



Good practice guide

Principles
to underpin
management by
public entities
of funding to
non-government
organisations

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Principles to underpin management by public entities of funding to non-government organisations

This is a good practice guide
published under section 21 of the
Public Audit Act 2001.

June 2006

ISBN 0-478-18164-7

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Auditor-General's overview

In recent years, more public attention has been focused on the effectiveness of public entities' funding arrangements with non-government organisations (NGOs).

Most public entities have their own policies and procedures to guide any funding arrangements they have with third parties. Also, there is a range of useful guidance for public entities to follow to ensure that public resources are applied for the optimal public benefit – notably, the Treasury's *Guidelines for Contracting with Non-Government Organisations for Services Sought by the Crown*.

I decided to publish this good practice guide to further enhance public entities' existing practices. It complements the existing guidance about NGO funding arrangements by taking a principles-based approach to guide public entities' decisions when they enter into funding arrangements with NGOs.

The guide has been developed for both the central government and local government sectors – and I expect all public entities to demonstrate that they have considered and acted in keeping with these principles.

Public entities are accountable for their performance and use of public resources whether they use those resources directly themselves, or whether the resources are disbursed to a third party. Where funding arrangements with third parties are used, public entities are accountable for the measurable achievement of the goals that the funding arrangements were designed to meet. At the same time, I recognise that public entities must manage their business within the resources available, and have therefore suggested a risk-based approach to managing funding arrangements with NGOs.

NGOs operate in a wide range of areas involving central and local government – from economic development to social services, recreation and culture. NGOs do not form part of the public sector (even though some of them may be heavily reliant on public funds for their revenue). NGOs have charitable purposes, are independent, and often draw heavily on voluntary contributions of both time and money.

The principles contained in this guide are not exclusively applicable to funding arrangements with NGOs. Rather, I encourage public entities to consider the principles of lawfulness, accountability, openness, value for money, fairness, and integrity in their decision-making about all of their funding arrangements, including those with the private sector.

The principles in this guide cannot be applied equally in all circumstances. That is why "how to" procedural guidance is not always appropriate and could sometimes be counter-productive.

Public entities need to assess funding arrangements on the basis of best possible public benefit. They need to be aware of the principles, and of any compromises that need to be made between principles in order to achieve the best possible public benefit. They must manage the risks inherent in doing so, and be open and transparent about their decisions.

There is tension between the principle of accountability, the principle of openness, and the trust relationship set out in the Government's commitment to a genuine partnership with the community and voluntary sector. While relationships or partnerships are not included as principles in this guide, I do consider that relationship-building is essential for the effective operation of public entities' funding arrangements with NGOs.

Collaboration and partnership between local and central government public entities and communities is now often expected if public policy objectives are to be realistic and achievable. However, I acknowledge that strong and sustainable relationships and, most particularly, partnerships, may be difficult to achieve where there are major disparities between public entities and NGOs in terms of relative power, size, and governance structures.

Once a decision is taken that public resources can be best applied for the public benefit through funding arrangements with NGOs, public entities should seek to understand the context that NGOs operate in, and work with them to identify and manage the risks to both parties of entering into funding arrangements.

There are increasing expectations about what acceptable conduct is for public officials and what constitutes the responsible use of public resources. Public entities need to recognise and respond to these expectations when they enter into funding arrangements with NGOs. The dynamic relationship between the principles set out in this guide, the need to take a risk-based approach (because no one size fits all), and effective relationship management must all be taken into account in managing public resources responsibly.

I wish to thank the various individuals and public entities that we sought advice and feedback from during the preparation of this guide.



K B Brady
Controller and Auditor-General

22 June 2006

Part 1

Introduction

- 1.1 This good practice guide sets out the principles that the Auditor-General expects public entities to consider – and act in keeping with – to manage funding arrangements with non-government organisations (NGOs).
- 1.2 While public entities could usefully consider the Auditor-General’s principles for all of their funding arrangements (including those that they have with the private sector), this guide has a specific focus on the principles that should underpin funding arrangements between public entities and NGOs.
- 1.3 The emphasis in this guide is mainly on the use of public funds. However, the principles apply to the use by NGOs of any public resources – for example, land, buildings, staff time, or assets.
- 1.4 The Auditor-General’s principles for good management of public resources are outlined in paragraph 1.15, and explained in detail in Part 3. We have also created 4 typical scenarios to show how the principles might be applied (Part 4). In Part 2, we describe NGOs and typical funding arrangements.

Why have we prepared this good practice guide?

- 1.5 We have previously published good practice guidelines for procurement of goods or services by a public entity,¹ and reported on several occasions our concerns about the management of contracts and other funding arrangements with NGOs.
- 1.6 During our audits of public entities in the past 2 years, we have also reviewed, at a high level, the management of public entities’ funding arrangements with NGOs. In our report *Central government: Results of the 2003-04 audits*,² we indicated that we intended to carry out further work in this area.
- 1.7 Public sector reform in the past 20 years has led to a broadening of the base of service delivery, both in New Zealand and overseas. NGOs are now frequently involved in delivering public services, influencing policy design and implementation, or performing a facilitative role to ensure that government objectives are met.³

Public entities are accountable for public resources used by NGOs

- 1.8 The public expects that public resources, including those funds derived from taxes and rates will return value for money – that is, that they will be managed lawfully, competently, and to good (public benefit) effect. The public also expects that public resources will be managed with integrity.

¹ *Procurement: A statement of good practice*, 2001.

² Parliamentary paper B.29[06a], March 2006.

³ Robert Buchanan and Colleen Pilgrim, *Transparency and Accountability in Government Decision-Making: Devolved Service Delivery*, May 2004. Paper prepared for the Conferenz 6th Annual Public Law Forum, see www.oag.govt.nz.

- 1.9 The Auditor-General gives Parliament and the public independent assurance over the use of public resources. This assurance includes an annual audit⁴ of the financial statements of all government departments, Crown entities, State-owned enterprises, local authorities, statutory boards, and other public bodies, including bodies that are controlled by any of these organisations. We refer to all of these collectively as “public entities”.
- 1.10 However, the roles and responsibilities of public entities have changed, especially in the past 20 years. Activities that were once carried out by public entities are increasingly carried out by NGOs on behalf of public entities.
- 1.11 A different set of risks arise when a public entity funds another organisation to deliver services on its behalf. A public entity still has responsibilities and obligations when it devolves public funds in this way. The public entity still needs to ensure that the NGO puts the public funds it receives to good use, and that the arrangement to manage the funding and the relationship between the NGO and the public entity is effective.
- 1.12 When NGOs receive public resources – most commonly through funding arrangements such as grants and contracts – it must be for the public benefit.
- 1.13 The Auditor-General has an interest (as the auditor of public entities) in ensuring that public entities make good use of their resources. However, the Auditor-General is not the auditor of NGOs that may receive grants or funds from those public entities.
- 1.14 Public entities are accountable for taking appropriate measures to ensure that public funds devolved to NGOs are used lawfully, effectively, efficiently, and with integrity. The Auditor-General is able to report to Parliament on how well public entities do this.
- 1.15 The Auditor-General expects public entities to show that they have entered into and managed funding arrangements with NGOs according to the following principles:
- **Lawfulness:** Have activities, resourcing, and accountability requirements been undertaken within the authority granted by Parliament?
 - **Accountability:** Have public entities given full and accurate accounts of their activities? Are governance and management arrangements suitable to address any concerns?
 - **Openness (transparency):** Is the nature of the funding arrangement, and the way in which it was entered into, clear to all parties?
 - **Value for money:** Are resources used effectively and efficiently, without waste, and in a way that optimises the public benefit?

4 An annual audit attests that an entity's financial statements comply with generally accepted accounting practice.

- **Fairness and Integrity:** Are public entities and NGOs that are involved in funding arrangements together meeting Parliament's and the public's expectations of an appropriate standard of behaviour in the public sector?

- 1.16 We recognise that a public entity must manage its business within the resources available. It must also operate in an environment of high – and often increasing – expectations about what is acceptable conduct for public officials, and what constitutes the responsible use of public resources.
- 1.17 We expect a public entity that is relying on an NGO to deliver public services and/or funding an NGO to demonstrate that it has considered and acted in keeping with these principles. The public entity is also responsible for showing this in respect of the work that the NGO does, where the NGO is delivering services on behalf of the public entity.

Management needs to be risk-based

- 1.18 Accountability requires a public entity to actively manage the risks involved in devolving resources and activities to an NGO. However, there are many competing risks – for example, lack of transparency from under-reporting versus high compliance costs.
- 1.19 This means that a “checklist” or “template” approach to managing funding arrangements may not be appropriate. Further, if there is to be value for money, there must be a balance between funding the administration of a policy, and funding that delivers benefit to the end user. The approach must be adapted to the particular situation.
- 1.20 Sometimes, to use the available resources for the most benefit to the end user, the funding arrangements will be less than optimal. An example would be where the most suitable provider has an inadequate governance or management structure. The public entity will need to assess the risks in any such arrangement, and make appropriate provision to manage them. It will need to be open about the reasons why the arrangements are less than optimal, and demonstrate how improvements will be sought.

How does this good practice guide differ from existing guidance?

- 1.21 There is other guidance available on the management of funding arrangements with NGOs.
- 1.22 The Treasury has a responsibility to ensure that all government departments and Crown entities are aware of, and take into account, best practice principles

in the management of public resources. The Treasury provides guidance on the contracting relationship with NGOs, as well as advice on good monitoring processes. This guidance is of interest to other public sector agencies.

- 1.23 The State Services Commission advises on state services management issues, and defines and promotes good practice in several areas.
- 1.24 Our good practice guide supplements the guidance of the Treasury and the State Services Commission.
- 1.25 Some government departments also have guidance, policies, and/or procedures in place on procurement or contracting. This documentation usually aims to be consistent with the Treasury guidance, or to reflect the findings of our reports, or both – for example, the Ministry of Social Development and the Ministry of Health adopt this approach.
- 1.26 The Office of the Community and Voluntary Sector, administered by the Ministry of Social Development, has a website on good practice funding, and is available to provide guidance to public entities and NGOs.
- 1.27 Such guidance has tended to focus on the processes of good practice, and providing “rules” around those processes, rather than focusing on the underlying principles.
- 1.28 In our view, because of the variety of public entities and NGOs, there is no single form or set of procedures that would be optimally effective for the good management of all funding arrangements with NGOs.
- 1.29 We also consider that, if there are prescribed rules for funding NGOs, there is a risk that the rules will be too onerous for both the funder and the NGO to put into effect.
- 1.30 In our view, putting the focus on understanding and using the principles for good management of public resources will help public entities to apply their limited resources to best effect.

How this good practice guide fits with our procurement guidance

- 1.31 “Procurement” is often used to refer to only the purchasing element of a funding arrangement. It may not necessarily encompass the whole of the life cycle of that arrangement, although, in our view, it should.
- 1.32 We expect our procurement guidelines (see paragraph 1.5) to be a benchmark for appropriate procurement practice, with both NGOs and other organisations. We also expect public entities to consider the principles outlined in this good practice guide in regard to their own procurement practices.

Life cycle of a funding arrangement with an NGO

- 1.33 The guidance already available has tended to focus on the best practice to follow at various stages throughout the life cycle of contracts with NGOs.
- 1.34 For example, the Treasury document *Guidelines for Contracting with Non-Government Organisations for Services Sought by the Crown* (the Treasury Guidelines document), is structured around the main stages of the contract life cycle, although it states that the guidelines may also be useful to public entities and NGOs that enter into other types of funding arrangements (such as grants).
- 1.35 The Treasury Guidelines document sets out 6 main stages in the life cycle of a contracting arrangement:
- planning for the funding arrangement;
 - selecting a provider;
 - negotiating the terms of the arrangement;
 - managing and monitoring the arrangement;
 - reviewing and evaluating the arrangement; and
 - starting over.
- 1.36 In our view, there is a close association between the second and third stages (selecting a provider and negotiating terms), and the last 2 stages (review and evaluation, and starting over). We see the life cycle of the funding arrangement between a public entity and an NGO as a 4-part process (see Figure 1).

How did we prepare this good practice guide?

- 1.37 To prepare this good practice guide, we first reviewed:
- the results of our recent relevant audits;
 - the guidance provided by the Treasury and the Office of the Community and Voluntary Sector;
 - overseas literature on the management of public funding to NGOs; and
 - guidance provided by Auditors-General in Canada, Australia (State and Federal), the United Kingdom, and the United States, from 1996 to 2005.
- 1.38 Next, we drafted a document, emphasising the underlying principles of lawfulness, accountability, openness, value for money, fairness, and integrity.
- 1.39 We then sought feedback on the draft document to gauge whether the principles were reasonable. We also queried the degree of change that public entities – and particularly those most involved in funding relationships with NGOs – would need to make if they were to adopt policies and practices consistent with our principles. Feedback was sought from:
- the Treasury (including the Crown Company Monitoring Advisory Unit);

Figure 1
Life cycle of a funding arrangement between a public entity and a non-government organisation



- the State Services Commission;
- the Office of the Community and Voluntary Sector;
- the Institute of Internal Auditors New Zealand Incorporated;
- the New Zealand Institute of Chartered Accountants;
- Audit New Zealand, and other selected audit providers;
- District Health Boards New Zealand;
- the Society of Local Government Managers;
- Local Government New Zealand;
- the Department of Internal Affairs;
- the Ministries of Education, Health, and Social Development;
- the New Zealand Agency for International Development; and
- a district health board.

1.40 We also received comments from a number of individuals active in, and with experience of, NGOs.

Part 2

Types of funding arrangements and relationships with NGOs

2.1 In this Part, we discuss:

- what an NGO is;
- typical funding arrangements with NGOs; and
- particular relationship considerations for public entities and NGOs.

What is a non-government organisation?

2.2 There are several ways of defining an NGO; some use the term in its wider sense to mean any organisation that is outside the government (whether or not it has a commercial interest). More usually – and we have taken this approach – the term is used in the sense of a not-for-profit organisation.

2.3 We have based our definition of an NGO on work by Statistics New Zealand on the definition of not-for-profit organisations,¹ and the *UN Handbook on Non-profit Institutions in the System of National Accounts*.²

2.4 On this basis, we use the term NGO in this guide to mean an organisation that is:

- **Independent of government** – The organisation is not part of government (either central or local) and does not exercise governmental authority in its own right. However, it does exercise its own authority in all matters relating to its own governance – that is, advocacy, policies, and procedures. The organisation may receive significant financial and/or other support from the Government, and it may have public officials involved in its governance. However, it has enough discretion in managing both its generation of funds and its use of funds, that its operating and financing activities cannot in practice be fully integrated with government finances. We acknowledge that the distinctions between the public and private domains are not always clear. In our view, and for the purpose of this good practice guide, some of the distinguishing features of organisations independent of government are that they have no regulatory or taxation powers and that they have no direct responsibility for the management of the expenditure of rates and tax revenue.
- **Self-governing** – The organisation is able to control its own activities, and is not under the effective control of any other body. It controls its management and operation to a significant extent, appoints its own chief executive officer and its own staff, has its own internal governance procedures, and enjoys a meaningful degree of autonomy. It can set and change its governing rules, and alter its mission or internal structure without having to secure permission from anyone other than the relevant registration authorities.

1 Statistics New Zealand is using a structural-operational definition, based on 5 main criteria, to determine which organisations fall in and out of scope of the Not for Profit Institutions Satellite Account.

2 This 2003 publication was prepared in close collaboration with Johns Hopkins University Centre for Civil Society Studies and the Economic Statistics Branch of the United Nations Statistics Division.

- **Non-compulsory** – Membership and contributions of time and money are not required or enforced by law or otherwise a condition of citizenship or determined by birth. NGOs can perform regulatory roles that make membership necessary to practise a profession (for example, the New Zealand Law Society that licenses lawyers to practise law). But, as long as membership is not a condition of citizenship, as opposed to a condition of practising a chosen profession, the organisation can still be considered non-compulsory. By contrast, organisations in which membership, participation, or support is required or otherwise stipulated by law or determined by birth (for example, iwi) would be excluded from this definition of NGO.
- **Non-profit making** – NGOs are organisations that do not exist to produce profits for themselves, and are not chiefly guided by commercial goals and considerations. They may accumulate a surplus in a given year, but any such surplus must be reinvested in the basic mission of the organisation, and not delivered to the organisation’s owners, members, founders, or governing board.

- 2.5 An NGO is an organisation in the sense that it usually has its own legal personality (for example, an incorporated society). Even if it does not have any formal legal status of its own, it will be recognised as an entity, with at least some degree of structure and measurable activity.
- 2.6 NGOs within the scope of the definition used for this good practice guide cover the spectrum in which local and central government are involved – from economic development, cultural, and recreational sectors to the more traditional sectors where NGOs assist government to achieve its objectives, such as social services, housing, education, and health.
- 2.7 Over time, a number of NGO “umbrella” groups have formed to support NGOs. Such groups assist their members with matters such as training, mentoring, and advocacy.

Typical funding arrangements with NGOs

- 2.8 Public entities, at both central and local government level, engage in different types of funding arrangements with NGOs. These arrangements range from grants that have very few conditions attached to their disbursement, to highly specified contracts for services that are paid by instalments against pre-set milestones or after the required services have been delivered.
- 2.9 At central government level, the appropriation type authorised by Parliament for the public funding will, to a large extent, determine the type of funding arrangement that the public entity will use to disburse the funding.

The funding continuum

- 2.10 Figure 2 shows the continuum of different types of funding arrangements, and the main distinctions between them. This good practice guide has been prepared with the funding continuum in mind.

Figure 2
The funding continuum

Unconditional grants	Conditional grants	Relational contracting	Classical contracting
Limited or general unspecified expectations of performance	Some specified expectations of performance	High expectations of an ongoing relationship	Potential for future relationship not necessarily a driver
		Detailed performance specifications. Accountability is enforceable. Currently – a shift to clearly linking activities purchased to outcomes.	

This diagram has been adapted from: Lawrence, H.D.V. (2005), *Funding the Community and Voluntary Sector*, The Office of the Community and Voluntary Sector presentation to Taranaki Funders' Forum, 26 April 2004.

- 2.11 In our view, the principles in this good practice guide are as applicable to an unconditional grant as they are to a conditional grant and a traditional or “classical” form of contract.
- 2.12 The scenarios in Part 4 provide some insight into how the principles can be applied in some of the different types of funding arrangements that exist within the funding continuum.
- 2.13 No matter what type of funding arrangement is used, it is critical that a public entity considers the risks; and plans, negotiates, manages, and monitors the funding arrangement in such a way that the public entity can be held to account for its effective and efficient use of those public funds.

Particular relationship considerations

Distinctive features of NGOs

- 2.14 NGOs are by definition not part of the public sector. Provision of public funding to them does not change this.
- 2.15 Using our definition, NGOs also have features that, taken as a collective set, mean that they differ significantly from public sector organisations or private sector companies.³ Those features may include:

³ Having noted this, public entities should consider the applicability of these principles for funding arrangements with for-profit organisations. However, this guidance has been specifically developed with public entities' funding arrangements with NGOs in mind.

- a charitable purpose;
- governance and staff are accountable to its members;
- inability to distribute profits from their operations, which gives them an objective different from that of for-profit corporations;
- involvement in producing public goods and services (as well as whatever private goods and services they may produce), but without exercising coercive or other statutory powers (for example, ability to levy rates);
- the use of volunteer as well as paid staff and, often, a revenue structure that can include large voluntary contributions of time and money;
- limited access to equity capital because of the prohibition on distribution of profits;
- in many countries, eligibility for special tax advantages; and
- legal rules about governance, reporting requirements, political participation, and related matters, separate from those for corporations.

Relationship and partnership considerations

- 2.16 While effective relationship management is not a principle in itself, it is important and does contribute to the effectiveness of the funding arrangement overall.
- 2.17 As noted in Part 1, public sector reform has led to a broadening of the base of service delivery, so NGOs are now frequently involved in delivery, policy, and facilitation in relation to public services.
- 2.18 The Government has acknowledged this situation in a statement about its intentions for relationships with the voluntary sector.⁴ The statement highlights the importance of relationships between government and community, voluntary, and iwi/Māori organisations being strong and respectful, and based on honesty, trust, and integrity. It also sets out the Government's commitment to fostering relationships that, among other things, recognise the independence of such organisations, promote effective 2-way communication between parties, and are founded on public accountability.
- 2.19 Therefore, we expect a public entity to use a collaborative approach that appropriately acknowledges the relationship that the Government currently expects between public entities and the non-government, not-for-profit sector.⁵
- 2.20 Some degree of collaboration and partnership between central and/or local government and communities is now expected if public policy objectives are to be realistic and achievable. To make policies realistic, policy choices around the

⁴ *Statement of Government Intentions for an Improved Community-Government Relationship*, December 2001, Ministry of Social Development.

⁵ See www.ocvs.govt.nz/about/government-intentions.html.

spending of public funds are usually made in consultation with those who are affected. NGOs often have a role in facilitating consultation with service users.

- 2.21 However, there is tension between the ideal of a collaborative partnership and the need for accountability for the stewardship of public resources. Even in a collaborative relationship, it is important for the accountability of the public entity to flow through to the NGO, and be reflected in the contractual arrangements.
- 2.22 Before the public sector management reforms of the past 20 years, there was a much lower level of accountability and transparency in the management of public resources. NGOs often received grants from public entities with little or no definition of, or insistence on, tangible outputs. Such arrangements were in line with the growing idea of partnership between government – both local and central – and community, especially in the delivery of social services.
- 2.23 However, the public sector reforms required accountability arrangements in general to be more “transparent”. This resulted in funding arrangements being made with NGOs that were increasingly contractual or quasi-contractual. Because of the pressure for accountability, public entities have tended to opt for a control approach when managing the risks in their relationships with NGOs. Contracts are seen as the way to achieve this control.
- 2.24 Where an NGO’s involvement in the delivery of services is a commercial arrangement, the usual forms of accountability – such as an arm’s-length commercial contract – would be appropriate.
- 2.25 Funding arrangements other than a formal, traditional contract might be more appropriate in some circumstances in a government–community partnership environment. However, just as a commercial arrangement does not prevent a high quality relationship, a partnership environment does not negate the need for a sound, business-like approach. Any transfer of public funds in return for consideration is, in law, a contract – even if contractual formalities are kept to a minimum. Any such agreements should be combined with a relationship that recognises the value and contribution of each partner.
- 2.26 Partnership is often aspired to in relationships between public entities and NGOs. However, it may be difficult to achieve a partnership where there are major disparities between the public entity and the NGO in terms of relative power, size, and governance structures. Where there is a partnership relationship, both parties need to keep each other’s interests in mind.
- 2.27 Sustaining the relationship becomes more important in a partnership, and requires different procurement strategies, management arrangements, and skills. Thought needs to be given to how to sustain the partnership, and balance the short- and long-term benefits of the relationship.

- 2.28 There may be tension about the nature of accountability in the public entity–NGO relationship. Public entities are accountable to Parliament – or to councils in the case of council-controlled organisations – and to the public, both in general and to service users in particular. An NGO is accountable to the public entity for the public funds that it receives, but also to its own “community”, and perhaps to other funders (other purchasers of services, or the general public where public donation is involved) and to service users. Yet an NGO, for capacity and/or capability reasons, may find it difficult to produce the level of information required by public entities for accountability.
- 2.29 The focus on accountability and openness has been a challenge for public entities and NGOs – for public entities in their ability to specify and monitor the use of public funds to the expected standard, and for NGOs in their ability to comply with reporting and other accountability requirements.
- 2.30 The government-NGO funding environment can also involve high risks and high costs. Relationships should be managed well – to manage the risks to the funds, but also to manage the risks to the end user in the event of a service failure.

Part 3

Principles for good management of public resources

A principles-based approach

- 3.1 Public resources should be applied for the best possible public benefit. Therefore, we expect public entities to be guided by certain principles when they manage public resources. These principles, in turn, will inform the development of the public entity's rules, policies, and procedures.
- 3.2 We expect public entities to demonstrate that they have entered into and managed funding arrangements with NGOs according to the following principles:
- lawfulness;
 - accountability;
 - openness (transparency);
 - value for money (resources are used effectively and efficiently, without waste, and in a way that optimises the public benefit);
 - fairness; and
 - integrity.

Dynamic relationship between the principles

- 3.3 The principles cannot be applied equally in all circumstances, which is why “how to” procedural guidance can sometimes be counter-productive.
- 3.4 A public entity needs to start from the basis that public resources should be applied for the best possible public benefit. It must be aware of where this compromises one or other of the principles, manage the risks inherent in doing so, and be open about it. Documenting decisions is important.
- 3.5 For example, a public entity may need – in the short term – to build the capacity of one particular NGO to deliver a service. If the public entity uses a non-contestable procurement approach, the principle of fairness is, to this extent, compromised (as far as existing potential suppliers are concerned). If the amount of funding involved is small, then the administrative costs to the public entity and to the NGO should be appropriately modest. Fairness to the NGO would to that extent have precedence over accountability.
- 3.6 We expect that the dynamic relationship between these principles, the need to take a risk-based approach, and effective relationship management will all be taken into account in managing public resources.

3.7 Individually, the principles can be explained as:

Lawfulness

Lawfulness

Public entities must act within the law, and meet their legal obligations.

3.8 Activities, resourcing, and accountability requirements must be undertaken within the authority of the Crown or any relevant legislation. A public entity must meet its legal obligations, and cannot contract out of them. For example, in central government, a Ministry cannot engage an NGO – using public funds – to lobby for a particular policy alternative, an activity which the Ministry is prohibited from doing.

3.9 The public entity also needs to be mindful of the NGO's legal obligations. For example, an NGO may have obligations within its trust deed which may not be over-ridden by the funding arrangement with the public entity.

Accountability

Accountability

Public entities should be accountable for their performance and be able to give full and accurate accounts of their activities, and have in place governance and management arrangements suitable to address any concerns.

3.10 There is much debate about compliance costs, for both funder and NGO, resulting from the need for accountability. Accountability is about performance and the measurable achievement of the goals that the funding arrangements were designed to meet.

3.11 To ensure that it can meet its accountability requirements, a public entity should keep sufficient records to show what it did, and why. Specifically, the records should show that the public entity:

- acted within its authority (for example, by documenting in the contract its authority to transfer funds to the NGO in return for the services to be provided);
- followed central or local government policy to the extent that it is required to do so;
- followed due process;
- gave due consideration to each potential service provider;

- observed the overall principles of equity and fairness; and
 - achieved value for money and optimal benefit to the end user.
- 3.12 The public entity's records should be readily accessible, both for good ongoing management, and for openness.
- 3.13 Where the funder's accountability responsibilities rely to a large extent on information provided to it by the NGO, this risk needs to be considered within the accountability arrangements between the public entity and the NGO.
- 3.14 From time to time, we are asked for our views on whether all NGOs applying for, or in ongoing receipt of, public funding should be required to provide audited annual financial statements to the funder.
- 3.15 We consider that this may not be a reasonable or justifiable request in all circumstances. It would not always be feasible, for example, for a small NGO to have its financial statements audited by a member of the New Zealand Institute of Chartered Accountants.
- 3.16 However, there are other forms of assurance that funders could seek from NGOs which would minimise compliance costs for both parties. In any case, public entities should take a risk-based approach to imposing such a requirement on an NGO, and use the principles contained in this good practice guide to inform their decision.
- 3.17 In the event that a public entity decides not to impose such a requirement on an NGO, it should be able to justify this decision.
- 3.18 These sorts of issues should be considered very early in and throughout the funding arrangement.

Openness

Openness

Public entities should act in a way that is – and is seen to be – transparent.

- 3.19 Transparent management throughout the life of the funding arrangement will ensure that:
- all parties to the funding arrangement understand and respect their own objectives;
 - all parties continue to understand and observe their obligations; and
 - benefits and value gained early in the funding arrangement are sustained throughout its life.

- 3.20 Openness depends on high standards of reporting and disclosure.¹ This has a dual benefit: it demonstrates that the public resource is being used properly, fairly, and effectively to the optimal public benefit; and the communication of risks to the NGO ensures that the NGO properly provides for present and future service delivery.

Value for money

Value for money

Public entities should use resources effectively, economically, and without waste in achieving their policies and end-user benefits.

Effectiveness and efficiency

- 3.21 The value-for-money principle involves several aspects, such as:
- balancing effectiveness with efficiency;
 - sustaining the funding arrangement (where this is desirable); and
 - demonstrating the competence of the public entity.
- 3.22 A public entity is accountable for using resources efficiently, to avoid wasting public resources. But this does not mean “lowest short-term cost”. Effectiveness and efficiency trade-offs may have to be made. Waste occurs when a service – no matter how cheap or expensive – is ineffective. Effectiveness and efficiency should be balanced to achieve value for money. By “value for money”, we mean the best possible outcome for the total cost, rather than the lowest cost.
- 3.23 As we note in Part 2, the costs and benefits of each arrangement must be evaluated in terms of what the public entity seeks to achieve – just as the public entity needs to assess, at the planning stage, whether an arrangement with an NGO is more or less appropriate than a commercial arrangement.
- 3.24 We expect a public entity to manage any risks to its own interests, and to use arrangements and processes such as monitoring, review, and evaluation to meet its need to demonstrate effectiveness and value for money.
- 3.25 At the planning stage, the public entity should be able to justify how it intends to apply the public funds. Further on in the life cycle of the funding relationship, it should also be able to demonstrate that the policy is having the desired effects, and that the money is not going to waste. If there are unintended outcomes from its policies, the public entity needs to be aware of these, and adapt its funding arrangements to take them into account.

¹ Securities Commission (2004), *Corporate Governance in New Zealand, Principles and Guidelines*, New Zealand.

- 3.26 The public entity must also be mindful of the cumulative effects of many small contracts in terms of waste through duplication of administration and monitoring. The public entity does not necessarily reduce risks by “splitting” funding between contracts.²

Tangible and intangible outcomes

- 3.27 It may be easier to justify the funding where outcomes, and the contribution of the funded services to these outcomes, are tangible – such as the specific health or welfare benefits of the services delivered. The choice of funding arrangement in this instance is likely to be contractual, and accountability for the outcome more easily demonstrated.
- 3.28 Nevertheless, the principle that public resources should be applied for the best possible public benefit still applies even where the desired outcome is less tangible. In the case of, for example, a “capability-building grant”,³ the questions “capability for what?”, “was capability improved?” and “how will we know?” still need to be answered.
- 3.29 Where there is less clarity as to the “deliverable”, both the public entity and the NGO may need to give more time during the negotiation stage to arriving at a clear understanding of how effectiveness is to be measured. (This also helps to ensure fairness in the treatment of the NGO.)

Suboptimal provider market

- 3.30 Some public entities operate in less than optimal situations, where there is no market of providers or where those that are available do not have quite the capability or capacity that is required. The public entity needs to acknowledge this, and take action to mitigate any risks that might arise. The actions taken, and the reasons for the actions, need to be documented.

Sustainability of the funding relationship

- 3.31 A public entity should take care that it does not put the continuity of a service unreasonably at risk in its pursuit of the lowest cost. For example, it should not exploit its negotiating position when there is only one potential supplier, or where the NGO relies substantially on its public funding.
- 3.32 A public entity should take into account the possible effects of its funding decisions on the number of NGOs available to supply a particular service, and on

² In our report, *Inquiry into the Ministry of Health’s contracting with Allen and Clarke Policy and Regulatory Specialists Limited* (December 2005), we note that a public entity needs to “ensure that consideration is given ... to the cumulative value and number of [low value] contracts” (page 7).

³ “Capability- or capacity-building grants” are grants made to providers to enable them to develop their ability to deliver public services more effectively, or to play a more effective role in community development.

their ability to deliver it. The public entity needs to fund the NGO at a rate that is fair and reasonable, and sufficient to sustain effective service delivery for the term of the arrangement, and not jeopardise long-term delivery prospects.

- 3.33 At the same time, the public entity should avoid accepting a “low-ball” or “loss-leading” tender that will not cover the costs, but is submitted to win the tender against a higher cost from an alternative supplier. The other suppliers’ cost estimates may perhaps be more realistically based on effective service delivery.

Competence and effectiveness

- 3.34 Another aspect of effectiveness is the competence of the staff of the public entity. We expect the public entity to be able to demonstrate that its staff members are well-trained and competent to manage public resources effectively.

Fairness

Fairness

Public entities have a fundamental public law obligation to always act fairly and reasonably. What public entities do should be open and impartial.

- 3.35 Where there are multiple providers who are capable of delivering the required services on behalf of the Government or local government, the public entity should give a fair opportunity to those NGOs to be selected to do so. This is comprehensively discussed in our procurement guidelines. The principle of fairness has some particular implications for selective (non-contestable or limited contestability) procurement, or where “capacity-building” grants are involved (discussed further in our scenarios in Part 4).
- 3.36 The public entity should also act reasonably in dealings with the NGO throughout the life cycle of the funding arrangement. This has several implications for the public entity. It means managing the tension between accountability, transparency, and high standards of reporting and disclosure on the one hand, and, on the other, managing the effects on the service provider of either compliance requirements or a failure of the policy to have the desired effect. Public entities should consider opportunities to use NGOs’ existing reporting requirements to other public entities before establishing separate accountability requirements for a “new” funding arrangement.
- 3.37 Compliance costs should be reasonable for a small NGO with restricted access to administrative resources, and recognise its commitment to ensuring that every dollar goes to supporting the service.

Monitoring effectiveness

- 3.38 The public entity needs to monitor the effect of its funding initiatives, and consider how everything funded contributes to the outcomes intended by the public entity. It is possible for a service to be delivered according to the funding arrangement in every way, and yet fail to make the intended difference. For example, an NGO may deliver services that change the eating habits of a target population, yet this does not result in reduced obesity in that population. The public entity needs to be able to determine the reasons for the policy failure, and if necessary, adapt or discontinue its funding initiative as a result. The process that the public entity uses to change the funding arrangements, should that be the case, should be fair and reasonable to the NGO.

Change of circumstances

- 3.39 Circumstances may also change which affect the adequacy of the original funding arrangements. For example, there may be circumstances where the initial expectations and agreements about the price for services to be delivered through a funding arrangement – such as those for a new or modified service – are insufficient to cover the “cost” of the services being provided. This may not become clear until the service delivery has begun.
- 3.40 In our view, funding arrangements need to be responsive to changing circumstances, provided that the relevant principles are still met and any decisions to deviate from initial agreements can be justified and are clearly documented.

Imbalance of power

- 3.41 The public entity and the NGO have different amounts of power in the relationship. The public entity is resourced directly by public funds, and influences the policy that underpins the funding arrangement. The NGO may depend on voluntary contributions of time and money, or it may depend on public funding, or a combination of both. It cannot direct the funding arrangement. To be fair and reasonable, the public entity should consider this power imbalance in the way in which it conducts the relationship.

Integrity

Integrity

Anyone who is managing public resources should do so with the utmost integrity.

- 3.42 Public entities and NGOs must meet Parliament’s and the public’s expectations of an appropriate standard of behaviour in the public sector. The public entity must

ensure that the NGO using the public resources is capable of, and is, managing the resources with a standard of conduct the public expects in the use of its taxes and rates.

- 3.43 A public entity should have policies and processes to underpin the highest standards of integrity – for example, a code of conduct; a policy on fraud. It should require its employees to declare any personal interest that may affect, or could be seen to affect, their impartiality in any aspect of their work. Expectations of conduct of public employees are clear.⁴
- 3.44 The public expectation about the management of public resources extends to the way that NGOs handle them. Whether the public resources are managed by a public employee or not, the public expects the resources to be managed with the highest integrity and honesty, and not for personal gain. The public entity will need to make this clear within its funding arrangement with the NGO. The NGO also needs to self-manage according to these expectations.

4 See the integrity and conduct section of the State Services Commission's website at www.ssc.govt.nz.

Part 4

Funding arrangement scenarios

- 4.1 We have created 4 scenarios to show how the principles might be applied, and how they interact, in funding arrangements with NGOs. The scenarios cover:
- a new “capacity-building” grant programme;
 - a grant programme;
 - a health sector contractual “chain” – from district health board to primary health organisation to NGO; and
 - a local government arrangement for funding many low-value grants.
- 4.2 The scenarios are drawn from our experience of typical funding arrangements. The details are “true to life”, but do not represent particular or actual public entities or NGOs. We use the life cycle described in Figure 1, but focus on parts of that process that are particularly important for each scenario.
- 4.3 The application of the principles by each public entity for each of its funding arrangements with NGOs should be, to a large extent, determined by the public entity’s own systems and processes. The scenarios are not intended to be a prescription of how public entities should go about organising themselves.
- 4.4 The scenarios deal with a variety of funding arrangements. Even where the funding arrangement is contractual in nature, it is not always necessary to have a traditional output-delivery contract to achieve the principles set out in this good practice guide. Two of the scenarios focus on grant arrangements, one looks at an arrangement to deliver results rather than outputs, and one deals with many low-value grants.
- 4.5 **Scenario 1** focuses on the planning phase of an initiative that provides new funding in the form of capacity-building grants. It demonstrates in particular how the principles of public benefit, accountability, and fairness are considered, and the risk-based approach that underpins the decisions taken.
- 4.6 **Scenario 2** deals with the risk management involved in making grants to NGOs for an overseas aid programme. It focuses in particular on managing the programme in a way that is responsive to the risks posed by each particular NGO provider, in order to make most efficient use of the resources used in selection and monitoring.
- 4.7 **Scenario 3** acknowledges the links from a government department to a Crown entity to the NGO that provides the service – in this instance, also involving a primary health organisation – and how this affects accountability. It focuses, too, on the trade-offs that are often required to ensure that public resources are applied for the best possible public benefit.
- 4.8 **Scenario 4** looks at how the principles apply in a typical local government situation where many low-value grants are made.

Scenario 1: Establishing a capacity-building grant programme

What is capacity building?

- S1.1 Increasingly during the past decade, central and local government bodies have used public funds to build the capacity of NGOs.
- S1.2 The policy decisions authorising the use of public funds for this purpose invariably define capacity as the skills, systems, processes, and structures of an organisation. While this definition provides the public entities administering the funding with significant flexibility in how the funding can be applied, it is important that the funding is not used to build capacity simply for capacity's sake.
- S1.3 To ensure that such public funding is used for public benefit, capacity-building funding should, in our view, be used to help NGOs to better contribute to achieving government policy goals. That is, all decisions to allocate capacity-building funding should clearly show how the resulting “built capacity” will benefit taxpayers and ratepayers.
- S1.4 As with the expenditure of all public funds, public entities entering into capacity-building funding arrangements with NGOs must be able to demonstrate how the principles outlined in Part 3 underpin their funding arrangements.

Capacity-building grants in the public sector

- S1.5 Almost all of the public funds allocated for capacity-building purposes in the central government sector are provided through Other Expenses to be Incurred by the Crown appropriations approved by Parliament. This is an important characteristic of capacity-building funding as it sets the parameters for these types of funding arrangements with NGOs.
- S1.6 Essentially, it means that the capacity-building funding is intended to be made available to NGOs through a conditional grant – that the funding is granted for a particular purpose or purposes, and that goods or services are not being purchased. This contrasts with the use of a contract where funding is disbursed on receipt of goods or services. A traditional contractual relationship may not be appropriate for NGOs receiving public funding as a capacity-building grant.

How one Ministry establishes and administers a new capacity-building programme

- S1.7 In this scenario, the fictitious Ministry for New Zealanders (the Ministry) is responsible for establishing and administering a new annual Other Expense appropriation of \$14 million for capacity building. Cabinet has approved the new capacity-building programme, with the funding authorised by Parliament through the Appropriation (Estimates) Act.
- S1.8 As this is a new initiative, the Ministry first establishes the operational parameters for administering the overall capacity-building programme. The Ministry uses the Cabinet policy decisions to guide its initial planning for funding arrangements with NGOs. This includes clarifying the policy intent (that is, the purpose and objectives for which the capacity of NGOs is being built) and ensuring that this intent flows through all of the Ministry's operational policy decisions in relation to the capacity-building programme. This helps to ensure that the Ministry is acting lawfully (that the public funding is being used for the purpose for which it was appropriated), and can demonstrate accountability to the responsible Minister for its administration of the capacity-building programme.
- S1.9 The Ministry recognises that careful scoping is required in setting up the programme because of the flow-on effects on the Ministry's ability to monitor and evaluate the programme's overall performance, and also each of the individual funding arrangements with NGOs.
- S1.10 In planning the implementation of the programme, the Ministry identifies:
- the ways in which the programme links with the Ministry's corporate objectives and its other outputs;
 - the overall resourcing implications for administering the programme, and what that means for the Ministry's other output priorities;
 - the senior manager in the Ministry who will be held to account for the programme through a performance agreement with the chief executive;
 - the timelines for the implementation of the programme in Year 1, and the periodic reporting to senior management that will occur on implementation progress;
 - the additional resources needed to manage the programme and the business case for senior management approval for each of the new positions sought;
 - the job descriptions for the new programme managers, and recruits to these positions using an open and transparent recruitment process;
 - the programme's effect on existing Ministry staff at a central and regional level;

- the respective roles and responsibilities for each of those Ministry staff who are going to be involved in the programme, and amends existing job descriptions and performance agreements as appropriate;
- the existing departmental systems, policies, and processes that are relevant to the implementation and monitoring of the programme;
- the processes and systems (including record-keeping) that need to be set up to support the ongoing implementation and monitoring of the programme;
- the main risks in programme implementation, and how these will be managed;
- the estimated breakdown of administration costs, and how these are to be funded (that is, they are to be funded separately from the \$14 million appropriation for the actual building of NGO capacity);
- a periodic reporting strategy to Ministers who have expressed a strong interest in the performance of the programme; and
- the data requirements for future evaluation purposes, so that this information can be built into the individual funding arrangements (where appropriate).

- S1.11 All of this information is set down in a comprehensive project plan that is considered and approved by the Ministry's senior management team. The project plan will be the subject of regular reporting of progress to the senior management team by the senior manager responsible for the programme.
- S1.12 It has taken the Ministry some time to plan this funding arrangement. The Ministry needs to ensure that it has managed the risks affecting the successful implementation of the programme; developed the necessary systems to ensure that the funding process is fair and transparent; and that it is able to meet its accountability obligations. Essentially, this means that there is a transitional period from when the funding was approved for disbursement (1 July), and when the Ministry will be in a position to move to the next phase – selecting which NGOs will receive capacity-building funding.
- S1.13 In the interests of transparency, the Ministry reports to Ministers its progress-to-date in implementing the programme. The report outlines the rationale for the transitional period; that is, the steps taken to ensure that the funding process is fair and transparent. The report seeks confirmation that the operational policies being prepared for the programme are consistent with the programme's overall policy intent as approved by the Government.
- S1.14 Once the Ministry has a solid platform for the overall programme, it moves to the next phase of the NGO funding arrangement life cycle.

Selecting NGOs and setting up monitoring systems

- S1.15 The programme is being established to build the capacity of NGOs to deliver services to the Ministry's clients throughout New Zealand. This gives the Ministry significant flexibility, but also creates some clear selection risks that it needs to actively manage.
- S1.16 When considering how the programme's \$14 million can best be allocated among NGOs to provide value for money, the Ministry uses demographic data, its knowledge about its current (and likely future) client base, and relevant information from its past experience in managing grant funding programmes.
- S1.17 It also sets up a process to fairly recognise that NGOs' funding applications will form a core part of the actual funding arrangement (and the monitoring thereof) while also acknowledging that some of the NGOs in most need of the programme's resources will find the application process a significant challenge.
- S1.18 This phase of the programme's implementation involves deciding:
- whether the programme will be used to fund as many NGOs as possible, to broaden the Ministry's potential provider pool, or on a smaller number of NGOs, with each receiving a significant amount to boost their capacity. This involves undertaking a cost-benefit analysis of each of the options;
 - how the \$14 million fund will be spread throughout the country, and among the different Ministry regions;
 - the eligibility criteria for NGOs wishing to access programme funding, and how the Ministry can be satisfied that each NGO meets the minimum eligibility requirements during the selection phase;
 - the advantages and disadvantages of a national approvals process versus an approvals process based in the Ministry's regional offices (including the consideration of the conflict of interest risks associated with having decision-makers closely located to applicants);
 - the appraisal criteria for applications for programme funding (including minimum score requirements), and how the appraisal criteria link to the original Cabinet approvals and the Ministry's strategic objectives and other relevant programmes;
 - whether specific legal or financial expertise is needed to add to the robustness of the selection process;
 - who will be responsible for making funding decisions (a panel versus the programme manager), and the quality assurance process that will operate for all funding decisions (including the appeals process);

- whether, for transparency purposes, the Ministry should seek independent assurance on the initial funding round for the programme (with the findings informing future programme funding rounds);
- how successful and unsuccessful applicants will be notified;
- the appeals process for unsuccessful applicants;
- how the Ministry will promote the programme to potential providers with whom it does not have an established relationship (over and above using its existing network of NGOs to promote the programme);
- how the Ministry, in the selection process, will take account of its existing knowledge of NGOs it has relationships with; that is, whether a “proven performer” will be able to apply for programme funding through a more streamlined process;
- how the funding of NGOs will link to the Ministry’s outcomes framework, and how the eligibility process and funding will ensure that grants from the programme will help the Ministry to achieve its intermediate outcomes as well as the Government’s policy objectives for the programme;
- how the Ministry can be assured that potential recipients of the programme’s funding are suitable for receiving public funds, and can be (and are prepared to be) held to account for their use of the funding;
- how the Ministry will use its limited resources to monitor the programme in the most effective way, to ensure that it closely monitors the most high-risk NGOs and applies sufficient monitoring to lower-risk NGOs; and
- the templates and standard forms the Ministry should create to help it to be consistent in its application of the selection and approvals process.

- S1.19 To ensure that its funding process will stand up to scrutiny, the Ministry documents the rationale for each of the decisions it takes in setting up the selection and overall monitoring processes for the programme.
- S1.20 It promulgates its operational policy decisions on its website, and the rationale for the criteria which will guide the selection process. The Ministry also decides that, for transparency purposes, it will publish an annual list of those NGOs which receive capacity-building funding, and for what purpose.
- S1.21 At the same time as these decisions are made, the Ministry also focuses on its internal operation of the capacity-building funding programme.
- S1.22 The Ministry identifies the risk of conflicts of interest in the selection phase, and prepares a clear statement and set of procedures about conflicts of interest for those staff involved in administering the programme. This set of procedures draws on the Auditor-General’s and the State Services Commission’s published material

on managing conflicts of interest in the public sector, and reflects the Ministry's corporate policy on conflicts of interest.

- S1.23 Before the capacity-building programme's first funding round, staff are given training on how the selection phase will operate, and on the underlying rationale for the funding criteria and decision-making process.
- S1.24 Staff are also informed of the need to consider the monitoring and evaluation requirements during this early phase, so that monitoring and evaluation are not treated as an after-thought. At all times, the original policy intent of the capacity-building programme is emphasised to staff – that is, that the funding should be used to build the capacity of NGOs that the Ministry will have an ongoing relationship with – specifically, with a view to the NGOs delivering services to the Ministry's clients.
- S1.25 The Ministry establishes a panel that will be convened if required to consider any decision appeals or complaints about the programme. The panel includes independent representatives from NGOs and the public sector.

Negotiating and recording the terms of the funding arrangement

- S1.26 The Ministry designs the funding documentation in the capacity-building programme so that NGOs are required to provide information that enables the Ministry to account for how the NGO has spent the grant funds (and, to the extent practicable, the effect of the funding). The Ministry must be able to demonstrate that each funding recipient has spent its grant for the purpose for which it was provided, and that the purpose relates to the policy's intent (which is to build a pool of potential NGO providers for the Ministry's client base).
- S1.27 The Ministry's approach to negotiating the terms of the funding arrangement reflects that it is fundamentally interested in having a long-term relationship with each of the NGOs it funds under the capacity-building programme.
- S1.28 In the medium to long term, the Ministry expects to contract with these same NGOs to deliver services to its clients. Given this, the Ministry approaches the negotiation process with a relationship focus, and uses each funding recipient's capacity-building application as the basis for the terms of the funding arrangement. The funding arrangement documentation makes these longer term intentions clear, but it is not a condition of the grants.
- S1.29 Importantly, the funding arrangement documentation is not in the form of a contract for services. It is more like a written record of the parameters within which the grant funding should be spent; what it cannot be spent on (in this case, capital works); how spending will be monitored (and the information that the NGO needs to supply to the Ministry to facilitate such monitoring); the jointly

developed risk profile of the funding arrangement (and how those risks will be managed); and each party's rights and obligations in the funding arrangement.

- S1.30 The Ministry ensures that each funding arrangement document under the programme (whether in the form of a contract or other form of written record) receives legal clearance before it is signed by the programme's project manager, who holds the appropriate financial delegations. This checking process – where appropriate, based on a risk assessment – also includes making sure that the NGO is not receiving funding for a similar purpose through other Ministry programmes, or through programmes operated by other government departments.¹
- S1.31 A signed copy of the documentation of the funding arrangement is issued to the NGO and kept centrally within the Ministry. It is also entered onto the Ministry's central database of funding arrangements which is linked to its finance system. This helps to ensure that payments are made only when funding conditions are met.
- S1.32 Each funding arrangement is assigned to a Ministry staff member who is a central internal and external contact point for all matters relating to that particular funding arrangement with that NGO. The staff member is responsible for:
- carefully compiling the official file for that funding arrangement;
 - undertaking all communication with the NGO on its performance in meeting the terms of the funding arrangement;
 - verifying that funding arrangement conditions have been met before any payments are made;
 - contributing information to the wider reporting of the programme's performance to senior management, Ministers, and to the public; and
 - carrying out a post-funding final assessment.

Conclusion

- S1.33 This scenario outlines the steps for establishing a new initiative, in line with our principles for managing funding arrangements with NGOs. As with the other scenarios in this good practice guide, this scenario is not meant to be used as a checklist. However, we consider that it provides some useful pointers on the issues that need to be considered at particular points in the process of setting up a new grants funding programme.
- S1.34 Most particularly, we expect public entities to thoroughly consider monitoring, reporting, and evaluation requirements as the programme is being set up, and before funding arrangements with NGOs are negotiated and signed.

¹ NGOs are asked to disclose applications to other funding sources for funds for similar purposes.

- S1.35 There is necessarily a sliding scale of monitoring for all programmes, as scarce resources need to be used wisely. However, in the interests of maintaining relationships and being transparent, public entities should be proactive in identifying where the risks lie in funding each NGO, and allocate sufficient resources to manage those risks satisfactorily.
- S1.36 No amount of monitoring will ever provide a total guarantee against provider failure. However, public entities will be better able to manage their NGO funding arrangements for the public benefit if they:
- consider risks and how they can best be managed early in the process; and
 - ensure that the policy objectives are guiding each decision during programme implementation.

Scenario 2: A risk-based approach to funding non-government organisations

- S2.1 It is essential that public entities take a risk-based approach to how they enter into funding arrangements with NGOs. This means identifying the type and scale of the risks that exist, and then managing those risks proactively.
- S2.2 Risks range from a lack of clarity about what outcomes are being sought to a lack of capability in the public entity to monitor the arrangement effectively, or in the NGO to deliver what is specified in the arrangement.
- S2.3 A common feature of funding arrangements between public entities and NGOs is the tension between the need for NGOs to be accountable for their use of public funds while not being unduly burdened by bureaucratic reporting requirements that hinder their ability to deliver what the arrangement requires them to. To get an appropriate balance between these 2 often competing demands requires the public entity to take a risk-based approach to its funding of NGOs.

How one Ministry funds domestic NGOs to deliver international aid programmes

- S2.4 In this scenario, the fictitious Ministry for International Assistance (the Ministry) manages the risks associated with funding New Zealand NGOs to deliver international aid programmes.
- S2.5 The Ministry is responsible for managing the government's overseas development funding. It works within the government's overseas aid policy framework, and its strategic priorities reflect its commitment to working collaboratively with partners and the international community.

How does the Ministry's funding scheme operate?

- S2.6 The Ministry funds development programmes through a wide range of NGOs and their overseas development partners. The funding is provided through a co-funding scheme, jointly managed by the Ministry and representatives of New Zealand NGOs, and is focused on supporting community development activity through the agencies that work with New Zealand NGOs in developing countries.
- S2.7 A feature of the funding scheme is that, for most cases, funds are available to match funds that NGOs are able to raise themselves. The more funding an NGO can raise, the more funding is available from the scheme to match these funds, up to specified limits. An NGO must demonstrate its ability to match the scheme's funds by submitting a statement from its treasurer or accountant, or a copy of a bank draft, or record of a telegraphic transfer.

- S2.8 The funding scheme is managed by a project selection committee consisting of 4 New Zealand NGO representatives and a Ministry representative.¹ Overall management rests with the Ministry's development programme manager, who is also the Ministry's representative on the project selection committee.
- S2.9 The project selection committee normally makes decisions by consensus, but a vote may be taken when consensus is not reached. Once a decision is reached, all members adopt it as a decision of the whole project selection committee.

How do the Ministry and NGOs work together on the funding scheme?

- S2.10 The funding scheme is based on the guiding principles set out in the Ministry's policy statement. There is a close correlation between these principles and those identified within the Strategic Policy Framework (a shared agreement that sets out the rationale and guiding principles for relations between the Ministry and NGOs).
- S2.11 The Ministry's first step in its risk-based approach is to gain the commitment of New Zealand NGOs to take a collaborative approach to achieving the overall outcome of eliminating poverty in target countries. This is because effective working relationships based on trust and a mutual understanding of each other's roles and responsibilities will reduce the likelihood of problems caused by unrealistic expectations and misunderstandings about respective obligations. In turn, this should increase the likelihood that funding arrangements will work effectively for both parties.
- S2.12 As well as the Strategic Policy Framework, the Ministry provides an NGO Funding Scheme Handbook. In line with the Ministry's commitment to working collaboratively with NGOs, the handbook, including associated template forms, was produced after extensive consultation between the Ministry, the NGO funding scheme project selection committee, and representatives from New Zealand NGOs involved in the international development sector.
- S2.13 The handbook contains all the information NGOs need in order to apply for funding. The handbook sets out:
- the policy framework within which funding applications must be made,
 - the application process;
 - the monitoring and evaluation arrangements;
 - criteria against which funding applications are assessed; and
 - template forms for funding applications and reporting and accountability requirements.

¹ The NGO representatives are elected by the NGO community for a 2-year term, and can serve a maximum of 2 terms. The Ministry representative has full speaking rights, but can vote only when a casting vote is required.

- S2.14 Another feature of the funding scheme is that the project selection committee also funds the provision of training workshops to build the capacity of NGOs to participate in effective development activities.

How one NGO gets involved with the funding scheme

- S2.15 This section of the scenario sets out the actions of the Ministry in its dealings with a fictitious NGO, Pacific Aid, in its applications to and dealings with the funding scheme. We explain how the scheme operates and gives effect to our principles and, in particular, describe the concept of a risk-based approach in practice.

Applying for funding

- S2.16 The Ministry receives an application from Pacific Aid for funding for an aid programme focused on generating income on a Pacific island. The Ministry does not know Pacific Aid.
- S2.17 The first step in the process is for Pacific Aid to submit an organisational profile to the funding scheme's project selection committee, and gain preliminary approval for the profile. This approval is needed before an NGO can submit funding applications to the scheme.
- S2.18 In support of its application, Pacific Aid submits to the project selection committee a letter requesting accreditation to the NGO funding scheme, a completed organisational profile, a copy of its constitution, its most recent annual report, and most recent audited financial statements. Approval depends on an NGO demonstrating that its activities are consistent with the funding scheme's development principles and criteria, and that it has the financial and management capability to assess, manage, and report accurately on projects for which funding is received.
- S2.19 This requirement enables the Ministry to ensure that any NGO it may fund is legitimate. The Ministry can therefore mitigate the risk of funding an organisation that is either unlawful or unlikely to be able to effectively deliver its obligations under a funding arrangement.
- S2.20 If the organisational profile is not accepted, the committee will have to explain its reasons for non-approval to Pacific Aid, and Pacific Aid will have the opportunity to appeal the decision.
- S2.21 Preliminary approval enables an NGO to apply to the scheme for funding for specific projects it wishes to deliver – this is called non-block² grant funding. Full approval depends on an NGO successfully applying for funding and reporting on

² Non-block grants are grants for individual projects. Block grants are distributed to NGOs that then decide which particular projects to support.

its activities over a 2-year period. Once full approval is received, an NGO is able to apply for block grants.

- S2.22 Having gained preliminary approval from the project selection committee, Pacific Aid then applies to the scheme for funding for the income-generation project it wishes to deliver. The Ministry sends Pacific Aid copies of the handbook, and a comprehensive funding application form.
- S2.23 The application must include information about the nature of the proposed project, including its goal and objectives, the rationale for the project, its expected duration, and who will benefit from it and how. The application must also include a detailed forecast budget for the project.
- S2.24 The project selection committee considers and approves the application for funding for Pacific Aid's proposed income-generation project, and recommends to the Ministry that funding be provided. If the committee had decided the application had insufficient supporting information, it would have requested further information from Pacific Aid, which would have been reconsidered by the committee at a later date. If the application had been declined, Pacific Aid would not have been able to reapply for that particular project again within the same financial year.
- S2.25 In considering an application, the project selection committee highlights any problems or potential weaknesses it identifies about a project. Future applications from an NGO are checked against the funding scheme database to see if any problems (such as the late submission of reports) may have arisen in the past. In this way, the project selection committee is able to monitor the performance of NGOs, identify any issues or risks specific to the NGOs, and take action accordingly.
- S2.26 NGOs must submit an application form for each individual project during the first 2 years of participating in the scheme.

Reporting

- S2.27 NGOs are responsible for ensuring that the funds they receive are used and accounted for in keeping with the funding scheme criteria, and for the purpose for which funding was approved.
- S2.28 The funding scheme handbook includes templates for the types of reports that NGOs must submit at specified times during, and at the end of, a funding agreement.
- S2.29 Under the scheme's funding arrangement, Pacific Aid is responsible for ensuring that its project partners are aware of the scheme's reporting requirements, and are prepared to provide the information needed to meet these requirements.

- S2.30 The reports that Pacific Aid submits include a detailed breakdown of actual expenditure against the budget included in the original funding proposal. Pacific Aid is also required to submit a report for its project within 15 months after the release of funds. The funding scheme withholds further funding until all reporting requirements have been completed satisfactorily.
- S2.31 The project steering committee must be notified of any changes to the project if what is being delivered differs from what was originally approved. Approval by the committee is required for any substantial changes.

Multi-year funding

- S2.32 Development projects can be large-scale and complex, and may take several years to complete. The NGO funding scheme recognises this, and multi-year funding is available to provide more flexibility to achieve objectives for a period of up to 5 years. Applications for multi-year funding must include a detailed monitoring and evaluation plan, to form the basis of the annual reports that are required throughout the life of the project. A full report must be submitted at the end of these projects.
- S2.33 Approval for multi-year projects is given in principle only, with funding for future years depending on the Ministry's annual appropriations from Parliament, and on the satisfactory performance of, and reporting from, an NGO during the first year of a multi-year project.
- S2.34 The reports describe the progress made against objectives and expected results, any issues or limitations that had changed or were likely to change the activities from those originally approved, and actual against budgeted expenditure.

Block grants

- S2.35 In the first 3 years after its initial application, Pacific Aid applies for and receives funding for 4 income-generation projects in the Pacific. It meets all of its reporting requirements for these projects. Having proved its ability to interpret and implement the funding scheme's criteria, to distribute the funds efficiently, and to report satisfactorily on its activities over a period of at least 2 years, Pacific Aid receives full approval from the project selection committee.
- S2.36 This means that Pacific Aid is eligible to apply for an annual block grant allocation, instead of having to apply for each individual project or programme. The block grant system has several advantages for the Ministry, the project selection committee, and NGOs. The system:
- has greater flexibility than the non-block grant system (which requires NGOs to apply for funding for each individual project);

- enables a quicker and easier response to the needs of partners in developing countries; and
 - promotes an ongoing partnership that is more consistent with the long-term nature of development activities.
- S2.37 Receiving a block grant enables Pacific Aid to decide which projects to support from its block grant, rather than having to apply for funding for each and every project.
- S2.38 In effect, through the block grant mechanism, the funding scheme delegates the project selection role to those NGOs in which it has confidence. The scheme requires such NGOs to report to the project selection committee on how they have used the grant.
- S2.39 To apply for a block grant, an NGO must be fully approved by the project selection committee, have well-managed financial and management systems, have project identification, appraisal, monitoring, and evaluation systems in place, and be able to demonstrate its capacity to provide matching funding for projects from its own funds. In addition, the NGO is required to participate in an organisational review including an overseas partner visit.
- S2.40 There are 4 levels of block grant funding, the first of which is up to \$500,000. NGOs are able to move up to the next level of funding after 2 years of having reported satisfactorily against these projects, and having demonstrated successful operations during this period.
- S2.41 To do so, NGOs must complete an application form that includes another self-assessment of its performance against the funding scheme criteria. The self-assessment also includes an overview of an NGO's previous development activities, and evidence of its successful operations within the funding scheme framework.
- S2.42 If the project selection committee considers that an NGO has not adequately met some criteria (for example, failing to report on time, or an unsatisfactory self-assessment) then it will take this into consideration when it decides whether or not the NGO can move to the next funding level. The failure of an individual project will not, in itself, be a reason to decline further funding.
- S2.43 Every year, each NGO that receives a block grant to undertake projects (of less than \$200,000 for each project) is required to submit detailed reports on up to 5 projects funded by the scheme. Additional detailed reports may be required for institutional reviews or impact evaluations. These progress reports include actual expenditure against budget for each of the projects under review.

Monitoring and evaluation

- S2.44 The primary basis of accountability for the scheme's funds is the submission by NGOs of regular reports to the project selection committee. The committee also conducts institutional reviews of recipients of the scheme's funds, as highlighted in the Funding Scheme Handbook and specified in the funding agreement.
- S2.45 Regular users of the funding scheme are subject to institutional reviews every 3 to 5 years to ensure that funds are being used in line with scheme's criteria. The purpose of the institutional review is to assess an NGO's management, financial, and project systems as they relate to receiving and managing the scheme's funds. The focus is on confirming compliance with the scheme's requirements, and the capacity of an NGO to meet the scheme's standards.
- S2.46 The type of review conducted depends on the amount of funds accessed by the NGO. The reviews can include desk reviews of documentation, site visits to New Zealand NGOs, and visits to selected developing country partners. Institutional reviews are conducted by teams appointed by the project selection committee, and involve the New Zealand NGO and its overseas partner.
- S2.47 In addition, mechanisms for operating the overall funding scheme, such as the processes used by the committee, are evaluated every 5 years.
- S2.48 The scheme places much emphasis on self-evaluation with appropriate external verification.

When problems occur

- S2.49 The funding scheme recognises that there are risks specific to development work. These risks include the development partner itself being a high risk because of:
- the political, social, or economic situation that it operates in;
 - the remoteness of project sites, which can make communication between the New Zealand NGO and the overseas partner difficult;
 - reliance on a certain individual within an NGO; and
 - the partner's limited financial management ability.
- S2.50 Generally, the funding scheme aims to promote innovative projects to address development needs. It recognises that it is important that NGOs are not deterred from funding projects that are potentially risky and, accordingly, sets out in the handbook some of the ways NGOs can approach such projects. Central to this approach is the need for clear and regular communication between the NGO and the project selection committee to ensure that both parties are fully aware of the nature and potential scale of risk involved.

- S2.51 If it becomes evident that an NGO that receives a block grant is having difficulty using the funds effectively, the project selection committee will discuss with the NGO ways to address the situation. The committee may request a detailed report from the NGO, and may initiate a review that involves visiting the NGO in New Zealand, overseas, or both.
- S2.52 An NGO will usually be given the opportunity to put right any problems identified within an agreed timetable. If little or no progress is made, then the committee may remove the NGO from block grant status and advise the Minister of this decision. In cases of fraud or serious negligence, the NGO may have its block grant status removed immediately, in keeping with the Ministry's policy on fraud and its code of conduct.
- S2.53 The project selection committee can require an NGO to repay funding if the intended objectives of a project are not going to be delivered.
- S2.54 A specific risk is that funds may be allocated to activities that fall outside the funding scheme criteria. An approach to managing this risk has been to ask the NGO community to develop guidance designed to reduce this risk, and to then incorporate the guidance into its own funding policy.
- S2.55 When this situation has occurred in the past, the project selection committee has written to the NGO and its in-country partner to raise the issue, and also to increase its understanding of the issue in the context of its ongoing relationship with the NGO. In addition, the issue has been noted for the team that was due to conduct the next scheduled agency review of the NGO concerned. On occasions when the risk was deemed to be significant, the NGO has been reviewed sooner.
- S2.56 When this situation has arisen, the project selection committee has also:
- invited the NGO to attend a project selection committee meeting to discuss the project selection committee's concerns;
 - provided the NGO with considerable feedback on issues and clarification of the reason for project selection committee decisions;
 - placed the NGO on a heightened reporting regime; and
 - lightened the reporting regime, but maintained it at a higher level than usual, once the project selection committee was satisfied that the NGO had taken action to address its concerns.
- S2.57 In instances where an NGO has not been able to ensure that its in-country partners have been undertaking activities provided for within the funding scheme criteria, funding from the scheme for projects involving those partners has been stopped.

Conclusion

- S2.58 The funding scheme takes a risk-based approach to how the Ministry enters into funding arrangements with NGOs. For well-established and proven NGOs, there is less need for intensive monitoring and oversight. Reports are still submitted by, and reviews undertaken of, these NGOs, but less regularly than for those funding arrangements with NGOs that are not as well known to the funding scheme.
- S2.59 Given the high number of NGOs active in development work, and the number and range of funding arrangements supported by the funding scheme, it is not possible for the project selection committee to have close oversight of each and every project that is supported under the scheme. Therefore, if the project selection committee is confident of the ability of an NGO to understand and apply the development principles and the scheme's criteria, and of its capacity to manage projects effectively, it hands over the role of assessing and approving projects to the NGO.
- S2.60 This is a pragmatic approach to managing and prioritising the risks associated with distributing public funds to NGOs. It relies on gradually setting up effective working relationships between the funding scheme and NGOs receiving block grants. It also relies on the monitoring and review processes put in place to assure the Ministry that the delegated project selection mechanism is working effectively.

Scenario 3: Managing public resources for health services

- S3.1 The following scenario is typical of funding arrangements with NGOs in the health sector.
- S3.2 The fictitious Midnorth District Health Board has made an agreement with one of its primary health organisations (PHOs) to run an initiative under the public health strategy *Healthy Eating, Healthy Action*.
- S3.3 The fictitious initiative – called *Kaihauora* – will target and involve Māori whose health is at risk.
- S3.4 Our scenario focuses particularly on:
- the complex accountability situation;
 - trade-offs between effectiveness and efficiency in the somewhat limited “market” of suitable NGOs;
 - the effects of needing to focus on what the public entity is trying to achieve (in this instance, the changing of population behaviour rather than on specific outputs); and
 - the importance of relationship understandings and agreements with NGOs in the health sector generally, and with local NGO and iwi groups.

Complex accountability in public health initiatives

- S3.5 There are accountability mechanisms in place to manage the funding delivery links in the health sector between the Ministry of Health (the Ministry), district health boards, and NGOs. The more recently created PHOs sometimes have a place in the delivery of certain initiatives (as in this scenario).
- S3.6 All public funding for health is appropriated by Parliament under Vote Health. The Ministry is the administering department.
- S3.7 Public health initiatives often involve a direct funding arrangement between the Ministry and various NGOs. However, in this scenario – as is often the case with the delivery of health services – the delivery of the public health strategy *Healthy Eating, Healthy Action* includes:
- district health boards (which are public entities, and receive public funding from the Ministry under a Crown Funding Agreement, using a formula based on the size and characteristics of their populations, and including expectations for specific initiatives);

- PHOs (which are not public entities, but must be not-for-profit, and are funded by district health boards to work with enrolled populations and their communities to achieve the objectives of the Ministry's Primary Health Care Strategy. PHOs are not audited by the Auditor-General. District health boards have primary health care service agreements with PHOs, and deliver funding on a capitation basis under that agreement);
- NGOs (which receive funding under contracts or agreements with the Ministry, the district health boards, or in some instances through the PHOs).

Relationship agreements with NGOs

- S3.8 Funding arrangements with NGOs in the health sector need to be considerate of relationship agreements between the public entities and NGOs.
- S3.9 The relationship between the Ministry and NGOs is formalised through the *Framework for Relations Between the Ministry of Health and Health/Disability Non-Government Organisations*.¹
- S3.10 Individual district health boards (such as our fictitious Midnorth District Health Board) may have similar agreements or at least consultative relationships with NGOs involved in the district health board's district. PHOs may have their own agreements or consultative relationships with NGOs. The Government has acknowledged the interdependence of primary health organisations and NGOs.²

Planning the *Kaihauora* initiative

- S3.11 District health boards receive funding from the Ministry to implement various health sector strategies, including the public health strategy *Healthy Eating, Healthy Action*.
- S3.12 In our scenario, the Midnorth District Health Board has carried out a thorough update of its health needs assessment when it reviewed its district strategic plan. It found that obesity, diabetes, and cardiovascular disease (which are linked in international medical literature) are unacceptably higher for Māori than for other groups in the district health board's population.
- S3.13 Trend analysis from several preceding years indicates that the health status for Māori in diabetes and cardiovascular disease is not improving relative to other groups in the population.

1 See www.moh.govt.nz/ngo.

2 See *PHOs and NGOs Working Together to Improve Health Outcomes: Opportunities and Issues*, speech by the Minister of Health, Hon. Annette King, to the NGO Working Group, NGO-MOH Forum, 19 March 2004 (Wellington).

Being clear about what the public entity is trying to achieve

- S3.14 The Midnorth District Health Board concludes that it needs to put in place a new initiative – *Kaihauora* – to tackle underlying public health issues and to get the results hoped for in the Primary Health Care Strategy, and related public health initiatives. *Kaihauora* aims to reduce obesity and increase levels of physical activity, and hence reduce the risk of related chronic health conditions such as diabetes and cardiovascular disease.
- S3.15 The Midnorth District Health Board prepares a business plan for the *Kaihauora* initiative. To fully consider the public benefits and the risks, the plan sets out:
- the Primary Health Care Strategy priorities and the related *Healthy Eating, Healthy Action* strategy underpinning the need for the *Kaihauora* initiative;
 - health status results for chronic conditions linked to eating and activity patterns for the Māori population within the District Health Board’s district;
 - the logic for intervention, including the potential health risks and costs without intervention;
 - other considerations, in particular the relationship agreement that happens to exist between the Midnorth District Health Board and NGOs;
 - options for intervention, with their relative costs and benefits, and recommends the preferred intervention (the *Kaihauora* initiative);
 - the resource requirements for implementing and maintaining the *Kaihauora* initiative; and
 - how the Midnorth District Health Board intends to assess the success of the intervention, if it is adopted.
- S3.16 Using that information, the Midnorth District Health Board decides to launch the *Kaihauora* initiative, to contribute to the long-term target of eliminating, within the next 10 years, the difference between diabetes and cardiovascular disease hospitalisation rates for Māori and the population average.

Managing trade-offs in selecting a provider and negotiating terms

- S3.17 The *Kaihauora* initiative aims to raise community awareness and is designed to encourage at-risk Māori in the district to adopt healthy eating habits and be physically active. Rather than the purchase of particular outputs, it requires changes to the health-contributing behaviours of its Māori population.
- S3.18 The Midnorth District Health Board is buying “results” – awareness of the message, and changes in the eating patterns and activity levels of the target

population. The District Health Board recognises that a traditional contract for specified outputs is not suitable. Nor does it have the capability or capacity among its own staff to carry out the initiative.

- S3.19 The Midnorth District Health Board consults with its PHOs, the NGO “umbrella” group in the district, and local iwi (since the initiative closely involves the Māori population) on the proposed initiative, and the intended results. They all agree that involvement of an NGO provider or providers, who have credibility with the at-risk Māori group, will get better results than using the DHB or PHO health professionals. Furthermore, in this instance, the DHB does not want to directly undertake either the initiative or its direct management. And, although it would like to, the local iwi does not have the capacity or capability to do so either.
- S3.20 In the view of the Midnorth District Health Board, the PHOs, iwi, and the NGO “umbrella” group, such a project will require the provider(s) to “know its communities” – its leaders, population profile, and the programmes and initiatives already running in the community. It must also be able to communicate the issues to community groups and look for ways to raise community awareness as a whole (for example, running catering programmes at the local marae to promote healthy eating information, and change the types of food that might be served to large groups at the marae).
- S3.21 They agree that the initiative fits well with the interests of one of the PHOs. The PHO undertakes to locate a provider or providers able to deliver the desired results. The PHO signs a variation to its primary health funding agreement with the Midnorth District Health Board, to give it additional funding to achieve the results intended in the *Kaihauora* initiative. It then seeks a provider or providers to accomplish this.

Seeking a provider

- S3.22 The Midnorth District Health Board policies require fairness, transparency, and value for money in the tendering process, which it usually achieves through open tendering. Under certain circumstances, this might not be a cost-effective or a possible approach, so the exceptions are clearly spelled out in its procurement policy. Further, to ensure that public money is managed fairly and transparently, a condition of its funding arrangements with its PHOs is that each PHO will act in the same way (that is, fairly and transparently) when in receipt of public funds.
- S3.23 In this circumstance, the PHO is to receive public funds from the Midnorth District Health Board. The PHO believes that there is a very limited pool of possible providers, but it wants to ensure that it acts fairly. It therefore seeks an expression of interest in consultation with the NGO “umbrella” group and local iwi as to how to do this most effectively.

- S3.24 The expression of interest document sets out clearly what the PHO expects to be achieved by the successful provider(s).
- S3.25 The PHO considers the responses, and concludes that a limited request for proposal (RFP), involving only 2 potential providers, is warranted.
- S3.26 Both of the potential providers respond to the RFP. One is an NGO with evidence of good credibility with local iwi and the target group, but light on track record in managing an initiative to raise community awareness. The other is an experienced social marketing company, with no particular experience with the target group.
- S3.27 For the reasons outlined earlier, the PHO decides that credibility with the target group is more likely to be effective in changing eating/activity patterns within the target group. It documents the reasons for its choice, accepting the risk that comes with the relative inexperience of the NGO.
- S3.28 The NGO also has concerns. It does not want to take on the job if it risks building up its capacity, delivering the social marketing messages effectively, and then losing the funding because the *Kaihauora* initiative as a policy proves to be wrong.
- S3.29 The PHO decides to design accountability and monitoring arrangements that will track the resource use without requiring unrealistic administration and reporting. In close consultation with the Midnorth District Health Board, it will also make clear to the NGO what the chances are of the policy being continued or terminated.

Trade-offs

- S3.30 To address these concerns requires some trade-offs between the principles that we expect public entities to follow:
- **fairness** (to other potential providers – for example, by open tendering) is traded off against **value for money** (using an expression-of-interest approach followed by a limited RFP, because the initiative is likely to draw on a limited pool of potential providers);
 - **accountability** (which in this instance could warrant detailed reporting by the NGO and intensive monitoring by the PHO) must be considered in the context of **fairness** to this small and administratively inexperienced NGO; and
 - **efficiency** is also considered in the context of **fairness** – funding must be appropriate, given that the provider must build up its own capacity, yet carries the risk that the *Kaihauora* initiative as a policy might not work and therefore could be discontinued by the Midnorth District Health Board.

Managing the risks

- S3.31 The approach adopted needs to be transparent, so that:
- the NGO is clear on what the risks are; and
 - the PHO can hold the NGO accountable for the public funds, and, in turn, be held accountable by the Midnorth District Health Board for spending *Kaihauora* funds and for taking justifiable risks with them.
- S3.32 These risks are documented, and the Midnorth District Health Board and the PHO adopt a procurement approach that:
- agrees the timetable and criteria for judging the effect of *Kaihauora* (on the health status of Māori). The timetable and criteria are made clear to the potential provider in early discussions (and later spelled out in the formal agreements between the Midnorth District Health Board and the PHO, and between the PHO and the NGO);
 - seeks an expression of interest/limited RFP. The approach is documented, to make it clear how potential providers will be selected;
 - agrees conditions for future renewal of the contract, so that the extent of contestability will be reconsidered;
 - has accountability mechanisms such as monitoring and reporting that take the level of risk into account (the NGO was unproven in this field), while acknowledging the NGO's limited experience of and resources for formal reporting (for example, the PHO makes allowance for funding accounting and auditing services for the NGO for the *Kaihauora* initiative); and
 - takes into account the costs of building the capacity of the selected NGO.

Accountability for the public health initiative

- S3.33 There are several levels of accountability in such an arrangement, and this is common in the health sector.

The Ministry of Health

- S3.34 In this scenario, at the highest level, the Ministry is accountable under legislation for spending of the appropriation for the *Healthy Eating, Healthy Action* strategy, and the achievement of particular health gains through adopting such a policy. The Ministry needs to be able to collect and manage information, so it can be satisfied that a reduction in obesity and an increase in physical activity will, in fact, lead to reduced adverse health effects. The Ministry is responsible for keeping the health sector informed on that issue.

The District Health Board

- S3.35 The Midnorth District Health Board is accountable under an agreement with the Ministry for the success of the *Kaihauora* initiative. It must demonstrate to the Minister and the public that using public funds in this way is making a difference to the health status of Māori, and is doing so as efficiently as possible.
- S3.36 Therefore, the Midnorth District Health Board puts in place an information collection and management process that measures progress against the agreed indicators. The indicators are awareness of the “message”, and changes in the eating and activity levels of the target population, over the agreed time. This includes reporting against the relevant indicators that it used before the *Kaihauora* initiative to assess the health needs of the target population.
- S3.37 The Midnorth District Health Board reports to its governing body at the agreed milestone dates, and also before decisions are made by the Board about whether to continue with the project.

The Primary Health Organisation

- S3.38 The PHO is accountable under its agreement with the Midnorth District Health Board for ensuring that:
- the public funding is applied by the NGO only to the agreed project (though making the agreed allowance for the infrastructure needed to sustain the project);
 - the funding of the project and its infrastructure is no more than is required to enable the NGO to get the appropriate results; and
 - the NGO provides sufficient information to enable the integrity and effect of its activities to be monitored.
- S3.39 The PHO requires the NGO to provide data to show that the public funds have been spent in keeping with the agreement. Because there is a substantial amount of money involved in the *Kaihauora* initiative, audited financial statements of the NGO are required. The PHO assists in setting up the systems needed to do this. It visits the NGO to enhance their relationship, and to support and develop the NGO’s capacity, and establishes an arrangement with local iwi to complement this support.

Success of the *Kaihauora* initiative

- S3.40 The essential aspect of the funding arrangement is that the NGO is accountable to the PHO under its funding agreement – not for specific outputs, but for ensuring that what it does makes a difference. It is accountable for providing

data on target group awareness and eating behaviour, and data to show that the public funds have been spent in keeping with the agreement (audited financial statements are required). “Credibility” of the NGO with the target group may not necessarily achieve any change in the target group’s behaviour. Its success needs to be demonstrated. The PHO seeks confirmation that the desired changes have resulted.

- S3.41 However, to reduce the compliance costs on the NGO, and to ensure independent confirmation of the impacts of the *Kaihauora* initiative, the data on target group awareness and eating behaviour is provided by an independent researcher on contract to the PHO.
- S3.42 The Midnorth District Health Board negotiates with the PHO about whether *Kaihauora* should continue; the PHO keeps the NGO informed of the status of *Kaihauora* as a policy initiative and negotiates with the NGO about whether its funding agreement will be renewed or, if not, whether the PHO will go to the market.

Conclusion

- S3.43 The funding arrangement with an NGO may require it to produce certain changes in the population – for example, to raise community awareness – rather than delivering particular services, and the funding arrangement needs to reflect the risks and uncertainties in getting results in such a case.
- S3.44 “Sole provider” procurement or (as in this scenario) procurement that does not go to the market in an open way, must be justified. The public entity must document its reasons for the approach, and take particular care to make sure that any alternative providers have been considered fairly before opting for a procurement approach that may not give equal access to all potential providers.
- S3.45 Where an NGO provider is chosen for its ability to effectively deliver messages to the target population (in this case Māori), it may be small and lack a sound administrative and accountability structure. The higher risks must be managed but not – if it is to be done effectively – with more administrative compliance. Management and monitoring arrangements may need to be lighter on paperwork, but stronger on support and contact – and perhaps with accountability information being gathered by third parties who have expertise in that area.
- S3.46 To a certain extent, efficiency may need to be traded off for effectiveness – that is, the focus of the funding arrangement should be on results achieved, not just lowest cost. However, the public entity still must monitor to ensure that public funding is being used only for the public benefit, that costs are reasonable, and that continuing the initiative is justified.

- S3.47 In this scenario, the monitoring and evaluation and consideration of the ongoing relationship is complicated by several linked sets of accountability arrangements – from a government department to a Crown entity to one non-profit organisation (the PHO) to an NGO provider. The monitoring and reporting arrangements need to recognise each set of accountabilities, and acknowledge the risks for each party.
- S3.48 When a public entity is expecting outcomes in the form of changes in population awareness or behaviour, rather than specific outputs, it needs to prepare a sound analysis to underpin its intervention rationale, measure its success, and then justify – if need be – continuing its relationship with the NGO provider. All parties in the funding-delivery chain need to be aware of the policy-results-funding links.

Scenario 4: Managing many low-value grants

- S4.1 Most local authorities and other public entities offer discretionary grants to local NGOs, because they recognise the public benefits that come from having a range of active community groups to complement their own activities as well as those of other agencies.
- S4.2 Public entities usually consider that such grants provide benefits such as:
- stability for established groups providing valued community services (such as sports clubs, and arts, cultural, or social support agencies); and
 - support for innovative community initiatives (such as community festivals, and social or recreational programmes for disadvantaged or at-risk groups).
- S4.3 Most grants are small – for amounts of a few thousand dollars or less – and there are likely to be many NGOs undertaking services and providing initiatives that merit support. Likewise, the NGOs applying for the grants that public entities such as local authorities offer are likely to be smaller and locally based, or focused on sport or cultural activities, care of children (such as playgroups) or the elderly, or local church or social support activities.
- S4.4 Usually, there are more groups seeking funding than there are funds available. Most communities have many community groups that hope for some support with their ongoing operations, as well as many once-only community events or initiatives that seek support. The public entity needs to consider the likely affect of the funding that it has available to distribute among applicants for grants.
- S4.5 A public entity needs to carefully consider the accountability arrangements it requires of a group for any grant. The demands made of a group need to be balanced against the broader public need to ensure that grants are used in keeping with the principles set out in this good practice guide.
- S4.6 A public entity also needs to:
- balance the interests of established and emerging groups;
 - set management and accountability expectations that reflect the size and scale of the grants involved;
 - meet public expectations for the responsible management of its public funding; and
 - consciously consider the trade offs between the principles of fairness, accountability, and value for money.

Planning for the funding arrangement

- S4.7 This scenario describes the approach of a fictitious local authority, the Arotake District Council (the District Council), through the life cycle of a funding arrangement, concluding with matters we consider that public entities giving low-value grants should design for and take into account. In this scenario, the District Council manages several grant programmes that are funded from different sources with different intentions.
- S4.8 The District Council has ensured that each programme has a clear purpose and eligibility criteria, to provide clear administrative guidance for awarding the grants. For discretionary programmes (where it chooses the purpose of the grant), the District Council has policies that link the grants to the nature of the public benefit anticipated and to its own strategic reasons for being involved in administering the grants. It also has policies that deal with its decisions to provide grants in different circumstances.
- S4.9 The District Council awards grants through:
- Community Grant Funds for projects that encourage community growth and participation. Preference is given to economically or socially disadvantaged groups, and projects that sustain and support a network of community organisations in the district. Community grants aim to help non-profit groups with local initiatives that support the District Council's strategic goals, for projects that focus on community development, health, and well-being.
 - A Youth Initiative Fund to recognise the important role young people play in the life of the district, and to support the District Council's strategic goals about young people (as outlined in its own planning and accountability documents).
 - A Safer Community fund that supports local initiatives to make the district a safer place to live.
 - Residents' Association Grants to recognise and support the important contribution that such associations make to the district by helping them with general running costs.
 - Māori Arts Grants for projects that emphasise traditional or contemporary Māori cultural influences. The District Council makes the grants to reflect its commitment to the Treaty of Waitangi, and the unique place of Māori culture and arts as representative of tāngata whenua.
- S4.10 The District Council also manages the distribution of grants under the Cultural and Artistic Development Funding Programme of the fictitious Department for Cultural Capacity.

- S4.11 The arrangements for seeking and assessing grant applicants are critical to managing the District Council's grant funding fairly and transparently. The District Council employs Community Advisers who are responsible for:
- liaising with NGOs, including making sure that the NGOs know about the interests of, and funding opportunities available from, the District Council and other organisations;
 - helping (where appropriate) NGOs to establish and maintain their own organisational capacity, through which the Community Advisers build their understanding of the capability of groups for managing grant funding and for delivering planned community initiatives and services;
 - running the application process, including providing information through newspapers and websites, and specific support to NGOs in preparing service intentions and application proposals;
 - assessing applications, including how the applications match the District Council's policies and strategy, and making recommendations to Councillors about applications;
 - managing, monitoring, and evaluating the use of grants provided and the success of the initiatives funded; and
 - taking part in reviews of policy, based on their knowledge of community needs and interests.
- S4.12 To promote grant funds to the widest range of NGOs (and to ensure that the District Council observes the principle of openness), the District Council also provides:
- public information about the availability, purposes, criteria, and application process through its website, and recent funding decisions in newspapers and through other public information that it produces; and
 - information and support targeted to NGOs and community groups, such as mailing information about grant application opportunities, and seminars to help organisations considering making applications.

Selecting an NGO and negotiating the terms

- S4.13 The District Council is careful to ensure that its consideration of applications follows a documented process.
- S4.14 First, Community Advisers assess grant applications and prepare recommendations for the District Council's grants subcommittee (a standing committee that acts under delegation from the District Council to consider and approve grants within the applicable policy, funding criteria, and application process).

- S4.15 The grants subcommittee assesses all the applications, both individually and relative to those currently before the District Council and recently approved, considering:
- the extent of demand or need and benefit intended to result from the service or initiative proposed;
 - the support requested from the District Council, and how the funding requested fits with the purposes of, and criteria for, the available funding; and
 - the capability of the group applying for funding, and the other resources or support the group may need for the proposal to succeed.
- S4.16 For the applications that it believes merit consideration for funding support, the grants subcommittee then considers:
- the nature and risks associated with any service or initiative proposed; and
 - the funding that should be provided, and how well this fits with the scope of the service or initiative that the group is proposing to undertake.
- S4.17 Finally, the grants subcommittee considers the form of the agreement, and the monitoring and accountability arrangements that will be suitable to put in place. It therefore considers:
- the form of the agreement – contract agreement or unrestricted grant;
 - the extent of financial reporting expectations;
 - the extent of reporting on the success or achievements of the service or initiative; and
 - the risks associated with the grant, and the extent of monitoring and support required.
- S4.18 For smaller grants with lower identifiable benefits, the District Council is more likely to award a grant with no specific reporting requirements. For example, each year the District Council provides very small grants of a couple of hundred dollars to Residents' Associations, to help with running costs such as stationery and postage.
- S4.19 The District Council does this because it wants to recognise the important contribution made by Residents' Associations in representing and advocating for residents and ratepayers of communities within the District Council's district. To be eligible to receive a grant, an Association must be legally constituted, be registered with the District Council, have an active membership of 10 people or more, meet at least twice a year, and keep records of its meetings. Having established that these criteria are met, the Council sets no further obligations on an Association, other than asking that financial statements and minutes be available on request.

S4.20 In contrast, the District Council also provides funding of several thousand dollars to an NGO, under its Youth Initiative programme, so that the NGO can employ a part-time Youth Development Co-ordinator. This funding is provided through an agreement that requires the funding to be spent in keeping with the NGO's application, and within one year of receiving the funding. The NGO must tell the District Council about any delays or modifications to the project. The Council asks the NGO to acknowledge the support it receives from ratepayers, and suggests some means by which the NGO can do this. The Council also requires a satisfactory report, noting that a failure to provide such a report will be considered when the NGO applies for any grant funding in the future.

Balancing accountability and value-for-money principles

S4.21 The District Council must balance the level of accountability it seeks through its reporting requirements with the funding that it provides. Generally, the more established an NGO is, the more likely it is to prepare information (such as audited annual financial statements) as a matter of course. However, annually audited financial statements are not a mandatory requirement (unless the founding document for the NGO specifies an annual audit requirement).

S4.22 The District Council considers financial accountability options, and requires audited financial statements for funding over a specified financial threshold. Beneath this financial threshold, it selects methods to ensure that there is accountability for the use of funds, for example:

- a detailed account of how money is spent, showing how funding comes into and goes out of the NGO's finances, and requires receipts to verify major expenditure; or
- the preparation of annual financial statements that are audited, or have been reviewed and signed by an independent and suitably qualified person. The District Council specifies that a suitably qualified person could be a bank manager, accounting graduate, retired accountant, or accounting technician, rather than a member of the New Zealand Institute of Chartered Accountants.

S4.23 The District Council also considers the reporting it should request about the progress with or achievement of the grant's purposes. Because it is dealing with many smaller-value grants, it is not likely to be either effective or realistic for the District Council to expect significant and demonstrable change because of its funding. In many instances (for example, providing grants to Residents' Associations), grants are made to reflect a benefit that the District Council believes exists, rather than a benefit that will demonstrably occur directly because of a grant.

- S4.24 The District Council ensures that the demands it makes about reporting achievements and benefits are in keeping with the funding provided. With the Residents' Association grant, the District Council confirms its view that a Residents' Association is capable of making a contribution for residents and ratepayers of an area by requiring evidence of minimum membership and activity.
- S4.25 For the Youth Co-ordinator, the District Council requires the NGO to report on:
- demographic information about the beneficiaries of the project (has the project helped the people it intended to?);
 - endorsements from beneficiaries or contact details of selected beneficiaries for the District Council to contact for endorsements (have the beneficiaries of the project agreed that the project has helped them, and in what way?);
 - other groups with which the NGO has worked (has the project helped to link the beneficiaries with other groups that could help them?); and
 - media coverage (was the NGO successful in generating broadly-based community interest in the project?).

Managing the funding arrangements, and monitoring and evaluating

- S4.26 The District Council considers what support and monitoring might be needed to help an NGO to manage identified risks, so that a service or initiative will achieve its intended purposes. Established and stable NGOs are likely to need less support or monitoring from the District Council than emerging NGOs. Ambitious projects that need extensive co-ordination are likely to require more monitoring attention and support from the District Council.
- S4.27 The District Council's Community Advisers are responsible for making such assessments, and for staying in contact with NGOs identified as likely to benefit from advisory support as the funded service or initiative is undertaken.
- S4.28 The District Council must ensure that it is accountable to its ratepayers and residents, or other individuals and organisations that provide funds for it to distribute. Therefore the District Council ensures that, in managing grant funding, it maintains discrete records for each identified fund. This lets the District Council demonstrate that it has used grant funds in keeping with the relevant criteria and policy.
- S4.29 The District Council's staff report to the grants subcommittee regularly about:
- the expenditure of grants;
 - an analysis of applications received, amounts of funding sought, the purposes of funding, and the amounts of funding approved;

- reporting requirements for grants, and the action taken where the requirements are not met;
- the reported results achieved by grants, noting the features of grants that appear to have successfully achieved the intended objectives compared to those that have not; and
- any features that could help the grants subcommittee with its funding decisions in the future.

S4.30 The District Council recognises that it is important that NGOs are accountable for their use of grant funds. However, it is aware, given the low value of most grants, that it is unrealistic to expect any individual grant to directly or substantially achieve the District Council's outcome or strategic objectives for providing grants.

S4.31 In most cases, the District Council provides grant funding to recognise the benefits it believes occurs through having active locally based NGOs. The Council therefore uses the reports it receives about individual grants, along with other social, economic, environmental, and cultural information, to assess whether its grant programmes are contributing to its intended outcomes and objectives – including having active and enthusiastic community groups in its area.

S4.32 Using the grant programme and general monitoring information, the District Council maintains the relevance of its policy framework and its alignment of the use of grants with its own strategic direction and intentions by reviewing its policies every 3 years. The timing of the review coincides with the timing for the District Council's statutory long-term planning obligations.

Conclusion

- S4.33 The important features of how a public entity administers the disbursement of many low-value grants are that the public entity:
- establishes a clear policy for grant programmes by ensuring it has an understanding of the purpose and criteria of the grant programmes it administers, and collects information to allow it to periodically review the policies and strategies to which grants contribute. This is to ensure that the policies and strategies continue to be relevant, and that the district council is satisfied with the progress it is making in delivering on its strategies and policies;
 - ensures that it has the resources and skills to help NGOs access funds, and maintains an awareness of the capacity of groups and the demands of projects to ensure that initiatives funded are consistent with the intentions of grant fund purposes and are achievable for the NGO;

- ensures that there is both general information and information that is targeted to NGOs to promote and encourage fair access to the available grant programmes;
- takes a risk-based approach to considering the extent of reporting and monitoring required, to balance the reporting burden with the particulars of the funding arrangement with the NGO; and
- ensures that it keeps suitable records to show that funds are used for their intended purpose and that, at an overall level, grants are delivering the public benefits anticipated from them.

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