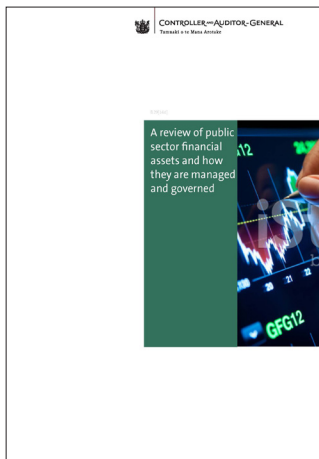




Summary of our report

A review of public sector financial assets and how they are managed and governed



For many years, the public sector has focused on managing debt. However, in the last couple of decades, the public sector's ownership of financial assets, such as cash, deposits, shares, and derivatives, has increased steadily. At 30 June 2014, the public sector's financial assets were worth about \$132 billion.

The public sector's increased holdings of financial assets has coincided with increasing innovation and technological change in financial markets around the world.

Unlike physical assets, many of the financial assets now in use are complex, interconnected, evolving quickly, traded often, and highly responsive to external circumstances. As a result, many of these financial assets offer new opportunities and challenges.

This report discusses the increasing significance of public sector financial assets and, using a sample of public entities, reviews how these assets are being managed and governed.

Value and use of financial assets expected to continue to increase

In the past, the holdings of financial assets in the public sector were relatively small and usually based around managing short-term cash needs and supporting debt requirements. Today, they are also being used to increase liquidity, flexibility, and risk management in the delivery of public services.

The Accident Compensation Corporation (ACC) and the New Zealand Superannuation Fund (NZSF) hold most public sector financial assets. Marketable securities (such as bonds and deposits) are the dominant financial asset class, but the use of derivatives has increased significantly in recent years. Treasury projections suggest that financial assets will increasingly dominate the Crown's balance sheet.

In local government, share investments are the dominant financial asset class. They include partnering and joint ventures with other local authorities, central government, and private organisations. Auckland Council holds more financial assets than any other local authority.

Good management and governance practices but with room to improve

We reviewed the financial assets of 14 public entities that, together, hold about 65% of all financial assets in the public sector.

By and large, all 14 had reasonably good structures and systems in place for managing and governing those assets.

Vital statistics:

- 49 pages
- Presented to Parliament on Wednesday 9 March 2016
- Contact: reports@oag.govt.nz

As expected, ACC, the NZSF, and the Government Superannuation Fund have effective management and governance practices over financial assets. They also lead in promoting responsible investment practices.

Investment portfolios of financial assets can be complex. Entities that use investment portfolios to support their core operational activities risk such portfolios becoming isolated from the organisation's general management and governance.

In these circumstances, governors could be supported by using independent expertise more or by public entities pooling financial assets for management purposes, as happens with the Local Government Funding Agency and the New Zealand Debt Management Office.

Public entities could also consider how to improve communication with stakeholders about the objectives and performance of their financial assets. The NZSF does this well. Public entities with significant financial assets can learn from the way the NZSF's investment beliefs, policies, and approaches are written and communicated to stakeholders.

Future opportunities and challenges require careful thought

As the value and use of financial assets continue to increase, we expect to see more opportunities, challenges, and risks. This is particularly so for central government, which holds a large (and changing) portfolio of financial assets.

The financial assets and associated liabilities of central government should be considered together, with a clear understanding of the risks being taken, how they are being managed, and the opportunities and challenges they create.

Wider matters such as how public assets and liabilities interact with, and influence, each other, the Government, the investment industry, and the economy also need careful thought.

Recommendations

The report contains three recommendations.

We have recommended that:

- **public entities holding investment portfolios regularly assess how they can strengthen the skills and capabilities for governing their financial assets;**
- **public entities with significant financial assets regularly assess how well they are managing and governing their financial portfolios and reporting to shareholders using nine particular questions; and**
- **the Treasury prepare a strategic perspective on and vision for holding financial assets in the public sector.**