

Ministry of Economic Development

Commerce Commission Review of Purchasing and Accountability Arrangements

31 October 2008



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Dear Sheryl

In accordance with the services agreement between the Ministry of Economic Development and PricewaterhouseCoopers dated 5 May 2008 ("Agreement"), we are pleased to attach our final report on the Commerce Commission's accountability and purchasing arrangements.

In accordance with our normal practice, we draw your attention to the restrictions relating to this report that are included in Appendix 1.

It has been a pleasure working with you in relation to this assignment. If there is anything else we can do to assist, please do not hesitate to contact us.

Yours sincerely

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1 Executive Summary

Background

The current Vote and output expense structure of the Commerce Commission (“the Commission”) is relatively complex. The Commission is funded from three Votes (Commerce, Energy and Communications), and provides outputs to five purchasing Ministers (Commerce, Communications and Information Technology, Energy, Agriculture and Consumer Affairs), with the latter three purchasing services via a devolved arrangement.

In 2004 the Ministry commissioned a review of the Commission’s purchasing and accountability arrangements. That review developed a set of principles that were used to assess the Commission’s purchasing and accountability arrangements. It recommended against any change to the Vote and output expense structure.

Since the last review, the main changes that are relevant to the Commission’s purchasing and accountability arrangements have been:

- new outputs for the development of regulatory principles, guidelines and rules for sector specific regulation;
- the introduction of the regulation of airports (the scope of work is still being determined);
- the reworking of output definitions within output expenses;
- an extension of the Commission’s regulatory responsibilities under the Telecommunications Act 2001; and

- the inclusion of outputs for framework development under each output expense.

Purpose

The Ministry has commissioned this latest review to re-examine the purchasing and accountability arrangements of the Commission, taking into account the changes noted above.

The overarching objective of the review is to assess whether the current purchasing and accountability arrangements remain optimal when assessed against the principles developed in the 2004 review and reflected in the terms of reference.

Principles to Guide Evaluation

Several principles are included in the terms of reference to guide the evaluation of purchase and accountability options. These can be summarised into three main categories:

- flexibility - enabling the Commission to deploy resources to areas of greatest regulatory impact;
- accountability – maintaining effective accountability to Government and other stakeholders (notably levy payers); and
- efficient functioning of government – ensuring that Ministers have the opportunity to participate in discussions that affect the attainment of the Government’s policy objectives.

This report describes various purchase and accountability options and evaluates them against the principles summarised above.

2004 Review – Vote and Output Expense Structure

At the Vote and output expense level, the current structure of purchasing arrangements is very similar to that which existed at the time of the last review in 2004. Consistent with arrangements in 2004, the Commission is still funded through three Votes and there are still five purchasing Ministers, some of whom purchase through a devolved purchasing arrangement.

The 2004 review concluded that the Vote and output expense structure was appropriate and did not need changing. More specifically, the 2004 review considered that it was appropriate to fund regulatory activities through separate Votes and/or output expenses where:

- Ministers have specific regulatory responsibilities (i.e. the energy and telecommunications sectors); and
- there is a need for transparency of costs and funding to levy payers (this also applied in the energy and telecommunications sectors).

At the same time, the review concluded that it was appropriate to retain the Enforcement of General Markets Regulations as a single output expense notwithstanding that this covered activities purchased by the Minister of Commerce (relating to the Commerce Act) and the Minister of Consumer Affairs (the Fair Trading and Credit Contracts and Consumer Finance Acts). The reason for this is the need to give the Commission the flexibility to allocate resources between activities in relation to these Acts given the interplay between them in contributing to competition and competitive outcomes.

Current Review

We have reassessed the Commission's Vote and output expense structure against the principles described in this report. The funding that is provided to the Commission needs to be unbundled into separate appropriations in order to provide an appropriate balance between accountability, flexibility and the efficient functioning of Government. The challenge is to identify the best Vote and output expense structure to achieve this.

Although there have been a number of changes to both the scope and scale of the Commission's activities, none of these changes substantively alter the roles and responsibilities of the Commission. Accordingly, the review concludes that for the most part, the existing Vote and output expense structure continues to offer the best arrangements when evaluated against the principles of flexibility, accountability and the efficient functioning of Government.

That said, there have been some changes, as noted under the background above, to the Commission's activities. The review has paid particular attention to these to assess whether or not they can be effectively melded with the existing vote and output expense structure. In this regard, we have specifically considered the purchase and accountability arrangements that need to apply in two new areas of activity; airports regulation and the development of regulatory guidelines, principles and rules.

Airports Regulation

The Commission will shortly take on responsibility for regulation in the airports sector. This follows an amendment to the Commerce Act and under the Act the Commission can, among other things, recommend to the Minister of Commerce what

airport services (at three international airports) should be regulated.

The review recommends that the Crown purchase Commission services relating to airports regulation through a separate output expense within Vote: Commerce. The Minister potentially has specific regulatory responsibilities in relation to the airports and, accordingly, it is appropriate that the Minister have direct involvement over decisions regarding the level of funding for activities in this area. Moreover, the ultimate funding for work in this area will come from levies on the airports. From a transparency perspective, therefore, it is better to separate funding for airports regulation into a separate output expense. For this reason, the review would not see it as appropriate to include funding for airports regulation within the existing Enforcement of General Market Regulation output expense.

We note that the Minister of Transport has responsibilities in relation to airports that operate under the Airport Authorities Act. If, at any stage, a decision was taken to transfer ministerial regulatory responsibilities from the Minister of Commerce to the Minister of Transport, purchasing arrangements would also need to change. In particular, it would make more sense to have a separate output expenses under Vote: Transport rather than Vote: Commerce.

Regulatory Guidelines, Principles and Rules

Currently, funding for this output is spread across two Votes (Energy and Commerce) and three output expenses. We recommend that the purchasing arrangement for the development of regulatory guidelines, principles and rules be modified to bring all of the appropriations under a single output expense within Vote: Commerce.

Our reasons for this are as follows.

- The objective of this work is to develop regulatory guidelines, principles and rules in order to provide business certainty and predictability by providing clarity about such matters as calculating the weighted average cost of capital, valuing assets and allocating common costs. There is likely to be a high level of commonality of input methodologies across various sectors comprising, at this stage, airports, gas and electricity. The output has strong economies of scope – that is, most of the methodologies will have applicability across all three sectors. It follows from this that it is not particularly sensible to have three sets of purchasing decisions being taken – one should suffice – and on this basis, the most logical choice of purchasing Minister would seem to be the Minister of Commerce (rather than a sector-based Minister).
- From a transparency perspective, there are advantages in having the cost of activity in relation to guidelines, principles and rules in one place rather than spread across three output appropriations. However as funding is recoverable by a levy on the gas, electricity and airport sectors, there is also a need for a degree of transparency and accountability to levy payers. In our view, this can be achieved through the use of separate outputs for each of the electricity, gas and airport sector, within the proposed output expense in Vote: Commerce.

The review has considered whether the appropriation for work on regulatory principles, guidelines and rules should be part of the Enforcement of General Market Regulation output expense. While this is an option, it is not preferred for the reason that the work is sufficiently distinct from other activities under this output expense and because it is appropriate for Ministers to decide on

the level of funding for this output independently of the work that the Commission undertakes under the umbrella of the Enforcement of General Market Regulation output expense.

Other Recommendations

This review makes the following recommendations in relation to other aspects of the Commission's purchasing and accountability arrangements:

Finalisation and signing of Output Agreement

- the Commission working with the Ministry to finalise its 2008/09 Output Agreement as soon as possible, and in future years that the Output Agreement be signed-off prior to the start of the relevant financial year.

Output Structure

- adding a separate set of outputs for Electricity Industry Reform Act (EIRA) related activity (EIRA cases, Determinations, Framework Development and Public Information / Education), within the Enforcement of General Market Regulation output expense, to provide improved transparency to the Minister of Energy;
- splitting the "Framework Development" output to better reflect the two distinct outputs that are currently combined within this output. The first of these outputs relates to the Commission's role in commenting on policy developed at the Ministry level. The other of the outputs is the development of operational policy by the Commission to give effect to policy and legislative frameworks;

Performance Measures

- regularly reviewing its performance targets, to ensure their continued relevance and appropriateness;
- clearly identifying each performance measure as either an accountability or information performance measure in the Commission's accountability documentation, and considering the appropriate number (and mix) of accountability performance measures;
- the Commission including outcome and impact measures in its Output Agreement and Annual Report in addition to the output focused quantity, timeliness and cost measures currently included in the Statement of Service Performance and Output Agreement;

Quality of Accountability Documentation

- including a one page, 'traffic light' summary of the key messages in each quarterly report, to provide readers with a clear and concise overview of areas with no problems (green), areas to be aware of (amber), and areas for concern (red);
- as part of its variance analysis in the executive summary of its quarterly reports, including a statement as to the Commission's intended course of action (if any) in relation to any significant and permanent variances; and
- in the body of the Output Agreement, specify which services (or outputs) it is that the Minister of Commerce purchases on behalf of the Ministers of Energy, Consumer Affairs and Agriculture.

We recommend that the Ministry of Economic Development and the Commission establish a joint review team, to be responsible for implementing the recommendations of this review.

Consistent with this final recommendation, we note that the aspects of the Commission's purchasing and accountability arrangements described above should be reviewed regularly to ensure that there continues to be an appropriate balance between the requirement for effective accountability and the need to avoid imposing unnecessary compliance costs on the Commission (or its monitors).

2 Introduction

Introduction

The Commerce Commission is an independent statutory body, established as a Crown Entity under section 8 and 8A of the Commerce Act 1986. As such it is subject to the Crown Entities Act 2004.

The Commission is responsible for the enforcement of a range of economic regulation and legislation.

The Commission has significantly grown in size over the last four years (since the previous review of the Commission's purchasing and accountability arrangements), reflecting the increasing volume and complexity of its activities.

The Ministry of Economic Development commissioned this review to re-examine the appropriateness of the Commission's purchasing and accountability arrangements, taking into account changes in Commission activity since the previous review undertaken in 2004.

Background

In 2004 the Ministry of Economic Development engaged PricewaterhouseCoopers to examine the appropriateness of the Commission's purchasing and accountability arrangements. That review developed a set of principles in relation to flexibility, accountability and the efficient running of government. The Commission's purchasing and accountability arrangements were then assessed against these principles.

The 2004 review concluded that the Vote and output expense structure in place at that time provided an appropriate balance between flexibility, accountability and the efficient running of government. The review also made a number of other recommendations in relation to strengthening the Commission's purchasing and accountability arrangements.

Purpose

The purpose of this review is to evaluate the accountability and purchasing arrangements of the Commerce Commission. The overarching objective of the review is to assess whether the current purchasing and accountability arrangements remain optimal in assisting the Commission in meeting its legislative obligations.

It is important that the arrangements reflect an appropriate balance between accountability (to Ministers and Parliament), and the flexibility to allocate resources to their highest value use, while recognising the statutory independence of the Commission.

The Terms of Reference for this review sets out the following key aspects for the review:

- an examination of the existing Vote and output expense structure and an assessment as to whether this structure assists or impedes the Commission and Ministers in relation to purchase decisions;
- an examination of the existing Vote and output expense structure and an assessment as to whether this structure fosters effective accountability for the delivery of outputs; and

- the identification and evaluation of alternate Vote and output expense structures in order to determine whether they would better meet the Commission's and the Government's objectives.

Scope

All Votes and output expenses through which the Commission is appropriated funding are included within the scope of this review. These are:

- Vote: Commerce:
 - Enforcement of General Market Regulation;
 - Enforcement of Dairy Sector Regulation;
- Vote: Energy:
 - Enforcement of Electricity Sector Regulation;
 - Control of Natural Gas Services;
- Vote: Communications:
 - Enforcement of Telecommunications Sector Regulation.

Approach

Our approach to this review has involved the following:

- identifying changes within the Commission or its external environment since the previous review which may impact on

the appropriateness of the Commission's purchasing and accountability arrangements;

- understanding the current purchasing and accountability arrangements, including how these have changed since the previous review;
- assessing whether, in the context of the key principles developed as part of the previous review, the existing Vote and output expense arrangements are appropriate, given the changes identified; and
- providing comment and recommendations in respect of the Commission's purchasing and accountability arrangements, other than in relation to the Vote and output expense structure.

Interviews conducted with Commission staff and officials as part of the baseline review included, where appropriate, discussion in relation to the Commission's purchasing and accountability arrangements.

During this review primary consideration was given to:

- the Commission's draft 2008/09 Output Agreement (which in substance follows the same structure as the 2007/08 version) and how this has changed relative to the Output Agreement that existed at the time of the previous review; and
- the Commission's most recent quarterly report to the Ministry of Economic Development (for the quarter ended June 2008). Regard was also had to the various quarterly reports made available to us since the previous review, to understand the nature of the changes in reporting.

3 Purchasing and Accountability Arrangements

This section sets out the current functions of the Commission and comments briefly on changes to the scale and scope of the Commission's activities that could have an impact on purchasing and accountability arrangements. It then summarises the current purchasing and accountability arrangements in place for the Commission, and highlights important changes relative to the arrangements in place at the time of the previous review.

Background

The functions of the Commission

The Commission has regulatory, quasi-judicial and/or enforcement responsibilities under the following Acts:

- the Commerce Act 1986;
- the Fair Trading Act 1986 ("FTA");
- the Credit Contracts and Consumer Finance Act 2003 ("CCCFA");
- the Electricity Industry Reform Act 1998 ("EIRA");
- the Telecommunications Act 2001; and
- the Dairy Industry Restructuring Act 2001 ("DIRA").

Changes to the Scope and Scale of the Commission's Activities

Compared to the last review (2004), there have been a number of changes to the scope and scale of the Commission's activities that are relevant to an assessment of purchasing and accountability arrangements.

- **The CCCFA** - the Commission has been increasing the level of investigation and enforcement under the CCCFA. At the time of the 2004 review, the CCCFA had only recently been enacted.
- **The Telecommunications Act 2001** - changes to the Telecommunications Act in December 2006 have given the Commission increased powers and enabled it to take a more proactive role in promoting competition in this sector. Included in the Commission's roles under the Act is making determinations in respect of designated access and specified services, undertaking costing and monitoring activities relating to the Telecommunications Service Obligations and monitoring and enforcing Telecom's compliance with its operational and accounting separation obligations (which were an important part of the 2006 legislative reforms).
- **Regulatory Principles, Guidelines and Rules** – the increasing focus on sector specific regulation has increasingly created a need for the Commission to ensure consistency in approach and underlying frameworks with respect to the regulation of specific sectors. The Commission will receive additional Crown funding of \$3.400m in 2008/09 and \$1.599m in 2009/10 to develop regulatory principles, guidelines and rules. The work is intended to be carried out in three stages:

- developing industry economic regulatory principles, guidelines and rules;
- developing detailed guidelines for subjects such as pricing principles and asset valuation; and
- applying the guidelines to develop generic and industry-specific methodologies.

Work on regulatory principles, guidelines and rules is being directed at the airport, electricity and gas sectors and the Commission's funding will be recovered (by the Ministry) via an industry levy.

- **Airports regulation** – This is a new area of regulatory responsibility, which has been conferred on the Commission by recent amendments to the Commerce Act. The legislative changes will subject Auckland, Wellington and Christchurch International Airports to an information disclosure, monitoring and reporting regime, to be administered by the Commission. Under the Commerce Amendment Act 2008¹, the Commission's function includes determining how the regime is to apply. An aspect of this is to make recommendations to the Minister as to what airport services should be regulated.
- **Input to policy development** - the Commission considers that it is being increasingly called on to provide advice to Government departments on a range of legislative proposals as a result of a large policy and legislative programme.

¹ Sections 56A(4) and 56E.

Overview of Current Purchasing and Accountability Arrangements

The Government purchases Commission services for the promotion of efficiency in markets and economic regulation of these markets through three purchasing Ministers, namely the Ministers of Commerce, Energy and Communications and Information Technology. The Minister of Commerce is the Minister responsible for the Commission and is also the purchaser of the largest proportion of the Commission's services (in dollar terms).

Current arrangements incorporate a devolved purchasing model in three areas:

- activity under the EIRA² is included under the Enforcement of General Market Regulation output expense (Vote: Commerce), with the Minister of Commerce purchasing these services on behalf of the Minister of Energy;
- activity in relation to the FTA and CCCFA is included under the Enforcement of General Market Regulation output expense, with the Minister of Commerce purchasing these services on behalf of the Minister of Consumer Affairs; and
- activity in relation to the DIRA is included under the Enforcement of Dairy Sector Regulation output expense (Vote: Commerce), with the Minister of Commerce

² This activity relates to the restructure of the electricity industry in order to facilitate competition and includes restricting the relationships between electricity lines and supply businesses.

purchasing these services on behalf of the Minister of Agriculture.

The Litigation Fund

The Commission receives funding via the non-departmental other expense appropriation Commerce Commission Litigation Fund (“Litigation Fund”). The purpose of this funding is to enable the Commission to always be in a position where it can “effectively and without delay undertake Court proceedings under the Acts for which it has enforcement obligations”³. The Minister of Commerce purchases major litigation activity on behalf of all purchase Ministers.

The Litigation Fund is available only to fund direct costs associated with major litigation activity. Except as specified below, indirect costs cannot be paid for out of the Litigation Fund. The Output Agreement sets out a number of criteria to assess whether intended litigation should be considered ‘major’, and therefore eligible for Litigation Fund funding. The Ministers of Finance and Commerce have joint delegated authority to transfer any unspent monies from one year to the next.

The Output Agreement also includes reporting requirements (via the Commission’s quarterly reports) for the Litigation Fund, including the amount of any transfer of funds from the Litigation Fund to the Commission’s output expense appropriations.

The Output Agreement

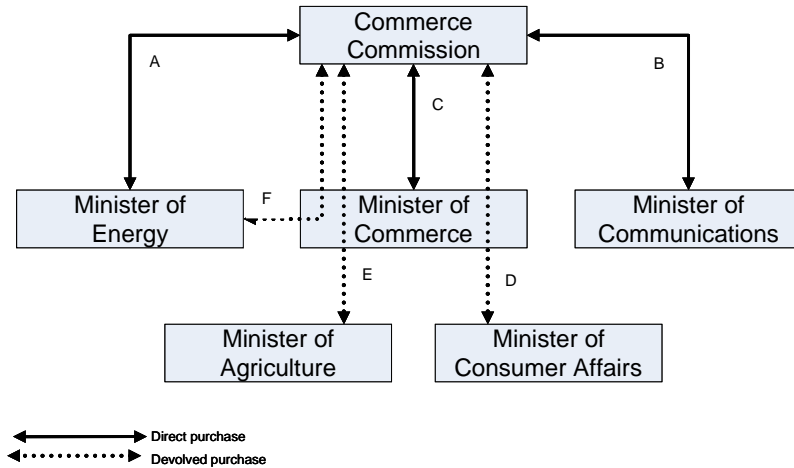
The Commission’s purchasing and accountability arrangements are documented in an annual Output Agreement, including purchasing arrangements as noted above, the output structure under each output expense, reporting requirements and the rules governing the Litigation fund. A full-breakdown of the output expenses and outputs in the 2008/09 draft Output Agreement is provided at Appendix 3.

The Output Agreement also recognises that, from time to time, the Commission may need to modify priorities and shift resources across outputs within an appropriation. The Output Agreement (clause 2.2) provides that the Commission can carry out such a reprioritisation without seeking formal approval from the relevant Minister(s), but is required to advise Minister(s) of such a reprioritisation (through the monitoring regime).

The following figure and table summarise the Votes and output expenses under which the Commission is funded, as well as the respective purchasing Minister.

³ 2008/09 Commerce Commission Output Agreement.

Figure 1: Commerce Commission purchasing arrangements



NB: The Non-departmental Output Expense *Commerce Commission Litigation Fund* (Vote: Commerce) is provided by the Minister of Commerce on behalf of all Purchasing Ministers and the Ministers of Agriculture and Consumer Affairs, and provides the means to support the Commission in meeting its responsibilities.

Table 1: Commission purchasing arrangements

Key	Vote	Output Expenses	Relevant Act
A	Energy	Control of Natural Gas Services Enforcement of Electricity Sector Regulation	Commerce Act
B	Communications	Enforcement of Telecommunications Sector Regulation	Telecommunications Act
C	Commerce	Enforcement of General Market Regulation	Commerce Act
D	Commerce	Enforcement of General Market Regulation	FTA CCCFA
E	Commerce	Enforcement of Dairy Sector Regulation	DIRA
F	Commerce	Enforcement of General Market Regulation	EIRA

Changes to Purchasing and Accountability Arrangements since the Previous Review

Whilst there have not been any changes to the Commission's Vote and output expense structure since the previous review⁴, there have been changes in respect of a number of other aspects of the Commission's purchasing and accountability arrangements. The following paragraphs briefly discuss these changes.

Output and Sub-output Structure

Key aspects of the output and sub-output structure in place at the time of the last review include:

- The output structure for each output expense included, where relevant, an output for each of following: investigation, adjudication, litigation, reports to the Minister and the provision of public information. This output breakdown was based on the nature of the 'task' being undertaken.
- Some outputs were segmented into sub-outputs⁵. This was generally based on the nature of the 'regulatory problem' or, implicitly, the relevant Act or part of the relevant Act under which the Commission was operating. For example, under the Enforcement of General Market Regulation output

⁴ That is, the Commission receives funding under the same output expense appropriations, which are under the same Votes.

⁵ Primarily in relation to the quantity performance measure only, as the amount of each appropriation, (in dollar terms) was previously only disclosed at the output expense level.

expense, the investigations output had the following sub-outputs:

- market behaviour investigations;
- market structure investigations;
- fair trading investigations; and
- standards investigations.

Since the previous review the output and sub-output structure has been modified in a number of ways, as outlined below.

Output and sub-Output Structure

The output structure within each output expense has been restructured, so that outputs are now based, where relevant, around the nature of the economic activity that gives rise to competition issues (e.g. determinations in relation to merger applications, unilateral conduct and co-ordinated behaviour).

At the sub-output level, the structure now reflects, where relevant, the nature of the action undertaken by the Commission. For example, under the Enforcement of General Market Regulation output expense, the sub-outputs for the market structure, coordinated behaviour and unilateral conduct outputs are administrative resolution, litigation or no further action.

Framework Development

An output for 'Framework Development' has been added under each output expense. Included within the output description is the provision of advice and information in relation to competition issues in the course of domestic law reform or international

engagement. This output includes a mix of policy and operational policy advice (and we comment further on the need for greater distinction between the two in section six).

Regulatory Principles, Guidelines and Rules

From 2008/09 the Commission has received additional Crown funding for the development of regulatory principles, guidelines and rules. The funding for this function has been spread over three different output expenses and across two separate Votes. This structure reflects the three industry sectors this project is being directed at:

- Airports, under the Enforcement of General Market Regulation output expense (Vote: Commerce);
- Electricity, under the Enforcement of Electricity Sector Regulation output expense (Vote: Energy); and
- Gas, under the Control of Natural Gas Services output expense (Vote: Energy).

A separate output has been included under each of these output expenses for regulatory principles, guidelines and rules development.

The Commission's work in relation to the development of regulatory principles, guidelines and rules is ultimately funded by a levy on the electricity, gas and airport sectors.

CCCFA and Fair Trading Act

Within the previous structure, CCCFA investigations and FTA investigations were grouped together in the same sub-output

within the investigations output of the Enforcement of General Market Regulation output expense. Although as noted above the overall structure of outputs and sub-outputs has changed, reflecting the increasing importance of CCCFA activity as noted above, CCCFA activity now has its own set of outputs separate from FTA outputs within this output expense.

Airports Regulation

This is a new area of regulatory responsibility for the Commission. Under current appropriations the Commission will receive funding for the regulation of airports from 2009/10 onwards, via the Enforcement of General Market Regulation output expense appropriation (Vote: Commerce).

The Commission's work in relation to regulating airports will be levy funded.

The Litigation Fund

In light of the Commission's objective to build internal legal capacity, a review of the Litigation Fund was carried out in July 2007, which resulted in increased flexibility for the Commission to transfer funds from the Litigation Fund to its output expense appropriations.

The outcome of this review and subsequent work (as noted in the draft 2008/09 Output Agreement), was a series of Cabinet decisions approving the permanent re-allocation of \$2.5m from the Litigation Fund appropriation to the Enforcement of General Market Regulation output expense appropriation from 2009/10 onwards (\$1.5m was transferred in 2007/08, and a further \$1.0m in 2008/09).

This funding can only be used for internal staff costs, including support staff, and indirect or overhead costs, that relate to major litigation.

The Ministers of Finance and Commerce also have joint delegated authority to:

- transfer additional funding of \$0.5m for the 2009/10 year onwards over and above the \$2.5m already agreed to; and
- to further transfer a portion of the transferred funding from the Enforcement of General Market Regulation output expense appropriation to other Commission output expense appropriations, provided the funding is used in relation to major litigation.

Funding

The following table sets out the output expense appropriations for the Commission.

Table 2: Commission Appropriations

<i>\$000, GST Exclusive</i>	05/06	06/07	07/08	08/09
Enforcement of General Market Regulation	12,602	13,343	15,079	17,745
Enforcement of Dairy Sector Regulation	905	905	905	905
Enforcement of Telecommunications Sector Regulation	3,500	4,000	7,928	7,790
Enforcement of Electricity Sector Regulation	2,667	4,267	3,317	7,117
Control of Natural Gas Services	1,250	1,000	2,181	1,952

The Enforcement of General Market Regulation output expense appropriation figures in Table 2 are inclusive of transfers from the Litigation Fund other expenses appropriation (see table 3 for details).

In this regard, we note the following.

- The 2007 Estimates states that the amount of the Enforcement of General Market Regulation output expense appropriation is \$13.579m. As noted above, subsequent to the Estimates being released, Cabinet agreed to a transfer of \$1.5m from the Litigation Fund to the Enforcement of General Market Regulation output expense for 2007/08, 2008/09 and 2009/10, which results in the figure of \$15.079m in the 2007/08 Output Agreement.
- The 2008 Estimates states that the amount of the Enforcement of General Market Regulation output expense appropriation is \$16.745m. This includes the \$1.5m transfer Cabinet had already agreed to. Subsequent to the release of the Estimates, a further \$1m transfer was also agreed to, which results in the figure of \$17.745m in the draft 2008/09 Output Agreement.

Table 3 opposite sets out the level of the Commerce Commission Litigation Fund other expense appropriation over the last four years, (including agreed transfers to output expense appropriations).

Table 3: Litigation Fund other expense appropriation

<i>\$000, GST Exclusive</i>	05/06	06/07	07/08	08/09
Litigation Fund appropriation	4,254	8,474	11,253 ⁶	10,500
Transfer to the Enforcement of General Market Regulation output expense appropriation	N/A	N/A	1,500	2,500
Litigation Fund appropriation (net of transfers out)	4,254	8,474	9,753	8,000

⁶ Includes expense transfer of \$1.813m.

4 Key Principles

To assess the Commission's current accountability and purchasing arrangements, and to determine if alternative arrangements provide a more appropriate balance between accountability and flexibility, regard must be given to the principles which underpin effective accountability and purchasing arrangements.

The Terms of Reference for this review sets out seven key principles which underpin effective Vote and output expense structure arrangements:

Flexibility

- enable the Commission to deploy its resources in the most efficient manner without undermining effective enforcement in any of the Commission's areas of responsibility;
- ensure the Commission maintains its statutory independence and has sufficient flexibility in managing its resource;
- ensure that the Commission is not over-loaded with excessively burdensome administration arrangements;

Transparency and Accountability

- facilitate parliamentary monitoring of the attainment of the Commission's performance measures;
- facilitate transparency in linking funding sources with particular outputs;

- provide assurances to stakeholders regarding the use of the Commission's resources. This is particularly relevant for the Commission's services which are funded by industry levies and where funding has been provided for an explicit purpose; and

Efficient functioning of Government

- ensure that Ministers have the opportunity to participate in discussions regarding the attainment of the Government's policy objectives, particularly where trade-offs are likely.

The previous review also considered an eighth principle, which also relates to the need for flexibility:

- allow the Commission to manage short term peaks and fluctuations in work flows across the Commission's areas of responsibility.

Our analysis also takes this principle into consideration.

Other considerations

All of these eight principles were used to assess Vote and output expense structure arrangements, as discussed in section 6.

There are also three principles which are relevant to the consideration and design of output structures within output expenses:

- homogeneity – outputs should involve the same type of activity (but not necessarily the same client group or outcome);

- materiality – too large an output expense risks poor output definition or problems with assessing performance. Too small an output expense risks unnecessary inflexibility; and
- final, rather than intermediate, outputs – it is important that output expenses relate to final outputs, such as the determination of authorisations, rather than intermediate outputs, such as research and analysis conducted by the Commission as inputs to the determination of authorisations.

Transfers between Votes and Output Expenses

The design of accountability and purchasing arrangements for the Commission must also have regard to, and be consistent with, the requirements under the Public Finance Act 1989. In particular, regard must be given to the rules governing transfers between Votes and output expenses.

The following table provides a summary of these rules.

Table 4: Rules governing transfers between Votes and output expenses

Transfers between	Rule
Votes	In practice, Cabinet approval is required initially, with ultimate legislative approval by Parliament.
Output Expenses	Under section 26A of the PFA, an Order-in-Council by the Governor-General is required. In practice, Cabinet approval is the substantive requirement.

5 Vote and Output Expense Structure

Previous review

The previous review identified two issues as most relevant to the design of the Commission's Vote and output expense structure.

The roles and responsibilities of the Commission and of Ministers

An understanding of these has an important bearing on Vote and output expense structures and purchasing arrangements. The nature of the different roles and responsibilities of the various purchasing Ministers and the Commission have implications for the degree to which it is sensible to aggregate some of the Commission activities into a single Vote and/or output expense. Each of the Ministers has a different level of statutory responsibility with regard to the outputs produced by the Commission. An aspect of this is the degree to which there is a need for the ability to re-prioritise resource between certain areas of Commission activity, and who should be making such decisions.

Funding arrangements

The Commission is funded from a number of sources. The Government funds general market regulation, but sector specific regulatory functions are funded (in part or in total) by industry

levies⁷ and/or transaction charges. This includes services provided under:

- Part 4 of the Commerce Act, which are, or are to be, fully funded by levies on regulated electricity, gas and airport companies;
- the Telecommunications Act 2001, which are funded by industry levies and transactions charges⁸; and
- the DIRA, which are partly levy funded.

Work in relation to the development of regulatory principles, guidelines and rules will also be levy funded.

Discussions with officials revealed that levy-based funding has been an important driver behind grouping sector specific regulatory activity under separate Votes or output expenses. There needs to be a degree of separation for levy funded activity, such that an appropriate level of transparency and accountability for the costs of these activities is achieved, including an ability to match the levies received and the funding appropriated.

Conclusions drawn in the Previous Review

The previous review considered each of the major areas of Commission activity in light of these issues, and developed a

⁷ In practice these levies are charged and administered by the Ministry, with the monies then appropriated to the Commission under the relevant output expenses.

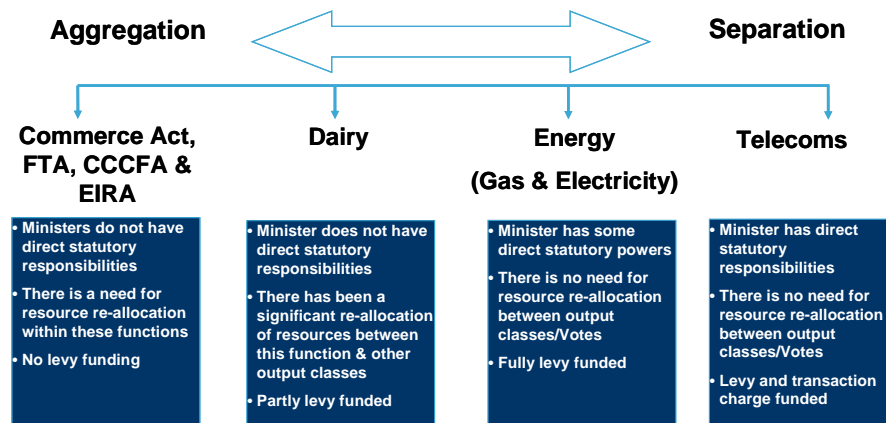
⁸ Access determinations are cost recovered through transaction charges on the applicants.

view as to the appropriate degree of separation or aggregation (into a single Vote or output expense) for each.

The need for separation was strongest with respect to regulatory activities in relation to the telecommunications sector. At the other end of the spectrum, the need for separation was considered least strong for general market enforcement activities and activity under the EIRA. Regulatory activities in relation to the DIRA and the electricity and gas sectors lay somewhere between general markets and telecommunications activity. Their relative position reflected the nature of Ministers' responsibilities and the extent of levy funding.

The following figure summarises this view.

Assessing the Appropriate Balance Between Aggregated and Separated Output Classes/Votes



The rationale behind this assessment was as follows:

General Markets

This includes the Commission's work in relation to the Commerce Act, the FTA and the CCCFA.

For several reasons, the previous review considered that a high degree of aggregation was appropriate, based on:

- activities in relation to the Commerce Act, Fair Trading Act and CCCFA needing to complement one another. Having a well conceived competition policy, and enforcement of that policy (in relation to the Commerce Act) is not, of itself, sufficient to achieve the objectives of competitive prices, better quality and greater choices for consumers. Competition laws may not always achieve these objectives because of lock-in and switching costs. Moreover effective competition relies on honest and fair trading, but competition of itself can create incentives to trade unfairly. There is a need for the ability to re-allocate resources within this area to achieve an appropriate balance between competitive markets and informed consumers;
- the Commission acting independently from Ministers in terms of the production of these outputs. Neither Minister has any direct involvement regarding the way in which the Commission undertakes activities in these areas, or in terms of the way in which the Commission exercises its quasi-judicial role;
- by virtue of its overriding purpose, and the accountability that stems from this, the Commission having incentives to determine the appropriate allocation of resources between the enforcement of competition laws and enforcement of consumer protection laws. The Commission is also best placed to determine how resources should be allocated (as it has the best information to make such decisions). Therefore

the Commission appears to be best placed to make re-prioritisation decisions within the Commission's general markets responsibilities; and

- none of the Commission's general markets activity being ultimately funded by industry levies.

The Telecommunications Sector

The previous review considered that a high degree of separation was appropriate, for the following reasons.

- The Minister for Communications and Information Technology has a number of direct statutory duties in respect of the services purchased from the Commission. The nature of these obligations suggests that the Minister for Communications and Information Technology needs to play a more direct role in the regulation of the telecommunications sector than that of the Minister of Commerce with respect to the general markets area. The Minister for Communications and Information Technology therefore requires greater influence over the allocation of resources within the Commission's Telecommunications activity than the Minister of Commerce does in relation to general markets.
- The Commission's activity in regulating the Telecommunications sector is fully funded by a combination of transaction charges and industry levies.

The Energy Sector

This includes Commission activity funded under Vote: Energy in respect of the regulation of the electricity and gas lines

industries, and also the Commission's responsibilities in relation to the EIRA (funded under Vote: Commerce).

The previous review concluded that the need for separation for the Commission's energy sector activities (excluding in relation to the EIRA) lies somewhere between that for general markets and the telecommunications sector, based on:

- the Minister of Energy having some direct statutory responsibility such as being able to request that the Commission report on whether regulatory control should be recommended to the Governor-General;
- the Commission's activity in regulating the electricity and gas lines industries being ultimately fully funded by an industry levy; and
- in practice there appearing to be no need for resource re-allocations between the Vote: Energy output expenses and other Votes.

The previous review concluded that a high degree of aggregation with the Commission's general markets responsibilities was appropriate for EIRA related activity, based on:

- the Commission's activity in relation to EIRA being similar in nature to that of other work under the Commerce Act; and
- The Commission's EIRA related activity not being funded by industry levies.

The Dairy Sector

The previous review concluded that the need for separation for the Commission's work under the DIRA lies somewhere between that for general markets and the Commission's electricity and gas responsibilities, based on:

- the nature of the activities undertaken by the Commission in respect of the DIRA being analogous to those under EIRA and general markets;
- the Minister of Agriculture having no specific regulatory responsibilities; but
- DIRA related activity being partially levy funded (which creates a need for some degree of separation).

Current State Assessment

Discussions with the Commission and officials have indicated that the issues identified in the previous review continue to be relevant in terms of Vote and output expense design.

This section re-considers, in light of the changes to the various areas of activity that the Commission is engaged in, whether the conclusions of the previous review as to the appropriate level of aggregation or separation still hold.

This section also considers the appropriate degree of aggregation or separation for the new areas of activity the Commission is engaged in (the development of regulatory principles, guidelines and rules), or will be engaged in the near future (airports regulation).

Enforcement of General Markets Regulation

This output expense includes a wide range of outputs aimed at enforcing the provisions of the Commerce Act, Fair Trading Act and CCCFA. There are also aspects of enforcement under EIRA included under this output expense. Overall, the review concludes that it is still appropriate to combine regulatory activities in these areas under a single output expense. The main reasons for this are:

- The objective of promoting competition and competitive outcomes relies upon the interplay between avoiding structures and behaviours that seek to limit competition and the principle of informed consumers. Competitive outcomes are potentially prejudiced if consumers are fed misleading information even if market structures are inherently competitive. Consistent with views expressed in the 2004 review, the Commission is likely to have the best information and incentives to make the choices regarding the allocation of resources between enforcement of the Commerce Act versus enforcement under the Fair Trading Act (and CCCFA). A single output expense provides the Commission with the flexibility it needs to make the appropriate trade-offs in this regard.
- Unlike sector specific regulatory responsibilities in relation to the energy and telecommunications sector, the enforcement of general markets regulation is not funded by levies. Accordingly, there is not the need to separate regulatory activities into distinct output expenses so as to provide appropriate disclosure of costs and their funding to levy payers.

- Ministers do not have direct statutory responsibilities in relation to activities which comprise the enforcement of general market regulations. Accordingly, there is not a need from this perspective to separate funding into different output expenses (e.g. one for the Minister of Commerce and another for the Minister of Consumer Affairs).

Enforcement of Telecommunications Sector Regulations

The previous review concluded that it is appropriate to have separate Vote funding for this output reflecting:

- The specific statutory responsibilities that can be exercised by the Minister (implying the need for the Minister to have more direct influence over the allocation of resources)
- The need for transparency to levy payers.

Although amendments to the Telecommunications Act 2001 in December 2006 have given the Commission increased regulatory powers, enabling it to take a more proactive role in promoting competition in this sector, the amendments have not affected the level of direct statutory responsibility of the Minister for Communications and Information Technology. Accordingly, the corresponding need for the Minister to play a direct role in the regulation of the telecommunications sector still exists. Accordingly, the review concludes that existing purchase arrangements remain appropriate.

The Energy Sector

The review concludes that the purchase arrangements for the Commission's energy sector outputs (excluding in relation to

EIRA) continue to lie somewhere between that for general markets and the telecommunications sector:

- the Minister of Energy has some specific regulatory responsibilities which argues for funding through Vote: Energy; and
- The Commission's responsibilities in this area continue to be levy funded. Funding through distinct output expenses (electricity and gas) assist with transparency as to the costs of regulatory activity in the energy sector.

Enforcement of Dairy Sector Regulations

Purchase arrangements governing the Commission's DIRA outputs also lie somewhere between that for general markets and the electricity and gas sectors.

The Minister of Agriculture does not have specific regulatory responsibilities and for this reason we do not perceive a need to go as far as establishing funding and purchase arrangements through Vote: Agriculture. The regulatory activities of the Commission are, ultimately, levy funded. Accordingly, a separate output expense within Vote: Commerce assists with the transparency that is needed for levy funded outputs.

Airports Regulation

Following recent amendments to the Commerce Act, the Commission will take on responsibility for the information disclosure regulatory regime that is to apply to Wellington, Christchurch and Auckland Airports.

This regime will be funded by an industry levy. Work is currently being done on developing this.

The Minister's role⁹ in relation to airports regulation is to recommend (following a recommendation by the Commission), that certain airport services be regulated. In this sense the Minister has some direct statutory responsibilities, but not to the same degree as the Minister for Communications and Information Technology with respect to the telecommunications sector.

Therefore it would appear that the need for separation or aggregation in relation to airports regulation is similar to that of the electricity and gas sectors, as:

- the Minister has some direct statutory responsibilities and it follows from this that the Minister needs some direct involvement over the allocation of resources relating to airports regulation. This argues for a separate output expense within Vote: Commerce; and
- the regulatory regime will be levy funded which increases the need for transparency with the level of cost incurred in regulating airports. Having a separate output expense appropriation assists in this regard.

Regulatory Principles, Guidelines and Rules

The development of regulatory principles, guidelines and rules is a relatively new area of activity for the Commission. The Commission has received additional funding for this area of

⁹ Based on the Commerce Amendment Bill as at the 5 Sept 2008.

activity, which has been split across three output expenses and two Votes, based on the three sectors this work is being directed at (i.e. airports, electricity and gas). This funding is to be recovered via an industry levy (\$1.69m from the gas and electricity sectors and \$1.31m from airports).

An issue is whether funding for this activity should be spread across two Votes and, within Vote: Energy, across the Enforcement of Electricity Sector Regulation and Control of Natural Gas Services output expenses.

The objective of this work is to develop regulatory guidelines, principles and rules in order to provide business certainty and predictability by providing clarity about such matters as calculating the weighted average cost of capital. Although the work is being directed across three sectors, the objective of this project is to ensure consistency of regulatory principles and their application across the three sectors. The first two phases of this work focus purely on generic, cross-sector principles and frameworks and as such there is a high level of commonality across the three sectors, and therefore strong economies of scope, i.e. frameworks and principles, once developed, should apply across all three areas of sector specific regulation. It follows from this that there is a need for tight coordination at the purchaser level. That is, it would not be efficient for two different purchasers to have differing views as to the scope of work required.

For this reason, the review considers that it would make more sense for there to be a single purchaser and purchase arrangement rather than the three arrangements with two Ministers currently in place. Accordingly, we propose a single output expense in Vote: Commerce (rather than Vote: Energy).

We note that funding is recoverable by a levy on the gas, electricity and airport sectors. This creates a need for a degree of transparency and accountability to levy payers which, in turn, could be seen as a reason for retaining separate appropriations through Votes Commerce and Energy. In our view, an appropriate level of transparency and accountability can be achieved through the use of separate outputs for each of the electricity, gas and airport sectors, within the proposed output expense in Vote: Commerce.

There is a risk that the Minister of Energy might perceive the proposed output expense as diminishing the Minister's purchase role. We consider that any issue in this regard can be handled through normal budget processes in that any initiative in one portfolio that impacts on the portfolio of another Minister will usually involve discussions between the relevant portfolios. Cross-portfolio impacts are not, of themselves, a reason for having separate purchase arrangements and separate Vote funding.

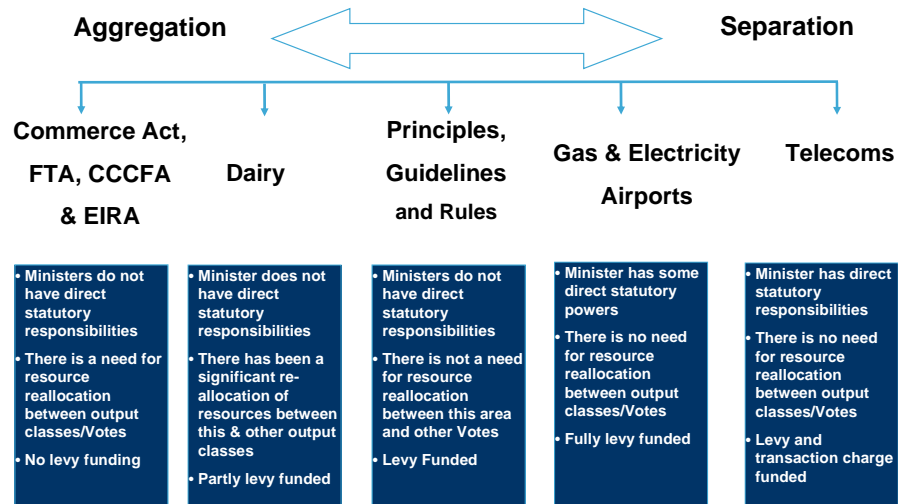
We have considered the option of providing the funding for regulatory principles, guidelines and rules through the output expense Enforcement of General Market Regulations. We consider that this option would also be acceptable provided that the activities were grouped and described as a distinct suite of outputs within this output expense (i.e. one each for electricity, gas and airports). We note that work on principles, guidelines and rules shares some of the characteristics of work on framework development and public information and education which are also outputs within the Enforcement of General Markets Regulation output expense.

Summary

The figure below summarises this review's conclusion as to the degree to which it is appropriate to either aggregate outputs under a single output expense or Vote, and the factors upon which this based. Key points to note are as follows.

- The need for separation continues to be strongest for the telecommunications sector work, with a high degree of aggregation appropriate for the general markets and EIRA areas, closely followed by work in relation to regulatory principles, guidelines and rules.
- The need for separation is somewhat stronger for electricity and gas, as the Minister of Energy has some statutory responsibilities in respect of the energy and gas sectors. This argues for escalating decisions regarding resource allocation up to the level of Ministers rather than leaving this solely within the ambit of the Commission. Levy funding in these sectors reinforces the desirability of separation.
- A separate output expense for enforcement of dairy sector regulations is appropriate in light of levy funding for these activities, although having this appropriation under Vote: Agriculture is not warranted given that the Minister of Agriculture does not have specific regulatory responsibilities.
- The need for separation or aggregation in relation to airports regulation is similar to that for the electricity and gas sectors, as the airports regulatory regime will be levy funded and the Minister has some statutory responsibilities (although not as wide ranging as those in the Telecommunications sector). A separate output expense within Vote: Commerce is recommended accordingly.

Assessing the Appropriate Balance Between Aggregated and Separated Output Expenses and/or Votes



6 Other Aspects of Purchasing and Accountability

Introduction

During the course of this review we noted a number of areas of the Commission's purchasing and accountability arrangements (other than the Vote and output expense structure) where improvements could be made. This section discusses those areas, along with comments on the areas for improvement noted in the last review.

Finalisation and signing of Output Agreement

We note that the 2008/09 Output Agreement is yet to be finalised by the Commission and purchasing Ministers. We understand from discussions with the Commission that it is currently in the final stages of being agreed, but given that this document covers the period 1 July 2008 to 30 June 2009, we would expect it to have been finalised well before now (September 2008).

Output Structure

Output and Sub-output Definition

As part of the previous review it was noted that the output structure was based around the task undertaken (investigation, adjudication, litigation), with sub-outputs, to a limited extent, broken down by the nature of the regulatory problem. The current output structure is based on the nature of the regulatory problem (in general to a greater degree of specificity than previous sub-outputs), with the sub-outputs providing information as to the action taken by the Commission.

This structure provides a closer alignment with statutory responsibilities and by implication closer alignment with addressing the types of economic conduct that comprises competitive outcomes (e.g. cartels, unilateral conduct and mergers that lead to the substantial lessening of competition).

The Commission has also segregated outputs in general markets for FTA and CCCFA, with a separate output for FTA cases as opposed to CCCFA cases. This is a useful improvement as it provides monitors with a richer picture of the mix of approaches taken, and allows performance issues to be identified in a more useful way.

The 2004 review noted that performance measures for CCCFA and FTA activity were grouped together under the same sub-output. It was recommended, recognising the increasing importance of the Commission's CCCFA responsibilities, that activity in relation to CCCFA be reported separately. The Commission has achieved this by, as part of its new output and sub-output structure, creating a separate set of outputs for CCCFA and FTA.

EIRA Outputs

Activity carried out by the Commission under the EIRA forms part of the Enforcement of General Market Regulation output expense. However, there is not a specific output or set of outputs for this activity. There is a sub-output for EIRA determinations, but only in relation to the timeliness performance measure. Although the nature of this activity is, in general, analogous to general markets market structure activity, and the previous section concluded that a separate output expense was not necessary, we would recommend a separate set of outputs for EIRA activity (i.e. EIRA cases, Determinations, Framework

Development and Public Information / Education). EIRA activity is purchased by the Minister of Commerce on behalf of the Minister of Energy, and a separate set of outputs would provide improved transparency and visibility, without a material reduction in flexibility for the Commission to re-allocate resource. The Commission should also be reporting timeliness, quantity, quality and cost information in respect of its EIRA related activity.

Framework Development Outputs

As part of its work, we would expect the Commission to:

- provide comment on policy developed at the Ministry level (sometimes referred to as big “P” policy). In general, however, Crown entities and regulators should not be the primary developers of policy; and
- lead the development of operational policy that gives effect to policy developed at the Ministry level (i.e. little “p” policy).

The following table summarises the roles of the Commission and the Ministries with regard to the development of policy and operational policy.

	Development role	Comment role
Policy	MED & Policy Ministries	Commerce Commission
Operational Policy	Commerce Commission	MED & Policy Ministries

Subsequent to the 2004 review, the Commission has added “framework development” outputs to each of its output expenses. These outputs appear to comprise Commission activity in relation to policy and operational policy.

The output descriptions in the Commission’s Output Agreement do not, however, provide a clear enough distinction between policy (with a big “P”) and operational policy. To address this, and as a first-best option, we recommend that the Commission consider splitting its framework development outputs into two separate outputs; one in relation to the Commission’s role in commenting on policy development, and the other for the development of operational policy by the Commission.

If this recommendation is not accepted, then as a second best option we recommend that the descriptions for the framework development outputs be amended in the Output Agreement to more clearly identify Commission activity in relation to policy, as opposed to operational policy.

Output numbering system

We note that the numbering system used to identify the output expenses and outputs in the Commission’s Output Agreement could be refined to ease understanding. The following table sets out the current numbering system used for output expenses, and our recommended approach. Key points to note are:

- the 3 outputs (across 3 output expenses) relating to the development of regulatory frameworks and principles are all numbered 17.2; and
- the outputs under the Enforcement of General Market regulation output expense are prefixed with 11 (for competition outputs), 12 (for FTA and CCCFA outputs) and 17 (for regulatory principles, guidelines and rules outputs).

Vote	Output Expense	Current Number	Recommended Number
Commerce	Enforcement of General Market Regulation	11, 12 & 17	1
Commerce	Enforcement of Dairy Sector Regulation	16	2
Communications	Enforcement of Telecommunications Sector Regulation	13	3
Energy	Enforcement of Electricity Sector Regulation	14 & 17	4
Energy	Control of Natural Gas Services	15 & 17	5

Outputs within each output expense should also be sequentially numbers (i.e. 1.1, 1.2 ...2.1, 2.2 etc).

Accountability – Enforcement of Dairy Sector Regulations

We note that the Commission has, for several years, consistently underspent its appropriation for the enforcement of dairy sector regulations. In the baseline report which accompanies this report, we have noted concerns about the low level of expenditure in this area.

We are also concerned that in its Statement of Intent, the Commission has chosen to recognise a level of revenue for this output which is below the level of the appropriation (specifically, the Commission has recognised revenue of only \$0.3 million compared to appropriation of \$0.905 million). In our view, this is not consistent with NZ IFRS and, leaving aside the interpretation of NZ IFRS, we consider this is inconsistent with Parliament's expectation that the Commission will deliver regulatory enforcement services to the tune of \$0.905 million. The accountability of the Commission should be against \$0.905 million; not \$0.3 million.

Performance Measures

In the previous review it was noted that performance measures in relation to CCCFA enforcement activity were grouped with those for FTA enforcement activity. The CCCFA was, and continues increasingly to be a significant area of activity, and on materiality grounds, it warrants separate recognition rather than being included as part of Fair Trading Act activity. The Commission, reflecting this and the restructuring of the outputs mentioned previously, now has a separate set of outputs and performance measures for FTA, CCCFA (and competition) related activities.

Performance Targets

We note that for each year since the previous review, the Commission has fallen short of several of the quantity and timeliness performance targets set in its Output Agreement and Sol. This suggests that there is a need to regularly review performance targets to ensure their continued relevance. We would expect the Commission to engage with the Ministry in relation to amending these targets from year to year as required.

Accountability versus Information Performance Measures

There are a large number of performance measures in the quarterly reports and Output Agreement. It is important to distinguish between accountability performance measures, against which the Commission should be held accountable, and performance measures which only provide information to assist monitors and Ministers in understanding the performance of the Commission.

It is not clear in the Output Agreement or in quarterly reports whether each of the Commission's current performance measures are 'accountability' or 'information' measures. It would be inappropriate (in terms of the sheer number of performance measures) for them to all be formal accountability measures. We recommend a clear identification of each performance measure as either an accountability or information performance measure in the Commission's accountability documentation, and consideration of the appropriate number (and mix) of accountability performance measures.

Impact Measures

The Crown Entities Act 2004 requires Crown Entities to have regard to the impact, or outcomes to which the outputs they produce contribute. Consistent with the intent of the Act, the Commission's most recent Annual Report includes qualitative (and to some degree quantitative) commentary in relation to the impacts of Commission activity. To continue to develop a focus on impacts in its accountability documentation, we recommend that the Commission seek to include outcome focussed performance measures in its Output Agreement and quarterly reports (as opposed to only including output focused performance measures, such as those in relation to the quantity, quality and timeliness of output production). This is an issue for both the Commission and its monitors to work on together.

Quality of Key Accountability Documents

Clearly, there is a need for the Commission to maintain high levels of transparency regarding the services that the Commission expects to deliver (as specified in the Output Agreement) and the services actually delivered and paid for by the Crown and levy payers. There are a number of areas where

the Commission has made improvements, but also a number where there is scope for further enhancement. These are discussed below.

Level of Detail of Cost Information

Our previous review recommended that cost information at the output expense and output level be included in both the Commission's output agreements and its quarterly reports. Our review of the Commission's recent accountability documentation has indicated that this is now occurring.

Transparency around Re-allocation of Resource in Quarterly Reports

Our previous review noted that there was limited transparency around the re-allocation of financial resource during the year in the Commission's quarterly reports. We note that the Commission's recent quarterly reports have addressed this, by reporting financial information for actual spend, budgeted spend (SOI), and re-forecast spend. A comparison of budgeted spend against re-forecast spend provides monitors with a picture of the degree to which re-allocation has occurred.

Documentation of the Nature of the Devolved Purchasing Arrangements in the Output Agreement

The Output Agreement notes that the Minister of Commerce purchases services on behalf of the Ministers of Energy, Consumer Affairs and Agriculture¹⁰. However it does not specify **which** services (or outputs) are purchased on behalf of which

¹⁰ 2008/09 Draft Output Agreement, s1.1.

Ministers. We recommend, from a transparency perspective, that the Commission explicitly document these arrangements in its Output Agreement.

Variance Analysis in Quarterly Reports

The executive summary section of the quarterly reports include a 'variance analysis', which discusses the various areas where the Commission is not 'on budget' (both in financial and non-financial terms). There are four elements we would expect to see in a variance analysis:

- clear identification of the nature and cause of the variance;
- an indication as to the significance of the variance;
- an indication as to whether the variance is likely to reverse within the course of the current financial year or be permanent; and
- for significant, permanent variances, a statement as to the Commission's intended course of action (if any) to manage and mitigate the variance.

Based on our review of the Commission's recent quarterly reports, the Commission appears to be doing the first three well, but the 4th is done to a limited extent only. We recommend that the Commission incorporate into its variance analysis a statement setting out its proposed course of action (if any) in relation to each significant and permanent variance.

'Traffic Light' Summary in Quarterly Reports

We also recommend that the Commission include a one page, 'traffic light' summary of the key messages in each quarterly report, to provide readers with a clear and concise overview of areas with no problems (green), areas to be aware of (amber), and areas for concern (red).

7 Recommendations

Finalisation and signing of Output Agreement

We note that the 2008/09 Output Agreement is yet to be finalised by the Commission and purchasing Ministers. We recommend that the Commission work with the Ministry to finalise the 2008/09 Output Agreement as soon as possible. We also recommend that in future years the Output Agreement be signed-off prior to the start of the relevant financial year.

Output Structure

We recommend that the output structure be modified by:

- adding a separate set of outputs for EIRA related activity, within the Enforcement of General Market Regulation output expense, to provide improved transparency to the Minister of Energy;
- combining the appropriations for work on regulatory principles, guidelines and rules into a single output expense under Vote: Commerce;
- adding a separate output for airports regulation within the Enforcement of General Market Regulation output expense;
- splitting framework development outputs into two distinct outputs; the first in relation to the Commission's role in commenting on policy developed at the Ministry level, and the second for the development of operational policy by the Commission to give effect to policy and legislative frameworks; and

- re-numbering the Commission's output expenses and outputs in a more systematic way.

Performance Measures

The performance measures utilised by the Commission in its accountability documentation could be improved by:

- regularly reviewing its performance targets, to ensure their continued relevance;
- identifying each performance measure in the Commission's accountability documentation as either an accountability measure or an information performance measure;
- reviewing the appropriate number (and mix) of accountability performance measures; and
- further developing outcome and impact performance measures to supplement the output focused quantity, timeliness and cost measures currently found in the Statement of Service Performance and Output Agreement.

Quality of Key Accountability Documents

There are a number of areas where the Commission's accountability documentation can be enhanced. We recommend that the Commission:

- include a one page, 'traffic light' summary of the key messages in each quarterly report, to provide readers with a clear and concise overview of areas with no problems (green), areas to be aware of (amber), and areas for concern (red);

- as part of its variance analysis, (in the executive summary of its quarterly reports), include a statement as to the Commission's intended course of action (if any) in relation to any significant, permanent variances; and
- in the body of the Output Agreement, specify which outputs that the Minister of Commerce purchases on behalf of the Ministers of Energy, Consumer Affairs and Agriculture.

Implementation

We recommend that the Ministry of Economic Development and the Commission establish a joint review team, to be responsible for implementing the recommendations of this review.

Appendix 1: Key Terms of Business and Restrictions

This Report has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose.

This Report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this Report and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the Commerce Commission. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this report are based on information available as at the date of the report.

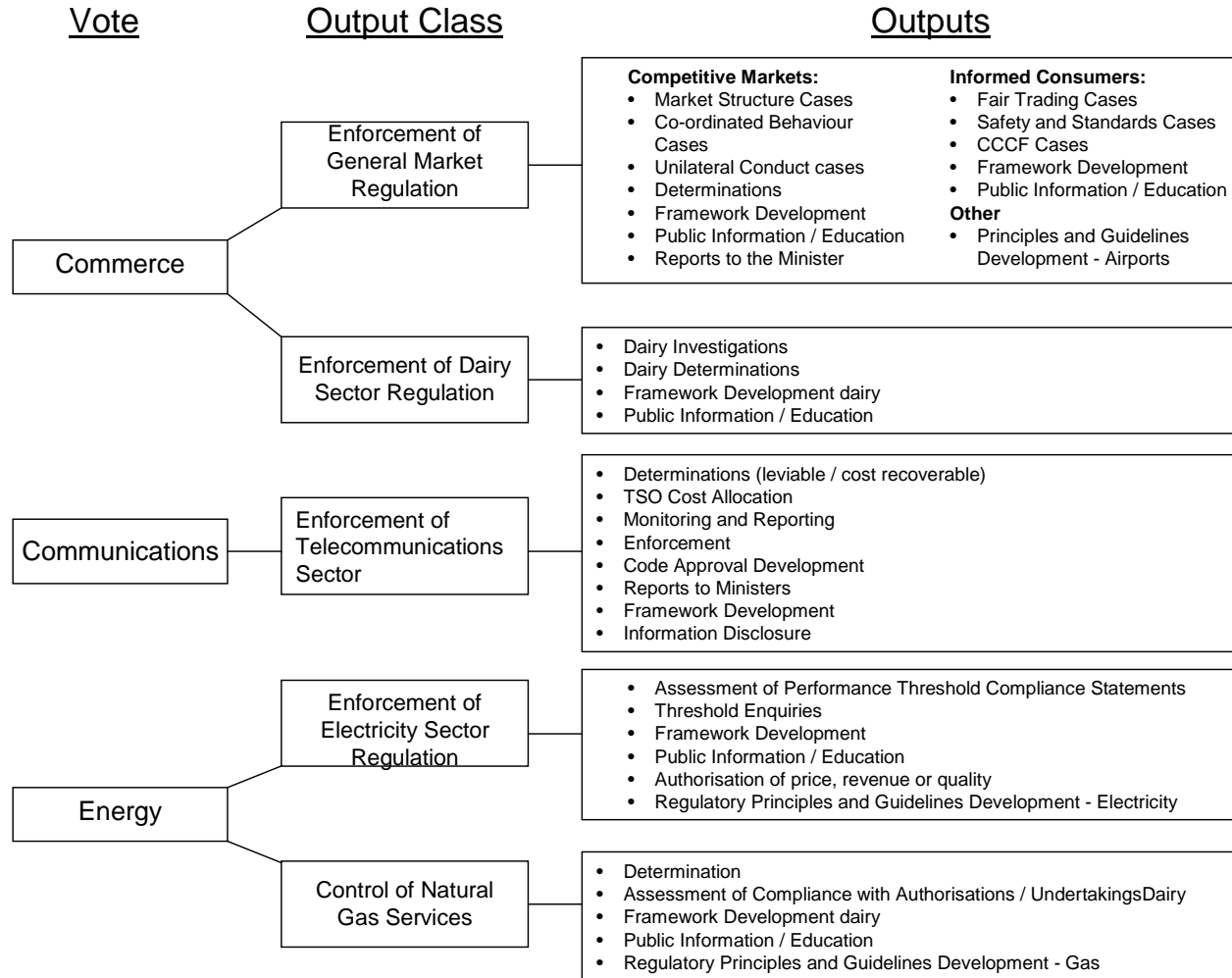
We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this report was not brought to our attention, or subsequently comes to light.

This report is issued pursuant to the terms and conditions set out in the services agreement between PricewaterhouseCoopers and the Ministry of Economic Development dated 5 May 2008.

Appendix 2: Glossary

Appropriation	An appropriation is a parliamentary authorisation for Ministers to incur an expense or liability.
CCCFA	The Credit Contracts and Consumer Finance Act 2003
The Commission	The Commerce Commission
DIRA	The Dairy Industry Restructuring Amendment Act 2001
EIRA	The Electricity Industry Restructuring Amendment Act 2001
FTA	The Fair Trading Act 1993
Litigation Fund	The Litigation Fund Other Expense Appropriation under Vote: Commerce
Output Expense	An output expense is a type of appropriation. Output expenses are costs or expenses incurred by departments and Crown entities in providing a group of similar outputs (goods and services).
Output	Outputs are the goods or services produced by a department or Crown entity. Outputs produced by the Commerce Commission are specified in the Output Agreement with Ministers, such as Output 1: Investigations.
PFA	The Public Finance Act 1989
Sub-Output	Sub-Outputs are sub-groups of the Outputs produced by a department or Crown Entity. An example of a sub-output for the Commerce Commission is Sub-Output 1.1 Market Behaviour Investigations.
Vote	A Vote is a grouping of one or more appropriations that are the responsibility of one Minister of the Crown and are administered by one department.
Purchase Minister	The Minister responsible for the appropriations of a Vote.
Responsible Minister	The Minister responsible for the financial performance of a department or Crown entity.

Appendix 3: Current Commerce Commission Output Structure



Appendix 4: Recommended Commerce Commission Output Structure

