Report of the
Controller and Auditor-General
Tumuaki o te Mana Arotake

on

Certain Matters Arising from Allegations of Impropriety at Transend Worldwide Limited

December 2002

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Overview by the Controller and Auditor-General

This report concerns Transend Worldwide Limited (Transend), a wholly-owned subsidiary of New Zealand Post Limited (New Zealand Post).

Transend is a company that is responsible for marketing to overseas postal agencies the expertise in postal reform and operating a modern postal system that has been built up within New Zealand Post. Until September 2001, Transend was also responsible for New Zealand Post's international mail services, by far the major business of the company. The Board of New Zealand Post (the Board) governs Transend.

Following its 2000-01 financial review of New Zealand Post, the Finance and Expenditure Committee recommended that I provide assurance that Transend has made improvements to its policies and procedures, following allegations about its operations. The Committee's concerns related mainly to the adequacy of the process that the Board had followed to investigate the allegations and whether any problems identified had been fixed.

This report is about:

- the governance arrangements that the Board has for Transend;
- the investigation process instituted by the Board in March 2001, following the receipt by a Board member of two anonymous letters alleging wrongdoing within Transend;
- the Board's response to the results of the investigation; and
- the extent to which the problems identified have been addressed.

In carrying out our inquiry, we examined:

- the adequacy of governance and accountability arrangements for Transend;
- the investigation process that the Board undertook; and
- Transend's policies and procedures for letting tenders, compliance with financial delegations, and controls over travel, accommodation and business expenses.

The allegations about Transend's operations have played out in the public domain over the past two years. In preparing this report, we felt that it was important to clearly outline the sequence of events and provide assurance that the necessary improvements have been made to Transend's policies, procedures, and operations.

Findings

Governance and Oversight of Transend

The current arrangements for New Zealand Post to exercise governance and oversight of Transend, and for Transend to be accountable for its actions to New Zealand Post, are appropriate.

During the period of events described in this report, the accountability arrangements did not always work as intended. The Board did not always receive reports providing realistic assessments of issues facing Transend. Several enhancements were made later to improve the arrangements.

During the period November 2000 to June 2001, six new members were appointed to the eight-member Board to replace those members whose term had expired. Having six new Board members over a period of eight months disrupted the continuity of the Board's consideration of very major issues. For the future, we believe it desirable that expiry of the term of appointment of members of the Board of a State-owned enterprise be spaced at longer intervals.

The Process to Identify and Investigate the Allegations

The process that the Board adopted in early 2001 to identify and investigate the anonymous allegations about Transend's operations was complex and involved a high degree of confidentiality. We are in no doubt that the Board took the anonymous allegations very seriously.

The Board took legal advice on how to communicate with the anonymous employees and gather information from them on a confidential basis. The process used to identify the allegations generally followed this legal advice. The process led to staff nominating other staff whom they felt could be approached confidentially for information, which resulted in a climate of mistrust within Transend.

The Board completed the process of identifying the allegations and undertook further enquiries itself and through PricewaterhouseCoopers (PwC). After reviewing the PwC report, the Board concluded that there were no problems of impropriety but that improvements in compliance with procedures were required. The Board decided that it had satisfactorily investigated the allegations and that further enquiry was not necessary.

However, in our view, a significant deficiency in the Board's approach was that it did not consider or seek legal advice on how the principles of natural justice would be accorded to the Transend staff who were the subject of the allegations. Those staff were never given any opportunity to respond.

New Zealand Post took appropriate steps to address the issues arising from the investigation of the allegations. The Board sought a number of reports from the Chief Executive and the Chief Financial Officer including the steps taken to strengthen policy compliance, financial management governance and reporting to the Board.

Reasonableness of Transend Travel Expenditure

The substantive changes to Transend's policies and procedures were made only after the appointment of the current Acting Managing Director on 12 March 2002. In our review of Transend expenditure, we found that in the period before his appointment, there had been a failure by the management of Transend to consider whether the expenditure that was being incurred by some staff was reasonable.

The Transend travel policy at this time differed from New Zealand Post policy in some key respects. The Board approved some but not all exceptions to the New Zealand Post policy in September 2000. Some parts of the Transend policy were not appropriate. The policies allowed a small number of Transend staff to incur expenditure that was wasteful and excessive.

Since late-2001, Transend staff numbers have been considerably reduced as it ensures that its expenditure is aligned with revenue. The senior management of Transend has been mostly replaced. Under the new management, there is a clear focus on consultancy services. Transend's travel policy has been aligned with that of New Zealand Post and expenditure is closely monitored.

Our review of travel, accommodation, and business expenditure since the changes showed adherence to the latest Transend policy. The latest Transend policy needs to provide further guidance on what is acceptable hotel accommodation, and meal and entertainment expenditure.

Lessons to be Learned

We think there are important lessons for all public entities arising from our report, including:

- The governance structures for subsidiaries must be closely monitored to ensure that they work effectively. In the case of subsidiaries where the parent board has ultimate responsibility, there must be comprehensive and realistic reporting to the parent board about the subsidiary's activities.

- Subsidiaries operating overseas pose particular risks that must be carefully managed.

- In general, the same policies and procedures should apply to the group (parent and subsidiaries). Any exceptions should be approved at an appropriate level. The need for the exceptions should be monitored carefully.

- Entities must ensure that they have adequate procedures in place to regularly examine compliance with policies and delegations and whether they remain appropriate.

- Credit card spending continues to be an area of risk and must be closely scrutinised.

- Public entities should encourage their employees to use the procedures set out in the Protected Disclosures Act 2000 (including their own internal procedures established under the Act) for making disclosures of serious wrongdoing, unless there is a sound reason for using alternative procedures. They should ensure that the procedures are adequately communicated to staff.

These are matters that New Zealand Post has addressed in its policy and practice.

An inquiry of this nature can be difficult for all parties involved. I acknowledge the assistance received from New Zealand Post in carrying out our inquiry. Access was provided to all the information we needed. Everyone we spoke to was at all times helpful and co-operative.

K B Brady
Controller and Auditor-General

16 December 2002

Part One

Introduction

What This Report Is About

1.1 This report is about:

- the anonymous allegations of impropriety that Mr Syd Bradley, the Deputy Chairperson of New Zealand Post Limited (New Zealand Post), received about Transend Worldwide Limited (Transend) operations in January 2001;
- the process that the New Zealand Post Board (the Board) subsequently followed to investigate the allegations; and
- the steps it took to address the issues identified.

1.2 The report also examines:

- the governance arrangements that New Zealand Post had for Transend; and
- the Transend policies and procedures on travel, accommodation and business expenses, letting of tenders, and compliance with delegations of authority – including how these policies and procedures have been implemented in recent significant operations and transactions.

1.3 In Appendix 1 we set out the names of the people that we refer to and the positions they held during the period of events that our report describes.

Why We Conducted Our Inquiry

1.4 The inquiry was the result of a recommendation from the Finance and Expenditure Committee to the Auditor-General. The Committee reported to the House on its financial review of the 2000-01 performance and current operations of New Zealand Post in April 2002. During the course of its review, the Committee examined the operations of Transend, an international postal consultancy subsidiary of New Zealand Post.

1.5 In its report[1] the Committee expressed concern about aspects of Transend's operations 4

> *We have a number of concerns in relation to the operations of Transend and the processes undertaken to evaluate the operations. We received wide ranging evidence suggesting management processes in Transend required improvement. We are uncertain whether the New Zealand Post board's procedures for dealing with these issues were robust enough to ensure that Transend's problems have been fixed. In particular, we are*

1 *2000/01 Financial Review of New Zealand Post Limited: Report of the Finance and Expenditure Committee*.

concerned that a full audit was not undertaken. We therefore recommend to the Auditor-General that he consider undertaking an audit of Transend to ensure its policies and procedures are adequate. As the international representative of a major State enterprise it is vital that Transend is managed in accordance with best practice.

1.6 Following the Committee's recommendation, the Auditor-General decided to inquire (under section 18 of the Public Audit Act 2001) into certain aspects of Transend's operations and their oversight by New Zealand Post.

The Committee's Concerns About Transend

1.7 During 2001 and in the early part of 2002, the Finance and Expenditure Committee met 13 times in the course of its financial review of New Zealand Post. A particular focus of the Committee was the activities of Transend. The Committee spent some time questioning Board members and senior staff from New Zealand Post and Transend on matters concerning Transend.

1.8 In its report to the House, the Committee commented on its concern about the way New Zealand Post had responded to questioning by the Committee 4

We consider New Zealand Post's response to our request was unhelpful and contributed to the need for four appearances before the committee for this financial review. We do not expect to be treated this way by any organisation that appears before this committee, including State enterprises.

1.9 We met with several members of the Committee before we began our inquiry to understand the reasons for the Committee's concerns, and to canvass their views on the possible ways in which the Auditor-General could appropriately respond to those concerns.

1.10 The Committee was especially concerned about the allegations of impropriety in Transend's operations and the adequacy of the process followed by the New Zealand Post Board to investigate these allegations. Members of the Committee had varying views about the extent of residual concern about Transend's operations – some did not have significant concerns about Transend operations, while others were not satisfied that New Zealand Post had addressed all matters arising from the allegations.

1.11 However, all members we met shared the view that an inquiry by the Auditor-General into Transend's operations would provide an independent view that would help set the record straight.

Terms of Reference for Our Inquiry

1.12 We decided on the following terms of reference for our inquiry.

Governance and Accountability

1.13 To inquire into:

- The adequacy of the existing arrangements for New Zealand Post to exercise governance and oversight of Transend, and for Transend to be accountable for its actions to New Zealand Post.

- Whether the process used by the Board of New Zealand Post, in response to allegations of impropriety it received in 2001 about aspects of Transend's operations, was sufficient to enable the allegations to be properly identified, investigated and acted upon.

- Whether New Zealand Post and/or Transend have taken sufficient steps to address all issues arising from that process.

Operational Policies and Procedures

1.14 To inquire into:

- The adequacy of Transend's existing policies and procedures for letting tenders, compliance with financial delegations, and controls over travel, accommodation, and business expenses.

- Whether those policies and procedures have been satisfactorily implemented in recent significant operations and transactions,

The Process We Followed in Our Inquiry

1.15 In general, we examined documents and events from the last two years. During the course of the 2000-01 financial review of New Zealand Post, the Finance and Expenditure Committee had obtained numerous relevant documents and testimony, which we referred to and utilised in our inquiry.

1.16 We interviewed:

- all the current Board members of New Zealand Post and the former Chairperson, Dr Ross Armstrong; the Chief Executive, Mr Elmar Toime; the former Managing Director of Transend, Mr Drew Stein; and several other members of staff of both New Zealand Post and Transend;

- the Board's legal counsel, Ms Kristy McDonald QC;

- Mr John Selby of PricewaterhouseCoopers (PwC), engaged by the Board to assist with the investigation of the allegations about Transend;

- Mr Cameron Mander (a partner of Luke Cunningham and Clere) appointed by the Board as an independent intermediary; and

- staff members of the Crown Company Monitoring Advisory Unit (CCMAU).

1.17 We examined a large number of documents 4 including the Board papers and minutes, policies and procedures and other papers relevant to our inquiry.

1.18 We reviewed:

- Mr Mander's summary of the allegations; and

- the financial transactions of Transend 4 to assess whether the policies and procedures for letting tenders, compliance with financial delegations, and controls over travel, accommodation and business expenses had been satisfactorily implemented in recent transactions.

Part Two

Transend Worldwide Limited

The History of Transend

2.1 Transend was previously called New Zealand Post International Limited (NZPIL). The diagram below outlines the history of the company.

1996	New Zealand Post International Limited (NZPIL) formed to manage New Zealand Post's offshore consultancy assignments.
1997	In late 1997 Board of New Zealand Post reviews International Mail and International Consulting Groups to identify synergies. One of the key factors driving the review was the Board's view that New Zealand Post had the ability to grow its international business. The review resulted in a decision to merge the International Mail and Consulting Groups into one organisation.
1998	International Group formed with effect from 31 March 1998 comprising both the International Mail and International Consulting Groups. Position of Group Manager International created to manage the newly formed International Group – Mr Drew Stein was appointed to this position. Mr Stein told us that his appointment as head of the NZPIL was part of the plan to expand the international consulting business and rejuvenate the international mail operation. In August 1998, Board approved the inclusion of the International Group's activities, with the exception of the International Mail Centre within NZPIL. Therefore NZPIL was reactivated (as originally envisaged) to be the legal entity for all offshore consulting work and New Zealand Post's international activities (rather than operating separately within the International Group).
1999	Only some of the revenues and expenses of the inbound international mail business was recognised in NZPIL's 31 March 1999 financial statements.
2000	The revenues and expenses of the entire international mail business and the consultancy business recognised in NZPIL's 31 March 2000 financial statements. In August 2000, the name of NZPIL changed to Transend Worldwide Limited, because NZPIL was no longer considered to fit with the worldwide consultancy business being built. (The presence of "New Zealand" in the name gave the impression that the company was too small and distant to take on large consultancy projects.)
2001	In September 2001, Transend restructured to refocus on its core business of postal consultancy services. The international mail business was transferred to the Letters and Enterprises business unit of New Zealand Post, with retrospective effect from 1 July 2001.

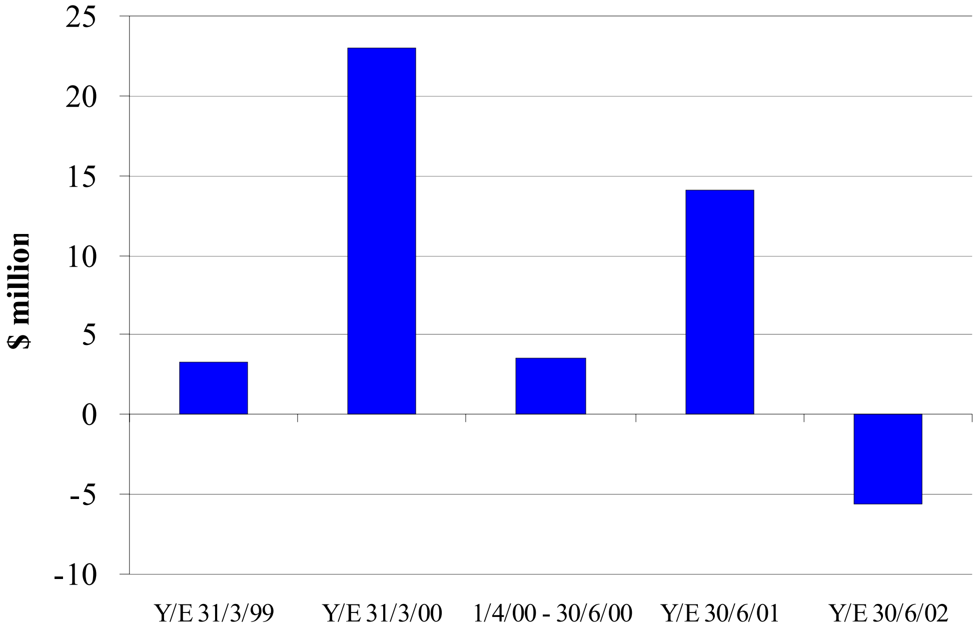
Transend's Profitability

2.2 Overall, Transend was a profitable operation for New Zealand Post 4 more particularly while it was responsible for the international mail business. Appendix 2 details three of the major management contracts won by Transend over the past few years.

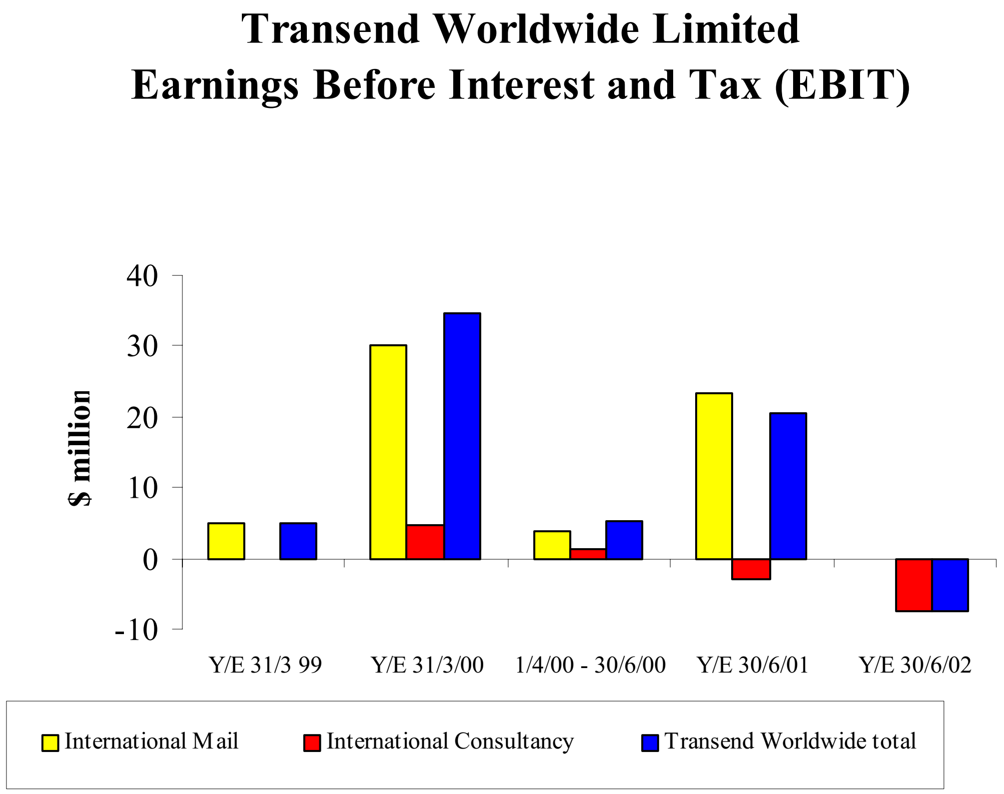
2.3 The following graph shows the net after tax surplus/deficit of Transend for the years ended 31 March 1999 and 2000; the three months ended 30 June 2000 (a change in balance date); and the years ended 30 June 2001 and 2002.

2.4 The result for the year ended 30 June 2002 is the result for the postal consultancy business only because the international mail business had been transferred to the parent company (New Zealand Post) with effect from 1 July 2001. The result for the year ended 31 March 1999 relates solely to the inbound international mail business from 1 November 1998. All revenue and expenditure relating to the rest of the international mail business and the consultancy business were accounted for through New Zealand Post.

Transend - Net After-tax Surplus/Deficit



2.5 While overall Transend was a profitable operation, the postal consultancy business was not always profitable. The next graph shows the respective earnings before interest and tax (EBIT) of the international mail business, the postal consultancy business, and the Transend total over the same period. (We have shown EBIT rather than the net after-tax result, because the latter result was not kept separately for the two businesses.)



2.6 Financially and operationally, postal consultancy services were only ever a small part of Transend. Transend now employs 22 staff and one contractor.[2] When international mail was part of Transend, it employed 94 staff and 10 contractors.[3] The international mail business accounted for over 72% of Transend's revenue and expenditure.

2.7 People we spoke to expressed different views on the validity of the above observations on the respective contributions of the international mail and postal consultancy businesses. Dr Armstrong told us that it is not valid to separate out the consultancy and international mail businesses within Transend, because they were viewed as one synergistic organisation with intertwined overhead structures. However, the source of the financial information we have presented here was Transend's management reports.

2.8 Another Board member suggested that the true profitability of the consultancy business could not be determined while international mail was included. He believed that this was a key reason for transferring international mail to the Letters and Enterprises business unit.

2 Figures as at 20 November 2002.
3 Figures as 30 August 2001. The staff numbers include long-term secondees.

2.9 Before the transfer, international mail had an expected EBIT for the year ended June 2002 of $24 million. After the transfer, the expected EBIT was re-calculated and a target set of $33 million. The actual EBIT achieved for the June 2002 year was $31 million.

Part Three

Governance

Governance of New Zealand Post Subsidiaries

3.1 New Zealand Post has a number of subsidiary companies.[4] These subsidiaries have been formed out of existing operations or have been acquired to develop the core business of New Zealand Post.

3.2 In its early years as a State-owned enterprise, the subsidiary governance model used by New Zealand Post had its directors represented on the boards of its main subsidiaries. The model aimed to ensure that the Board was fully informed of any issues within its subsidiary.

3.3 In 1994 the Board revised the governance arrangements for subsidiaries. Under the new arrangements, wholly owned subsidiaries of New Zealand Post operated as business units of New Zealand Post through a management structure, rather than having a formal board structure. The Managing Director of each subsidiary reported directly to the Chief Executive of New Zealand Post, who is accountable for the operations of subsidiaries. The Board is ultimately accountable for the governance of subsidiaries which provide regular and comprehensive reporting to the Board.

3.4 In 2001, the Board re-examined the governance arrangements for its subsidiaries. Board papers on various matters relating to subsidiary governance were presented to the May, August, September and November 2001 Board meetings. These papers were prepared as a result of matters arising from the Board's investigation into Transend.

3.5 At the same time as considering the question of reporting on subsidiaries, the matter of whether the Board members should be represented on subsidiary boards was considered and a general conclusion reached that there is no reason for such representation. One Board paper referred to the *Institute of Directors Best Practice Statement 2000/1 Boards of Subsidiaries*, which states that 4

> *Whether any useful purpose is served by other parent company directors, in addition to the CEO, also being directors of group subsidiaries is a moot point. Reporting procedures can have a bearing. Parent company directors sitting on the board of a subsidiary can put management in a difficult position. On the other hand, parent company directors on the board of a subsidiary that reports directly to the parent board can improve monitoring procedures and provide an overview interest. In the final analysis it will usually be a question of which format will, in the particular circumstances, serve the interests of the group as a whole.*

3.6 The Board paper noted that actual subsidiary governance practice varied amongst different groups of companies and depended on the particular circumstances of the group concerned.

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4 As at 30 June 2002, New Zealand Post had 10 operating subsidiaries (including Transend Worldwide Limited and Kiwibank Limited) and 8 non-operating subsidiaries.

3.7 At its September 2001 meeting, the Board reaffirmed the subsidiary governance model, with some changes being made to the level of subsidiary reporting to the Board.

3.8 During 2001, the Board approved further changes to the New Zealand Post Governance Policy. Substantive changes included:

- Each wholly-owned subsidiary must adopt New Zealand Post policies, unless the Board or Chief Executive (depending on the level of approval of the original policy) approves otherwise. This is consistent with its "one company" principle 4 which ensures that New Zealand Post, its business units and subsidiary companies operate under one business philosophy, and with one strategy and direction.

- The Board would approve the appointment of directors of operational subsidiaries, and the Chief Executive would appoint the directors of non-operational subsidiaries and associate companies.

Governance of Transend

3.9 Transend has a two-person board that comprises the Managing Director of Transend and the Chief Executive of New Zealand Post. This board is a "statutory" board only. In practice, the New Zealand Post Board governs Transend, and Transend reports to the Board at its monthly meetings.

3.10 As a wholly owned subsidiary, Transend is bound by New Zealand Post policies (with approved exceptions) and delegations of financial authority.

3.11 The other controls that operate in the governance of Transend are:

- The ability of the internal audit function to report directly to the Chief Executive of New Zealand Post, the Chairperson of the Finance and Risk Committee, and the Chairperson of the Board on any matters of concern.

- Oversight by the New Zealand Post Chief Financial Officer of compliance with financial delegations. The Corporate Finance Group also scrutinises the Transend monthly Board reports and collates them, with other subsidiary Board reports, for presentation at Board meetings.

- The availability of the Chief Executive to be questioned by the Board on any aspect of Transend's activities at Board meetings.

3.12 For the Board, Transend's operations as an international consultancy business are by their nature, an area of higher commercial risk. Transend operates in competitive overseas markets, where winning work is costly and uncertain. Local interests may be opposed to postal reform. The cancellation of Transend's contract with the South African Post Office (see Appendix 2) with a substantial loss of revenue highlights the risks of Transend's operations. There can also be physical risks for Transend staff working in difficult and dangerous environments.

3.13 We examined:

- the extent to which the Board had considered risks and issues within Transend;
- whether the Board was satisfied that it was fully informed; and
- how these risks and issues were being managed.

3.14 Board members are well aware that to fulfil their duties as directors they need to ensure that they receive comprehensive and realistic reporting about Transend and any emerging business issues. Some Board members commented to us that they had found Transend's monthly operational performance reports often to be "good news reporting" and that it was not easy to learn of current or impending difficulties.

3.15 The Board minutes support this view. One example relates to the reporting of Transend's proposal to take over the management of an overseas postal consultancy business. The Board minutes show:

- In March 2001, Transend advised the Board that the Transend proposal had been accepted in principle. The background information provided to the Board on the proposal noted that, although there had been difficulties with the proposed take-over, negotiations were now being fast-tracked and that the management contract could start on 1 April 2001. However, a more likely start date was 1 July 2001.
- The Transend year-to-date operational performance report presented to the May 2001 Board meeting noted that negotiations had stalled. The report said that the reasons for stalling were not known, because the negotiations had been extremely positive and amicable, and full agreement by both parties was imminent. Although these comments had been made in the performance report, there was no record of a discussion of the contract in the Board minutes.
- The June and July 2001 Board minutes record no further updates from Transend on progress with the contract.
- In August 2001, the Chief Executive of New Zealand Post, Mr Toime told the Board that, during an overseas trip, he had met with senior management of the parent company of the take-over target to test whether the acquisition proposal was likely to be realised. He reported that, while line management supported the proposal, it had always lacked support at a senior level. It had also become apparent to him during this trip that Transend needed to take a more critical and deliberative view of opportunities that were pursued.

3.16 The above example shows that Transend management was keen to report events when the take-over was proceeding, but appeared less keen to inform the Board in any detail when it stalled. It was left for Mr Toime to find out the underlying reasons for the likely failure of the takeover bid.

3.17 The former Managing Director of Transend, Mr Stein, told us that the New Zealand Post Board was informed of all the key issues at each Board meeting, and that Transend introduced more comprehensive reporting to the New Zealand Post Board at his initiative.

3.18 It was against this background of optimistic reporting and a seeming reluctance to report negative events that the Board decided that it needed closer oversight of some of Transend's activities.

3.19 Transend had made a bid to manage Maltapost (see Appendix 2) and the Board set up a small subcommittee both to oversee the bid and to review other Transend activities. Mr Stein had originally suggested that such a committee would be useful. In essence, the Board wanted to be satisfied with the strategic value to New Zealand Post and queried the benefits for Transend and for Maltapost. After questioning Transend management, and reviewing the proposal in detail, the Board was satisfied that the proposal was well founded.

3.20 While the Board was now satisfied with the Maltapost bid, it had difficulties with what it considered were optimistic projections in Transend's 2002-2004 Business Plan considered at its January 2002 meeting. The Board had a number of comments and queries about the plan. The Board approved the plan, noting that it would be reviewed as part of the coming business planning round.

3.21 Board members told us that, since the retirement of the former Managing Director of Transend, they find the reporting from the Acting Managing Director to be more realistic and more balanced. They feel more confident that if there are significant issues within Transend, these will be brought to their attention.

Dynamics of the New Zealand Post Board

3.22 The Board has eight members, each serving a three-year term. During the period November 2000 to June 2001, six new members were appointed to the Board to replace members whose term had expired. These replacements occurred at a crucial time, as the Board was occupied with establishing the new banking subsidiary Kiwibank. (The establishment of Kiwibank attracted a great deal of public attention and controversy. Confidential Board papers were leaked.) During this period, Transend's contract with the South African Post Office (SAPO) was terminated and the anonymous allegations about Transend operations were made.

3.23 The nature and weight of these issues would have been challenging to a well-established Board. Occurring as they did, at a time of considerable change in the Board, they resulted in tensions in working relationships. Board discussion on matters relating to Kiwibank and other issues was often robust.

3.24 The relationship between the Chairperson and the Deputy Chairperson broke down during this period. This was extensively reported in the media and was evident from our review of Board papers. The relationship breakdown itself and the airing of Board matters in the public domain were further considerable challenges. Mediation was needed to resolve the breakdown.

3.25 Board members commented to us that, following the satisfactory resolution of the issues between the Chairperson and Deputy Chairperson, the Board became a closer unit and worked well together. Some Board members felt there were positive aspects to having new members, as they brought fresh perspectives to issues before the Board.

Our Views on Governance

3.26 Both the Board and New Zealand Post's senior management have been keen to ensure that there is an appropriate model for the governance of subsidiaries, which is well understood and works effectively. The debate has been around the two possible subsidiary governance models:

- where subsidiaries have a fully operational board providing governance of the subsidiary, with representation of parent company board members on that board; and
- where subsidiaries are considered a business unit of the parent company, with the parent board providing the necessary governance.

3.27 Both models of subsidiary governance are common and can work effectively. New Zealand Post uses the latter model for subsidiaries and business units (with some exceptions). For this model to work effectively there must be comprehensive and realistic reporting to the parent board about the subsidiary and business unit activities.

3.28 The senior management of the parent company has a key role to play in ensuring that the reporting by the subsidiary is subjected to scrutiny and challenge before being presented to the parent board. The board must also make full use of all available sources of independent advice, where it considers this is necessary.

3.29 In our view, the governance arrangements used for Transend did not always work as intended during the period of events covered in our inquiry. However, several enhancements have been made to the arrangements, which we discuss in Part Five.

3.30 The parent board also needs to ensure that the governance model used is reviewed at regular intervals to ensure that it remains appropriate for its subsidiaries. New board members should be made aware of the model used and its strengths and weaknesses.

3.31 Having so many new board members in such a short period of time posed difficulties, particularly in light of the significant activities of New Zealand Post at the time. The continuity of the New Zealand Post Board's consideration of very major issues was undoubtedly disrupted by these changes. We believe it desirable that expiry of the term of appointment of members of the Board of a State-owned enterprise be spaced at longer intervals.

Conclusion

3.32 The current arrangements for New Zealand Post to exercise governance and oversight of Transend, and for Transend to be accountable for its actions to New Zealand Post, are appropriate. During the period of events described in this report, the arrangements did not always work as intended. As a result, several changes have been made to enhance governance and accountability arrangements for Transend (see Part Five).

Part Four

The New Zealand Post Process to Identify and Investigate the Allegations

Receipt of the Allegations

4.1 At a Board meeting in February 2001, Dr Armstrong, told the meeting that Mr Bradley had received an anonymous letter that made serious allegations about the management of Transend. Mr Bradley had given the letter to Dr Armstrong just before the Board meeting in January. The Board agreed that a copy of the letter should be given to each member in a sealed envelope and the letter discussed at the March Board meeting.

4.2 Before the March meeting, Ms Kristy McDonald QC provided advice to the Board on what action should be taken over the letter. Ms McDonald's advice was that:

- the anonymous letter seemed to suggest knowledge of events within Transend and should be taken seriously; and
- before undertaking a detailed investigation, the Board should make preliminary enquiries to establish whether there was any evidence to support the allegations and justify a more thorough inquiry.

4.3 It was clear from the advice that, if the Board decided to embark upon a full inquiry, more thought would need to be given at that time to the basis upon which that inquiry should proceed.

4.4 At the March Board meeting, Mr Bradley told the Board that another anonymous letter had been placed under his hotel door late on the night before the Board meeting.

The Process to Identify and Investigate the Allegations

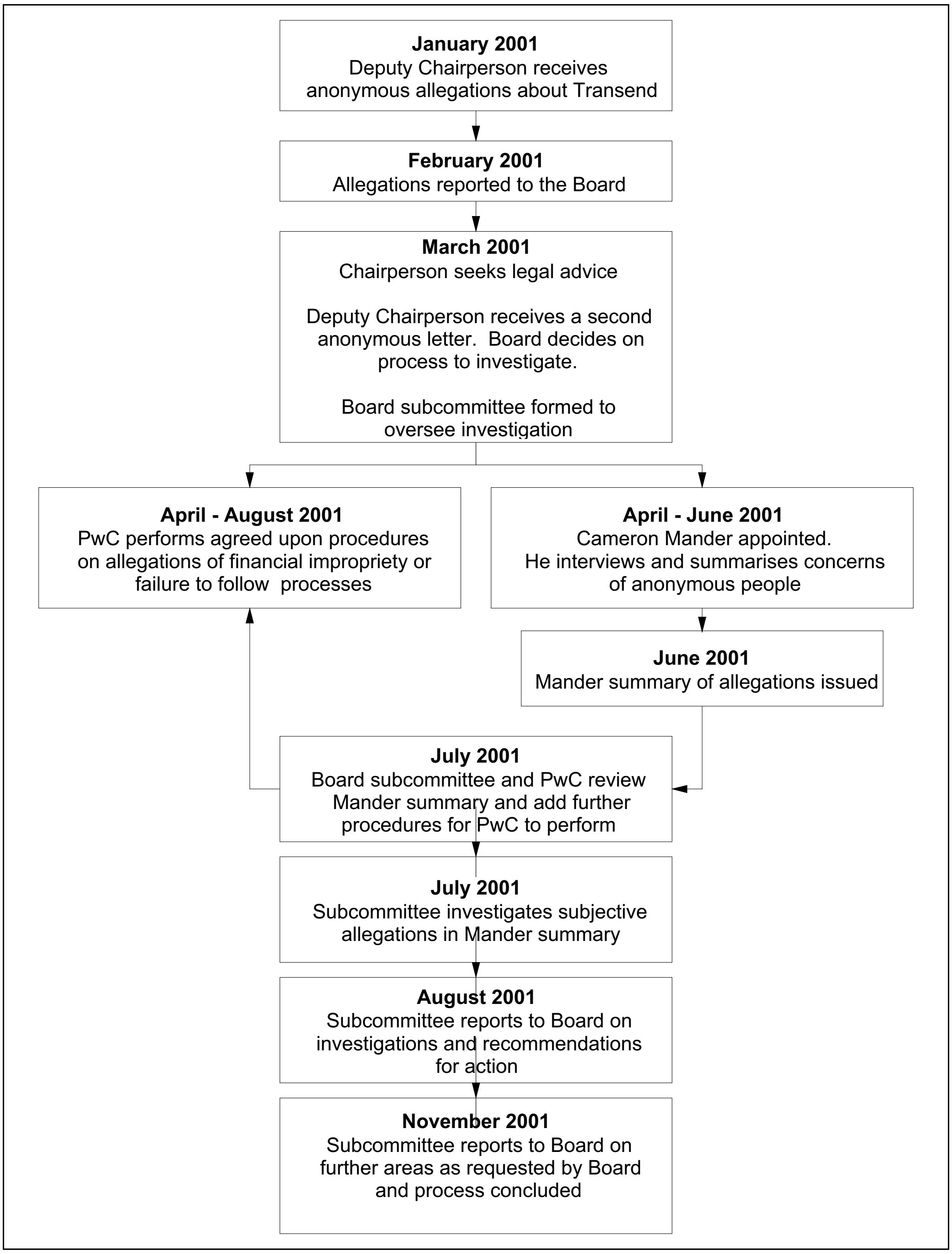
4.5 At the conclusion of normal business at its March meeting, the Board held a private session to decide how to deal with the allegations in these two letters.

4.6 A Board member kept the minutes of this private meeting, since all members of management had been asked to leave. The minutes do not document who attended the meeting and do not record the decisions made by the Board – they only record the nature of the discussions in an abbreviated and confusing form. This is poor practice. The Board recognised this and subsequently decided that New Zealand Post's company secretary should be present at any future confidential or private meetings of the Board to record proceedings.

4.7 One Board member believed that the allegations should be taken seriously, and that the focus should be on expenditure. Some members agreed with this view and felt that the Chief Executive should be involved. However, other members felt that the Chief Executive should not be involved since the letters had also referred to him. We understand the Board finally concluded that it was to be a Board investigation and that, other than the Chief Financial Officer, management was not to be involved in any way.

4.8 Following the private Board meeting the Chairperson and the Deputy Chairperson met with the Chief Executive to tell him the allegations would be investigated.

4.9 Based on our interviews with Board members, Ms McDonald, Mr Mander, and Mr Selby, and our review of relevant documents, we describe the process to identify and investigate the allegations in the following paragraphs. The following diagram illustrates the key steps in the process.



4.10 The Board members took the allegations seriously and decided that further investigation was necessary. The Board appointed Dr Armstrong and Mr Syd Bradley (who was subsequently replaced by Mr Ken Douglas) to form a subcommittee to investigate the allegations. New Zealand Post's Chief Financial Officer, Mr Nazir Awan, assisted the subcommittee.

4.11 Although the Board was clear about the purpose of establishing the subcommittee, it did not give the subcommittee formal terms of reference. We consider that in the circumstances this fell short of good practice.

Report by PricewaterhouseCoopers

4.12 The Board subcommittee assessed the allegations. Where the allegations related to matters of fact (e.g. alleging financial impropriety or failure to follow processes), the subcommittee asked PwC, in late-March 2001, to report all available information to the subcommittee. Therefore, PwC was asked to perform some specific procedures, initially based on the allegations in the anonymous letters (see Part Six). Based on the information in PwC's report, the subcommittee was to report to the Board on any action that the Board needed to take.

4.13 The work performed by PwC was in the nature of "agreed upon procedures" in accordance with the *Standards and Guidelines for Agreed Upon Procedures Engagements* issued by the Institute of Chartered Accountants of New Zealand.

4.14 The agreed upon procedures engagement format was chosen because it was considered to best fit what the Board was aiming to achieve with the investigation.

4.15 PwC presented an interim report to the Board's May 2001 meeting and a final report to the Board's August 2001 meeting. We examine the PwC report in Part Six.

The Mander Summary of Allegations

4.16 Ms McDonald advised the Board on 30 March 2001 that a solicitor be appointed to act as an independent intermediary for the anonymous employees and to receive their concerns. This was to allow the Board to obtain further information from these employees to decide whether a full inquiry was warranted.

4.17 The Board accepted the advice and, in April 2001, it appointed Mr Cameron Mander (a partner of the legal firm of Luke, Cunningham and Clere). Mr Bradley believed that it was possible for a link to be established to the writers of the anonymous letters. Mr Mander's role, as initially defined, was to represent this group and to provide confidential assistance to them to prepare more detailed representations to the Board.

4.18 However, after meeting with a person who Mr Bradley thought might be able to provide a link to the authors of the letters, Mr Mander found that it would not be possible for him to act in this way. Instead, he was offered the opportunity to contact a number of employees who, it was thought, might be willing to express their concerns about Transend.

4.19 Ms McDonald wrote to the Board advising that if Mr Mander was to take the initiative and contact employees whose names had been supplied to him, this would be a different role from that originally envisaged by the Board.

4.20 The Board subsequently instructed Ms McDonald that Mr Mander should contact employees whose names had been supplied to him, and do so in a way that would maintain the confidentiality of those employees. Mr Mander was not to investigate the allegations but merely to receive and record the concerns of employees. Ms McDonald briefed Mr Mander accordingly, and Mr Mander proceeded to contact employees on the basis of names supplied to him.

4.21 Ms McDonald's legal advice also suggested that New Zealand Post's Chief Executive, Mr Toime, and Transend's Managing Director, Mr Stein, should be advised of the Board's investigation and should be given an opportunity to comment on the process. Mr Awan's recollection is that he briefed both Mr Toime and Mr Stein about the general nature of the process. However, their views on the appropriateness of the process were not sought.

4.22 Mr Mander spoke with 12 people in a mixture of face-to-face and telephone interviews. Mr Mander recorded their concerns and compiled them in a 22-page summary, which was provided to the subcommittee. The anonymity of the people who spoke to Mr Mander was maintained at all times. Neither New Zealand Post, nor Transend, nor PwC, nor we, know who these people were.

4.23 Mr Mander told us that all staff he contacted were willing to speak to him. Their only concern was that speaking to him could lead to their identification and possibly jeopardise their career in the organisation.

4.24 Mr Stein told us he had been approached by some staff who were very annoyed at having been contacted. His recollection was that this was the first he knew that the Board had appointed a solicitor to whom staff could report their concerns.

4.25 In the view of Mr Stein and some other Transend staff, Mr Mander's confidential contacting of staff whose names had been supplied to him created a climate of distrust within Transend. Staff did not know what the allegations were, why this secretive process had been put in place, or why their names had been given to Mr Mander as people he should contact.

4.26 Mr Toime's recollection is that he was informed that the subcommittee had asked Mr Awan to instruct Ms McDonald to brief a solicitor known only to her. He told us that, at no point, can he recall knowledge of the name Cameron Mander in connection with the process.

4.27 At the end of June 2001, Mr Mander sent his summary of the allegations to Ms McDonald, who forwarded it to Mr Awan.

The Board Subcommittee

4.28 The subcommittee and PwC considered the Mander summary, and asked PwC to perform further procedures.

4.29 The subcommittee investigated the subjective allegations in the Mander summary itself. The subjective allegations related to management decisions, such as Transend's pricing of bids.

4.30 Either PwC or the Board subcommittee examined all matters raised in the Mander summary. The subcommittee reported to the Board on 8 August 2001, setting out its conclusions and recommendations, and noting that the inquiry process had been rigorous and covered all major issues. These conclusions and recommendations are set out in Part Five.

4.31 The Board asked the subcommittee to investigate three further matters of concern:

- redundancies made in the UK office restructuring;
- payments made to a consultant employed in South Africa; and
- an issue raised about the whistleblower policy.

4.32 The subcommittee reported to the Board on these matters in November 2001, indicating that all had been addressed satisfactorily.

Our Views on the Process

4.33 The process put in place by the Board to identify and investigate the allegations was complex and resulted in direct costs to New Zealand Post of $182,000 (comprising legal fees of $38,000 and other professional fees of $144,000). It also involved a high degree of confidentiality.

4.34 The approach that the Board took needs to be considered in the context of the events of the time and other issues already facing the Board. At the time the anonymous letters were received, New Zealand Post was under pressure. Setting up Kiwibank had resulted in huge publicity for New Zealand Post. Unfortunately, from New Zealand Post's perspective, the leaking of confidential Board papers had increased the publicity. The public scrutiny that occurred influenced the Board to ensure that any investigation process it put in place for the anonymous allegations could withstand any public criticism that it had not properly and independently investigated the allegations.

4.35 We are in no doubt that the Board took the anonymous allegations very seriously. The Board took legal advice on how to communicate with the anonymous employees and gather information from them on a confidential basis. The Board followed this legal advice with one exception.

4.36 The legal advice to the Board suggested that an opportunity should be provided to Mr Toime and Mr Stein to give their views on the suggested process to investigate. While both of them were briefed about the general nature of the process to collect information from the anonymous employees, their views on the process were not sought.

4.37 The process led to staff nominating other staff whom they felt could be approached to provide information about alleged wrongdoing. It seems some staff were unhappy at being nominated as someone to be approached by the independent intermediary. The unsolicited approaches to selected staff inviting them to report their concerns heightened the sense of mistrust, and resulted in a number of non-specific allegations that in many cases were more about disagreement with management decisions than about alleged wrongdoing. Some Transend staff felt they were operating in an environment of distrust and without support from the Board.

4.38 The Board decided that it had satisfactorily investigated the allegations, having:

- received Mr Mander's summary of the allegations; and
- undertaken further enquiries, both by itself and by PwC.

4.39 In our view, a significant deficiency in the Board's approach was that it did not consider or seek legal advice on how the principles of natural justice would be accorded to those Transend staff referred to in the allegations in the anonymous letters and in the Mander summary. The rights of those staff referred to in the allegations were overlooked.

4.40 The initial PwC report prepared in May 2001 on the basis of the anonymous letters was provided to Mr Stein for his response, but the final PwC report (prepared on the basis of the Mander summary) was not. Other staff about whom allegations were made were not given an opportunity to respond to the allegations.

4.41 The PwC report and information about the Board's investigation were ultimately made public through the Finance and Expenditure Committee's financial review of New Zealand Post.

4.42 The Board sought legal advice only on how to communicate with the anonymous employees and gather information on a confidential basis from them. Having decided not to conduct a further inquiry, the Board considered it unnecessary to seek legal advice as to how such an inquiry might be conducted.

Use of the Protected Disclosures Act 2000

4.43 The Protected Disclosures Act 2000 (the Act) came into effect on 1 January 2001, just before the Board began the process to investigate. We considered whether the Act should have been used to facilitate the process of disclosure and subsequent investigation of the allegations.

4.44 The Act is concerned with the disclosure and investigation of serious wrongdoing in or by an organisation, and protects employees who make such disclosures in accordance with the Act. Sections 7 to 10 of the Act stipulate the procedures that must be followed if an employee is to have the protection afforded by the Act. Section 11 of the Act requires all public sector organisations (which include New Zealand Post) to have appropriate internal procedures for dealing with protected disclosures. The procedures must:

- comply with the principles of natural justice;
- identify the persons in the organisation to whom a disclosure may be made; and
- include reference to the circumstances in which a disclosure may be made to the head of the organisation or to an external authority (including a Minister or an Ombudsman).

4.45 New Zealand Post had established a "whistleblower" procedure by December 2000, as required by section 11. Dr Armstrong has told us that the Board chose not to use that procedure in receiving and investigating the allegations, because the letter-writers had chosen to remain anonymous.

4.46 In our view, there would have been a number of advantages in encouraging the employees to use the Act and the whistleblower procedures that New Zealand Post had established under the Act, when making their allegations.

- Encouraging the employees concerned to use the Act would have protected those employees from retaliatory action in the event that management discovered their identities.
- Under the internal whistleblower procedure, the employees concerned would have been advised of the independent intermediary to whom they should report any concerns. Although the process that the Board adopted allowed people to report their concerns to an independent intermediary, the disadvantage of that process was that it allowed people to nominate other individuals whom they felt could be approached to provide information about alleged wrongdoing.

- The whistleblower policy also requires that if the disclosure of serious wrongdoing is about another employee or contractor, that person would be given adequate opportunity to comment on the disclosure – consistent with the requirement in section 11 of the Act that the policy comply with principles of natural justice. As already noted, the process followed to investigate the allegations did not provide staff about whom allegations were made any opportunity to comment on the allegations.

- The application of an internal whistleblower procedure may have resulted in a less complex process, and potentially have avoided some of the direct costs incurred in professional fees.

Conclusions

4.47 The process that the Board used in response to allegations of impropriety it received about aspects of Transend operations allowed the allegations to be properly identified and acted upon.

4.48 The Board gathered sufficient information to decide whether a full inquiry was necessary. Having gathered this information, and having undertaken further enquiries and investigations, the Board decided that the process it had followed to investigate the allegations had been satisfactorily completed and further enquiry was not necessary.

4.49 A consequence of the Board’s approach was that it did not consider or seek legal advice on how natural justice requirements would be met and matters such as:

- the appropriate structure for a further enquiry;

- the level of documentation that would be required; and

- how interested parties would participate.

4.50 Public entities should encourage their employees to use the procedures set out in the Protected Disclosures Act 2000 (including their own internal procedures established under the Act) for making disclosures of serious wrongdoing, unless there is a sound reason for using alternative procedures. Entities should ensure that the procedures are adequately communicated to staff.

Part Five

Steps Taken by New Zealand Post Following the Investigation of the Allegations

Conclusions and Recommendations of the Board Subcommittee

5.1 On 8 August 2001, following the completion of the investigation into the allegations, the subcommittee presented a summary report to the Board outlining its conclusions and recommendations. The subcommittee concluded 4

- *That the inquiry process had been rigorous and has covered all the major issues identified in the anonymous letters and through the independent legal process. We are satisfied with the representation made to us by John Selby (PwC) and Nazir Awan (New Zealand Post CFO).*

- *That there is sufficient evidence from the audit findings that there are issues that need to be addressed as a matter of urgency.*

5.2 The subcommittee recommended the following 4

- *A report from the Chief Executive Officer on steps that will be taken to strengthen Policy Compliance including review of Delegated Authority (September Board).*

- *A report from the Chief Executive Officer on steps that will be taken to ensure effective implementation of Protected Disclosures Act 2000 (Whistle Blowers Act) (September Board).*

- *A report from the Chief Financial Officer on compliance audit of all other subsidiaries (November Board).*

- *A report from the Chief Financial Officer recommending financial management governance and reporting of parent and subsidiary information to the Board (November Board).*

5.3 The Board accepted the subcommittee's report. After reviewing the PwC report, the Board concluded that there were no problems of impropriety, but that improvements in adherence to procedures were required.

5.4 Based on our interviews, it was clear that most Board members were of the opinion that the PwC report did not find any serious wrongdoing. They considered that it raised matters of the adherence to policy, and issues most aptly described as "technical" or "administrative" in nature.

5.5 The Board's position can be summarised by a statement made by Mr Bradley to the Finance and Expenditure Committee on 17 April 2002, when commenting on the Board-initiated inquiry into the allegations 4

I agree with the board position on the evaluation of that inquiry, which acknowledged that we had learnt some lessons, and I think Elmar mentioned some processes that had become a bit sloppy. I don't think there's any doubt about that, but that is not the position of the Board now.

5.6 His view reflected the position within the Board, which is that the inquiry into spending by staff showed no evidence of misconduct or fraudulent behaviour. It did show there had been some "exceptions" or non-compliance with procedures.

Chief Executive's Report to the Board

5.7 In August 2001, the Board gave Mr Toime an opportunity to comment on the Board's investigation of the allegations and the PwC report.

5.8 Mr Toime summarised his views in a report to the Board as 4

- *There is a case to answer for improvements in process and governance.*
- *There is no evidence of fraudulent behaviour.*
- *Decision-making was frequently made on the run, without proper documentation or discussion of alternatives, and sometimes based on views of people not versed in the "Post way".*
- *The rate of growth was spectacular, pushing resources to the limit, and leading to an environment where poor judgement calls were made.*
- *The management culture was not open, leading to situations where strategic choices were not understood in the lower ranks.*
- *A significant and viable business was created based on commercial risk-taking that was not well understood throughout the organisation.*
- *A culture gap existed between established Post people and newcomers, some of which was desirable and required, but other behaviours were inappropriate.*
- *Failures were primarily ones of management control, and would have come to light through normal audit processes.*

5.9 Mr Toime's frank and direct assessment acknowledged the achievements of Transend but also pointed to problems at the time and the need for improvements.

Subsequent Events

5.10 Transend was restructured in September 2001. The international mail business was transferred to the Letters and Enterprises business unit of New Zealand Post to enable Transend to refocus on its postal consultancy services business.

5.11 Reports were made to the Board in accordance with the subcommittee's recommendations (see paragraph 5.2). We summarise below the key points in the reports.

Subsidiary Governance and Policy Compliance

5.12 The report covering subsidiary governance and policy compliance was presented to the September 2001 Board meeting. The report reviewed operating subsidiaries to determine the need for them and the appropriate subsidiary governance structures. The report also looked at the steps to be taken to strengthen policy compliance.

5.13 The report concluded that Transend (postal consulting services only) should remain as a subsidiary and did not require a formal board governance model. Mr Toime agreed with this conclusion subject to a number of provisos – including that:

- A clear charter and detailed business plan would be made available to and approved by the Board.
- An adequate reporting framework would be developed.
- If Transend wished to diversify outside postal consultancy, the Board would review the appropriateness of the governance structure.

5.14 The report also said that the current process for ensuring compliance with New Zealand Post policy by subsidiaries required improvement. Responsibility to ensure that policy was effectively implemented was assigned to the newly appointed Corporate Risk Manager.

5.15 In preparing the report, discussions had been held with the heads of each business unit and subsidiary to gauge their awareness of New Zealand Post policy and its applicability. Mr Stein told the review team that New Zealand Post policy was applied where applicable. However, there were two main areas of difference – the travel and human resource policy – which he said had been amended to address risks relating to an international consulting business.

Protected Disclosures Act 2000

5.16 At the September 2001 meeting, the Board received a report on the effectiveness of New Zealand Post's implementation of the Protected Disclosures Act 2000, including internal communication and awareness initiatives.

5.17 The report showed that New Zealand Post had taken several steps in publicising the procedures soon after they came into force. External legal advice confirmed that the procedures complied with all legal requirements.

Subsidiary Compliance Audit

5.18 In accordance with the Board request to review policy compliance by New Zealand Post subsidiaries, New Zealand Post Risk Review (internal audit) prepared a report on behalf of the Chief Financial Officer and presented it to the November 2001 Board meeting.

5.19 The Risk Review report examined the level of compliance by subsidiaries with New Zealand Post policy and delegated financial authorities. A number of subsidiaries were reviewed, but the report noted that the review of Transend and another subsidiary review were still to be completed at that time.

5.20 The report said that the level of compliance was satisfactory. However, awareness of New Zealand Post policy was variable. More education was required, together with a simplification of the policy framework.

Financial Management Governance and Reporting

5.21 A review of financial management governance and reporting within the New Zealand Post group was carried out and reported to the November 2001 Board meeting.

5.22 The report noted that a number of new initiatives were under way that would enhance financial management governance and reporting – including:

- a dual reporting line from the finance team leaders within each business group and wholly-owned subsidiary to the Head of the Business Group and to the Chief Financial Officer of New Zealand Post; and

- the implementation of a new comprehensive financial management information system.

5.23 A revised financial Board reporting regime was also implemented, as requested by the Board.

Changes Made by the New Acting Managing Director of Transend

5.24 In March 2002, Mr Stein retired on medical grounds. An Acting Managing Director, Mr John Allen, was appointed. Mr Allen's prime objective has been to ensure the survival of Transend. Since his appointment, he has significantly restructured Transend. A revised business plan has been put into effect, and changes made to the travel and human resource policies (which had been different from New Zealand Post policy). We summarise the changes made in the following paragraphs.

Revised Business Plan

5.25 New Zealand Post still sees the potential of the international postal consulting market as significant. As a result, Transend is one of New Zealand Post's four "flagship initiatives", and close cooperation from other parts of New Zealand Post is expected.

5.26 The focus of the revised business plan is on consulting 4 primarily in the area of operational excellence. While historically Transend has been successful in gaining management contracts, the plan acknowledges that such contracts are high-risk. Cost containment is a major consideration. There is a greater focus on winning work in selected geographic regions.

Changes to Travel Policy

5.27 In a memo to staff on travel policy, Mr Allen summarised the problem with the past approach within Transend 4

> *All of the costs of running Transend's business of course, including travel and accommodation, have to be more than covered by earnings from clients. Currently, that is not happening.*

5.28 The memo went on to note that the travel policy within Transend would be aligned with that of New Zealand Post. The point was also made that 4

> *The New Zealand Post focus is on prudence and legitimate business purpose. I ask that managers who approve travel proposals to satisfy themselves that there is a real business need for the journey, and that the routing and accommodation and period of absence meet the new requirements.*

5.29 The two main ways in which the Transend travel policy has been aligned with that of New Zealand Post are:

- The Transend policy specified the standard for hotel accommodation as "first class". This has been changed to match New Zealand Post's policy, which specifies an accommodation standard of a "modest business class" hotel.

- The Transend policy for air travel provided for business class travel for flights of more than 3 hours. This has been changed to match the New Zealand Post policy of business class travel for flights of more than 5 hours duration within a 24 hour period.

Human Resources

5.30 The changes made to human resource practices under Mr Allen include:

- Work objectives are formally established for all staff, who also complete individual development plans.

- Contractor agreements are now carefully reviewed to ensure that contractors complete the work being sought by Transend and without incurring unnecessary costs to Transend.

- A formal procedure is being developed to seek feedback on seconded personnel, Transend performance, and client satisfaction.

5.31 There has also been substantial change to the physical layout at the Transend Head Office. Under the previous management, separate offices were provided for senior staff. This was seen by some staff to restrict communication with them. An open plan layout has now been installed as a means of improving communication.

Conclusion

5.32 In our view, New Zealand Post took appropriate steps to address the issues arising from the investigation of the allegations. However, the changes to policies and procedures were not implemented soon enough. The appropriate changes to policies and procedures were made only after the appointment of the new Acting Managing Director. We explain the basis for our views further in Part Seven.

Part Six

Matters Raised in the PricewaterhouseCoopers Report

The PwC Report

6.1 PwC issued its final report to the Board of New Zealand Post in August 2001. As we have described in Part Four, the PwC report was a key step by the Board to investigate the allegations.

6.2 The report is now a publicly available document. It is structured to reflect the series of procedures that PwC performed. PwC's role was to collect all the facts relevant to the subject of each procedure, and to perform some testing of transactions to ensure compliance with policies.

6.3 The nature of the PwC report is such is that it can be difficult for the reader to get a sense of its overall findings. In this part of this report, we summarise some of the findings of the PwC report and our views on them. The PwC findings set the context for some of the observations we make later in this report.

The Decision to Establish a Transend Office in Madrid

6.4 The Board asked PwC to report on a number of matters relating to Transend's decision to set up an office in Madrid with effect from 1 July 2000. PwC found that there was no documentation showing a formal comparison of the business merits of establishing an office in Madrid with the merits of other location options.

6.5 As part of its marketing to clients, and to inform New Zealand Post staff of its activities, Transend used to publish a magazine entitled *4front*. The June 2000 issue of *4front* describes the thinking behind the decision to establish a base in Madrid, which stemmed from a discussion that Mr Stein had with officials of the Spanish Post Office (Correos y Telegrafos) in early 2000. The magazine noted that 4

> *Somewhere in mid-air during the marathon 33 hour plane journey home, Drew was convinced it was time for NZPIL* [as Transend was then called] *to have a presence in Europe and that Madrid was an ideal location.*

6.6 The article went on to explain why Madrid was the ideal location. The reasons listed included:

- It would be easier to visit customers if based in Europe rather than in New Zealand 4

  > *From Madrid, we can now visit customers five or six times a year rather than three, which is all we could manage before*.

- A base in Europe would send a message that Transend was serious about doing business in that part of the world.

- Finally, and probably more importantly, a strong relationship had been developed with Spanish Post, and both organisations had already partnered each other in the pursuit of business opportunities in Central and South America. Being based in Madrid was seen as a way of gaining a foothold in Europe and a doorway into Latin America.

6.7 Former Transend staff told us that, in order to compete for postal contracts within Europe, a registered office in Europe was required.

6.8 As recorded in the PwC report, Deloitte Touche Tohmatsu was asked to review the taxation and regulatory implications of setting up an office in Madrid. Deloittes' conclusion was that taxation rules in Spain meant that it was not attractive as a hub for carrying out work elsewhere in Europe.

6.9 Deloittes also advised that, for non-European nationals, work permits had to be obtained before any work starts. The PwC report noted that some Transend staff worked in Spain without work permits.

6.10 The Board asked PwC to obtain a copy of a letter from the New Zealand Ambassador in Spain to Transend. PwC reported that Transend staff were unaware of having received such a letter. Months later, and following a request by the Finance and Expenditure Committee, the letter was found on Transend's files. The letter was dated January 2000. In it, the New Zealand Ambassador highlighted some of the challenges Transend would face in working with Spanish Post.

6.11 In our review of Transend files, we noted that a senior member of Transend's Head Office replied to the letter from the Ambassador.

6.12 Transend pushed ahead with its plan to set up an office in Madrid. However, soon after there was a change within the top management of Spanish Post. In a letter to Transend's management of 22 May 2000, Spanish Post said it was no longer interested in a business relationship with Transend.

6.13 Transend staff arrived in Madrid in June 2000 and Transend maintained an office in the suburbs of Madrid until July 2001.

6.14 The PwC report noted that it could find no evidence that a meaningful working relationship had been established between Transend's Madrid Office and Spanish Post. However, former Transend staff told us that a large number of meetings were held between the two organisations on various issues.

The Decision to Establish a Subsidiary in the United Kingdom

6.15 The Board also asked PwC to report on the decision by Transend to establish an office in Bray (which is about an hour's travel west of central London).

6.16 In February 2001, Transend reconsidered the wisdom of staying in Madrid and decided that it needed an office in the United Kingdom, with a reduced presence in Madrid. The decision was made to lease a building in Bray, which is a 20-minute drive from Heathrow Airport. Proximity to the airport was a factor in choosing the location.

6.17 The building in Bray has two storeys and 16 rooms. It has a historical classification that restricts the type of modifications that can be made to it. Altering the building 4 such as allowing part of it to be sublet 4 would be difficult.

6.18 The lease of the building is for a period of ten years from 24 May 2001 to 25 May 2011, with a break clause at 23 May 2006. The cost of the lease is £75,000 a year. The cost of the lease until May 2006, recognised in Transend's June 2002 financial statements as an onerous lease[5], reflects the exit costs associated with the lease.

6.19 Mr Stein signed the lease in June 2001. PwC reported that Mr Stein did not have the delegated authority to do so.

6.20 Three staff currently work out of the Bray office. The building is far bigger than required, but Transend cannot terminate the lease before May 2006. The building was leased in anticipation of gaining work that did not eventuate.

Issues Around the Tender for International Travel

6.21 The Board asked PwC to report on a tender conducted by Transend in 1999 for the selection of a preferred airline. Transend believed its travel costs could be reduced through discounts and rebates by arranging all its international travel with one airline. Transend expected to spend between $3 million and $5 million a year on air travel. In late-1998, airlines were invited to tender to be the preferred airline, and Transend selected Qantas.

6.22 PwC found that:

- An evaluation panel had been set up to review the tender proposals and recommend which tender should be accepted.
- There was no documentation to indicate that the views of the panel were obtained to support the selection of Qantas.
- The summary of the proposals that was prepared said that neither of the two proposals being considered stood out as offering a better service to all destinations.
- There was no financial analysis of the tenders to indicate why the Qantas tender was considered to be the best.

5 For financial reporting purposes, an onerous lease is one where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Kamden Marketing

6.23 The Board asked PwC to detail the process followed in the selection of Kamden Marketing for the provision of marketing services to Transend. Kamden Marketing is a small company based in Auckland.

6.24 PwC found that:

- Kamden Marketing was appointed directly by Mr Stein to provide marketing services – he had the authority to make such an appointment.

- The principal of Kamden Marketing had known Mr Stein for many years. He had undertaken work for Mr Stein in the past that included management of printing requirements, production of publications, and provision of strategic advice.

- Over a four-year period, Transend paid Kamden Marketing a total of $896,000.

6.25 The principal of Kamden Marketing was also selected to head a major postal consultancy management contract that Transend was seeking to set up in Europe (although the contract did not proceed). The Board asked PwC to report on how the principal had been proposed for appointment to this position.

6.26 PwC found that:

- there was no evidence of a formal selection process comparing the skill sets required for the proposed role with those possessed by possible candidates; and

- although it had been represented that the European postal organisation favoured the appointment of this person, there was no external documented evidence to support this representation.

Human Resources

6.27 The Board asked PwC to establish whether direct appointments to positions within Transend had been carried out in accordance with New Zealand Post policy.

6.28 PwC obtained oral representations (because the policy did not require formal evidence to be kept) from human resource managers that New Zealand Post policy had been followed.

Internal Control Procedures

6.29 The Board asked PwC to perform a number of procedures in relation to the internal controls at Transend, including:

- Checks on adherence to delegated authorities.
- Checks on whether cash advance claims, credit card purchases, and travel costs of Mr Stein and the staff reporting to him were in accordance with the relevant policies. The checks also looked at expense claims of overseas operations (South Africa, Spain, and the UK).

6.30 PwC found a number of instances where the applicable policy had not been followed. The instances included spending outside existing policy and a person without the necessary delegated authority approving expenditure.

6.31 The travel expenditure policy required the Managing Director to approve flights, reasons for travel, and cash advances for staff reporting to him. PwC found 43 exceptions where the approval of the Managing Director had not been obtained. In 18 of these cases there was no approval. In 21 cases, the Chief Financial Officer of Transend had approved the travel. In four cases, approval was by another direct report of the Managing Director.

6.32 The review of approvals and adherence to policy in relation to credit card purchases, cash advances, and travel invoices found 49 exceptions in a sample of 180 items tested.

Our Views

6.33 The PwC report provides detailed information on a number of matters relating to Transend's operations. In general, the information provided by PwC indicates poor judgements 4 often associated with an optimistic view of outcomes 4 with little regard to costs. Decisions made were often poorly documented without full discussion of alternatives. There appear to have been flaws in the tender process used to select a preferred airline. The report also shows poor adherence to policies and procedures on travel-related expenditure.

6.34 In summary, the PwC report highlighted a number of control failures.

6.35 In a memo dated 4 May 2001, Mr Stein had provided detailed comments on the initial PwC draft report of May 2001. Mr Stein was aware of the concerns noted in the report about people approving expenditure without the necessary delegated authority. His memo said that this was an area that was *being treated extremely seriously*.

6.36 It was surprising, therefore, that a month later he signed the long-term lease for the Bray office without having the necessary delegated authority.

Part Seven

Transend Policies and Procedures and How They Were Implemented

What We Looked At

7.1 We examined:

- the appropriateness of the current policies, procedures, and controls over travel, accommodation and business expenses;
- whether these policies and procedures had been satisfactorily implemented in recent operations and transactions;
- the procedures for letting a major Transend tender; and
- compliance with financial delegations.

7.2 PwC had found that there had been poor adherence to policies and procedures by Transend staff. We also examined the policies and procedures that had been in place in Transend, and how they had been implemented. This was necessary to establish the context and need for changes to policies and procedures.

7.3 In the following paragraphs, we set out our findings and views on:

- the policies and procedures of Transend before the PwC report and how they were implemented; and
- the current policies and procedures of Transend and how they have been implemented in recent significant transactions and operations.

Travel, Accommodation, and Business Expenses

7.4 Travel, accommodation and business expenses form a large part of Transend's operational budget. The expenses are high, in part because of New Zealand's relative distance from Transend's main markets.

7.5 We expected that expenditure would conform with the following benchmarks:

- It would comply with the appropriate policies.
- It would be prudent, sensible and demonstrably for business purposes. Given that New Zealand Post is a State-owned enterprise, the norm we applied was what would be considered acceptable travel, accommodation, and business expenditure in a comparable commercial environment.

Policies and Procedures Before the PwC Report

7.6 Transend had different travel policies from New Zealand Post until the new Acting Managing Director, Mr Allen, was appointed in March 2002. Formal approval of these policies by New Zealand Post could not be located. As discussed earlier (see paragraph 3.8), the Board made changes to the Governance Policy during 2001, which included the requirement that each subsidiary was to adopt New Zealand Post policies, unless the Board or Chief Executive approved otherwise.

7.7 The New Zealand Post travel and entertainment policy, approved by the Board in September 2000, applied also to all wholly owned subsidiaries (including Transend). The policy included reference to those areas where the Transend policy differed (essentially air travel).

Air Travel

7.8 The Transend travel policy (from October 1999 until December 2001) stated that all international travel was to be by business class (domestic travel was economy class). This policy can be contrasted with the New Zealand Post travel policy, which provided that international travel by business class could only be undertaken if the duration of flights was more than five hours in a 24-hour period.

7.9 The New Zealand Post policy noted the exception to the policy for Transend in relation to both domestic and international travel. It states that 4

> *The Managing Director of Transend had discretion over the class of travel, relative to certain countries, flight schedules, seating options and class of travel our customers are travelling.*

7.10 A policy that provides that all international travel will be business class means that even short flights could, in accordance with the Transend policy, be flown business class. Transend had an office in Madrid, and numerous short haul trips were made from Madrid to other cities within Europe. Examples of short flights that were flown business class were:

- Madrid to London – 2 hours 15 minutes
- Madrid to Geneva – 1 hour 50 minutes
- Madrid to Brussels – 2 hours 10 minutes
- Brussels to Amsterdam – 45 minutes.

7.11 The most frequent flights were return trips from Madrid to London. The return economy class fare from Madrid to London cost $842 compared to a business class fare of $2,256. Flying these short trips by business class was allowable under the Transend travel policy, but incurred unnecessary costs.

7.12 While some Transend managers would fly short trips by business class, this was not a privilege that was always extended to other staff working for Transend.

7.13 In one example, a Transend manager denied a contractor (engaged from another New Zealand Post subsidiary) an opportunity to make a 17-hour journey using business class, citing budgetary constraints. However, the Transend manager himself made numerous short flights within Europe by business class. Insisting that someone should make a long flight by economy class could be perceived as Transend senior managers applying one standard to themselves and a different standard to others.

7.14 We also have concerns with the rationale for some of the Transend travel decisions 4 as illustrated by the following example.

7.15 In July 2000, a senior manager based in Transend's Madrid Office advised Mr Stein of his plans to visit South America. As discussed earlier (see paragraph 6.6), an important reason for establishing the Madrid Office was to use Spanish connections to develop business into South America. Hence it was appropriate for the planning of such visits to proceed.

7.16 These plans unfolded as follows:

- July 2000 – advice to Mr Stein that visits would be needed to Costa Rica, Peru, Brazil, Trinidad and Tobago, and (possibly) Chile.

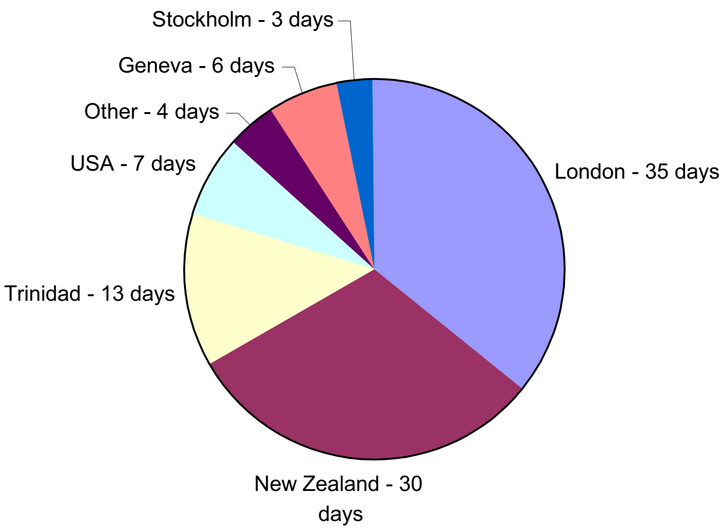
- August 2000 – further advice to Mr Stein that the programme of visits would be Trinidad and Tobago for the opening of the new mail centre, then on to Chile, Peru, Argentina and New Zealand. After that, the manager concerned would fly on to Australia to collect his work permit for working in Spain. The manager told Mr Stein that there would be little additional cost in coming back to New Zealand via South America. The purpose of the visit to New Zealand was to meet people from the United States Postal Service (USPS) who were going to be in New Zealand.

- Early October 2000 – the manager told Mr Stein of a further change in plans. He was now intending to travel to Cuba to meet the President of Cuba, to Trinidad, and then to New Zealand to meet with the people from USPS.

7.17 Although the manager went to Trinidad for three days, he did not go to Cuba or South America, but travelled from Trinidad directly to New Zealand. He spent a week in New Zealand and then returned to Madrid by way of Sydney. Given the presence of other senior Transend staff in New Zealand, including Mr Stein, it is difficult to see why it was necessary for someone to fly from Madrid to meet with staff from the USPS. The manager concerned told us that it was important to meet the USPS staff, when they were in New Zealand, as Transend was hoping to win substantial business from USPS.

7.18 We reviewed the itineraries of the trips undertaken by the Madrid-based Transend manager, with primary responsibility for South America, from July 2000 to July 2001. The travel undertaken is summarised in the chart below:

Travel by a Transend Manager, Madrid Office - July 2000-July 2001



7.19 The amount of time spent in New Zealand and the lack of trips to South America are difficult to understand.

7.20 There were also trips to Transend operations in other countries for which the costs of the visit appear to outweigh the benefits. For example, two Transend staff visited a Transend operation in Trinidad and Tobago. One manager stayed for three days. The other manager stayed for seven days to gain input from local management and staff about issues within the Transend operation.

7.21 This manager completed a report following the visit. The information in the report was simply a transcription of what people had said. Although the manager concerned told us that the issues were discussed with the site manager of the Transend operation, the site manager could not recall the report or the discussion. The total of the airfares and hotel costs incurred by the manager producing the report came to almost $22,000.

7.22 This was an expensive way of acquiring an assessment of a local situation, especially as there were at least two other more cost-effective options available. The other manager, who had to visit the operation as part of his duties, could have attended to this task. A written report addressing the issues within the operation could have been sought from the site manager.

7.23 In our view, it was not appropriate for Transend to have a travel policy stating that business class travel was to be used for flights outside of New Zealand. This led to unnecessary expense. In addition, expensive travel was undertaken to obtain information that could have been obtained in more cost-effective ways.

Accommodation

7.24 The Transend travel policy (from October 1999 until December 2001) did not set out the standard of hotel accommodation and the acceptable costs. The policy stated that *guidelines were to be established in relation to the quality, standard and costs of accommodation and that a list of preferred hotels, motels etc was being developed.* These guidelines and list were never completed.

7.25 The New Zealand Post policy (which also applied to Transend) set out the norm as a "modest business class" hotel. However, this standard only applied to domestic travel, defined as travel within and between New Zealand or Australia and within any country with which New Zealand Post had a consultancy contract.

7.26 We found several examples where some Transend staff stayed in hotels at the top end of the market. When visiting London, Transend staff would stay at the Hotel Inter-Continental. The Inter-Continental group of hotels were Transend's preferred suppliers.

7.27 Some Transend staff stayed at the more expensive rooms of the Inter-continental and incurred varying nightly room costs ranging from $930 to $1,238.

7.28 These room costs were generally for shorter stays of 2 to 3 nights. Some Transend staff stayed at the Inter-Continental for extended periods of up to 10 nights, but were able to negotiate reduced room rates of $630 a night.

7.29 Two of the Madrid-based Transend staff who stayed on a regular basis at the London Inter-continental would specify "Hyde Park View" when they made their hotel bookings. On one occasion the travel agent advised that 4

> *Unfortunately there are no deluxe rooms available with Hyde Park views. I would have to upgrade to a rate of £335 ($1,131). I have requested an upgrade on this room as well.*

7.30 The Transend staff concerned told us that the Hyde Park views came at no extra cost and had significantly better natural light. They also told us that the Inter-Continental gave Transend significant discounts off the usual room rates.

7.31 However, the Transend travel agent told us that the rooms booked for Transend staff at the Inter-Continental with a Hyde Park view could at times cost approximately $130 a night more than rooms without such a view. Documentation to support the view that significant discounts were provided could not be located on Transend files. Even if the room rates at the Inter-Continental were discounted, it still represents expensive accommodation.

7.32 We also noted another occasion when a Madrid-based Transend manager was at a one-day meeting in London intending to fly out the same day. The meeting finished late and the manager had to find another hotel in which to stay, as the Inter-Continental was fully booked. The only hotel room he could apparently find in London at short notice was at the Hilton Park Lane, which had a room rate of $1,963 a night.

7.33 We noted also that, on one occasion, a senior Transend manager stayed at the Willard Inter-Continental in Washington. The cost of the three-night stay at the hotel came to $5,398.

7.34 Mr Stein told us that he was comfortable with the standard of hotel accommodation used by Transend staff, which he views as acceptable for any international operation. Mr Stein also observed that not all hotels that Transend staff stayed at were luxurious. He cited an example of a hotel he stayed at in Africa where there was no running water and for two days he had to wash and shave using coca cola.

7.35 In our view, the Transend travel policy should have specified the standard and costs of the hotel accommodation for international and domestic travel. Because of the lack of specificity in the travel policy, the accommodation costs of some senior Transend staff were not in breach of Transend's policy, but they were manifestly unwarranted and excessive.

7.36 Transend staff frequently stayed in London to pursue business opportunities. We appreciate that London is an expensive city in which to stay. However, there are less expensive hotels in London. We asked Transend's travel agent to suggest a range of acceptable but less expensive hotel accommodation in London. The travel agent suggested hotels with nightly rates in the range of $290 - $472. Some New Zealand based Transend staff were able to stay in less expensive hotels than the Inter-Continental.

Meal and Entertainment Costs

7.37 The Transend credit card policy provided that 4

> *Customer entertainment is chargeable on the business card. Meals and entertainment of other company personnel are not reimbursable unless approved by your project director.*

7.38 The Transend Guidelines for Business Related Domestic/International Travel provided that 4

> *Entertainment should only be for clear business purposes. Claims must be supported by the name of the person(s) and the company (ies) being entertained.*

7.39 We found examples of Transend staff entertaining each other and charging the cost to a Transend credit card on the basis that work-related matters were being discussed. Approvals for such entertainment were always given, but the names of staff at the meals were not always indicated. It was left to the Transend finance staff, when processing the card payments, to try and establish the names of the persons at the meals, sometimes weeks after the event. Despite strenuous efforts by finance staff, they were not always successful, resulting in the names of people at these meals not being listed, in breach of Transend's policy.

7.40 Some staff often held work meetings at restaurants close to the Transend Head Office in Wellington and charged the cost to Transend. These were the types of meetings that in most organisations would take place at work. However, in Transend some staff considered it appropriate to meet in restaurants and charge the costs to the Transend's credit card. For example:

- Some staff would lunch at a local restaurant to discuss issues to do with Transend work. The cost of these lunches (a substantial proportion of which was for alcoholic drinks) was charged to a Transend credit card.

- Some other Transend staff would meet at a local café and would charge the cost to Transend. The cost of food and drinks at these meetings was charged to Transend on the basis that work matters had been discussed.

7.41 In our review of expenditure on meals and entertainment we noted:

- a three-day meeting, held in London in January 2001 and hosted by Transend, at which the food and alcohol costs came to $8,646 and $1,638 respectively; and

- two days later, a one-day meeting held in London by Transend, at which $5,055 was spent on food and $1,331 on alcoholic drinks.

7.42 There was no indication of the names, or even the number, of people attending these meetings. Our understanding is that up to 9 Transend staff may have attended. There were also non-Transend people present.

7.43 Transend engaged a consultant to assist with its work in London and he provided marketing services for a proposal. Transend paid the consultant's hotel account which included:

- a dinner that cost $405;
- two nights later, a dinner that cost $435; and
- a lunch that cost $524.

7.44 There was no indication as to whether these costs related only to the consultant or whether other people were present. Transend management approved these costs without querying them.

7.45 In our view, there was no justification for some Transend staff in Wellington to hold regular work-related discussions at a café or restaurant and charge the cost to Transend. The expenditure clearly breached the intent of the policy and specific guidelines. Approval of the expenditure by managers did not remedy the breach. Some meal costs incurred while travelling overseas were also excessive by any standard. We do not consider the work/food/alcohol combination was a recognised practice in the contemporary business environment to the extent that some Transend staff assumed it was.

7.46 The spending practices by some Transend staff encouraged the development of a view amongst a few staff that prudent spending was not important. The driving force from Transend management was to win contracts and little priority was given to managing everyday overhead costs.

Policies and Procedures After the PwC Report

7.47 Following the findings of the PwC report, it was reasonable to expect a tightening of controls over spending in Transend.

7.48 In November 2001, Mr Stein told staff that more checks were to be made to ensure compliance with policies. In particular, there was to be greater testing of adherence to policies relating to cash advances and credit card expenditure. Such tightening of controls was an appropriate response to the concerns detailed in the PwC report about adherence to procedures.

7.49 However, we did not observe any noticeable change in the credit card spending by some Transend staff following the PwC report – i.e. from August 2001 to March 2002. For example, some staff continued to have expensive meals at overseas restaurants and to entertain each other at local restaurants.

7.50 In January 2002, Transend changed its travel policy without reference to the Chief Financial Officer of New Zealand Post. Formal approval by New Zealand Post for these changes could not be located. Changes made to the policy included:

- Domestic air travel was to be by economy class (except for the Managing Director) unless approved by the Managing Director. "Domestic air travel" meant any travel within New Zealand and, for the UK office, air travel within Europe (of up to three hours duration).

- International air travel was to be by business class, except for travel between New Zealand and Fiji, Vanuatu and Australia, when economy class fares would be provided. However, under the policy the Managing Director was allowed to travel business class to these destinations. For the UK-based staff, travel of less than three-and-half hours duration was also to be by economy class.

- "First class" hotels was the applicable standard for hotel accommodation 4 but the final choice was to take account of factors such as availability, price, location, duration of stay, and purpose of visit.

7.51 Following Mr Stein's retirement and Mr John Allen's appointment as Acting Managing Director, Mr Allen noted in a memo to staff on travel policy that Transend's travel policy would be aligned with that of New Zealand Post.

7.52 The three main ways in which that has been achieved are:

- The Transend standard for hotel accommodation now specifies a "modest business class" hotel.

- The Transend policy for air travel now provides for business class travel only for flights of more than five hours duration within a 24-hour period.

- The Managing Director is subject to the same standards as any other traveller.

7.53 Our review of travel, accommodation and business expenditure since the changes showed adherence to these latest Transend policies. Expenditure incurred showed prudence and was for legitimate business purposes.

7.54 While Transend's travel policies have generally been aligned with those of New Zealand Post, further steps need to be taken:

- The recent changes in Transend's travel policy need to be made permanent by incorporation in the approved policy statement. Currently, the change has been notified only by way of a memo from the Acting Managing Director.

- Transend's operating manual needs to be changed to ensure that when a permanent appointment is made to the Managing Director position, the policy changes made are preserved.

- Transend's travel policy should contain guidelines as to standard and cost of the hotel accommodation for international and domestic travel; the expected meal costs within New Zealand and overseas; and the expectations regarding the entertainment of other company personnel. There have clearly been problems in the past with these aspects of expenditure, and the Transend travel policy should provide appropriate guidelines.

- The Chief Executive of New Zealand Post should approve the Transend travel policy, including any exceptions to the New Zealand Post policy. The need for exceptions should be carefully considered.

Tender for Airline Services

7.55 We examined how in June 2002 Transend went about tendering for a preferred supplier of airline services. Transend:

- Issued a Request for Proposal (RFP) that clearly described the service being sought to allow tenderers to correctly price their bids.

- Specified the factors that were important to Transend for the service being sought.

- Evaluated tenders received against agreed criteria. A member of the New Zealand Post procurement section was on the evaluation panel.

7.56 The RFP contained a schedule that:

- listed the main countries that Transend staff travelled to;

- listed the cities travelled to within those countries;

- indicated the number of trips over the last year to those destinations; and

- indicated the amount spent on travel to those destinations.

7.57 Shortly after the RFP was issued, it was amended to ask that proposals be extended to apply to the wider New Zealand Post group. Transend's travel requirements comprised the majority of the required services.

7.58 A four-person evaluation panel evaluated the tender responses. The panel scored the responses on a number of factors 4 including price.

7.59 The documentation shows that, after the tender closed, each tenderer made a presentation to the panel where additional information was presented and questions asked. Additional information was requested from Air New Zealand and Qantas, which was provided.

7.60 In the case of Qantas, the panel observed that its price was significantly greater than that offered by Air New Zealand. Qantas was given an opportunity to submit a revised price but without any indication of what price might be acceptable. Qantas submitted a new price but the panel concluded that, based on all the evaluation criteria, Air New Zealand should be awarded the contract.

7.61 The reasons for selecting Air New Zealand were clear and well documented.

Our Views

7.62 The June 2002 tender for a preferred supplier of airline services was, with one exception, carried out in a professional manner. The reasons for selecting Air New Zealand were convincing, easy to follow, and clearly documented.

7.63 Contacting tenderers after close of tenders is acceptable subject to no tenderer receiving (or appearing to receive) unfair advantage over any other tenderer. It was not acceptable for Transend to go back to only Qantas and ask whether it wished to reconsider its price. This was not good practice because it was unfair to the other tenderers.

Delegations of Authority

7.64 We tested compliance with financial delegations by Transend in recent large transactions. We found that financial delegations had been complied with.

Overall Views and Conclusions

7.65 The Transend travel policies were different in some key respects from New Zealand Post policies. Formal approval of these policies by New Zealand Post could not be located.

7.66 Transend's previous travel, accommodation and business expense policies allowed a small number of its staff to incur expenditure that was clearly excessive and wasteful.

7.67 Three months after the report of the Board subcommittee, Mr Stein announced a tightening of controls on expenditure. In our view, the Transend policy change in December 2001 to specify first class hotels as the standard for hotel accommodation was an inappropriate response to concerns arising from the PwC report. Expressing a different set of rules for the Managing Director was also inappropriate.

7.68 The substantive changes to the Transend policies and environment were only made following the appointment of Mr Allen in late-March 2002.

7.69 The current travel, accommodation and business policies of Transend have been implemented satisfactorily in recent significant operations and transactions. Delegations of authority have been complied with in recent significant transactions.

7.70 We recommend that:

- recent changes to the travel policy should be formalised by incorporation in the policy statement; and
- further guidance be provided on what is acceptable hotel accommodation, and meal and entertainment expenses.

Part Eight

Lessons Learned

8.1 Arising from our inquiry, we have found a number of important lessons for all public sector entities.

Governance

8.2 The governance structures for subsidiaries must be closely monitored to ensure that they work effectively and (when necessary) amended. There must be comprehensive and realistic reporting to the parent board about their activities – reporting that is frank in its assessments of strengths, weaknesses, and possible outcomes.

8.3 The senior management of a subsidiary must be conscious of the needs of its board. The senior management of the parent should assess the adequacy of reporting to the board by subsidiaries.

8.4 Subsidiaries with overseas operations pose particular risks that must be carefully managed.

Policies and Procedures

8.5 Generally speaking, the same policies and procedures should apply to the parent and wholly-owned subsidiaries (this is New Zealand Post policy). Any exceptions should be approved at an appropriate level. The need for the exceptions and their application should be monitored carefully.

8.6 Entities must ensure that they have adequate means to regularly examine both compliance with policies and delegations and whether they remain appropriate.

8.7 Credit card expenditure remains an area of risk for all organisations. Credit cards are an efficient means of paying for legitimate expenditure. But management needs to ensure that basic rules on the use of credit cards are adhered to 4 such as ensuring that:

- Where a meal or function is paid for by credit card, the cost is charged to the credit card of the most senior person present.
- Costs charged to credit cards for accommodation, meals, and entertainment are reasonable and "make business sense". Even where someone with the appropriate authority has approved such costs, credit card expenditure still needs to be independently tested to ensure that it is prudent and complies with applicable rules.

Appendix 1

List of Individuals Referred To in This Report

The individuals referred to this report are:

Name	Position
New Zealand Post Limited	
Dr Ross Armstrong	Chairperson, New Zealand Post Limited – until June 2002.
Mr Syd Bradley	Deputy Chairperson, New Zealand Post Limited.
Mr Elmar Toime	Chief Executive, New Zealand Post Limited.
Mr Drew Stein	Managing Director, Transend Worldwide Limited – until March 2002.
Mr Nazir Awan	Chief Financial Officer, New Zealand Post Limited.
Mr John Allen	Acting Managing Director, Transend Worldwide Limited – from March 2002.
Other	
Ms Kristy McDonald QC	Legal counsel to the Board of New Zealand Post Limited.
Mr Cameron Mander	A partner of Luke Cunningham Clere, appointed by the Board of New Zealand Post Limited as an independent intermediary.

Appendix 2

Transend's Key Management Contracts

Over the past few years Transend has been successful in winning contracts with overseas postal agencies. Transend undertook a range of offshore consulting work 4 which included work in countries as diverse as Portugal and Malaysia. Transend won three substantial management contracts as described briefly below.

South African Post Office

In September 1999, Transend secured a three-year contract to help manage the South African Post Office (SAPO). SAPO was losing money and wanted to modernise its operations and return to profitability. According to Transend, the contract, estimated to be worth $54 million, was the largest postal management contract ever tendered and was won against strong competition from international postal consulting groups. Winning the contract was a major achievement for Transend. To fulfil the contract, Transend based its own staff and staff from other parts of New Zealand Post in South Africa.

Under the contract, SAPO entered into a Strategic Management Partner Agreement (the SMP Agreement) with Transend. Under the Agreement, Transend was not responsible for the entire operations of SAPO. For instance, the Postbank, Pensions and Medical Business areas of SAPO were not within the scope of the Agreement. Transend's agreement related to the postal business of SAPO only. The SMP Agreement comprised six main targets relating to service delivery and postal network performance. An additional objective was to improve the financial performance of the business over the three years of the contract.

The SMP Agreement was complex. It comprised 31 individual projects, each with objectives, timetable, and deliverables. The key aims of the SMP Agreement included reaching financial break-even (for a defined part of the business), installing four million postal addresses by the end of 2002, and obtaining better coverage from the postal retail network.

In October 2000, SAPO arranged for Arthur Andersen to review the first year of the contract. The resulting report noted that the extent of the change envisaged by the SMP Agreement was enormous and that 4

> *Based on our experience, we consider the enormity of the change required by the Post Office by virtue of the SMP and the associated time scales to be way beyond that we have seen in any comparable, including more stable and more sophisticated, postal authorities globally.*

The Arthur Andersen review found that there had been satisfactory progress in 28 of the 31 projects. The report concluded that 4

> *Year 1 has seen some significant progress with certain of the projects of the SMP, however there are also areas where progress has been limited. With the appropriate focus and prioritisation many of these areas are probably capable of being "caught up" over the remaining period of the SMP.*

However the report noted a number of significant concerns 4 not so much with what had been achieved, but with the context within which the SMP Agreement changes were taking place. These concerns can be summarised as:

∉# a lack of a common agreement and understanding within SAPO about the changes;

∉# too much being expected of the SAPO management team, which lacked the experience and skills to undertake the changes; and

∉# considerable conflict between SAPO and Transend staff.

In Arthur Andersen's view, these changes were taking place within a "vacuum". The vacuum was caused by key positions within SAPO not being filled by the SAPO Board 4 which was having an adverse impact on ownership of the change programme, accountability, and commitment to change.

In early-2001, it became clear that SAPO was facing major financial problems. By that time, over 3500 employees had been made redundant. The employees' union was opposed to further redundancies.

During February 2001, strike action took place in the processing and delivery areas, over attempts by management to stop unauthorised payments of triple time. The strike was triggered and resolved without any consultation with Transend.

The Government then organised a further review of the Transend contract and, in May 2001, Transend learnt through the media that cancellation of the contract was being contemplated. Transend managers have told us that there had been no prior warning of SAPO's intentions. Transend believed it was reaching agreement with SAPO on the priorities it should focus on delivering.

The contract was terminated by a mutually negotiated settlement in October 2001 that involved the payment of several million dollars to Transend. Some New Zealand Post Board members told us that this was mainly due to the efforts of Mr Stein.

Trinidad and Tobago Post Office

In late-1998, Transend won a contract to improve the efficiency of the Trinidad and Tobago Post Office (TT Post). The project is being funded by a loan from the World Bank, and will cost $10 million. The bulk of the funding has been applied to modernisation of the information systems and replacement of the vehicle fleet.

Staff from New Zealand Post, under contract to Transend, are based in Trinidad and Tobago.

Transend has summarised the key parts of this contract as follows:

- The Trinidad and Tobago government engaged Transend to manage the postal service, reporting to a government-appointed Board.

- The plan has been to transform TT Post from a loss-maker into a profit-maker that has the capacity to pay back the World Bank loan from its own revenue.

- TT Post moves about 30 million items of mail a year. Transend expected that this would double over the five years of the contract and provide a 150% rise in mail revenues.

- At the end of the five-year contract in late-2003, Transend expects to hand back to the government of Trinidad and Tobago a modern and efficient postal service.

The World Bank has reported on the performance of Transend against annual targets set in the management contract. The World Bank report noted that 4

> *A lot more is being accomplished than simply extending universal delivery. TTPost is making a giant contribution to the national good by virtually building from scratch a national address infrastructure that often involves naming streets and assigning house numbers where none existed before. This has great value to the state of the commercial sector and the emergency services of Trinidad and Tobago.*

A challenge for Transend in relation to this contract is that planned staff reductions have now been put on hold by the government department responsible for TT Post. If these redundancies are not put in place, Transend will find it difficult to meet profitability targets. Should this eventuate, there is an agreed process for the contract to be re-negotiated.

Maltapost

In February 2002, Transend signed a two-year management services contract for the management and operations of Maltapost. Maltapost is the state provider of postal services in Malta. Transend has also taken a 35% equity stake in Maltapost. Under the terms of the management contract, Transend has appointed a Chief Executive and two other senior managers. Two New Zealand Post executives are appointed to the Board of Maltapost.

Key elements of the contract include improving mail processing, establishing retail point-of sale-systems, developing new products and services, and expanding commercial arrangements internationally.