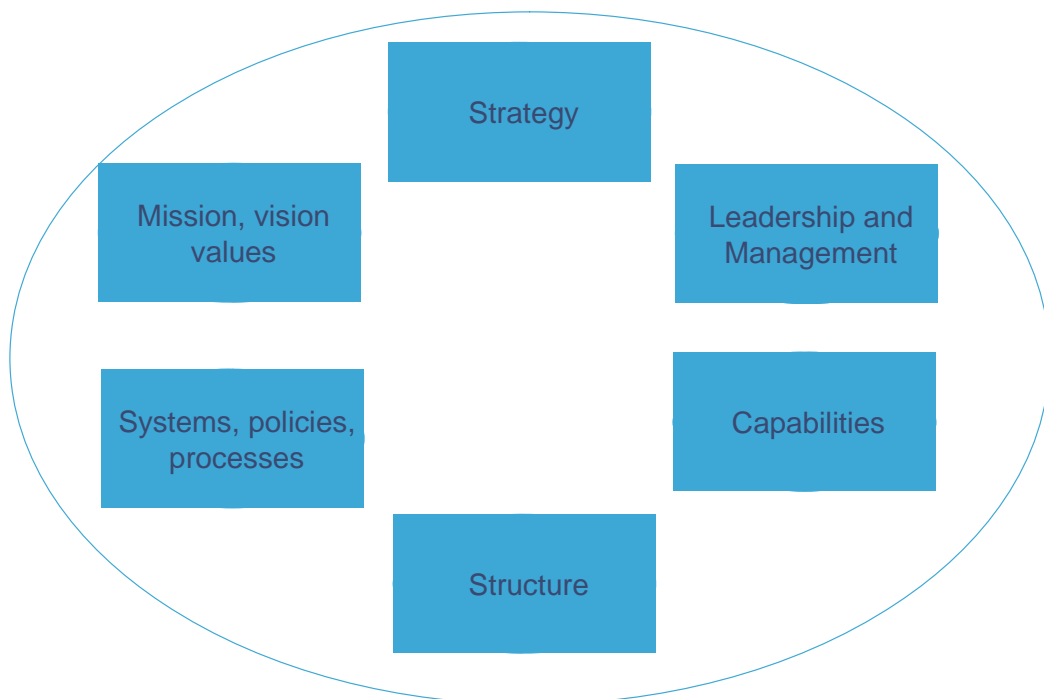
5.2 For several reasons, however, we consider that the CCO model continues to have relevancy and that turning to structural solutions, in the form of bringing functions back within Council, is not the most appropriate strategy to adopt.

5.3 We believe that there are gains to be made from amending the operating framework and its associated mechanisms rather than wholesale change and restructuring. This is discussed further below.

### **Structure is Only One Part of Organisational Performance**

5.4 Organisational performance is a function of many factors as illustrated in the simplified diagram below.

#### Framework for Organisation Performance



5.5 By implication, focusing on structure in isolation is unlikely to address performance concerns. In our view, even if CCO functions were brought back within Council, this option would not address the range of issues discussed in section two above.

## **The Underlying Issues are not Necessarily Structural in Nature**

5.6 Based on the analysis of issues discussed in section two above, we consider that the underlying concerns regarding CCOs are not inherently structural in nature. Rather, the concerns and underlying issues have more to do with the other elements of organisational performance including, in particular:

- processes and systems that do not:
  - adequately support aligning CCOs with Council objectives;
  - foster the best incentives for performance;
  - provide for effective accountability;
- CCOs do not necessarily have a clear view of Council's views in relation to mission, vision and values; and
- current arrangements do not necessarily capture the full value of existing capabilities or exploit opportunities to bring additional capabilities (e.g. the advisory group).

5.7 Changing the organisational structure by bringing functions within Council rather than under Trusts or Companies will not of itself address all of these matters.

## **Rationale for Establishment**

5.8 There are reasons specific to each CCO as to why the functions were established under a Trust or Company structure rather than kept within Council. In broad terms, one or more of the following considerations was relevant to the decision to establish each of the CCOs to:

- enhance the ability to attract funding from non-Council sources. An example includes the St James Theatre Trust where sponsorship funding is a key part of the overall revenue. The underlying assumption is that sponsors are more willing to provide funding to an entity that is not directly part of Council than to Council itself;
- give focus to the roles and functions undertaken by the CCO and minimise the diversion of management time that inevitably arises if the activities are part of a division within Council;
- provide opportunities to attract specialist resources and capabilities particularly at a Governance level. In general CCOs have more ability to tailor employment arrangements to attract the right people than is true of Council. Personnel with a strongly commercial background, for example, are likely to view the CCO structure as more attractive than being an employee within, or contractor to, Council. More specifically, the CCO boards have been fortunate in having high calibre directors and trustees. It is doubtful that Council could attract such people to work as an employee of Council recognising the difference between being a Governor as opposed to being an advisor and or employee;

- provide more operational flexibility. Decision making processes within Council machinery can be complex. Devolving decision making to a CCO can assist in terms of allowing more timely decision making which, in turn, means that CCOs can be more agile and more nimble in responding to opportunities, and threats, as they arise; and
- create a framework to allow multiple Councils to contribute to shared outcomes (e.g. Positively Wellington Business). The CCO structure allows multiple councils to jointly share in the ownership of the organisation. This cannot be achieved if the functions were undertaken by a division of a council.

5.9 For the most part, we consider that these reasons for having CCOs still have currency. Most, if not all, of the reasons are enduring in nature; they are not in the nature of factors that are relevant at one point in time, but not at another. Among the factors, it is worth observing that, across the CCOs, the Council has been fortunate in being able to draw upon a wide group of highly able and respected people to lead the CCOs at Board and senior management levels. We do not consider that it would be in the Council's interests to lose the value that this creates by dismantling the CCOs and bringing their functions back with Council.

5.10 That said, however, just as the arm's-length nature of CCOs provides the opportunity for focus, it also creates scope for a degree of misalignment with Councils objectives. Structural change, in the form of bringing functions back within Council, is not the best solution to this. Other structural changes such as further amalgamation of functions can still be considered, however, for other reasons. This is discussed further in the next section.

5.11 The table below summarises the rationales for establishing CCOs and applies them to each of the CCOs that are part of this review.

<b>Rationale for Establishing a CCO</b>					
<b>Entity</b>	<b>Attract external funding/sponsorship</b>	<b>Provide greater focus</b>	<b>Attract specialist resources</b>	<b>Operational flexibility</b>	<b>Multiple owners</b>
Capacity	X	✓	✓	✓	✓
Cable Car	X	✓	X	✓	X
Waterfront	X	✓	✓	✓	X
PWT	✓	✓	✓	✓	X
PWB	✓	✓	✓	✓	✓
St James	✓	✓	✓	✓	X
Stadium	✓	✓	✓	✓	✓
Basin Reserve	✓	✓	X	✓	X
Museums	X	✓	X	✓	X

<b>Rationale for Establishing a CCO</b>					
<b>Entity</b>	<b>Attract external funding/sponsorship</b>	<b>Provide greater focus</b>	<b>Attract specialist resources</b>	<b>Operational flexibility</b>	<b>Multiple owners</b>
Zoo	✓	✓	X	✓	X

5.12 In short, for all of the CCOs there are at least two out of the five criteria that support continuation of the CCO model. We consider therefore that there is a strong case for continuing to use the CCO model for the functions performed by the CCOs.

## 6 Alternatives to the CCO Model

### Organisation Form Options

6.1 Of the ten CCOs that form the focus for this review, three are companies (Capacity, Wellington Cable Car Limited and Wellington Waterfront Limited) and the rest are incorporated charitable trusts. The LGA provides considerable freedom over the choice of organisational forms for CCOs. Possibilities other than the company and trust options include joint ventures, partnerships

6.2 The trust and company organisational forms are commonly used within local government. We consider that they continue to be appropriate forms to use for CCOs. The advantages of the trust model include:

- incorporated trusts provide trustees with broadly the same protection against personal liability as company directors have (although there are limits to this);
- provided it is recognised as such by Inland Revenue, charitable trusts are exempt from income tax. We note, however, that the hurdles for achieving tax exempt status are increasing. Further, for large donations or gifts, they are exempt from gift duty; and
- The trust constitution can be tailored to reflect the specific functions, powers and objects intended for the CCO.

6.3 The advantages of the company model include:

- the protections against personal liability;
- arguably the limited liability status offers protection for Council (although in reality the corporate veil is thin);
- the governance framework provided by the Companies Act is tried and tested.

6.4 We do not see any reason for discontinuing with the trust and company forms for CCOs. Moreover, we consider that the current mix of company and trust forms across the ten CCOs within this review is appropriate. The company form is obviously more appropriate for activities that are inherently commercial in nature and where the objective to achieve at least some return on capital. None of the CCOs that are trusts currently fall within this definition and, equally, all of the CCO companies are inherently commercial activities in nature.

### Merger/Amalgamation Options

6.5 A recent report prepared for the Council noted that there are many CCOs and observed that, as a result, there are high governance and other transaction costs involved. This raises the question of whether or not the structure of the existing CCOs is optimal in the sense of there being an optimal demarcation of roles, functions and responsibilities. This is an issue around the optimal horizontal integration of the CCO portfolio.

6.6 The choice of structural options is potentially very large. To keep the analysis manageable, three options for approaching the horizontal integration issue are considered:

- horizontal integration based around **outcomes**;
- horizontal integration based around **separation of asset ownership from service provision**; and
- horizontal integration achieved through use of **holding structures**.

### **Outcomes**

6.7 With a bit of stretching and imagination, the 10 CCOs within scope can be grouped around four outcomes:

- Economic Development – PWB, PWT and Wellington Waterfront Ltd (although there is also a recreational outcome stemming from the work of the Company)
- Recreation – WRST and Basin Reserve
- Learning, Culture and Heritage – St James, Museums and (arguably) the Zoo
- Infrastructure services that enable economic activity – Capacity and (arguably) Wellington Cable Car Limited (WCCL).

6.8 Common outcomes, of themselves, are neither sufficient nor necessary to justify horizontal integration. Taking Capacity and WCCL as examples, both help with the efficient functioning of the local economy, both have service provision and infrastructure as common characteristics, but it is highly unlikely that many would advocate merging the two. There are no business or operational synergies between the two entities. Slightly more formally, there are no economies of scale or scope that exist in order to warrant merger.<sup>7</sup>

6.9 [ ] Economies of scale and scope are not, however, sufficient conditions for horizontal integration although these conditions do tend to be necessary because they encompass the following criteria:

- Minimise costs
- Maximise efficiency and effectiveness

6.10 In order to justify horizontal integration (i.e. merger), there is a range of other criteria that should also be considered:

- the need for clear accountabilities, roles and responsibilities;
- the ability to deliver against the Council's objectives and outcomes;

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<sup>7</sup> Economies of scale exist when, for example, the scale of output doubles, but the increase in costs is less than double. Economies of scope arise when one entity can produce two (or more) outputs with less resource than can two (or more) separate entities each producing just one of the outputs.

- the effective management of risk; and
- the effectiveness of decision making.

6.11 The relatively distinct nature of the activities undertaken by each of the ten CCOs means that there are unlikely to be strong economies of scope. In fact, the risk is that there could be diseconomies of scope if the CCOs were joined in some fashion. In particular, we consider that management of risk and the basis for effective decision making would be undermined if mergers between the CCOs were to occur. The nature of the businesses that each operates in, the nature of the risks involved and the types of activity are for the most part quite different between each of the CCOs. Trying to manage these differences under the umbrella of a single organisation would present considerable challenges and cost. In short, if mergers were to be considered further, much more work would be required to assess the options, based around outcomes, against the various criteria listed above to be confident that benefits would outweigh the likely costs and risks.

### **Separation of asset ownership from service provision**

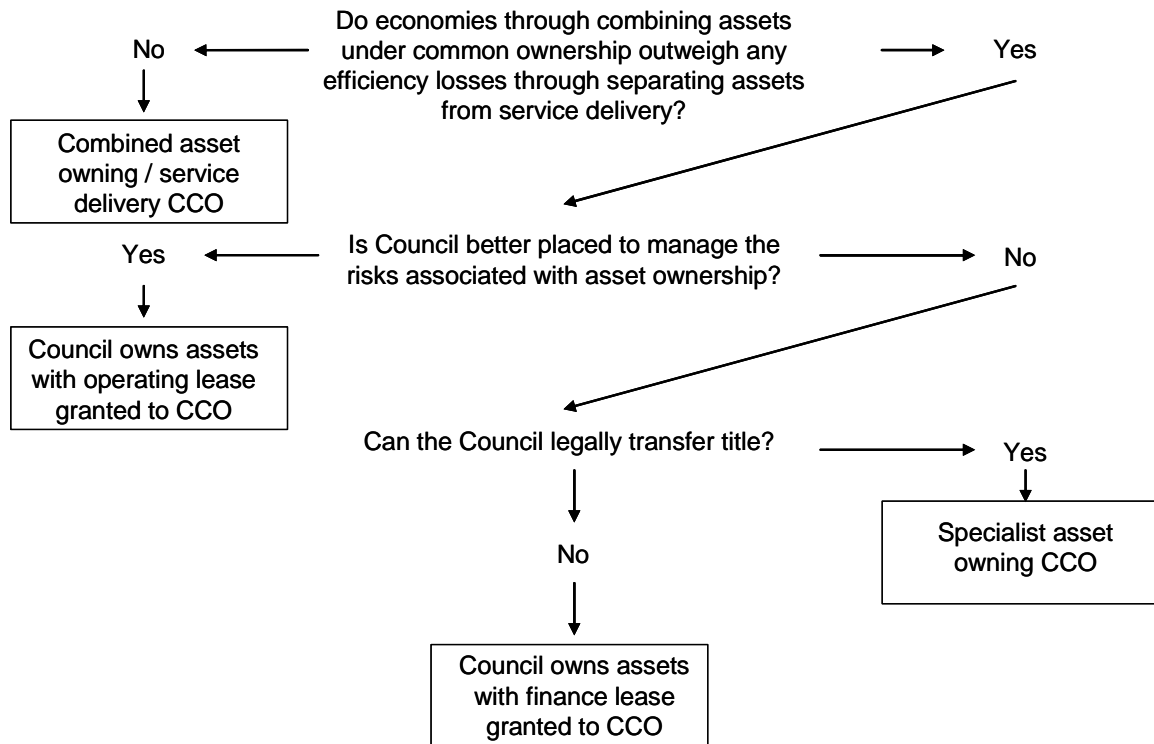
6.12 Instead of grouping CCOs around outcomes, an alternative is to group CCOs around functions. In particular, we have considered the option of reconfiguring the CCOs into two categories; the first involved with owning assets and the second involved with the provision of services. To some extent, such a separation has occurred already within the 10 CCOs within scope. These, and other examples include:

- organisations that specialise in owning and leasing buildings;
- aircraft leasing companies;
- executive leasing organisations (human capital);
- owners of infrastructure (e.g. telecommunications) that are used by multiple service providers;
- the Council owns the land occupied by the Zoo, but outsources the running of the Zoo to the Wellington Zoo Trust;
- the shareholders of Capacity own the infrastructure assets (pipes, pumps etc). Capacity's role is to manage and maintain those assets for the provision of services. (This is not strictly a division between ownership and service provision. A better example is the separation between energy and lines companies).

6.13 The key issues to consider are:

- whether separating asset ownership from service delivery gives rise to any inefficiency;
- whether there are economies of scale to be obtained through bringing assets under common ownership; and
- who is best placed to manage the risks that go hand-in-hand with owning assets.

6.14 There is a decision tree to be worked through as illustrated below.



6.15 Working through the decisions tree leads to one of four outcomes as indicated in the boxes. It should be noted that under a finance lease the risks and rewards normally associated with asset ownership effectively transfer to the lessee (i.e. the CCO).

6.16 [Four] of the ten CCOs within this review own assets of significance:

- Wellington Cable Car Limited (overhead trolley wires, the cable car and associated infrastructure)
- St James Theatre Trust (building)
- Museums Trust (buildings and collections)
- Wellington Regional Stadium Trust (building and associated infrastructure)



6.17 [Three of the four] CCOs own buildings that comprise a major part of their overall assets. A possible option to consider is to establish a building owning CCO that would then effectively lease the buildings to the various CCOs who would then use the buildings, as they do now, in the provision of services. Potentially, there could be some economies through centralising building ownership and management responsibilities within one CCO. Within the scope of this review, analysis of the potential financial benefits has not been required. We note, however, that the nature of the buildings associated with the Wellington Regional Stadium Trust, the St James Theatre Trust and the Museums Trust are specialised in nature. The degree of specialisation reflects the nature of the service being provided. As a general rule, the greater the degree of specialisation, the less likely it is that there would be economic benefits from separating asset ownership from service provision. Accordingly, on initial consideration, it is doubtful that establishing a building owning CCO would make a lot of sense.

6.18 The assets owned by Capacity and Wellington Cable Car Limited also are highly specific to the services being provided and, accordingly, there are risks in separating them from service provision.

### **Holding Structures**

6.19 The final set of structural options to consider is some form of holding structure arrangement. Under this option, another layer of governance would be established – some form of board – that would have responsibility for exercising governance over some or all of the CCO Boards. The private sector analogy is that of a parent company with one or more subsidiary companies.

6.20 Clearly, adding another layer of governance involves additional cost. Moreover, by adding another layer of governance, this option further distances the CCOs from Council. Such an arrangement would appear to reinforce, rather than address, some of the concerns within Council and which have spurred this review.

6.21 The holding structure option would only be considered further if it is expected to reduce governance costs in some other respect. To assess this requires further work to be undertaken around the roles and responsibilities of the “holding board” and what implications this carries for the roles and costs associated with the CCO Monitoring Unit and wider Council. On the face of it, however, it is difficult to see how a holding structure would add value.

### **Criteria for Establishing CCOs**

6.22 The option of establishing a CCO is essentially one of three choices. The other two are to undertake the functions within Council and to outsource the functions to a third party. The outsourcing option has not been an explicit part of the brief for this review and is not considered in any detail, although many of the criteria used to compare in-house provision against provision of services by CCOs also apply to decisions relating to outsourcing.

6.23 Some of the criteria mirror those described in section five above:

- Ability to attract external funding
- Provide stronger focus
- ability to attract specialist resources

- flexibility
- multiple owners.

6.24 There are other criteria to consider that focus more on the fundamentals of good governance and achievement of outcomes. The decision as to whether to establish a CCO should include consideration of whether this model:

- **promotes clear accountabilities.** Without clear accountability, incentives to deliver against the Council's desired outcomes are diminished. In section three, we have identified a number of issues that weaken the accountability of CCOs to Council. However, the points made in section four, if addressed, mean that the CCO model is very capable of delivering effective accountability;
- **clearly defines roles and responsibilities.** If they are not, there is greater risk of gaps or duplications in service delivery. The nature and scope of activities undertaken by the CCOs is best governed through the Sol. As indicated in sections three and four, there is scope for improving the Sols and, as part of this, providing greater clarity over roles and responsibilities;
- **promotes effective decision making and enables achievement of the Council's desired outcomes.** This means assigning decision making responsibilities to those who have the best information and right incentives to consider the options and make the right trade-offs. Consideration needs to be given as to whether the nature of the decisions being taken needs to be close to Council (e.g. because of political sensitivities or the level of risk involved);
- **achieves efficiency and effectiveness.** Decision making should lend itself toward selecting the right mix and level of outputs (effectiveness) and further that those outputs are produced with no waste of resources (efficiency). Getting the right incentives is a key factor in this respect. It can be argued that the CCO model can produce quite powerful incentives that can be harnessed to drive efficiency and effectiveness;
- **effectively manages risk** taking into account all of the dimensions of risk. This is also an issue of assigning risk to those who are best placed to manage it which in turn is a function of incentives, information and flexibility to manage risk.

### Next Steps

6.25 The commentary above has highlighted a range of issues that need to be considered as part of the required implementation phase. The more significant of these, and the issues that need to be addressed as a matter of priority, are

- changes to the process by which draft Sols are considered and approved;
- the terms of reference and composition of the proposed Advisory Group; and
- as part of this, the role of the Councils' committees in relation to CCOs.

6.26 In addition to these initiatives, there are many other suggestions for enhancing monitoring and accountability arrangements. It should not be the expectation that all of these can be implemented simultaneously and/or necessarily within a short time frame. There is a piece of work for the CCO Unit to develop a plan for the development and sequencing of the various initiatives advocated in this report.

## 7 Recommendations

7.1 It is recommended that the Council note that:

- (a) the objectives for this review have been to:
  - determine the most appropriate model(s) for carrying out the activities currently undertaken by CCOs; and
  - identify areas where reporting to, and monitoring by, the Council needs to be amended and enhanced;
- (b) the review has evaluated the way in which the CCO model currently works and has identified a number of opportunities for strengthening governance and accountability arrangements including:
  - making better use of letters of appointment and reviewing CCO deeds and constitutions;
  - modifying Board appointment processes and policies;
  - strengthening Board induction processes;
  - realigning the scope of Sols along the lines of the requirements under the Public Finance and Crown Entities Acts;
  - establishing an Advisory Group attached to the CCO Performance sub-committee;
  - changing the process by which draft Sols are considered and approved;
  - reviewing performance measures and re-focusing performance reporting;
  - suggestions regarding the role of the CCO Unit; and
  - better communicating roles and responsibilities (and streamlining communication channels as part of this);
- (c) the review recommends against rejecting the CCO model for the reasons that the underlying organisational forms are tried and tested and provide sound overarching governance and accountability frameworks;
- (d) the review also considers that the issues identified with respect to the current functioning of the model are not inherently structural in nature and have more to do with weaknesses in systems and processes and a relative lack of clear mission, vision and values;
- (e) the Local Government Act allows for a wide range of possible organisational forms;
- (f) the review has not identified any compelling reasons to depart from the existing company and trust forms currently in use;

- (g) the review has also considered several options for merging CCOs in some form; and
- (h) reflecting the relatively distinct nature of the functions performed by each of the CCOs, there are unlikely to be significant efficiencies from merging CCOs.