

## **SPENDING PUBLIC MONEY WISELY AND WELL: HOW TO PUT BASIC PRINCIPLES INTO PRACTICE**

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### **The role of the Auditor-General in public sector accountability**

The Auditor-General is the auditor of about 4000 public entities, including government departments, Crown entities of all kinds, local authorities and their subsidiaries, state-owned enterprises, port companies, licensing trusts, community boards, cemetery trusts, as well as a long list of “miscellaneous” bodies. We audit everything from the Crown financial statements, Air New Zealand, and the Super Fund, through to the Patriotic and Canteen Funds Board and the Riccarton Bush Trustees.

The day to day work of the office therefore gives us a very broad view of public sector activities. Given the nature of auditing, it is also quite a deep and detailed view. A good auditor understands the entity, as well as its accounts. The process of giving an audit opinion on financial statements also involves forming a view on the health and reliability of an organisation’s governance and management systems.

That is even more so for the public sector auditor. As well as the ordinary work of providing assurance over the financial statements, Parliament has directed the public sector auditor to take on a broader set of assurance functions. The Public Finance Act, Crown Entities Act and Local Government Act all require us to audit the non-financial performance information included in annual reports – the information on how they are planning their work, organising resources, and measuring performance, over time. The Local Government Act 2002 also requires us to audit the information contained in Long Term Council Community Plans – the future financial projections that underpin the 10 year plans that local authorities must produce. And our own Act, the Public Audit Act 2001, gives us a performance audit function under which we can examine effectiveness and efficiency, compliance with statutory obligations, waste, probity and financial prudence. That Act also gives us capacity to carry out other audit services, and to inquire into any matter concerning an entity’s use of its resources.

This reference to inquiries reflects the long tradition of the office being asked to look into matters of public concern in public entities, particularly if there is a financial or probity aspect to the concerns. Examples from (relatively) recent memory include inquiries into Te Wananga o Aotearoa, Cambridge High School, Ross Armstrong’s expenses, Donna Awatere-Huata’s financial dealings, the ‘flak jackets’ inquiry, contracting practices in the Ministry of Health, and various parliamentary funding issues. We’ve also in the last year looked at the controls around the funding for the possible development of a new stadium in Dunedin, examined allegations of impropriety and dysfunction at the West Coast Development Trust, and reviewed the decisions made in relation to the purchasing back of regulatory service functions at Queenstown Lakes District Council.

The Auditor-General is not an avenue for formal legal review. But the office clearly has a significant role as a public sector accountability mechanism. Across all parts of our work, we regularly look at issues that have a public law dimension to them or which might equally be examined through a judicial review lens. And the general audit discipline also includes a standing professional requirement to assess the adequacy of an organisation's compliance with legal obligations. This is part of the overall task of providing assurance over the health and reliability of management systems and is specifically covered in auditing standards produced by the Institute of Chartered Accountants of New Zealand and by the Auditor-General.

For public lawyers, the inquiry function is the most visible and is likely to be the most relevant part of the Auditor-General's work. In practice we often function as a first port of call for people concerned about a decision-making process, particularly if it involves public sector spending or contract management, or questions about the management of conflicts of interest. Like the Ombudsmen, asking the Auditor-General to look at something is effectively free for the correspondent. We don't carry out a full inquiry into every issue that gets raised with us, but we always do some preliminary work to see if there is a significant issue that warrants attention. It can therefore be a useful way of getting a quick independent view on the nature of possible problems. A review by the Auditor-General does not and cannot change what has happened, as the only powers of the office are to report and to recommend. But it can encourage entities to change future behaviour and sometimes to address possible failings in past processes. Public reporting can produce results.

The other functions of the office intertwine with the inquiry work, in a way that is often not very visible. When people write to us we try to make a strategic assessment about how best to respond. Sometimes we choose to look at the issue directly in a specific inquiry, and sometimes we refer the issue to the auditor to keep an eye on more generally or to do some additional work in the context of the annual audit. The pattern of issues being raised with us can also feed into the development of our ongoing programme of performance audits, and into the process of determining what we are going to ask auditors generally to look at in their annual audit work across a sector or a period of time. It also informs our decisions on which topics might benefit from the publication of a new or updated good practice guide.

There is no explicit function of producing good practice guides in our legislation, but it is a natural flow-on from the rest of our work. We put out these guides to give people easy access to the thinking and expectations that get developed, particularly in our inquiry and performance audit work – for example on conflicts of interest. It is basic to auditing that you should set out in advance the expectations against which you will be assessing performance, and good practice guides therefore provide us with a valuable benchmark for assessing performance in areas that do not have formal standards elsewhere. They also, most importantly, are designed to help public entities do the right thing.

### **The Auditor-General's interest in procurement and other funding arrangements**

The way in which public funds are administered through both grant programmes and procurement contracts is a regular cause of concern, and is frequently the subject of complaints to this office. Substantial amounts of public money are involved. The Auditor-

General is therefore overseeing an expanding programme of work to examine policies and practice in this area and to support wider government initiatives to improve performance.

In June 2006, we published a good practice guide on funding arrangements with NGOs, and earlier that year we completed a performance audit on the administration of grant programmes by the Foundation for Research, Science and Technology. In 2006/07, we followed that up with a performance audit of Te Puni Kokiri's administration of grant programmes, and began a performance audit to examine the Ministry of Health's funding arrangements with Non-Government Organisations ("NGOs"). At the request of the Minister of Health, we also carried out a performance audit of the conflict of interest procedures of the three district health boards in the Auckland region, after the successful judicial review challenge to a major procurement decision by those entities.

Procurement is a specific and significant subset of the general area of funding arrangements. It covers all business processes associated with buying, spanning the whole cycle from identifying needs to disposing of the product or completing all the service requirements. Given that broad definition - and the wide range of public activities that are achieved through, or supported by, procurement in some form - it is an activity that is critical to the effectiveness and efficiency of public entities. In the last few years, procurement has featured more strongly in our annual audit work, a number of inquiries, and in some special studies and reviews.

In terms of our annual audit work, we asked our auditors of government departments, State-owned enterprises, Crown entities, and some other entities to examine aspects of procurement as part of the 2006/07 annual audits. Specifically, we asked these auditors to review the entity's procurement policies and some aspects of practice, and to report any concerns.

We also continue to provide ongoing assurance services, outside the annual audit process, about specific procurement processes and the development or review of organisational policies and procedures on procurement to a wide range of public entities.

Based on this work, we consider that there is considerable room for improvement in entities' procurement policies and practices. On the positive side, most entities have policies and procedures in place, and these policies were clearly based on the core principles of value for money, fairness, and openness. But more than half of the policies we looked at in our annual audits needed some improvement. And in practice we regularly come across or are asked to provide advice on situations that fall well short of good practice standards. (More detail on these findings from our annual audit work is provided in our recent publication, *Central government: Results of the 2006/07 audits*, part 4, "Procurement, grants, and other funding arrangements".)

This is a core area where people expect the office to be active, perhaps because it combines several of our traditional areas of interest – money, probity, and the management of decision-making processes. It is also an area that has attracted considerable public concern in recent times, for example through several high profile controversies in district health boards. We are continuing to expand our efforts in this field across the full range of our activities.

## The two new good practice guides

For public entities, procurement and the different types of funding arrangements can be a very confusing area. There is a complex mix of different organisations involved, types of funding arrangements, and procedural rules and requirements. It is not always clear what rules or expectations apply when. We often get asked questions such as:

- Does it matter whether something is a grant or a contract? If so, what difference does it make?
- When does a procurement policy apply? Are there any equivalent rules if it does not apply?
- Should we manage everything as a contract?
- Should we do anything different if we are contracting with a non-government organisation?

We have therefore recently updated and reissued our good practice guide on procurement (*Procurement guidance for public entities*), and have also produced a new guide entitled *Public sector purchases, grants, and gifts: Managing funding arrangements with external parties*.

We use the phrase “funding arrangements to external parties” to cover the span of procurement and purchasing (large and small), grant funding, and gifts – anything where an entity is handing public money over to someone else in some form to achieve its goals. The “someone else” in this transaction might be a private company, a non-government organisation or charitable trust, an individual, or another public sector organisation.

This more general guide explains the range of funding arrangements that public entities commonly enter into and how to think about which type of arrangement suits a particular circumstance. It aims to clarify:

- how the different processes and expectations fit together;
- what the basic principles are; and
- what choices public entities need to make when they plan for, and enter into, any kind of funding arrangements with external parties.

The procurement guidance sits underneath that overall framework and gives more specific advice and guidance on how to go about purchasing goods and services and running procurement processes. The key difference from our previous work is that the focus now is on encouraging entities to think strategically – the emphasis is on “doing it smarter” rather than on compliance with standard processes or checklists. The guidance now also explicitly acknowledges a much wider range of circumstances than straightforward commercial procurement in a market situation and recognises that general tender processes will not always be the best way to manage a purchase. Tendering often will be a safe and proven way to ensure a fair process and value for money. But sometimes it can be counter-productive or involve excessive compliance costs. The new guidance encourages entities to think about their circumstance and to be willing to defend the reasons why they might do something different in some circumstances. The focus is on core principle rather than detailed procedural expectations.

## Two basic questions

In essence, we expect public entities to be able to satisfy themselves, and the public on two simple questions:

- Are they spending public money carefully?
- Are they properly managing the process for spending it?

Spending money carefully involves the ability of the public entity to account for what the money is being used for, as well as an assessment of effectiveness, efficiency, and value for money. Properly managing the process for spending money involves looking at whether the public entity made decisions lawfully, fairly, and in keeping with good administrative practice, ethical requirements, and the entity's own policies.

## Six basic principles

We have therefore articulated six basic principles, which we think are relevant to the use of all public funds.

- **Accountability** – Public entities should be accountable for their performance and be able to give complete and accurate accounts of how they have used public funds, including funds passed on to others for particular purposes. They should also have suitable governance and management arrangements in place to oversee funding arrangements.
- **Openness** – Public entities should be transparent in their administration of funds, both to support accountability and to promote clarity and shared understanding of respective roles and obligations between entities and any external parties entering into funding arrangements.
- **Value for money** – Public entities should use resources effectively, economically, and without waste, with due regard for the total costs and benefits of an arrangement, and its contribution to the outcomes the entity is trying to achieve. Where practical, this may involve considering the costs of alternative supply arrangements.
- **Lawfulness** – Public entities must act within the law, and meet their legal obligations.
- **Fairness** – Public entities have a general public law obligation to act fairly and reasonably. Public entities must be, and must be seen to be, impartial in their decision-making. Public entities may also at times need to consider the imbalance of power in some funding arrangements, and whether it is significant enough to require a different approach to the way they conduct the relationship.
- **Integrity** – anyone who is managing public resources must do so with the utmost integrity. The standards applying to public servants and other public employees are clear, and public entities need to make clear when funding other organisations that they expect similar standards from them.

The new funding framework explores what these principles mean in practice across a range of different types of funding arrangements and across the life cycle of each of those arrangements. When we put these two dimensions together, they provide the two axes of a matrix for some concrete guidance to entities.

## The spectrum of funding arrangements

For those entering into funding arrangements, an important first step is to understand the underlying nature and purpose of the arrangement, so that expectations are clear and the arrangements can be structured and managed appropriately.

A commonly used and simple typology asks whether the fundamental purpose of the arrangement is to buy, invest, or give to the external party:

- “Shopping” or “buying” arrangements (procurement) are a form of purchase, and can range from simple and low-value purchase transactions to major construction or other infrastructure developments that may be managed through full and formal procurement processes.
- “Investing” arrangements often take the form of grants, and are designed to build capacity or to support a particular activity or organisation.
- “Giving” arrangements, along with donations and other forms of unconditional grants and payments, are where the public entity provides something without any conditions attached.

Thinking about those three broad groups can help public entities to clarify the basic purpose or nature of what they are trying to achieve with any particular programme of funding arrangements. However, for practical purposes it is useful to go a step further and think about the different types of arrangements within each of those broad groups.

Therefore, as a second stage, we have broken procurement into four subsidiary categories:

- major and minor conventional contracts operating in an ordinary market situation; and
- major and minor contracts with a significant relationship dimension (which we term “relational purchases”).

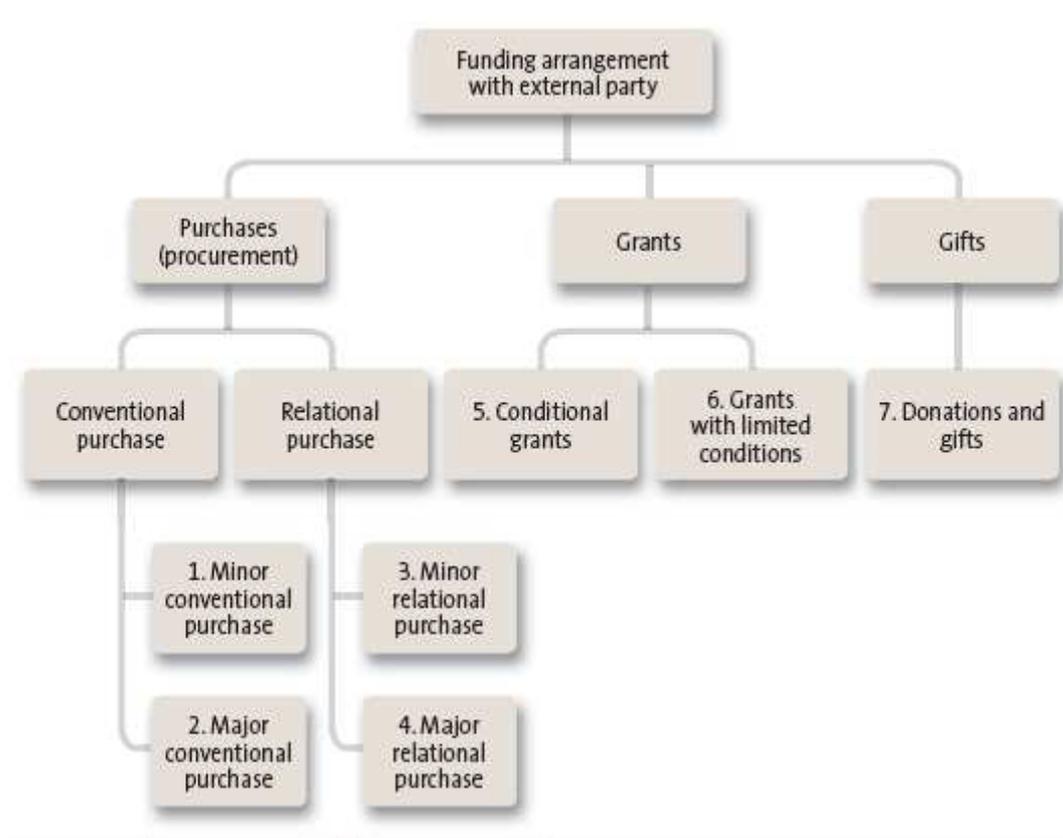
Similarly, we divide the category of grants into conditional grants and those with only limited conditions, to distinguish between major funding support for substantial projects or development activity (which is likely to attract significant controls) and more easily managed or minor grants (which may have fewer conditions attached).

It would be possible to break down these categories further. For example, we could differentiate between small simple gifts or donations and more substantial grants with no conditions attached, or between major contracts that are once-only purchases and major contracts that involve long-term supply chain arrangements. Equally, it would be possible to collapse the categories into two major groups – grants and contracts. However, for practical purposes, we have found it useful to work with these seven categories.

Figure 1 shows the way in which we divide the general area of funding arrangements with external parties into seven categories.

**Figure 1**

**The seven categories of funding arrangements with external parties**



These are not inflexible categories. One type of arrangement can blur into the next, and a funding arrangement with an organisation may have several dimensions to it. We and others have described a continuum or spectrum of arrangements, from formal or simple contracts, to contracts with a relationship focus, through to conditional and unconditional grants and gifts. A highly specified or conditional grant can look very similar to a relational purchase contract. The distinction between a minor purchase and a major one is also subjective. Even though the lines between the categories are not solid, it is useful at a practical level to identify the different types of funding arrangements as a starting point for guidance on appropriate administration and management.

Figure 2 shows the different types of funding arrangements as a spectrum, as well as the guidance documents from the Office of the Auditor-General that are relevant to each.

**Figure 2**

**The spectrum of funding arrangements and relevant OAG publications**

Funding arrangements	OAG good practice guides				
	Overall framework	Procurement	Public private partnerships	NGO funding arrangements	Sensitive expenditure
Minor conventional purchase	✓	✓		✓	
Major conventional purchase	✓	✓	✓	✓	
Minor relational purchase	✓	✓		✓	
Major relational purchase	✓	✓	✓	✓	
Conditional grant	✓			✓	
Grant with limited conditions	✓			✓	
Gift or donation	✓				✓

**The seven categories of funding arrangements**

**Minor conventional purchases**

Minor conventional purchases are relatively self-explanatory. All public entities will have a range of goods and services that they buy regularly, that are of relatively low value, and that are able to be bought through ordinary procurement systems. Common examples include office consumables, such as stationery or catering, or once-only and short-term contracts for professional or consulting services. There will usually be a reasonable range of suppliers or providers to choose from, so that ordinary market-based procurement techniques and competitive processes are likely to be effective as a way of managing the price and value for money.

**Major conventional purchases**

As with the previous category, the presence of an effectively functioning market is the main factor in a conventional contracting environment. That means that ordinary market disciplines can be expected to operate well to manage price and value for money. Major conventional purchases are high value – possibly worth millions of dollars. Inevitably, they carry higher risk to the public entity and require a different level of planning, authorisation, documentation, monitoring, and general management.

Examples of major conventional purchases include contracts to procure or build capital assets, information technology contracts, and major consultancy contracts.

There can be some overlap between this category and that of major relational purchases, as there is a growing pattern of managing major contracts through more strategic arrangements such as partnering and project alliances. Such arrangements may have a lot in common with major relational purchases, even if they are developed within a market context.

### **Minor relational purchases**

There are two main factors that suggest that a purchasing arrangement might not fit the conventional category, and might be better conceptualised as having a significant relationship dimension. They are:

- the absence of an effective or meaningful market to provide the goods or services; and
- the strategic importance of the goods or services, or of the relationship with the provider, for the public entity.

These two factors may be present more often for public entities purchasing goods or services that are essential to the delivery of public sector (and implicitly non-market) services, that are highly specialised, or that are provided by non-commercial and public interest bodies such as non-government organisations.

Other factors that might suggest a relational purchase include the nature of the goods and services purchased, the duration of the relationship between the public entity and external party, the relationship between the public entity or external party and an end user (such as a person receiving health care or other social services), and the specialist nature of the goods or services. For some external parties, there may be other policy goals that are relevant and that would suggest a relational approach, such as a goal to support the development of a strong and stable non-government organisation or civil society sector, or a goal to encourage strategic relationships or build capacity within some part of the wider state sector.

In such situations, conventional market-based systems for managing a contract may not be appropriate or particularly effective. It may be more useful to give greater weight to the relationship or strategic dimensions of the contract and to set up other systems to manage the dimensions usually managed by competitive market mechanisms.

Common examples of minor relational purchases include contracts to purchase policy or other advice from specialist advocacy or special interest representative groups, highly specialised professional advice, small and specialised research work, or the supply of minor health services or a niche product produced for a particular and unusual requirement.

### **Major relational purchases**

The same factors apply to major relational purchases. The main difference between the previous category and this one is the value or size of the goods or services being purchased. A larger contract will inevitably require additional attention and management throughout its whole life cycle.

Examples of major relational purchases include residential care or other social support services (where the funding arrangement may need to provide stability for end users for many years), major and long-term research contracts, or significant professional or consultancy relationships.

As already noted, there is an overlap between this category and that of major conventional purchases, through the growing use of relationship-based contracting arrangements in major projects such as infrastructure development.

## Conditional grants

A grant is a funding arrangement that is designed to support an organization or an activity rather than to buy goods or services. It can operate on any scale, from very small and localised grants to extremely large grants to support major infrastructure projects. We have found it most useful to distinguish between grants that have substantial conditions attached and grants that have very few conditions, rather than to focus on the value of the grant. However, it is likely that a high value grant will require more substantial and complex conditions.

Conditional grants are where the public entity manages the risk of non-performance by attaching significant conditions to the ongoing payment of funds. Common conditions include:

- dividing a project into stages and releasing funds only as each stage is completed;
- requiring the commitment of other funders to be confirmed before releasing all funds; or
- requiring particular project management disciplines to be used, such as regular audit or the use of only certified or approved personnel or contracted providers.

There may also be conditions that require funds to be repaid if they are not used to achieve the purpose of the grant.

## Grants with limited conditions

Grants with only a few and relatively simple conditions are common when the funding is relatively small. One example is grants to community groups from a fund set up for specific purposes, such as an environmental projects fund. Another is a fund that people can apply to if they want to organise an event to celebrate Waitangi Day or similar. Other examples include scholarship funds or grants to support an organisation with a specific initiative (for example, a community consultation exercise) or to build the organisation's capacity (for example, by setting up a website).

However, not all grants within this category are small. In some circumstances, grants of foreign aid, for example, might have limited conditions attached, because they are being provided to another government and it may not be appropriate to impose strict conditions or reporting requirements in that context. In other contexts, aid funding may take the form of a grant with substantial conditions, or may be a contract with a provider to deliver a particular set of services or outcomes.

## Gifts

Gifts are self-explanatory. Sometimes public entities just give money, goods, or time to an external party. Things that are explicitly called gifts or donations are easily identified and should be covered by the public entity's policy on such matters. We have already set out our expectations in this area in our good practice guide, *Controlling sensitive expenditure: Guidelines for public entities*. However, a grant may sometimes be awarded with no conditions attached at all. We would categorise an unconditional grant as a gift.

## **The life cycle of funding arrangements**

At each stage of the life cycle of a funding arrangement, a public entity needs to think about what the principles require for that type of arrangement in that particular context.

The life cycle of funding arrangements is discussed in our good practice guides on non-government organisations, procurement, and partnership arrangements, as well as in the Treasury non-government organisation guidelines. In summary, a life cycle approach requires the public entity to think about the different stages that the arrangement will go through. We summarise these as:

- planning for the funding arrangement;
- selecting a provider and agreeing the terms;
- managing and monitoring the arrangement; and
- reviewing, evaluating, and starting over (where appropriate).

## **Choosing an approach to a funding arrangement**

As already explained, the basic principles will be relevant regardless of the funding arrangement's purpose or type. However, the way in which they are given practical effect may vary considerably depending on the form of the funding arrangement.

It is therefore important for public entities to decide which type of funding arrangement is appropriate when they prepare the business systems, policies, and procedures to support particular categories of funding, and when they enter into individual transactions or arrangements. We have identified some questions to help public entities consider the characteristics of particular types of transactions and relationships, and identify the most appropriate category of funding arrangement.

### **What is the goal?**

A public entity should focus on what it is trying to achieve in any particular context. It should ask, at a very simple level, what the goal is with a particular funding arrangement. Is it a purchasing relationship, where the public entity is buying goods or services of some kind? Or is it essentially an exercise in capacity building or general support, where the public entity is assisting an external party with a particular activity or project, or with some part of its ongoing operation? The answer to these questions will determine which types of funding arrangements are going to be most appropriate – those that are designed to support purchasing or those that support grants and gifts.

### **What is the relationship context?**

An important part of the context for any funding arrangement will be the relationship background. That background may have sectoral and strategic, market, and end-user dimensions, as well as the general relationship between the public entity and the external party.

**Sectoral or strategic context:** Is there any general sectoral relationship or strategic context that needs to be considered? For example, central and local government have operated a “partnership” relationship for some years and have shared strategic goals that might at times inform the way that central government funds some local government activity. Similarly, the Government has a programme of activity for its relationship with non-government organisations and community organizations in the social services sector. This activity aims to give greater acknowledgement to the capacity building and support aspects of those relationships, and the importance of ensuring a sustainable civil society sector.

**Type of organisation:** What type of organisation will receive the funding? Although all types of organisations can feature in all of the funding categories, there are some specific relationships that are more common in particular categories. For example, relationships in the “giving” and “investing” categories are much more likely to involve non-government organisations and other non-profit bodies than commercial organisations. Relationships with foreign governments may have very few enforceable conditions attached and so are more likely to be grants with limited conditions. Relationships with commercial organisations are much more likely to be purchase or procurement contracts of some kind. Therefore, although the type of body being funded does not determine the funding category, it can indicate the categories that are more likely to be appropriate.

**Length of relationship:** Is the funding arrangement long or short term? Even if it is short term, is it part of a longer-term relationship between the public entity and the external provider? The continuity of the relationship between the funder and the external party may be relevant. A long-standing relationship – for example, with a community provider of a specialist service – will often suggest that the contracting environment will be shaped by what we have termed “relational” considerations rather than market factors. Equally, although an individual contract may be for a short term and of low value, if it is part of a long-term pattern of procurement from a single external party, then the public entity may need to have a system in place to respond to the cumulative total of work going to that provider.

**Presence of a market:** Are there many potential providers of the goods or services being sought? Are there many potential buyers? The more effective the market, the more likely it is that the arrangement will be a conventional contract using traditional competitive disciplines to manage price. If there is only one plausible supplier, then the arrangement may be better managed as a relational contract.

**The end users:** The purpose of many funding arrangements is to deliver a service or provide support to individuals needing assistance – for example, by supporting residential care facilities or other forms of social support. It may be important to consider the needs of the recipients or end users of a service when thinking about the relationship with the external party. For example, if the end users of the service are going to value long-term stability highly, then that will affect the way the public entity should manage the funding arrangement with the provider. A more long-term and strategic approach to quality and price will probably be more appropriate than the use of short-term market-based disciplines.

## Thinking about risk

Identifying and managing risk is a vital part of any business planning. Public entities need to think about risk when they put in place business processes, policies, and procedures to manage funding arrangements with external parties, as well as when they consider entering into any individual funding arrangement. Thinking about risk will help a public entity to make appropriate decisions on how to structure and manage funding arrangements both at a system and individual level.

**Control:** What level of control does the public entity want over the detail of what is done and the outcome? Are there significant requirements around the quality of what is delivered? In general, the greater the level of control that the public entity seeks or expects, the more likely it is that the relationship will be a highly specified and contractually enforceable conventional or relational purchasing arrangement. If significant control is not needed or appropriate – for example, because of the autonomy and governance arrangements of the external party – a grant arrangement may be better.

**Performance and consequences:** What happens if the external party does not do what is intended? Is the intention to create legally enforceable performance or delivery obligations? If the intention is to make the provider legally accountable for delivering the contracted goods or services, then it is more likely that the relationship should be set up as a contractual purchase arrangement where the parties can withhold payment or go to court to seek remedies for non-performance. In a grant relationship, the consequence of non-performance is likely to be an end to the current funding arrangement, reputational damage, and a reduced ability to obtain similar funds in future. There may be an obligation to return funds not used for the purpose of the grant. However, the external party may be less accountable for the quality or detail of what is being produced with the funding.

**Tolerance of risk:** What level of risk is the funding public entity prepared to tolerate? What level of risk does the particular activity carry? Within a grant framework, higher risk may lead to a more structured arrangement, with more conditions attached to the ongoing release of funds. Within a purchasing context, higher risk to a public entity may sometimes lead to a greater emphasis on strategic and relationship aspects, and might therefore push the contract into the relational category. The closer interaction of a relationship-based approach can sometimes be a sensible way of managing risk to an acceptable level.

**Sustainability:** If the government or the public entity has a long-term interest in the viability of the external party, or the sector or market it operates in, that interest may affect how the public entity approaches the relationship as a whole and any particular funding arrangement. It is likely to affect how it defines and manages risk, because risks to the external party's viability may also be seen as risks for the public entity.

## Value

The other aspect of the strategic context that deserves specific mention is the monetary value of a funding arrangement. It is common sense that high-value contracts should attract more attention, at every stage of their life cycle, than contracts for small amounts. At this broad level, high value is one simple indicator of risk.

The definition of high and low value funding arrangements will differ between public entities, depending on the nature of their activities and budget. However, in any public entity, policies and systems should support an approach that tailors the level of planning, documentation, and monitoring to the financial significance of the arrangement for the public entity.

### **Generic expectations for all funding arrangements**

There are some matters that are so fundamental to public sector administration that they are generic expectations for all categories of funding arrangements. Our generic expectations are:

- any proposed use of public funds should be for the public purpose or goals of the public entity – that is, it should fit with the entity’s overall strategic and business planning;
- for government departments, all funding arrangements must be within the scope of the relevant appropriation, which sets the terms on which Parliament has authorised the use of public funds;
- individual funding decisions must fit within the budget of the public entity, and must have appropriate justification for the cost of the particular funding arrangement;
- delegations of authority should be in place within a public entity, and spending decisions must be taken at the right level in keeping with those delegations;
- all funding arrangements should be managed in keeping with a public entity’s policies and procedures unless there is a documented decision, at the right level, to do something differently;
- all those involved in making decisions or managing funding arrangements must act in keeping with the state sector code of conduct or any equivalent sectoral or organisational documents setting ethical standards;
- systems must be in place to ensure that all those involved in making decisions or managing funding arrangements appropriately identify, manage, and record conflicts of interest; and
- record-keeping systems should be in place to support effective decision-making, monitoring, and management, and to enable the public entity to be open and accountable.

### **Some practical considerations**

The principles are deliberately at a high level. They are a starting point, and a reminder of the basic obligations on those spending public money. In any particular public entity or situation, they need to be applied flexibly and practically, to achieve the goals of the public entity or of the particular funding arrangement through the most sensible means. We have previously described this as taking a risk-based approach.

For example, the principle of accountability at its simplest means that a public entity has to be able to explain what public money has been used for. For a very minor and simple

purchase, this may require no more than a receipt for a bottle of milk or a note on the back of a taxi receipt recording the purpose of the travel. For major contracts, such as for a new information technology system, much more would be needed to reflect the same principle, such as fully developed business cases, formal documented approvals at the appropriate level, detailed contracts, ongoing and systematic monitoring of progress under the contracts, and full documentation of the whole procurement process.

When deciding how to give effect to these principles in any particular situation, public entities should consider:

- **The goal** – It is important for the public entity to focus on what it is trying to achieve. Process should not dominate at the expense of the outcome.
- **Simplicity and proportionality** – The requirements put in place for the funding arrangement should be as simple and practical as possible, considering the amounts involved, the complexity, and the level of risk. It is appropriate to consider compliance costs for the parties, and seek to reduce them where possible.
- **The context** – The arrangements need to fit with the overall context of the funding arrangement, including any more general relationship that the external party has with the entity or with other relevant government organisations. For example, a funding arrangement between a department and a non-government organisation may need to take account of any general government policy on relationships with the community and voluntary sector.
- **The risk** – Public entities need to identify risks in or around the funding arrangement and to consider how to manage those risks. This should not be seen as encouragement to be overly risk averse. The key is to get the right balance between risk and expected benefit, and to do so consciously.
- **The nature of the parties** – The needs and standards of public entities – for example, for accountability or transparency – may be quite different from those that the external party usually encounters. Equally, the external party's needs may be quite different from those of the public entity. For example, a non-government organisation may have unique obligations to constituent groups or members. Relationships are likely to proceed more constructively and effectively if each party understands the needs of the other and the consequences of those needs for them.

## Putting it all together

The Office of the Auditor-General has put together:

- The basic principles;
- The different types of funding arrangements;
- The life cycle of the funding arrangements;
- The advice on choosing an appropriate type of arrangement, and
- The practical guidance on how to go about managing the arrangement.

The result is a relatively comprehensive matrix which sets out some default expectations and guidance for each stage of each type of funding arrangement. A copy of that matrix is published with the good practice guide and accompanies this paper.

The expectations set out in that chart are not rules, or fixed things that we would expect every entity to do every time. Rather, they aim to give entities a sense of the types of things that might be done to give effect to their responsibilities at each stage of the process. They need to be seen alongside our primary expectation, which is that we expect public sector entities to be thinking about the nature of their responsibilities and the role that different types of funding arrangements have in their work, and to have developed their own strategies and policies for how they are going to manage that activity appropriately. We also expect them to be thinking about what the principles might require in any particular circumstance, taking into account that wide range of practical factors.

For public lawyers, this should be starting to sound like familiar territory. When we audit or inquire into an entity's activities in this area, we are looking to see if it had sensible reasons for what it was doing. That is not too far away from the judicial review test of reasonableness. We are also looking to see whether it had taken adequate account of the public sector basics of accountability and good process – in the public law world that touches the same bases as checking whether a decision was made fairly and according to law. So we too, ultimately, are another check on whether public power is being exercised fairly, reasonably, and according to law.

## List of references

### Office of the Auditor-General good practice guides

*Public sector purchases, grants, and gifts: Managing funding arrangements with external parties* (June 2008)

*Procurement guidance for public entities* (June 2008)

*Managing conflicts of interest: Guidance for public entities* (June 2007)

*Controlling sensitive expenditure: Guidelines for public entities* (February 2007)

*Principles to underpin management by public entities of funding to non-government organizations* (June 2006)

*Achieving public sector outcomes with private sector partners* (February 2006)

### Other Office of the Auditor-General reports

*Managing Funding to non-governmental organizations – from principles to practice* (June 2008)

*Central Government: Results of the 2006/07 audits* (B29[08a], 2008)

*The Auditor-General's Auditing Standards* (B29(AS), 2008)

*New Zealand Trade and Enterprise: Administration of grant programmes – follow-up audit* (March 2008)

*New Zealand Agency for International Development: Management of overseas aid programmes* (January 2008)

*Management of conflicts of interest in the three Auckland District Health Boards* (November 2007)

*Te Puni Kōkiri: Administration of grant programmes* (May 2007)

*Foundation of Research, Science and Technology: Administration of Grants Programmes* (May 2006)

*Inquiry into the Ministry of Health's contracting with Allen and Clarke Policy and Regulatory Specialists Limited* (December 2005)

*Inquiry into certain aspects of Te Wānanga o Aotearoa* (December 2005)

*New Zealand Trade and Enterprise: Administration of Grants Programmes* (December 2004)

A full list of OAG publications is available on the website: [www.oag.govt.nz](http://www.oag.govt.nz).

### Other references

Unwin, Julia, *The Grantmaking Tango: Issues for Funders*, Baring Foundation, London, 2004

National Audit Office (UK), *Working with the Third Sector*, June 2005, available on [www.nao.org.uk](http://www.nao.org.uk)

National Audit Office (UK), *Financial Relationships with Third Sector Organisations – a Decision Support Tool for Public Bodies in England*, 2007, available on [www.nao.org.uk](http://www.nao.org.uk)

# Summary of features of, and expectations for, the different categories of funding arrangements

Type of funding relationship	Minor conventional purchase	Major conventional purchase	Minor relational purchase
<b>Features that indicate this type of relationship</b>	<p>Legally enforceable obligations to deliver.</p> <p>Likely to be an effective market.</p> <p>Low or moderate value.</p> <p>May be unplanned or once-only purchase.</p>	<p>Legally enforceable obligations to deliver.</p> <p>Likely to be an effective market.</p> <p>High value.</p> <p>High risk.</p> <p>Possibly long term.</p> <p>May have alliancing or partnership characteristics.</p>	<p>Legally enforceable obligations to deliver.</p> <p>May not be an effective market.</p> <p>May be a long-term relationship between the parties, even if specific contract is limited.</p> <p>Provider may be highly specialised.</p>
<b>Common examples</b>	<p>Consumables, such as stationery.</p> <p>Once-only professional or consultancy services.</p>	<p>Capital assets.</p> <p>IT systems.</p> <p>Major consultancy services.</p>	<p>Policy advice or peer review services from an advocacy group.</p> <p>Specialist professional advice.</p> <p>Research.</p> <p>Minor health services.</p>
<b>General expectations: planning stage</b>	<p>Any planning, decisions, and approvals follow the entity's policies and procedures.</p>	<p>Formal planning and project systems put in place to manage the contract process.</p> <p>Suitably skilled staff assigned.</p> <p>Legal advice on process and contract as needed.</p>	<p>Any planning, decisions, and approvals follow the entity's policies and procedures.</p> <p>A key person assigned to manage the particular funding arrangement.</p> <p>Early liaison between the key person and any others in the public entity involved in managing the relationship with the external party.</p>
<b>General expectations: selection stage</b>	<p>Selection process may vary (direct negotiation, quotations, preferred suppliers, closed tenders) but will involve periodic reference to the market.</p> <p>May be standard form contracts, or little negotiation of terms.</p> <p>Documentation of agreement.</p>	<p>Competitive selection process (preferably open tender).</p> <p>Formal processes with procedural safeguards.</p> <p>Negotiation of specific and detailed terms and conditions.</p> <p>Full formal documentation of contract.</p>	<p>Selection process may be limited if no effective market, or if urgent and specialist goods or services needed.</p> <p>May be no negotiation of terms, or use of standard form contracts.</p> <p>Documentation of agreement, possibly through an exchange of letters.</p>
<b>General expectations: monitoring stage</b>	<p>Possibly periodic payments, dependent on performance.</p> <p>Monitoring through normal office systems for processing receipts and invoices.</p>	<p>Systematic oversight.</p> <p>Comprehensive reporting.</p> <p>Payments dependent on performance.</p>	<p>Payments dependent on performance.</p>
<b>General expectations: review stage</b>	<p>Periodic review of satisfaction with suppliers.</p>	<p>Programmed review well before contract expires.</p>	<p>Periodic review of purchasing experience and satisfaction.</p> <p>Periodic discussion with external party about mutual needs and satisfaction.</p>
<b>Sources of guidance</b>	<p><i>Procurement guidance for public entities</i></p> <p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p> <p><i>Mandatory Rules for Procurement by Departments.</i></p>	<p><i>Procurement guidance for public entities</i></p> <p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p> <p><i>Achieving public sector outcomes with private sector partners</i></p> <p><i>Mandatory Rules for Procurement by Departments.</i></p>	<p><i>Procurement guidance for public entities</i></p> <p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p> <p><i>Mandatory Rules for Procurement by Departments.</i></p>

## Basic principles

Accountability • Openness • Value for money • Lawfulness • Fairness • Integrity

Major relational purchase	Conditional grant	Grant with limited conditions	Gift or donation
<p>Legally enforceable obligations to deliver. May not be an effective market.</p> <p>Likely to be a long term and substantial relationship between the parties.</p> <p>Critical supplies or services.</p> <p>High risk</p> <p>May have alliancing or partnership characteristics.</p>	<p>Supports a “public good” activity, organisation, or project.</p> <p>Limited ability to legally enforce performance.</p> <p>Funding is staged; tranches released as milestones achieved.</p> <p>Significant conditions attached (for example, commitment of other funders, procedural checks).</p> <p>Often not a commercial body.</p>	<p>Supports a “public good” activity, organisation, or project.</p> <p>Limited ability to legally enforce performance.</p> <p>Any obligations likely to be around process and reporting.</p> <p>Unlikely to be a commercial body.</p> <p>May involve a relationship with another government.</p>	<p>No obligations attached.</p> <p>Usually very low value.</p> <p>Unlikely to be a commercial body.</p>
<p>Residential care services.</p> <p>Major research programme.</p> <p>Ongoing professional advice.</p>	<p>Support for major development projects (for example, a community facility).</p> <p>Research grants.</p> <p>Ongoing support for a public interest activity or organisation.</p>	<p>Foreign aid.</p> <p>Environmental grant.</p> <p>Minor research.</p> <p>Support for specific purpose initiatives (for example, setting up a website for a community group).</p>	<p>Business gifts.</p> <p>Gifts to build relationships.</p> <p>Cultural courtesies.</p> <p>Marketing and public relations giveaways.</p> <p>Koha.</p>
<p>Planning, decisions, and approvals at a level appropriate to the scale of the contract.</p> <p>Suitably skilled staff assigned.</p> <p>Early liaison between the key person and any others in the public entity involved in managing the relationship with the external party.</p> <p>Legal advice on process and contract as needed.</p> <p>Assessment of risks and relationship context.</p>	<p>Process to check that purpose aligns with entity’s business or functions.</p> <p>Organisational policy and business planning to develop systems and criteria for considering applications or requests.</p>	<p>Process to check that purpose aligns with entity’s business or functions.</p> <p>Organisational policy and business planning to develop systems and criteria for considering applications or requests.</p>	<p>Authorised in accordance with entity’s policies.</p>
<p>Selection process more likely to involve direct negotiation than competitive systems.</p> <p>If no effective market, may use other approaches to determine price (for example, open book, benchmarking components, or independent peer review).</p> <p>Clear documentation of agreement and what is being funded.</p>	<p>Systematic process for considering applications or requests against criteria.</p> <p>Specific assessment of the basis for the amount of the grant sought.</p> <p>Clear documentation of terms of the grant and what is being funded.</p> <p>Clear and appropriate conditions set to manage risk and ensure suitable accountability.</p>	<p>Systematic process for considering applications or requests against criteria.</p> <p>Specific assessment of the basis for the amount of the grant sought.</p> <p>Clear documentation of terms of the grant and what is being funded.</p> <p>Some clear and appropriate conditions set to manage risk and ensure suitable accountability.</p>	<p>No application process.</p> <p>Voluntary.</p> <p>May be a tangible gift, or money, or time.</p>
<p>Systematic oversight.</p> <p>Reporting requirements tailored to situation.</p> <p>Periodic payments, dependent on performance. For long-term contracts, periodic review to ensure that the rationale for the arrangements continues to apply.</p>	<p>Regular reporting or other checks (at an appropriate level) to assess progress and whether further funds should be released, to enable funder to assess success.</p> <p>Payment may be in advance of delivery/performance but could be in stages to manage risk.</p>	<p>Payment may be in advance of delivery/performance but could be in stages to manage risk.</p> <p>Possibly some ongoing reporting or monitoring arrangements, depending on risk, scale, and nature of the relationship, to enable funder to assess success.</p>	<p>No reporting by recipient.</p>
<p>Programmed or regular review to check the purpose still relevant, satisfaction of both parties, price, and any other issues.</p>	<p>Full reporting of achievements against the purpose of the grant.</p>	<p>Some reporting of achievements against the purpose of the grant.</p>	<p>Recording through normal office systems for minor expenditure.</p>
<p><i>Procurement guidance for public entities</i></p> <p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p> <p><i>Achieving public sector outcomes with private sector partners</i></p> <p><i>Mandatory Rules for Procurement by Departments.</i></p>	<p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p>	<p><i>Principles to underpin management by public entities of funding to non-government organisations</i></p>	<p><i>Controlling sensitive expenditure: Guidelines for public entities</i></p>

