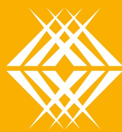
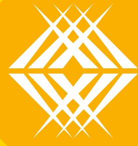
Tertiary Education Commission
Te Amorangi Mātauranga Matua



Governance and accountability for TEI investment in related entities

Responding to the 2016 legislative changes

2016 legislation clarifies how TEIs invest in related entities and makes changes to their reporting requirements. The changes strike a balance between encouraging innovation and managing risk.



What are related entities?

A related entity is an entity in which the investor has the ability to control or exercise significant influence over the financial or operating decisions of the entity.

Commercial entities owned, controlled or significantly influenced by TEIs are increasingly used as vehicles for business activity by TEIs. They include subsidiaries, associates, investment trusts, partners and joint ventures. In 2015, the 165 related entities of TEIs were mainly used to:

- **carry out contracted research or to commercialise research and intellectual property**
- **operate services of various kinds, such as student accommodation, sports facilities and car parks**
- **provide education abroad.**

Investment in a related entity provides both opportunities and risks that can affect a TEI's profitability and financial position.

The changes:

Clarify that tertiary education institutions (TEIs) do not need approval from the Minister of Finance to invest in related entities.

Maintain group-level reporting and reinstate the requirement for parent-level reporting.

Give the Minister responsible for tertiary education a new power to require information about a related entity where there is reason to think the entity may pose a risk to a TEI.

The changes recognise and support the important role that related entities play in enabling TEIs to be innovative and outward facing. They are intended to provide a modern, fit-for purpose legislative framework that strikes a balance between encouraging innovation and managing risk. The risk lies in the potential for a poorly performing entity to undermine the performance of a TEI and compromise its ability to perform its core roles of education and research.

Governance and accountability for TEI investment in related entities

Transparency and accountability are two of the principles that support good governance and reporting. As the TEI governing council is responsible for the overall performance of a TEI and its investment in related entities, it is important that council members have a clear line of sight and receive good information about the activities of any related entity.

Good governance encourages clear accountability

Good governance arrangements for the related entity include board members with the right leadership skills and experience who meet sufficiently frequently to provide effective strategic direction. Appointing a member of the TEI parent council to a place on the board of the related entity is not sufficient on its own to provide the parent council with visibility of the activities of the related entity. In certain circumstances, it may give rise to a conflict of interest for that council member.

To provide transparency, governance arrangements must be supported by timely and accurate management reporting to the parent TEI council to keep council members up to date with both the opportunities and the risks associated with each related entity.

The TEI council should seek assurance from senior management that sufficient capability is available to ensure that risk is appropriately managed, mitigated, and reported on for the all TEI investments in related entities.

Accountability is a vital element of good governance

In addition to the statutory requirement, good practice reporting also means publishing information in the TEI annual report about related entities, their activities, and the scale of their operations. This will enable readers of the financial statements to form a view about the impact of the investment in a related entity on the TEI's performance and is in line with the accounting standard for related entities: NZ IAS 24 Related Party Disclosures.

The statutory requirement for TEI related entities to separately report has been removed, but some related entities will have reporting obligations under other legislation, for example as registered charities or trusts. For all their related entities, TEIs should obtain sufficient financial and service performance information to enable:

- auditors to reach their opinion on the financial statements of the parent TEI and its statement of service performance
- readers of the TEI financial statements, including parliamentarians and taxpayers, to gain a full picture about the achievements of the TEI including its investment in related entities and the resources used.

Ministerial approval for investment in related entities is no longer needed

The changes bring certainty to the way a TEI invests in a related entity. They make it clear that TEIs can invest in related entities without seeking approval from the Minister of Finance or undertaking any form of approval process from central agencies for these investments.

All investments must continue to meet the requirements of section 192 of the Education Act 1989, which states that TEIs can only perform actions that relate to their core functions of education and research or can be performed in association with those functions.

The new legislation aligns the law with current practice and removes any ambiguity from the process for TEIs investing in related entities.

Changes in reporting practices

The new legislation strengthens TEI reporting practices by:

- reinstating the requirement for parent-level reporting
- providing a new power for the responsible Minister to require information.

These changes are intended to balance the risk created by removing Ministerial approval for TEI investment in related entities.

Parent-level reporting reinstated

While the requirement for group-level reporting remains, the changes reinstate the requirement that TEIs prepare separate financial statements for the parent entity, which was inadvertently removed by the Crown Entities Amendment Act 2013.

The requirement for TEIs to prepare parent-level financial statements means that the reader can compare the financial results of the parent with the group's results.

Reinstating reporting at parent-level is intended to increase the transparency of the performance of a TEI's core business and its investment in related entities. It will allow readers of the financial statements, including the Tertiary Education Commission (TEC), to see the impact of related entities on overall group performance and to identify where a related entity could be putting the core performance of its parent TEI at risk.

Minister has new power to gather information

The changes give the Minister responsible for tertiary education a new power to require information about a related entity if there are reasonable grounds to believe the entity poses a risk to a TEI.

This will enable the TEC to gain the information it needs to understand why a related entity is performing poorly, to determine the impact on the TEI, and to better support the TEI to actively manage the risk.

What are reasonable grounds?

The Minister must apply the risk assessment criteria under section 195A of the Education Act 1989 when deciding whether reasonable grounds exist to believe that a TEI may be at risk as a result of investment in a related entity.

In practice, this means the Minister may only require additional reporting if there is sufficient information to show that one or more of the risk assessment criteria would apply to the TEI concerned. The criteria are notified in the New Zealand Gazette.

The financial monitoring framework referred to in these risk assessment criteria is available on the Tertiary Education Commission's website.

What is the history behind the changes?

Under the Education Act 1989, TEIs have the power to invest money and to acquire securities in related entities. Until the 2016 legislative changes, the power to invest was subject to section 65I of the Public Finance Act 1989, which requires the Minister of Finance to approve all investments of public money (other than deposits with a bank or in public securities). This meant that the Minister of Finance needed to approve TEI investments in related entities.

However, advice in the mid-1990s from the Ministry of Education, the Office of the Auditor-General, the Treasury, and Crown Law was that any investments made for educational purposes did not need approval. So, for the most part, TEIs have not been seeking the Minister of Finance's approval when investing in related entities. The Government's current legal advice is that this interpretation was incorrect and that the legislation covered TEI investment in related entities.

Law change was necessary because:

- enforcing section 65I of the Public Finance Act 1989 in relation to TEI investment in related entities would place a heavy compliance burden on TEIs, potentially limiting their ability to be outward looking and innovative, and
- the Treasury considered that section 65I was inappropriate for authorising investments in related entities. The purpose of the section was to regulate investment by the Treasury of cash that is temporarily surplus to the Crown's requirements, not to regulate the establishment of related entities, such as subsidiary companies set up to progress business interests.

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