Controller and Auditor-General
Tumuaki o te Mana Arotake

Inquiry Report

Inquiry into certain allegations made about Housing New Zealand Corporation

Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

E-mail: reports@oag.govt.nz
www.oag.govt.nz

Inquiry into certain allegations about Housing New Zealand Corporation

This is the report of an inquiry we carried out under sections 17 and 18 of the Public Audit Act 2001.

June 2006

ISBN 0-478-18160-4

Foreword

The Board of Housing New Zealand Corporation asked me to consider undertaking an inquiry after allegations made by a former contractor of the Corporation appeared in the news media.

The allegations were potentially serious, and warranted looking into.

It is important to note that I have examined only one small part of the Corporation. My findings cannot, and should not, be applied to the Corporation as a whole. While I have identified some concerns about the management and administration of the National Property Improvement team, I always expect to find areas for improvement in an inquiry.

All affected parties were given an opportunity to comment on a draft version of this report.

I thank the Corporation for its help and co-operation with my inquiry.

I also thank Ernst & Young, PricewaterhouseCoopers, and the other parties involved for their help and co-operation.

K B Brady
Controller and Auditor-General

9 June 2006

Contents

Figures

Summary

In March 2006, we received information about certain allegations made by a former contractor of Housing New Zealand Corporation (the Corporation). On 10 April 2006, the Board of the Corporation asked the Auditor-General to consider conducting an inquiry into those allegations, and the Corporation's response to them.

The situation arose in 2005. On 8 August 2005, the contractor notified the Chief Executive of the Corporation by e-mail that he had concerns that:

- certain accounting practices in the Corporation's Modernisation and maintenance programmes were inappropriate, and produced misleading financial results;
- certain inspection activities in the Corporation's Modernisation and maintenance programmes were carried out inadequately, or not at all; and
- he was bullied by other staff in response to his concerns.

The contractor did no further work for the Corporation after 8 August 2005. A settlement agreement was reached between the General Manager Assurance Services (the GM Assurance Services) and the contractor on 14 December 2005, which included a payment to the contractor of $3,000. One of the terms of the agreement was that the contractor would not communicate publicly or privately any of his concerns about the Corporation or other parties, including through communications with any Minister, member of Parliament, journalist, or radio or television station.

The allegations made by the contractor were potentially serious, and we advised the Board on 11 April 2006 that we would conduct an inquiry.

Our inquiry looked at:

- the Corporation's handling of the allegations, including the events leading up to the settlement agreement with the contractor; and
- the allegations made by the contractor.

Our findings about Housing New Zealand Corporation's handling of the allegations

The initial investigation of the allegations

The Corporation made an immediate and genuine effort to investigate the contractor's allegations. It sought an agreement with the contractor as to what the allegations actually were, and agreed for the matter to be looked at internally, with a level of review by the external auditor. This was a reasonable response in the circumstances.

The payment made to the contractor

The payment made to the contractor was an ex gratia (voluntary) payment that recognised his grievance about the abrupt nature of his departure from the Corporation. It was part of a pragmatic solution by which the GM Assurance Services sought the contractor's co-operation in moving the matter forward and enabling an orderly investigation of his allegations. The payment was calculated appropriately, and was based on about 2 weeks' income that the contractor might have expected to receive if his engagement with the Corporation had been terminated with notice.

The terms of the agreement (except for the non-disclosure clause, which we discuss below) were fair and reasonable. However, the way the agreement was drafted was unwise. Referring to the payment immediately before the non-disclosure clause created a perception that the payment was being made in return for the contractor's silence. Had that been the intention of the parties, it would have been highly inappropriate. However, we did not find any indication that either the contractor or the Corporation intended or understood that to be the case. The non-disclosure clause was included in the settlement agreement at the initiative of the contractor, not the Corporation.

The process used to reach the settlement agreement

We have concerns about the process used to reach the settlement agreement. These include a lack of documentation of the rationale for entering the settlement and a failure to obtain written legal advice, although oral advice was obtained from external legal advisors. Despite this, the GM Assurance Services had a clearly formulated rationale for the decision to settle with the contractor and make a payment to him.

The Chief Executive's role

The Chief Executive orally approved the decision to negotiate a settlement with the contractor, and the financial parameters for the settlement. However, she did not see or approve the terms of the agreement entered into, including the non-disclosure clause. The Chief Executive was kept properly informed of progress, and discharged her responsibilities appropriately.

The non-disclosure clause

In our view, including the non-disclosure clause in the agreement was unwise. The form in which it appeared was inappropriate because it purported to close off legitimate avenues for disclosure of information about serious wrongdoing under the Protected Disclosures Act 2000.

However, there was some justification for a non-disclosure clause in some form, given the contractor's repeated indications that he would disclose his concerns publicly. The clause would have been acceptable if it had been drafted in terms that preserved the contractor's right to make any disclosure permitted by law.

Our findings about the contractor's allegations

The Corporation had difficulty investigating the contractor's allegations because many of them lacked specific detail. The contractor provided us with a greater amount of information, but we also had difficulty investigating because of insufficient detail.

Some of the allegations raised by the contractor were, in our view, based on a misunderstanding by the contractor of the Corporation's accounting practices or a lack of appreciation of the overall picture. Given the size of the Corporation, we would not expect all staff members (nor contractors) to be involved in, or understand, the full accounting and reporting structure within the Corporation. This is especially so for an individual who spent only a number of months working for one area of the organisation.

We investigated all the allegations and reached the following general conclusions:

- Our inquiry did not give rise to any significant concerns about the Corporation's financial accounting practices.
- However, we do have some concerns about management reporting practices within the National Property Improvement team. In our view, there is a lack of suitable accounting resources at the operational level, a lack of ownership or responsibility over programme accounting, a need for improved documentation, and a need for better alignment between management reporting and financial accounting records.

Our recommendations are set out in the "lessons learned" section of this summary.

Allegations about accounting and reporting practices

The contractor alleged that capital spending on Community Group Housing properties was reported in an untimely manner. We do not share that concern in respect of financial accounting for the Corporation as a whole. However, we are concerned that not all spending is recorded within monthly management reports in the month in which the costs are incurred.

The contractor alleged that reversing journals were being used to manipulate results. The Corporation's use of reversing journals is in keeping with generally accepted accounting practice. We have no concerns with the use of such journals.

The contractor alleged deliberate manipulation of results between financial years. He expressed specific concern about an accrual of $720,000 in advance of the work being completed and about costs of $2.1 million held in a suspense account. We found that while an over-accrual of at least $200,000 did occur at 30 June 2005, we do not consider that this was a deliberate attempt to manipulate the reported results. We also found that if the job has been incorrectly set up, costs are held in a suspense account when such costs are uploaded into the accounting system. In such circumstances, staff identify the appropriate codes manually, and clear items out of the suspense account. The contractor helped with clearing costs amounting to about $2.1 million from this account, relating to 2 financial years.

We have no concerns about this suspense account as such, because costs are appropriately included in the Corporation's balance sheet for financial reporting purposes. However, to provide an accurate picture of various programmes throughout the year, the costs held in this suspense account also need to be included for management reporting purposes.

We consider that the accumulation of costs in a suspense account over a period of many months without being cleared was inappropriate. We note that the account now has a much lower balance and is reconciled each month.

The contractor alleged that there was manipulation of results between various programmes. We found no evidence to support this allegation.

The contractor alleged that management reports were manipulated so as to disguise the true cost of projects. We found that management reporting of the Greenstone Gardens project did not consistently identify the extent of budget overrun on the project, because of the practice of comparing actual costs to forecast costs rather than the approved budgeted costs and because an accrual of $722,000 relating to the project was not correctly allocated to the project.

However, we did not find any evidence to support the contractor's allegation that management reports on the performance of the Auckland Modernisation programme were manipulated. We noted that the under-performance of the programme had been drawn to the attention of the Assurance Committee of the Corporation's Board. Therefore, the non-performance was not suppressed but, rather, was highlighted for the attention of the Board, as was appropriate.

The contractor alleged that payments made by the Corporation under the Property Maintenance Assessment System (PMAS) contract exceeded the contracted amount. In our view, the structure of the contract makes this unlikely and we found no evidence to suggest that this occurred.

The contractor raised general concerns about the robustness of the accruals process for some housing programmes. While we detected some inaccuracies in the accruals for the Modernisation programme relating to the end of the 2004-05 financial year, some of these appear to have resulted, at least in part, from errors made by the contractor.

We consider that the supporting documentation relating to accruals could be improved. This ought to reduce the potential for errors in future.

The contractor alleged that there was an unauthorised transfer out of a project manager's 2005-06 budget without discussion with the manager. We consider that the "unauthorised transfer" was the consequence of an under-accrual from the previous year, and affected the 2005-06 actual figure rather than the 2005-06 budget figure.

Alleged suppressing and "watering down" of internal audit findings

The contractor alleged that internal audit findings were "watered down" or suppressed. We did not find any evidence to support this allegation.

Contestability of the Property Maintenance Assessment System contract

The contractor raised concerns about the tender process used by the Corporation to outsource the PMAS contract during 2005. In our view, the decision made to award the contract to the existing provider was appropriate. However, we do have some concerns about insufficient documentation of the tender process, and the adequacy of some aspects of the Corporation's procurement policies.

We did not find any evidence to substantiate the contractor's concern that the existing provider won the tender because of a personal relationship between an individual in the existing provider's company and a senior manager at the Corporation. The senior manager was not involved in evaluating the tenders, and the evaluation panel's recommendation was adopted by the Corporation without amendment by the senior manager.

Alleged inappropriate programme reporting structure

The contractor alleged that there were inappropriate reporting lines within the National Property Improvement team. This is a management decision that we do not intend to express a view on, but we note that managers within the Corporation have previously considered this matter.

Organisational culture

The contractor also alleged, in connection with his allegations about accounting and reporting practices, that he was bullied by 2 staff members. Although such issues are more within the mandate of the State Services Commissioner, we did discuss issues of organisational culture with the staff members we spoke to.

The contractor's concern arose out of differences of opinion with staff members that perhaps were not handled or managed in the most appropriate manner. There is a distinction between strong management and workplace bullying. We did not find any reason to refer the contractor's allegations to the State Services Commissioner for further investigation.

Use of Crown funding and third party revenue

We did not find any lack of clarity or transparency around the Corporation's use of Crown funding and third party revenue.

Lessons learned

Several features of the matters we inquired into were unusual, but there are lessons that can be learned by all public sector organisations.

Induction procedures

The Corporation appears to have not considered whether the contractor needed to participate in the Corporation's formal induction process. Given that he was to work in many respects as if he were an employee, formal induction would have been desirable. He could have been told about the State Services Commission's Code of Conduct, to the extent it is adopted by the Corporation, and the procedure for making protected disclosures under the Protected Disclosures Act 2000.

Protected Disclosures Act 2000 procedures

The manner in which the contractor's disclosures were made and subsequently managed was largely consistent with the Corporation's internal policy on the Protected Disclosures Act. However, this appears to have been largely coincidental. Our inquiry reinforces the need for staff and management of public sector organisations to be aware of their respective rights and duties under the Protected Disclosures Act.

Use of non-disclosure clauses in severance agreements

There is a need for guidance for public sector employers on what is acceptable practice when using non-disclosure clauses in severance agreements. We have

tried to set out what we consider to be acceptable practice (see Part 4), after consulting with Crown Law and the State Services Commission. We commend Part 4 to all public sector employers.

Accounting and reporting practices

In respect of the Corporation's accounting and reporting practices, we recommend that:

1. Housing New Zealand Corporation report all programme spending in the monthly management reports when such costs are incurred, regardless of whether the costs have been entered into Rentel or are held in a clearing account.
2. Housing New Zealand Corporation reconcile each month the financial information in the management reports and the expenditure recorded in its accounting records. This would, for example, ensure that the clearing accounts (which are in capital work in progress in the general ledger) are accurately reflected in management reporting in the month the costs are incurred.
3. Housing New Zealand Corporation track leasehold property improvements on a property-by-property basis.
4. Housing New Zealand Corporation consider whether project managers need additional training on relevant accounting matters.
5. Housing New Zealand Corporation complete as soon as possible the guidelines and procedures for the Modernisation programme, to provide clarity for staff about allocating costs.
6. the Wellington-based Finance team remind all business groups within Housing New Zealand Corporation what the requirements are for manual accrual journal entries, and that exceptions will not be made.
7. Housing New Zealand Corporation employ suitably qualified accounting resources within the National Property Improvement team.
8. Housing New Zealand Corporation clarify the ownership of, and management responsibility for, the programme accounting function within the National Property Improvement team.

The Corporation's procurement processes

As a result of our review of the PMAS contract, we recommend that Housing New Zealand Corporation:

9. follow the documentation requirements of its tender policy, and adequately supervise staff given responsibility for day-to-day management of tenders.

10. review its procurement policy and processes to ensure that they are consistent with best practice and relevant public sector procurement guidelines, and to ensure that any guidelines in use form part of that policy.

Materiality and our 2004-05 audit

In an in-depth inquiry, it is always possible that concerns will be uncovered that have not been identified in the normal course of the annual audit.

Ernst & Young, acting as the Auditor-General's appointed agent, audits the financial statements of the Corporation each year. An audit, by its very nature, does not involve considering each accounting transaction. Rather, systems are audited, and selected transactions and balances are tested. In carrying out an audit, the auditor considers whether an amount is "material", which is largely determined by the size of an entity's assets and budget.

The Corporation has assets worth about $11 billion, and spent about $635 million in the 2004-05 financial year. In our view, none of the accounting transactions that we examined were material in the context of the Corporation's financial statements taken as a whole.

The scope of our findings

It is also important to note that we have only examined one small part of the Corporation. Our findings cannot, and should not, be applied to the Corporation as a whole. While we have identified some concerns about the management and administration of the National Property Improvement team, we always expect to find areas for improvement in an inquiry.

Part 1
Introduction

1.1 In this Part, we explain:

- how our inquiry came about;
- the scope of our inquiry; and
- how we conducted our inquiry.

How our inquiry came about

1.2 On 27 March 2006, we received information from Ernst & Young concerning allegations made by a former contractor of Housing New Zealand Corporation (the Corporation) about certain accounting and management practices. As the Auditor-General's appointed agent in auditing the Corporation, Ernst & Young is required to inform us of any significant audit-related issues identified during the course of an audit or at any other time.

1.3 On 10 April 2006, the Board of the Corporation asked the Auditor-General to consider undertaking an inquiry into:

- the contractor's allegations; and
- the Corporation's response to the allegations, which had resulted in a settlement agreement with the contractor.

1.4 The settlement agreement was dated 14 December 2005, and involved a payment by the Corporation to the contractor of $3,000 in full and final settlement of all claims the contractor might have against the Corporation (including his concerns about the abrupt manner in which his contract with the Corporation had ended). In the agreement, the contractor agreed not to communicate publicly or privately any of his concerns about the Corporation or other parties, including through communications with any Minister, member of Parliament, journalist, or radio or television station (the non-disclosure clause).

1.5 The Auditor-General agreed to the Board's request to conduct an inquiry. Terms of reference were formulated and agreed with the Board on 11 April 2006.

1.6 We consulted on the terms of reference with the Department of Building and Housing, the State Services Commission, the Treasury, the Department of the Prime Minister and Cabinet, and the Office of the Minister of Housing.

Scope of our inquiry

1.7 Our inquiry examined:

- the Corporation's handling of the allegations raised by the contractor, including whether the issues raised by the allegations were appropriately included in the Corporation's internal audit programme;

- the events leading up to the signing of the settlement agreement, including:
  - the negotiation of the agreement, how the terms of the agreement were arrived at, and the advice taken by the Corporation about the agreement;
  - what the payment of $3,000 was for, at whose initiative it was negotiated, and how it was calculated;
  - how the agreement was authorised and, in particular, whether the Chief Executive of the Corporation authorised the agreement or was aware in advance of its terms; and
  - the Corporation's policies and procedures for making protected disclosures; and
- the allegations made by the contractor.

1.8 The full terms of reference for our inquiry are set out in Appendix 1.

1.9 One of the contractor's original allegations was that certain inspection activities in the Corporation's housing Modernisation and maintenance programmes were carried out inadequately, or not at all. When we met with the contractor at the start of our inquiry, the contractor did not raise the adequacy and frequency of property inspections as an issue other than in connection with payments made to the Corporation's provider of property inspection services. Accordingly, we do not discuss the allegation further in this report.

How we conducted our inquiry

1.10 Our inquiry team first met with the contractor to obtain further details about his concerns.

1.11 We also met with various staff members from the Corporation's Manukau and Wellington offices.

1.12 We discussed the inquiry with various external parties, including Ernst & Young, PricewaterhouseCoopers (which assists the Corporation's internal audit function), and organisations that have done business with the Corporation relevant to our inquiry, in particular with the National Property Improvement team.

1.13 We reviewed a significant amount of documentation from the Corporation and performed some specific audit testing.

1.14 We gave all the affected parties a chance to comment on a draft version of the report.

Part 2
Dealings between Housing New Zealand Corporation and the contractor

2.1 In this Part, we describe:

- the circumstances surrounding the contractor's engagement with the Corporation;
- the contractor's raising of his allegations, and the circumstances of his departure from the Corporation;
- the Corporation's initial investigation of the contractor's allegations; and
- the events leading up to, and following, the settlement agreement.

2.2 We discuss our view on the Corporation's management of these events in Part 3, and discuss the Protected Disclosures Act 2000 and the appropriateness of the non-disclosure clause in the settlement agreement in Part 4.

The engagement of the contractor

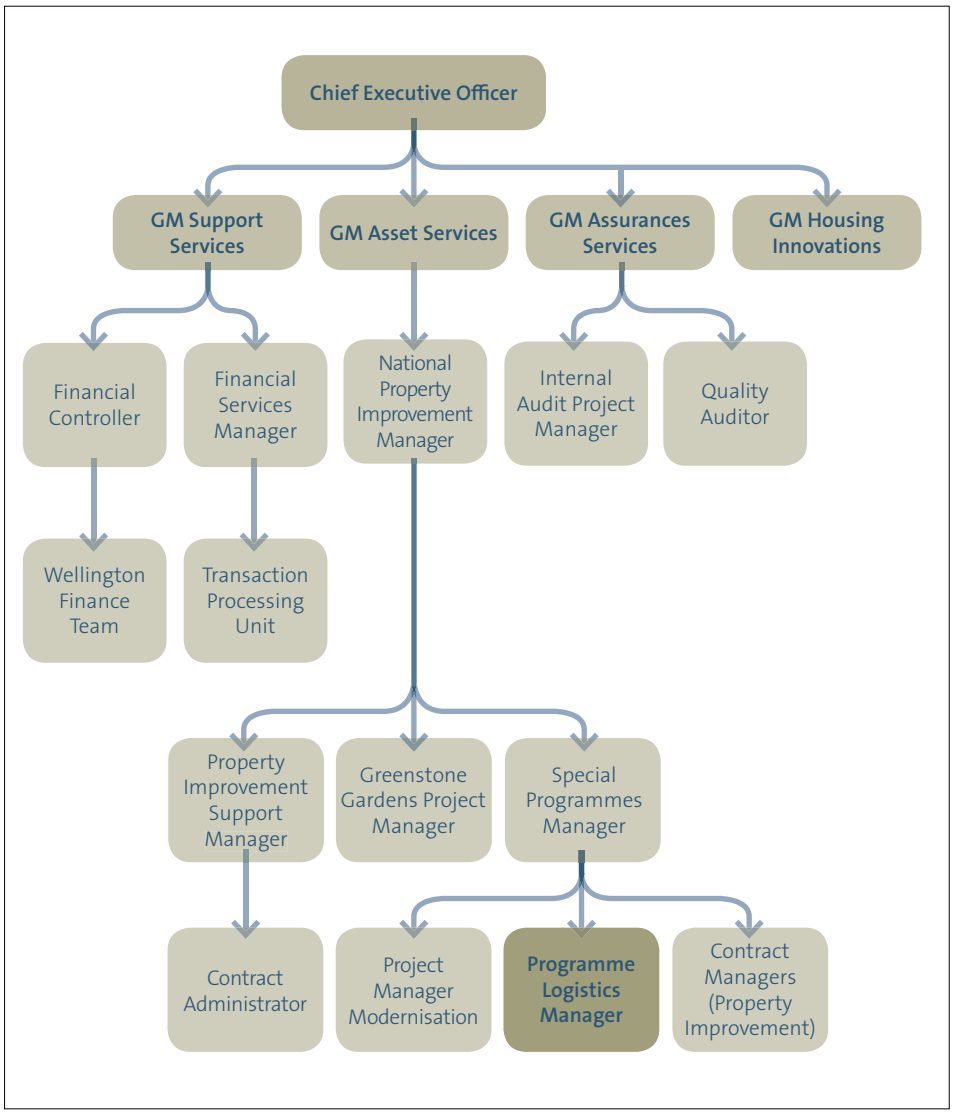
2.3 The contractor was engaged in February 2005, to fill the role of Programme Logistics Manager (see Figure 1) at the Corporation's Manukau office while the incumbent was seconded elsewhere. The role entailed helping the Special Programmes Manager (who was the contractor's line manager). Important outcomes for the role included ensuring that:

- robust systems and reporting frameworks were in place, to provide timely and accurate information to assist delivery and monitoring of special asset improvement programmes; and
- appropriate data and information were collected and reported.

2.4 The engagement was made through an executive leasing company (the leasing company). Under the contract between the leasing company and the Corporation, the leasing company agreed to supply staff to fill the Programme Logistics Manager position for 40 weeks from 18 February 2005. The contract also included a weekly review of the contractor's activities. The Corporation had the right to end the assignment at its discretion, and was to notify the leasing company – not the contractor – if this was the case.

2.5 There was no contract for services directly between the Corporation and the contractor. However, for the duration of his engagement, the contractor worked largely as if he were an employee of the Corporation (for example, he was based at the Manukau office, worked normal office hours, and had been issued with a mobile telephone for business use).

Figure 1
The position of the contractor within Housing New Zealand Corporation and other positions and teams discussed in this report



2.6 The contract between the Corporation and the leasing company also stated that all contractors on assignment with the leasing company understood that their engagement was as a contractor, and should not be regarded as an employment relationship with either the leasing company or any company to which they were on assignment.

2.7 The Corporation has a robust induction programme for new employees, but its induction policy is silent on induction procedures for contractors. New employees attend a 3-day National Induction Programme covering (among other areas) making and resolving complaints, taking action on harassment, and employee assistance programmes. In addition, the Corporation's internal policies and procedures (the Quality Management System or QMS) are available through the intranet, on every computer desktop.

2.8 Although the contractor was provided with guidance and support, we were told that he did not attend the formal induction programme. No one, including the contractor, recalled any information being provided to him about the Protected Disclosures Act 2000 by the Corporation. However, information about "whistle-blowing" under the Protected Disclosures Act was available in the QMS on the contractor's computer desktop.

Raising allegations, and the contractor's departure

2.9 The contractor told us that he had had concerns for some time before his engagement ended on 8 August 2005. He could not be specific about the date, but said that he raised the concerns with the leasing company. The contractor told us that the leasing company told him that it had a "liability contract" with the Corporation, and had advised him to do what he was told.

2.10 The leasing company told us that it advises contractors to raise issues with it, but also emphasises that contractors should raise issues with the organisation they are working for. In this case, the leasing company became aware of personal conflicts between the contractor and others in the Corporation around June or July 2005. The contractor, a representative of the leasing company, and the Special Programmes Manager met to discuss these conflicts, but not any allegations. The leasing company's representative at this meeting recalled that they had reminded the contractor that he was a contractor, was to follow the Special Programmes Manager's directions, and was to avoid upsetting people.

2.11 On 18 and 19 July 2005, the contractor e-mailed his concerns about some accounting issues to several colleagues in the Corporation's Manukau office. The contractor told us he had been working on a "reporting model" for the Community Group Housing (CGH) programme, and had formed a view that the Corporation was slow in putting CGH capital expenditure into Rentel (the Corporation's housing asset tracking system).

2.12 We were told that the contractor's e-mails upset Transaction Processing Unit (TPU) staff. We were told by Corporation staff that an informal meeting to discuss these e-mails was arranged between the contractor, the Special Programmes

Manager, and the National Property Improvement Manager (the senior manager responsible for Special Programmes) on or about 19 July 2005.

2.13 However, although the contractor told us that he was prevented from contacting TPU staff after 19 July and was told to apologise, he did not recall the meeting.

2.14 The Corporation's managers involved told us that, as the line managers of staff involved, they considered a "cooling off" period would be beneficial, and the contractor was asked to stay away from the TPU for only a couple of days. They added that there was little reason for the contractor to have regular contact with the TPU. The National Property Improvement Manager also told us that he suggested the contractor apologise to the Financial Services Manager (who is the TPU manager). He recalled that this was a suggestion, not a direction, to aid working relationships within the office. There are no records of these discussions.

2.15 Precisely what happened between 18-19 July 2005 and the contractor's departure on 8 August 2005 is unclear. Several factors appear to have been intensifying around this time. First, the contractor had concerns about the Corporation's accounting policies and practices. Secondly, the contractor believed that he had been told to apologise to TPU staff or leave the Corporation. Thirdly, Finance staff were beginning to challenge the contractor's understanding of accounting issues, and had identified what appeared to be a financial error by the contractor (see Part 5). Fourthly, the Financial Services Manager had previously discovered inappropriate personal use of the Corporation's mobile telephone by the contractor. Finally, because of the first and third issues noted above, the contractor had been involved in a bruising e-mail exchange with TPU staff.

The contractor's departure

2.16 On 8 August 2005 the contractor sent an e-mail to the Chief Executive of the Corporation stating his "...intention to resign from my contract at [the Corporation], effective immediately". The subject line of the e-mail was "Why do I need to apologise?", and it alleged:

- inappropriate financial practices;
- abuse of power by certain Corporation staff; and
- lack of respect and fairness by certain Corporation staff.

2.17 The contractor copied this e-mail to 4 other senior managers in the Corporation: the Manukau-based Financial Services Manager, the Wellington-based Financial Controller, the General Manager Support Services (who was overseas, and did not return to New Zealand until some 3 months later), and the General Manager Asset Services (the GM Asset Services). The e-mail was not copied to the Special Programmes Manager.

2.18 The Chief Executive told us that she did not know of the contractor before receiving his e-mail. She was concerned about the e-mail she received, and asked the GM Asset Services to prepare a response. (The GM Asset Services is a member of the Executive Team, based in the Corporation's Wellington office, and responsible for the National Property Improvement team in which the contractor worked.) The Chief Executive told us that she would not have regarded it as inappropriate for someone in the contractor's position to inform the Chief Executive directly of concerns about alleged wrongdoing in the Corporation.

2.19 On 9 August 2005, the Financial Services Manager e-mailed a response to the allegations to the Chief Executive. The response said that:

- the annual audit of the Corporation had been carried out by Ernst & Young, and Ernst & Young had not raised any concerns of the kind now raised by the contractor;
- he and other staff rejected the contractor's allegations of abuse of power by Corporation staff; and
- the contractor's concerns about lack of respect were not justified.

2.20 The contractor did not turn up for work on 9 August 2005, which is consistent with his stated intention to "resign" with immediate effect. However, the Special Programmes Manager told us that, when he rang the contractor early that day to find out where he was, the contractor said he was sick. He made no mention of his e-mail to the Chief Executive the day before, purporting to "resign". The Special Programmes Manager found out about the e-mail message only later that day.

2.21 The contractor told us that he spoke with the Special Programmes Manager and offered to work out a 2-week notice period, but was prevented from returning to work after 8 August 2005. The Special Programmes Manager did not recall this conversation, and was adamant that the contractor did not give 2 weeks' notice. Many of the staff we spoke to who had seen the contractor's e-mail of 8 August told us that they considered he had effectively terminated his own assignment with the Corporation.

Involvement of the leasing company

2.22 Under the contract between the Corporation and the leasing company, the expectation was that the leasing company would handle any performance or termination issues. The contractor told us that he was clear that he was a contractor, not an employee. However, the contractor "resigned" from the Corporation without involving the leasing company.

2.23 On 10 August 2005, a representative of the leasing company met with the contractor, the Special Programmes Manager, and one other staff member. We understand that the meeting was mostly about the contractor repaying money owed to the Corporation for personal use of a mobile telephone, and returning the mobile telephone and office access keys. There was little discussion of the contractor's concerns. The leasing company representative recalled making the contractor aware that the Protected Disclosures Act 2000 (referred to at the meeting as the "Whistleblowers Act") offers certain protections.

Use of the Corporation's mobile telephone

2.24 The Corporation's policy regarding mobile telephones is not included within the QMS. However, the Corporation told us that any equipment provided to staff, including mobile telephones, is essentially for business purposes. The Special Programmes Manager told us that the contractor was advised, when the mobile telephone was provided, that it was to be used only for business purposes. The Corporation's guidelines on discretionary expenditure provide that one call home a day, up to 30 minutes long, is considered reasonable on any business travel of more than one day.

2.25 The contractor used the mobile telephone for personal calls, including international calls, that incurred charges that amounted to $1,909.62. The Financial Services Manager brought this matter to the attention of the contractor on 30 June 2005. This followed the usual procedure where inappropriate use of the Corporation's equipment or resources is identified. The contractor agreed that he would repay this amount to the Corporation.

2.26 The Financial Services Manager is the Corporation's "gatekeeper" on sensitive expenditure.

The initial investigation of the contractor's allegations

2.27 The Chief Executive told us that, on or about 11 August 2005, after the initial response from the Financial Services Manager, she asked the GM Asset Services to prepare a fuller response to the contractor's allegations. The contractor was informed of this by e-mail and telephone.

2.28 The investigation included making inquiries of the National Property Improvement Manager, the Financial Services Manager, and the internal auditor. The GM Asset Services also attempted, although without success, to obtain further information from the contractor (both directly and through the leasing company) about his allegations. The contractor told us that he was willing to provide further information if the Corporation apologised to him.

2.29 There was further correspondence between the contractor and the GM Asset Services during this period. On 30 August 2005, the GM Asset Services sent an e-mail to the contractor, in which the GM Asset Services:

- noted that the contractor did not wish to provide further information;
- expressed regret that the contractor did not think his concerns were being appropriately addressed;
- explained that his concerns were being taken very seriously, that they were being investigated, and that an audit had been commissioned; and
- pointed out that payment of the charges for unauthorised mobile telephone calls was yet to be received from the contractor.

2.30 During August 2005, the Corporation's internal auditor undertook an investigation at the request of the GM Asset Services. On 31 August 2005, he reported to the GM Asset Services that he had reviewed the ledger accounts that the contractor had referred to in his 8 August 2005 e-mail. The internal auditor concluded that the accounts appeared to be operating correctly, and that he had not found any areas of concern. However, he also said that the contractor's e-mail had not fully explained his concerns. The internal auditor recommended that the contractor be approached again and told that a review of the limited information he had provided showed no concerns.

2.31 The next day, the GM Asset Services sent an e-mail to the contractor. He explained that the internal auditor had completed his investigation, but that he did not have enough information to fully understand what the contractor's detailed concerns were, and to date had identified no instances of inappropriate accounting. The GM Asset Services mentioned that the internal auditor had asked whether the contractor would be prepared to be contacted directly by him so that he could follow up on the contractor's concerns.

2.32 In the contractor's response to this e-mail, he said that he would be prepared to co-operate with an investigation if it was undertaken by the Corporation's external auditor (that is, Ernst & Young), followed by a report directly to the Corporation's Board.

2.33 The GM Asset Services advised the contractor that the investigation was being directed by the General Manager Assurance Services (the GM Assurance Services), to whom responsibility for the matter was subsequently transferred. The GM Assurance Services is responsible for the internal audit function, reports directly and independently to the Chief Executive, and is accountable to the Assurance Committee of the Corporation's Board.

2.34 The GM Asset Services discussed this further with the contractor during a telephone conversation on 6 September 2005. The contractor said that he was willing to talk to the GM Assurance Services, and would "pinpoint specific detail" for him. The contractor also told the GM Asset Services that he:

- believed that the Corporation's Board had been misled (although he did not say how);
- considered that he had no choice but to end his engagement with the Corporation; and
- would go to the media or the Minister of Housing if he was not satisfied that his complaints were being addressed.

Events leading up to, and after, the settlement agreement

The GM Assurance Services' initial investigation

2.35 The GM Assurance Services was given responsibility for the investigation. He met the contractor on 9 September 2005, and obtained some further detail about the alleged financial irregularities. However, the contractor refused to provide full details without receiving an apology for the way in which, in the contractor's view, his contract with the Corporation had ended.

2.36 On 13 September 2005, the GM Assurance Services met with the Chief Executive for one of their regular meetings. The contractor's allegations were on the agenda. According to the Chief Executive's notes from this meeting, the GM Assurance Services reported to the Chief Executive on his conversation with the contractor. The conversation included that the contractor had concerns about the circumstances in which his engagement had ended, that the GM Assurance Services intended to continue to attempt to identify clearly what the contractor's allegations were about, and that the GM Assurance Services would arrange an appropriate investigation if specific details of the allegations could be provided. The Chief Executive endorsed this course of action.

2.37 The GM Assurance Services became ill soon afterwards, taking 2 weeks' sick leave followed by a period of substantially reduced hours between 15 September and 25 October 2005, when he did some work from home. The GM Assurance Services told us that, on his return to the office, it took some time before he was working at full capacity again.

2.38 Progress during this period slowed, but did not stop. The internal auditor was asked to investigate the contractor's allegations further, and the GM Assurance Services informed the contractor of this on 12 October 2005. However, the internal auditor did not receive any further information from the contractor. The

matter was taken up again by the GM Assurance Services after his return from sick leave.

2.39 The contractor began to press for payment, sending an invoice for $1,226.68 (including GST) to the GM Asset Services for "payment in lieu of notice" dated 12 October. At the time, the GM Asset Services' view was that the contractor was not eligible for such a payment because he had not been an employee.

2.40 During the next several weeks, the contractor continued to communicate regularly with the GM Assurance Services. The record of e-mails shows that the contractor became more insistent that he wanted "payment in lieu of notice" and an apology. He continued to link providing more information about his allegations to such an apology.

2.41 The contractor viewed the GM Assurance Services as independent, and told us he had confidence in him. The GM Assurance Services, in turn, gradually formed a view that the contractor was someone who had "fallen out" with his superiors. The GM Assurance Services told us he thought that the contractor's unhappiness with how he had been treated had clouded the contractor's view about the allegations, although he did not believe that the contractor was dishonest. The GM Assurance Services was determined to investigate the allegations further – and saw building a good relationship with the contractor as pivotal to gaining the information needed to investigate successfully. The GM Assurance Services told us that he had some sympathy for the contractor's request for a payment in lieu of notice. The GM Assurance Services also spoke with the Special Programmes Manager. The Special Programmes Manager told him that the contractor had worked hard for the Corporation while the contractor was there.

2.42 The GM Assurance Services kept the Chief Executive informed of his discussions with the contractor during late October and November 2005. The GM Assurance Services also mentioned, in general terms, to the Assurance Committee in late October that a former contractor had raised concerns about some of the Corporation's practices.

2.43 The GM Assurance Services told the Assurance Committee that Ernst & Young, the external auditor, might need to be involved, but the Corporation would have to first see if there was any substance to the allegations. Ernst & Young was not formally involved during this time, but was made aware informally that the Corporation was investigating some allegations. We have seen no evidence to suggest that the Board was aware of the precise nature of the allegations at this time, or of the terms of the settlement ultimately reached.

2.44 During November 2005, the GM Assurance Services and the contractor worked on an agreed list of the contractor's allegations. After a number of revisions, the document was agreed and signed by the GM Assurance Services and the contractor on 23 November 2005. The Chief Executive saw and approved the final version of the list of allegations, which would form the basis for a further investigation.

Events leading up to the settlement agreement

2.45 Communication continued between the GM Assurance Services and the contractor after the list of allegations was agreed. The communications included repeated requests by the contractor to be paid an amount in lieu of notice.

2.46 The GM Asset Services had earlier (in August 2005) told the contractor that there was no direct contractual relationship between the Corporation and the contractor. In October 2005, the GM Asset Services told the contractor that he was not eligible for a payment in lieu of notice because he was not an employee. Further, the Corporation's contract with the leasing company did not require the Corporation to give any period of notice.

2.47 The Corporation continued to pursue reimbursement of money owed for personal mobile telephone calls. We understand that the final amount owed by the Corporation to the leasing company was, with the agreement of the contractor and the GM Asset Services, offset against the $1,909.62 charged for personal calls made by the contractor using the Corporation's mobile telephone. After this, the contractor still owed the Corporation $441.49. E-mail correspondence between the GM Asset Services and the contractor in mid-October 2005 showed that the contractor agreed he owed this amount, and would pay it to the Corporation.

2.48 In an e-mail on 24 November 2005 to the GM Assurance Services, the contractor acknowledged that there was no contractual entitlement for him to receive any payment in lieu of notice, but he contended that the circumstances under which he had not been allowed to return to work at the Corporation were questionable. He also referred to a recent employment law case that, he said, set a precedent likely to be in his favour. He commented that he would "take this matter as far as it can go". The contractor wanted a payment to be made to him before 15 December 2005, although he was prepared for the apology and investigation to take longer.

2.49 The GM Assurance Services told us that he discussed the issue of payment in lieu of notice with one of the Corporation's external legal advisors in the first week of December 2005, and was advised orally that there was no legal requirement for the Corporation to pay any amount to the contractor as a payment in lieu of notice. The GM Assurance Services told us that the advice he received suggested

that he could pay the equivalent of up to 3 or 4 weeks' pay to the contractor in resolution of the contractor's concerns about the circumstances of his departure, but that the Corporation should resist any claim for more money by the contractor. We are not aware that the contractor at any time asked for more than about 2 weeks' pay in lieu of notice.

Authorisation of the financial parameters for the settlement

2.50 The GM Assurance Services told us that, on receiving the legal advice, he formed the view that the settlement of the contractor's grievance should include a payment to the contractor to recognise the abrupt nature of the contractor's work finishing with the Corporation. He decided to seek the Chief Executive's approval for this. He approached the Chief Executive by telephone on 9 December 2005, but was unable to speak with her. Instead, he left a message on her voicemail, explaining the legal advice that he had obtained, that the contractor was asking for the equivalent of about 2 weeks' pay, and that the contractor was threatening to take legal action against the Corporation.

2.51 The Chief Executive confirmed that the GM Assurance Services left her a telephone message on 9 December 2005, indicating his intention to negotiate a settlement with the contractor and seeking her approval of a financial limit of $6,000. We were shown the record of a voicemail message she left for the GM Assurance Services on 9 December 2005. It said –

> *Thank you for your message about* [the contractor]. *I'm very happy for you to go to that $6,000 limit. I'm very happy for you to use your judgement generally about that cost. I don't think it's exorbitant at all.*

2.52 We asked the Chief Executive why she considered it necessary for her to approve the settlement in this way, and what she had intended her approval to signify for the GM Assurance Services. She told us that it was the practice at the Corporation that the Chief Executive agree with the relevant General Manager the maximum sum that could be paid when settling an employment issue with an employee. She explained that the rationale for this involvement in financial settlements is to alert the Chief Executive to both the organisational risks and the financial risks associated with settling any disputes with employees. Her recollection was that the figure of $6,000 that she authorised was to pay the contractor an amount that he believed he was owed under the balance of his contract.

2.53 However, the Chief Executive also made it clear to us that she did not consider that, by giving her approval in the manner she did, she either approved in advance the terms of the settlement or implied that she expected to be asked for a further

approval. She told us that the GM Assurance Services had not discussed the proposed terms of the agreement with her, other than the amount, nor would she have expected him to do so. She regarded finalising an agreement as a matter for her managers, with input from Human Resources staff and legal advice.

2.54 On the next day, 10 December 2005, the Chief Executive travelled overseas on leave, and did not return until the evening of 14 December 2005.

2.55 We sought confirmation from the Corporation of its policy for severance payments involving employees. The extract from its Human Resources Guidelines that we were provided with mentions "managed exits", and states that the sign-off for an agreement is to be by the relevant General Manager. The employee's manager must consult with the Human Resources Account Manager and the Human Resources Leader, and obtain sign-off from the People Capabilities Manager. It does not mention a requirement to obtain approval or sign-off from the Chief Executive.

2.56 The Corporation explained that any "severance payment" or its equivalent made to a contractor would usually be authorised according to the Corporation's standard financial delegations.

Negotiating the terms of the settlement

2.57 The GM Assurance Services told us that his intention in entering into a settlement agreement with the contractor was to provide finality to the issue of a payment in lieu of notice, and the related contractual arguments raised by the contractor. The GM Assurance Services mentioned an increase in the contractor's demand for a payment from the equivalent of about one week's pay in August 2005 to 2 weeks' pay. He told us that a payment of $3,000 did not seem unreasonable to put an end to the dispute, and would enable him then to focus on the investigations into the contractor's concerns.

2.58 On 12 December 2005, the contractor sent an e-mail to the GM Assurance Services saying that he was prepared to enter a settlement, on the understanding that:

- the GM Assurance Services had overall responsibility for investigating the contractor's allegations;
- the action took into account the serious nature of the concerns;
- the Corporation paid for 2 weeks' in lieu of notice, less $400 for the personal mobile telephone calls; and
- the contractor would receive a fair and reasonable reference from the Corporation.

2.59 The contractor said that, in return, he would:

- not raise his concerns with the Minister of Housing, the parliamentary opposition, or anyone else;
- provide the external auditor with specific details about the allegations; and
- not raise the matter further once the investigation had been completed.

2.60 The contractor also sent to the GM Assurance Services an invoice for 2 weeks' "payment in lieu of notice" of $3,000, less $400 (roughly the outstanding amount owed for personal telephone calls). The total amount on the invoice was $2,925, after the inclusion of GST.

2.61 On the same day, the GM Assurance Services drafted an agreement based on the terms contained in the contractor's e-mail, and referred it to the Corporation's external lawyers for comment. Their advice on the draft was again given orally. The GM Assurance Services' recollection of this advice was that there could be difficulties with enforcing some of the terms of the agreement, but there was no suggestion that they were illegal.

2.62 The GM Assurance Services told us that he understood that the contractor was obtaining his own legal advice about the settlement agreement. The leasing company was not involved in the negotiation of the settlement agreement.

2.63 The GM Assurance Services discussed the situation with 2 members of the Human Resources team in the Wellington office. The Human Resources Manager's recollection is that they met with the GM Assurance Services at his request on or around 12 December 2005. The Human Resources Manager told us that she advised the GM Assurance Services that the Corporation's practice (applicable to employees) was that a confidential settlement agreement could be entered into only according to the terms of the Corporation's Investigation and Escalation Protocols. This usually involved mediation or an agreement being reached between the parties' lawyers and signed off by a mediator. The Human Resources Manager told us she advised that this would also be the preferred path in the case of this contractor.

2.64 The Human Resources team was not consulted on the later negotiation of the settlement agreement with the contractor, nor on the terms of the settlement agreement.

Execution of the agreement

2.65 The draft agreement included a provision that the agreement was to be executed by the GM Assurance Services on behalf of the Corporation, but "subject to Chief Executive approval". The GM Assurance Services told us that he understood that he needed authorisation from the Chief Executive for the agreement.

2.66 We ascertained from telephone and facsimile records that neither the GM Assurance Services nor the Acting Chief Executive contacted the Chief Executive while she was overseas on leave, and that there was no discussion at any time with the Chief Executive about the terms of the agreement other than the financial limit mentioned in paragraph 2.51. Both the GM Assurance Services and the Chief Executive confirmed this in their evidence to us.

2.67 On 14 December 2005, the GM Assurance Services faxed a copy of the proposed settlement to the contractor. The contractor signed the letter and faxed it back to the GM Assurance Services at 2:53pm.

2.68 Later that afternoon, there was some e-mail correspondence between the GM Assurance Services and the contractor about obtaining the necessary approval for the agreement. The GM Assurance Services sent an e-mail to the contractor explaining that the Chief Executive was away, but that he would see if the Acting Chief Executive was prepared to authorise the agreement so that it could be settled that day.

2.69 The GM Assurance Services told us that he met with the Acting Chief Executive about the settlement agreement on 14 December 2005. The GM Assurance Services told us that he would have explained to the Acting Chief Executive that he already had the approval of the Chief Executive to the amount of the payment, and that he had received legal sign-off from external lawyers. He believed that he showed the Acting Chief Executive the draft agreement, explaining that it needed to be finalised. He told us that he wrote the Acting Chief Executive's initials on the draft agreement and put a tick against them, which he told us confirmed that the Acting Chief Executive's approval had been obtained orally. The Acting Chief Executive did not recall the meeting, or discussing the draft agreement with the GM Assurance Services. However, the Acting Chief Executive explained to us that he had a busy work day on 14 December, including off-site meetings, and had no reason to believe that this discussion with the GM Assurance Services did not occur.

2.70 The GM Assurance Services also recalled discussing the enforceability of the confidentiality clause with the GM Asset Services, in particular the difficulty of enforcing the clause if the information became public, because the damage (in this case to staff reputations) would have been done. He likewise made a tick against the GM Asset Services' initials that he wrote on the draft agreement. The GM Asset Services told us that he was sure that the GM Assurance Services would have discussed the settlement in general with him as a matter of courtesy, but he did not recall any particular discussion with the GM Assurance Services about the settlement agreement or its terms.

2.71 The GM Assurance Services told us that he then signed the version of the agreement that the contractor had returned to him, and inserted after the words "subject to Chief Executive approval" the comment "now given". He initialled that addition, and faxed the letter back to the contractor. The GM Assurance Services told us that this reference to approval being "now given" was to the Acting Chief Executive's oral approval.

2.72 The final version of the settlement agreement, with names deleted, is set out in Appendix 2.

2.73 The Chief Executive told us that she did not see the final settlement agreement until 16 March 2006.

Events after the settlement agreement – the Corporation's investigation of the agreed list of allegations

2.74 The agreement provided that the GM Assurance Services was to be responsible for ensuring that the investigation of the agreed list of allegations was concluded to the satisfaction of the external auditor.

2.75 The GM Assurance Services told us that he considered the allegations could best be addressed as part of the normal internal audit programme, rather than through a separate investigation. The GM Assurance Services said he had doubts about whether there was substance to the allegations, and was influenced in this view by many factors. These included:

- the contractor's insistence on an apology before providing further information;
- his own view that the contractor's unhappiness with the Corporation affected the contractor's view of the Corporation's practices;
- the payment in lieu notice claim;
- the result of the initial internal audit into some of the allegations in August 2005;
- the comfort received from the external auditor's sign-off of the 2004-05 financial statements; and
- knowledge that the Corporation is subject to an extensive internal audit process, and an external audit.

2.76 The GM Assurance Services told us that, although he viewed the matter as arising from an upset former contractor who had fallen out with his superiors, he treated the allegations as serious and needing investigation. However, given his reservations, he thought that a special investigation was not warranted because of the business interruption it would cause. Rather, the investigation formed part

of the internal audit programme. It was his intention to get sign-off from the external auditor on the results of the investigation, as agreed with the contractor in the settlement agreement.

2.77 The GM Assurance Services was on leave during the Christmas period until 13 January 2006.

2.78 The GM Assurance Services met with the Chief Executive for a regular performance review on 10 February 2006. The Chief Executive told us that she recalled that the investigation was a task on the GM Assurance Services' list of matters outstanding. There was a discussion about it, and the Chief Executive told us that she asked the GM Assurance Services to ensure that he was getting on with the investigation.

2.79 On 16 March 2006, after the first of the contractor's public statements about his allegations, the Chief Executive met with the GM Assurance Services for another routine meeting. Her notes of the meeting record that "very little" had been done on the investigation, that she was not satisfied with the lack of progress, and that she wanted a progress report the next day. The GM Assurance Services was unable to meet this deadline, but provided an update on 24 March 2006. The GM Assurance Services explained in the update that not all of the contractor's allegations had been investigated, but that progress had been made in trying to determine if there was any validity to the contractor's concerns.

2.80 The Chief Executive told us that she was concerned that the Board should receive a full and proper explanation of the investigation that was being made. She accordingly directed the GM Assurance Services to provide a full written report identifying the nature of the allegations, the people who were investigating each of the allegations, the provisional responses, and when the investigation would be finished.

2.81 The GM Assurance Services provided a comprehensive report on 29 March 2006.

2.82 During this period, the contractor continued to contact the GM Assurance Services requesting news of progress with the investigation. It is apparent from this correspondence that the contractor expected the Corporation's external auditor to conduct the investigation. On 2 April 2006, the contractor sent an e-mail saying that his understanding was that his allegations were to be investigated by the external auditor. The GM Assurance Services responded by referring to the settlement agreement, and the statement that it was his responsibility to ensure that these matters were concluded to the satisfaction of Ernst & Young.

2.83 In late October 2005, the GM Assurance Services mentioned to Ernst & Young that a contractor had made some allegations, and commented that he would need to

talk to Ernst & Young about the allegations. In December 2005, the GM Assurance Services again informally said to Ernst & Young that its assistance would be needed. In February 2006, after the Assurance Committee meeting, the GM Assurance Services mentioned to Ernst & Young that he needed to get a review done to Ernst & Young's satisfaction. This is consistent with the GM Assurance Services' statement to us that the Corporation was committed to following this matter through.

2.84 No more details about the nature of the investigation were given to Ernst & Young until late March 2006, when Ernst & Young was formally briefed. Ernst & Young told us that it explained to the Corporation that Ernst & Young could be satisfied with an investigation only if Ernst & Young did it, or were heavily involved in the investigation. Ernst & Young advised us of the allegations soon after the meeting, in keeping with its obligations as the Corporation's external auditor.

2.85 The Corporation's investigation was continuing when we carried out our inquiry.

Part 3
The management of dealings with the contractor

3.1 In this Part, we describe:

- our understanding of the nature of the agreement reached with the contractor;
- our expectations for how a Crown entity in the Corporation's position ought to have responded to the contractor's allegations and to his concerns about the way he had been treated; and
- whether, in our view, the Corporation met those expectations.

3.2 We discuss one aspect of the settlement agreement – the provision by which the contractor agreed not to raise his concerns with the Minister, members of Parliament, or the news media – along with issues related to the Protected Disclosures Act 2000 in Part 4.

What was the nature of the agreement?

3.3 Important points about the contractor's relationship with the Corporation are that:

- The contractor was not an employee of the Corporation. All arrangements concerning his engagement, and his remuneration and expenses, were covered by the contract between the Corporation and the leasing company. The contractor had signed a confidentiality statement as part of his contract with the leasing company.
- In particular, no money was to change hands between the Corporation and the contractor under that contract, and any arrangements about ending the engagement were to be made with the leasing company.
- The contractor nevertheless considered that the engagement had unfairly and abruptly ended, and that the Corporation was at fault for this. Accordingly, he sought an apology and a payment from the Corporation directly.

3.4 In our view, the contractor's claim for a "payment in lieu of notice" was, in legal terms, a claim for compensation for the abrupt manner in which the contractor's engagement had ended. The contractor was seeking compensation for the income he thought he should receive if the engagement had been terminated with a period of notice. The contract between the leasing company and the Corporation did not provide for a notice period.

3.5 The dispute between the contractor and the Corporation had the characteristics of an employment dispute. Similarly, the settlement agreement had the characteristics of a severance agreement with a departing employee. However, while there was clearly a dispute between the Corporation and the contractor, there was no written contract directly between them. Nevertheless, there is clear

evidence of the contractor's grievance and the Corporation's willingness to accept some responsibility for it.

3.6 We consider that the payment made to the contractor was, in essence, an *ex gratia* (voluntary) payment in recognition of that responsibility, but without any formal admission of liability. In our view, the agreement was reached as a pragmatic solution in the circumstances, to enable the contractor's allegations to be investigated.

Our expectations

3.7 There were 2 elements to the Corporation's response to the contractor's allegations.

3.8 First, in relation to the allegations about inappropriate financial management and managers' conduct, we expected that the Corporation would have taken steps to investigate the allegations promptly, and with a level of resource suitable for the nature and seriousness of the allegations.

3.9 Secondly, because the legal foundation for the contractor's claim to the Corporation for an apology and a payment in lieu of notice was unclear, we expected the Corporation to have considered the claim first in the context of its contract with the leasing company. In the normal course of events, a contractor on an assignment through a third party leasing company would have advised the leasing company of any wish to end the assignment. It would then be up to the leasing company and the Corporation, as its client, to decide whether another individual should be supplied to complete the assignment.

3.10 Nevertheless, the circumstances indicate that, for one reason or another, the matter was not resolved like that. Instead, the Corporation decided to negotiate a settlement directly with the contractor. We expected to find a clear and documented rationale for taking that step.

3.11 We expected that the Corporation, having decided to negotiate a settlement similar in its terms to an employment settlement, would apply the accepted "best practice" (with necessary modifications) for resolving employment disputes that end in termination of the employment relationship. Accordingly, we have used our 2002 report *Severance Payments in the Public Sector*[1] as the basis for our expectations about the settlement and the events that came before it.

3.12 Our 2002 report was designed to illustrate some of the risks involved when employers in the public sector make severance payments, and other kinds of non-contractual payments, to departing employees. But it also acknowledged –

1 ISBN 0-477-02895-0.

> *... the obvious point that an employer should endeavour to manage the employment relationship in such a way that makes these situations truly exceptional. ... Public sector employers need to act in a manner that is consistent with their obligations both as an employer and in respect of the public funds that they manage. Balancing the two sets of obligations can be difficult. The main purpose of the report is to find an effective way of doing so.*[2]

3.13 In preparing our 2002 report, we formed a set of expectations about what a public sector employer ought to do or consider before making a severance payment. The expectations were reflected in 6 principles. In summary, we said –

> *... we expect a public sector employer to:*
>
> - *seek and obtain specialist advice (in writing) before reaching a severance agreement;*
> - *use a fair, sound, and documented process to reach the severance agreement;*
> - *ensure that the terms of the severance agreement are fair, reasonable, transparent, and properly authorised; and*
> - *keep its stakeholders appropriately informed throughout the process, taking into account the nature of the stakeholder's interest and the need to protect other interests (such as the privacy of employees).*[3]

Our views on the response to the contractor

What was the dispute really about?

3.14 In our view, the disagreement between the contractor and the Financial Services Manager started a chain of events. The conflict was initially about the contractor's extensive personal use of a mobile telephone. The Financial Services Manager identified this personal use, and $1,909.62 owing to the Corporation for personal calls, in June 2005.

3.15 As noted in Part 2, other factors emerged during July and August 2005. The contractor raised concerns about accounting practices, which in turn led to a strained relationship with the TPU. The contractor also believed that he had been told to apologise for upsetting TPU staff. More widely, the contractor's own accounting competence was beginning to be challenged by the Finance team.

3.16 In an effort to resolve these issues, the leasing company met with the contractor and the Special Programmes Manager in either June or July 2005. The leasing company told us that the contractor was someone who required strong management. It had attempted to provide support by keeping in regular contact with both the contractor and the Special Programmes Manager.

2 Ibid, page 7.

3 Ibid, page 8.

3.17 The Corporation's actions around both the contractor's allegations and his claim for an apology and a payment were heavily influenced by the contractor's e-mail to the Chief Executive on 8 August 2005 (see paragraph 2.16). The Chief Executive told us that, rightly in our view, she expected that any member of staff who had significant concerns about the way the Corporation was carrying out its business should feel free to communicate those concerns directly to her. After that, it would be a matter for local managers to investigate and report on the concerns to the relevant General Manager. The Chief Executive and, if necessary, the Board and the responsible Minister would be informed after that.

3.18 However, in this instance, the matter became complicated by the contractor's persistence in raising his concerns with General Managers, even after his claims had initially been investigated and a response given to him. It is clear to us that the Corporation's difficulties in dealing with the contractor were also exacerbated by:

- the ongoing lack of specific details about his allegations;
- his unwillingness to provide those details until his grievance about the circumstances of his departure from the Corporation had been addressed and an apology had been received;
- his repeated indications that he would approach the news media or the Minister of Housing if he did not receive satisfaction; and
- his reference to "taking the matter as far as it can go".

3.19 From the outset, the Corporation drew a distinction between the allegations and the need for them to be investigated, and the resolution of the contractor's grievance. But the extent to which the Corporation allowed itself to be influenced by the contractor's persistence, and his indications of willingness to publicise his concerns, are also important. In our view, the Corporation was also driven by a degree of pragmatism in seeking to reach a settlement with the contractor, when there was clearly no legal obligation to do so.

The Corporation's response to the contractor's accounting and reporting allegations

3.20 We are satisfied that the Corporation made an immediate and genuine effort to conduct an investigation into the contractor's accounting and reporting allegations. These efforts were not helped by the contractor's unwillingness to provide more information to support those allegations, which were not specific enough for the internal auditor to fully pursue. We consider that:

- the approach of seeking an agreement with the contractor about what the allegations were (that is, making an agreed list of allegations) was a sensible way to proceed; and
- agreeing for this matter to be looked at internally, with a level of review by the external auditor, was a reasonable response in the circumstances.

3.21 The lack of a clear understanding between the GM Assurance Services and the contractor about how the investigation would be carried out was unfortunate. However, we consider that the proposed approach of the GM Assurance Services – that Ernst & Young would review the Corporation's internal investigation – is consistent with the wording of the settlement agreement.

3.22 The GM Assurance Services' inclusion of the matter in the internal audit programme did not lead to a timely resolution. However, this needs to be balanced against the difficulty of substantiating the allegations and obtaining enough detail about the contractor's concerns to be able to audit them. The Christmas-New Year holiday period was also a contributing factor.

3.23 The Corporation briefed Ernst & Young in detail only in late March 2006. This was when Ernst & Young was told the detail of the allegations, and that the Corporation expected the investigation to be carried out to the satisfaction of the Corporation's external auditor. Ernst & Young in turn briefed us about the allegations on 27 March, noting that it had told the Corporation that Ernst & Young (and therefore the Auditor-General) could be satisfied with an investigation only if Ernst & Young did it or was heavily involved in the investigation.

3.24 It is clear that the Chief Executive of the Corporation was both aware of, and concerned about, the delay, and rightly expected the GM Assurance Services to fulfil the responsibility he had assumed in the settlement agreement. In our view, the Chief Executive's monitoring of progress on the matter through her General Managers was appropriate.

The Corporation's response to the contractor's claim for an apology and payment in lieu of notice

3.25 In our view, the contractor ended his engagement with the Corporation on 8 August 2005. We acknowledge that the contractor believes that he was effectively forced to leave because he would not apologise. However, his purported "resignation", with immediate effect, was in writing. We consider that the Corporation was entitled to view the engagement as having ended.

3.26 It was therefore reasonable, and what we would expect, for the Corporation to require the contractor to return its property (such as the mobile telephone and

office access key) immediately after his departure. It was also reasonable for the Corporation to ensure that the contractor reimbursed it for the cost of any unauthorised or personal use of the mobile telephone.

3.27 We would have expected all communications between the Corporation and the contractor after his departure to have been through the leasing company. We are satisfied that the Corporation was fully aware of the nature of the relationship and tried to do this. However, the contractor persisted with direct communication with the Corporation's staff. It was reasonable for staff to deal directly with him from that point.

3.28 The Corporation might have been less inclined to settle the contractor's claim had the settlement not been a condition of providing further information to substantiate his allegations. It therefore needed a firm rationale for the decision to enter negotiations, and we are satisfied that the GM Assurance Services understood this. He was of the opinion that the Corporation should take some responsibility for what had happened.

3.29 However, we have several concerns about the process that resulted in the settlement agreement:

- We expected to see a documented rationale for the settlement agreement, and we also expected to see written legal advice on the decision to enter settlement negotiations. There was no documented rationale, and the only legal advice obtained was oral.
- The lack of documentation became a problem when the GM Assurance Services sought the Chief Executive's approval of the financial terms for the settlement. The GM Assurance Services had discussed the need for a settlement at a regular management meeting with the Chief Executive. It is possible that there was a common understanding, at that time, about the rationale for making a payment. However, the evidence about the approval tends to show a lack of a common understanding. The Chief Executive appears to have been under the impression that the Corporation would be paying the contractor an amount calculated by reference to the balance of his contract. That was not the case. It would have helped if the matter had been documented, and authorisation given in writing.
- We have also been unable to establish precisely why the Chief Executive's approval was necessary, either for the financial parameters of the settlement (as approved by the Chief Executive before she went on leave) or for its terms (approved by the Acting Chief Executive, according to the GM Assurance Services' evidence). We did not find any documented support for the Chief Executive's understanding that she should approve the parameters of any

severance payment. However, the practice clearly has merit, and we urge the Corporation to consider including it in its employment policies and procedures.

- Because the agreement was not, strictly speaking, an employment settlement, it may be that the policy on severance payments did not apply. But we would have expected the Corporation to follow the intent of that policy and, in particular, for the Corporation's human resources staff to have been consulted on the terms of the settlement agreement.

3.30 Despite these reservations, there can be no question that the GM Assurance Services acted appropriately by seeking the Chief Executive's approval of the decision to enter negotiations, the financial parameters, and (through the Acting Chief Executive) the terms.

3.31 In the context of the "best practice" guidance in our 2002 report, we conclude:

- The GM Assurance Services had a clearly formulated rationale for the decision to settle with the contractor and make a payment to him. The GM Assurance Services sought appropriate legal advice on the decision to settle and the terms of the agreement. However, the decision-making process could have been better documented and written legal advice should have been obtained.
- The payment made to the contractor was not large, and was calculated appropriately. It was based on about 2 weeks' income that the contractor might have expected to receive if the engagement had been terminated with notice.
- The agreement was properly authorised, and its terms were fair and reasonable. (This finding excludes the non-disclosure clause, which we discuss in Part 4.)
- The Chief Executive was kept properly informed of the contractor's allegations, the dispute and its resolution, and the ensuing investigation. The Board was rightly informed through its Assurance Committee in October 2005, albeit briefly, that concerns had been raised about some of the Corporation's practices. We note that it was the Chief Executive's intention to inform the Board of the outcome of the investigation in 2006.
- We do not consider the settlement with the contractor was sufficiently momentous or important to have been brought to the Chief Executive's or the Board's attention. There was no need for the Chief Executive to have seen the terms of the agreement after she returned from leave.

Part 4
Disclosures of information

4.1 The contractor's allegations and later disclosures of information were widely described in the news media as "whistle blowing". Before our inquiry began, there was considerable negative publicity about the non-disclosure clause in the settlement agreement, under which the contractor agreed not to communicate any of his concerns about the Corporation with any Ministers, members of Parliament, or news media.

4.2 Legislation on "whistle blowing" has existed since 2000 – it is called the Protected Disclosures Act 2000 (the Act). It was enacted to provide safe and appropriate channels for an employee[1] to report concerns about serious wrongdoing in an entity, without fear of the employer retaliating.

4.3 Our terms of reference included examining the Corporation's policies and procedures for the Act, and whether the contractor was aware of them. The Act was also relevant to assessing whether the non-disclosure clause that formed part of the contractor's settlement agreement with the Corporation was appropriate.

4.4 In this Part, we:

- explain what the Act is about, discuss its application to the circumstances revealed by our inquiry, and express our views on how the contractor raised his concerns about certain practices at the Corporation;
- discuss the use of non-disclosure clauses in severance agreements, and state our views on the appropriateness of the clause used in this case; and
- make observations on the lessons to be learned.

The Protected Disclosures Act 2000

4.5 The Act describes its purpose (in section 5) as follows –

> *The purpose of this Act is to promote the public interest—*
>
> *(a) by facilitating the disclosure and investigation of matters of serious wrongdoing in or by an organisation; and*
>
> *(b) by protecting employees who, in accordance with this Act, make disclosures of information about serious wrongdoing in or by an organisation.*

4.6 The Act establishes an escalating series of channels through which information may be disclosed. Internal procedures (if any) must be used first, with the alternative of disclosure to the "head or deputy head of the organisation". Thereafter, an unsatisfied employee may take the matter externally, first to an "appropriate authority"[2] and after that to a Minister of the Crown or an Ombudsman.

1 The Act defines "employee" to include a contractor. We use the term in the same sense in this Part.

2 The term "appropriate authority" covers a wide range of agencies including the Police, the Serious Fraud Office, the Chief Executive of a government department, the Controller and Auditor-General, and the State Services Commissioner.

4.7 Alternatively, the employee may have direct recourse to a higher authority if the matter is urgent or exceptional, or if the person to whom disclosure must be made internally "is or may be involved in the disclosure" or is related to, or associated with, any such person.

4.8 Under section 6, an employee may disclose information using these channels if –

(a) the information is about serious wrongdoing in or by that organisation; and

(b) the employee believes on reasonable grounds that the information is true or likely to be true; and

(c) the employee wishes to disclose the information so that the serious wrongdoing can be investigated; and

(d) the employee wishes the disclosure to be protected.

4.9 Knowledge of the Act is an important (and obvious) precondition to its use. Section 11 imposes a duty on every public sector organisation (which includes the Corporation) both to establish internal procedures for receiving and dealing with disclosures and to publish information about those procedures, and how to use them, "widely in the organisation and ... at regular intervals".

The contractor's disclosure of concerns

4.10 We identified the following questions about the Act's application in this case:

- Were there internal policies for making disclosures about serious wrongdoing, and were they adequate for this situation?
- How recently had the internal policies been published within the Corporation, and was the contractor aware of them?
- Could the matters of concern to the contractor have amounted to "serious wrongdoing" as defined in the Act?
- Did the contractor use the channels prescribed by the Act or the Corporation's internal procedures? If not, did the Corporation recognise that the Act may have been available to him?
- Did the Corporation follow its internal policy in investigating the contractor's concerns?
- Was there evidence of retaliation against the contractor for making his disclosures?

The internal policy

4.11 The Corporation has a policy for dealing with protected disclosures. We reviewed the policy and found it appropriate. The policy states that –

The Corporation is committed to encouraging, assisting and protecting those staff who identify and disclose instances of serious wrongdoing either within the Corporation or wrongdoing which is being committed by the Corporation.

4.12 The term "staff" is not defined, but can reasonably be interpreted to include contractors who work in the Corporation's offices as well as employees.

4.13 The policy requires any staff member who believes, on reasonable grounds, that serious wrongdoing is being, or has been, committed in or by the Corporation to disclose their concerns in writing to their General Manager, with a copy to the GM Assurance Services. Those managers, together, are responsible for arranging "for the allegations to be appropriately investigated".

4.14 The policy also permits disclosure to:

- the Chief Executive directly, although only if the circumstances in section 8 of the Act apply (that is, that there are no internal procedures, the General Manager is believed to be involved in the serious wrongdoing, or the General Manager is not the appropriate person to make the disclosure to); and
- an "appropriate authority", a Minister, or an Ombudsman.

4.15 The policy says that "all investigations ... must follow the principles of natural justice", and gives the following options –

- *Setting up an internal investigation (where financial misuse is alleged this is likely to involve an internal audit)*
- *Setting up an independent enquiry; or, in some circumstances*
- *Referring the matter to the police.*

4.16 The General Manager to whom a disclosure is made must report the fact of the disclosure to the Chief Executive, keep them advised of progress, and report on the outcome at the appropriate time.

Publication and awareness of the internal policy

4.17 The contractor did not undergo the Corporation's formal induction programme, which included training on the policy underlying the Act. However, there is evidence that he was made aware of the Act, although not directly by the Corporation's staff, on more than one occasion.

4.18 It does not appear that the policy on protected disclosures is specifically circulated to staff on any regular basis, but its coverage in the induction process and its ongoing availability to staff through the intranet is consistent with the requirement in section 11 of the Act to disclose it at "regular intervals".

Application of the Protected Disclosures Act in this case

4.19 It is not possible to form a definitive view on whether the subject matter of the contractor's allegations amounted to "serious wrongdoing" in terms of the Act at the time they were made. Nor does it appear that the contractor consciously set out to use the Act when raising his concerns, or that the Corporation consciously treated the disclosure as having been made under the Act.

4.20 There is no case law on whether or how the Act applies in these circumstances. However, in our view, if the subject matter of an employee's concerns meets the test of "serious wrongdoing" and the employee follows the procedures prescribed by the Act (including the organisation's internal policies), then the disclosure should be treated as if it had been made under the Act.

4.21 Whether or not the parties consciously used or applied the Act in this case, it is clear to us that both the ultimate method of disclosure and the managerial response (including the method of investigation) were broadly consistent with the Corporation's internal policy. The evidence shows that the contractor initially raised his concerns with colleagues and line managers. When that did not produce a useful outcome for him, he raised them directly with the Chief Executive. This was not consistent with the policy, but the contractor's action of copying his e-mail to various other senior managers (including the responsible General Manager) was. The management response of referring the financial matters to the internal auditor was exactly consistent with the policy.

Retaliation

4.22 We reported in Part 2 that there was a lack of agreement about what happened between 18-19 July 2005 (when, according to Corporation staff, the contractor and his managers met to discuss the issues that had arisen between staff) and the contractor's departure on 8 August 2005. The managers we spoke to told us that the meeting was informal, and that it resulted in a suggestion to the contractor that he might wish to apologise to colleagues who had been offended by the way he raised his concerns.

4.23 The contractor disputes that a meeting took place. However, he told us that he believed he had been ordered to apologise or go.

4.24 The lack of a written record – which would have been good management practice – makes it impossible to know whether the meeting took place, or, if it did, whether there was simply no common understanding of what was said.

4.25 Whatever the case, we consider it unlikely that the contractor was subjected to retaliatory action, as the term is understood in the Act, for having raised his concerns.

Non-disclosure clauses

4.26 An employer is entitled to safeguard its reputation and the value (commercial or otherwise) of its information, which can easily be damaged by unauthorised or inappropriate disclosures of the employer's business or affairs. An employee has implied obligations of fidelity to, and trust and confidence in dealings with, their employer. The courts have been prepared to enforce those obligations, particularly in cases where an employer's commercial position is at risk.[3]

4.27 Accordingly, employment agreements routinely prohibit employees from disclosing the employer's information without proper authorisation. An employer may legitimately extend a prohibition beyond the employee's term of employment. The duty of fidelity also survives the ending of an employment relationship.

4.28 An employee in the public sector also has certain legal and ethical duties in handling official information and political neutrality. For example:

- The *Public Service Code of Conduct* (the *Code*) says that –

  It is unacceptable for public servants to make unauthorised use or disclosure of information to which they have had official access. Whatever their motives, such employees betray the trust put in them, and undermine the relationship that should exist between Ministers and the Public Service.[4]

- The *Code* applies only to the core public service, not to Crown entities such as the Corporation. However, this and other guidance in the *Code* could be used to inform approaches taken in the wider state sector – including any future codes of conduct for Crown entities[5] – on this type of issue. We were informed by the Corporation that it has integrated the *Code* into a number of its human resources policies, and that the *Code* is available on its intranet.
- The Official Information Act 1982 provides statutory processes for disclosing official information. However, under the Official Information Act, an employee must have delegated authority to disclose information on their employer's behalf. There are also criminal sanctions against the corrupt use or disclosure of official information[6] by officials.[7]

4.29 An employee (or former employee) who has information about serious wrongdoing in an organisation may be considered to have an ethical duty to bring it to the attention of the organisation or its stakeholders. The Protected

3 *Nedax Systems Ltd v Waterford Security Ltd* [1994] 1 ERNZ 491 (WEC20/94).

4 State Services Commission, *Public Service Code of Conduct*, page 16.

5 See State Sector Act 1988, as amended in 2004, section 6(ha).

6 Crimes Act 1961, section 105A.

7 For the purposes of a Crown entity, "official" includes its members, office holders, and employees – Crown Entities Act 2004, section 135.

Disclosures Act is the means for an employee who wishes to act in good faith to disclose the wrongdoing. If the employee has other motives, or does not see the Act as a useful or appropriate mechanism for disclosure, they can pose risks for a public sector employer.

4.30 Indiscriminate or inappropriate disclosures can be highly damaging. The damage might occur, for example, if an employee discloses information about alleged wrongdoing directly to the news media rather than to an "appropriate authority", or to an Opposition MP rather than to the responsible Minister. The issue for an employer facing such risks is what steps it may legitimately take to address them without, at the same time, suppressing information (or opportunities to disclose information) that it may be in the legitimate interests of the organisation's stakeholders or the public to know about.

4.31 A public sector employer in this situation may be justified in restating to an employee the continuing nature of the employee's legal and ethical obligations. If circumstances justify it, the employer may also ask the employee to agree to extend the duty of confidentiality beyond the end of the employment relationship, in the form of a non-disclosure clause in a severance agreement.

4.32 However, a non-disclosure clause has limits. It cannot undermine the right of an employee, or a former employee, to disclose information under the Act. In other words, the parties to an employment relationship cannot "contract out" of the Act. Any non-disclosure clause must be regarded as subject to at least an implied term preserving the Act's application.

Using non-disclosure clauses when resolving employment disputes

4.33 Employees do sometimes become concerned about their employer's actions or practices. The employee may raise the concern with their employer or manager. How the employer responds – or is perceived by the employee to respond – to the disclosure can be crucial in determining the employee's future actions. If the employee does not feel that the concern has been addressed, they may decide to leave – or to stay and "live" with it. Alternatively, the employee may decide to raise the concern externally – whether by using the Act or some other means.

4.34 These situations can easily cause disaffection for either or both of the parties to the employment relationship. If the matter becomes a dispute, the Employment Relations Act 2000 encourages the parties to explore the possibility of resolution without litigation. If the relationship is beyond repair (as it often will be after a "whistle-blowing" episode), a severance agreement may be the end result.

4.35 Both parties will value their reputation in such a situation – when deciding to settle and when negotiating the terms of the agreement. Typically, an agreement will contain undertakings by the parties not to disclose the terms of the agreement to anyone else. Sometimes, the parties may also agree to a non-disclosure clause where they undertake not to say anything about each other publicly except what they have agreed to say (for example, in a prepared statement or media release).

4.36 We discussed these issues in our 2002 report on severance payments in the public sector. The report noted (at paragraph 2.38) that, although there may be good reasons for a severance agreement to contain a confidentiality clause, including protecting either or both parties' reputations, there are risks for both parties in binding themselves to secrecy. We urged public sector employers to include confidentiality clauses only when genuinely necessary, and in the interests of both parties.

4.37 Our report did not contain any specific guidance about non-disclosure clauses under which departing or former employees agree not to disclose anything about the employer's affairs after their departure. In the short time available to us to undertake this inquiry, we have consulted with Crown Law and the State Services Commission (which administers the Act) to consider what an acceptable approach might be to such clauses.

4.38 In our view, a public sector employer should take the same approach that our report took to the question of confidentiality clauses generally, by considering in each case:

- what information-related interests it needs to protect in the circumstances – for example, the commercial or political sensitivity of information to which the departing employee has had access;
- whether a non-disclosure clause of some kind is genuinely necessary to achieve that protection; and
- how that protection can be achieved while, at the same time, ensuring that the employer's actions will receive the appropriate form of external scrutiny.

4.39 Finding the right balance will always be a matter for judgement in the particular circumstances of each case.

4.40 In summary:

- An employer cannot contract out of the Act. Neither can it contract out of the Official Information Act 1982 nor any other means of public accountability[8] through a non-disclosure clause applying to the terms of the agreement. Yet

8 For example, scrutiny by a parliamentary select committee, or recourse to an Ombudsman or the Auditor-General.

it would be good practice to make any non-disclosure or confidentiality clause subject to those matters. That is best achieved by a general condition stating that nothing in the non-disclosure clause prevents the parties making any disclosure of information permitted or required by law.

- In appropriate cases, it will also be reasonable for an employer to place restrictions on employees or former employees disclosing confidential matters. An employer is entitled to take reasonable steps both to safeguard its reputation and to protect its information from indiscriminate disclosure. It is also entitled to rely on former employees continuing to observe relevant legal and ethical duties. However, any restriction on disclosure must not only be lawful, proportionate, and for a justifiable reason, but should also be subject to a condition of the kind set out in the previous point.
- As with any other contract, an employer could not lawfully enforce a former employee's undertaking of confidentiality unless it gives consideration for it. Consideration need not be monetary – mutual undertakings would be sufficient to create a binding contract. Yet, as a matter of practice, severance agreements commonly involve some payment to the departing employee. In our view, in appropriate cases it is acceptable for a non-disclosure clause to be included in an agreement as one of several terms, and for the agreement to include payment by the employer to the employee. But the agreement should not be written in such a way that links (or gives the appearance of linking) the payment expressly, or solely, to the non-disclosure clause.

Applying this practice to non-employees

4.41 The circumstances in this case involved a contractor who was employed by a leasing company, not the Corporation. Employee leasing arrangements are commonly used in the public and private sectors. It is also common practice to engage some personnel under contracts for services rather than as employees. These people may spend time in the entity's workplace, mix with its employees, and have access to the entity's information on a similar basis as employees.

4.42 An entity needs to bear in mind that the duties of fidelity, trust, and integrity that are implied terms of every employment agreement may not necessarily be implied in an employee leasing contract or a contract for services. This may influence the approach that the entity takes in response to a dispute with the contractor.

Subject to this, the practice outlined in paragraphs 4.38-4.40 should be followed to the extent it is applicable.

Our views on the non-disclosure clause

4.43 The non-disclosure clause was included in the agreement at the initiative of the contractor, not the Corporation.

4.44 We consider that the GM Assurance Services included the non-disclosure clause in the agreement out of his wish to secure the contractor's co-operation in moving the matter forward and enabling an orderly investigation. The GM Assurance Services was also aware of the contractor's repeated indications that he would approach the Minister of Housing or the news media if he was not satisfied that his allegations had been adequately investigated. The GM Assurance Services told us that he attempted to create a transparent process through the reference to the review being completed to the satisfaction of Ernst & Young.

4.45 We note that the contractor had been required by the leasing company to sign a confidentiality statement, which included a restriction on disclosing any information obtained by the contractor during his assignments. The non-disclosure clause in the settlement agreement reflected the substance of the contractor's existing contractual obligations.

4.46 The non-disclosure clause purported to prevent the contractor from raising his concerns with any Ministers. In this regard, it was inappropriate because it was inconsistent with the contractor's rights under the Act.

4.47 To the extent that the non-disclosure clause prohibited the contractor from approaching the news media or members of Parliament other than Ministers, it was not inconsistent with the Act, because the Act does not provide protection for employees who make disclosures in that manner. But the Corporation was concerned that the contractor would make indiscriminate disclosures of information. Given this, the GM Assurance Services was justified in seeking to manage those risks by including the prohibition in the agreement in response to the contractor's undertaking that he would no longer publicly discuss his concerns. However, it is likely that the clause would have been framed differently if the parties had been more conscious of the ongoing relevance of the Act.

4.48 The placement of the non-disclosure clause immediately after the reference to a payment of money to the contractor was unwise, because it created the basis for a perception that the payment was being made in return for the contractor's silence. Had that been the intention of the parties, it would have been highly inappropriate. However, we found no indication that either the contractor or the GM Assurance Services intended or understood that to be the case.

4.49 Overall, we agree with the public statements by the Minister of Housing and the Corporation's Chairperson that including the non-disclosure clause in the agreement was unwise. The form in which it appeared was inappropriate because it purported to close off avenues that would be available under the Act. However, we consider that there was some justification for a non-disclosure clause in some form. Had the clause been drafted in terms that preserved the right of the contractor to make any disclosure permitted by law, it would have been acceptable. Consultation with the Corporation's Human Resources team about the text of the agreement might have achieved this.

Part 5
Allegations about accounting and reporting

5.1 In this Part, we set out:

- our expectations; and
- our consideration of the allegations made by the contractor about accounting and reporting issues, which were:
  - untimely accounting on Community Group Housing (CGH) projects;
  - costs coded to accounts at the end of the month, and inappropriately reversed the following month;
  - manipulation of results between financial periods;
  - manipulation of results between programmes;
  - manipulation of monthly management reports;
  - inadequate verification of invoices;
  - lack of robustness of accruals within National Property Improvement team programmes; and
  - unauthorised transfer of budget from the Modernisation programme.

5.2 The lack of detail provided by the contractor to support his allegations has made it difficult for us to be sure that we have adequately dealt with each of the allegations made.

Our expectations

5.3 We expected to find:

- clear lines of responsibility for programme accounting;
- proper controls within the accounting systems, and the timely completion of accounting functions;
- accuracy of both financial reporting and monthly management reporting; and
- appropriate documentation and formality surrounding accruals and other accounting practices.

Accounting for projects within the Community Group Housing programme

5.4 The CGH programme is a minor part of the Corporation's overall housing programme – comprising about 1500 houses in a total housing stock of about 66,000 properties. The CGH programme helps community groups and iwi provide access to community housing for people with special housing needs. The Corporation purchases and leases properties, with the aim of supplying 80 to 100 additional properties each year. The CGH programme had a capital budget of $21.166 million in 2004-05.

5.5 The contractor alleged that accounting for CGH capital spending was untimely. He alleged that there could be a 6- or 7-month delay in finalising the allocation of costs into Rentel, making it impossible to tell at any given time what amounts had been spent or committed.

5.6 The allegations were not specific enough for the Corporation to determine their substance. Therefore, when we interviewed the contractor, we sought to identify specifically which CGH accounts he was referring to. Beyond telling us that his concerns related to 4 or 5 general ledger accounts, the contractor was unable to provide us with details about the accounts.

5.7 We focused primarily on the 3 accounts that the contractor specifically referred to in correspondence before his departure from the Corporation (GL 80.1.510.7582, GL 10.1.850.5656, and GL 10.1.850.5657). One of these accounts relates to leasehold improvements on CGH properties, and the other 2 are clearing accounts used by several programmes. In addition, we identified 2 more clearing accounts of a similar type to those specifically referred to by the contractor.

5.8 The first of the 5 general ledger accounts (GL 80.1.510.7582) records improvements made to CGH leasehold properties. The Corporation leases rather than owns these properties, and improves them to make them suitable for a particular community group's purpose (for example, constructing a ramp so tenants in wheelchairs can access a building). Although the Corporation records the properties individually in Rentel, the leasehold improvement costs are not currently recorded in Rentel.

5.9 Improvement costs incurred on CGH leasehold properties are held in a separate ledger account, which is incorporated into the Corporation's Statement of Financial Position (commonly referred to as "balance sheet"). These costs are then amortised (amortisation is similar to depreciation) over the life of the property lease. The Corporation bases the amortisation on the average lease life, which is estimated to be 10 years. Therefore, the Corporation records one-tenth of the balance of the account as amortisation each year. The total balance in the account at 30 June 2005 was about $119,000.

5.10 The other 2 general ledger accounts identified by the contractor relate to infill development and acquisitions (GL 10.1.850.5656 and GL 10.1.850.5657). In considering these accounts, we assessed the CGH expenditure coded to them, as the contractor's concern was specifically about CGH capital spending. The total balance in these 2 accounts at 30 June 2005 was $1.832 million, of which only a very small proportion related to CGH properties.

5.11 In addition, there are a further 2 accounts (GL 10.1.850.5595 and GL 10.1.850.5659) relating to relocating, storing, and improving properties that have been moved off the Corporation's land and that will be used at other sites. These accounts operate in a similar manner to the accounts discussed in the previous paragraph.

5.12 Costs incurred (for example, valuation fees, and the cost of Land Information Memoranda) are coded to the 4 accounts until each property has been set up within Rentel. Although these accounts are expense accounts (as opposed to asset or capital accounts), the spending coded to them relates to capital projects and – in keeping with generally accepted accounting practice – should be capitalised. Therefore, each month the amount in these accounts is transferred through a reversing journal entry to a capital work in progress account, so that it is recorded within fixed assets on the balance sheet. In our view, this treatment is appropriate. It ensures that the costs are correctly reflected in the balance sheet at the end of each month.

5.13 Some of the projects with costs kept in the 4 general ledger clearing accounts run for a significant period, such as 12 months or more. This means that some costs in these accounts will be several months old, but this does not in itself indicate untimely accounting processes.

5.14 Land development costs are recorded in one of these accounts, because Rentel does not have analysis codes for land development costs (for example, drainage costs). Land development costs are held in the accounts until they are cleared annually as part of the accounting entries for the housing revaluations. This treatment is not inappropriate, although we note a process improvement project is currently under way to incorporate land development analysis codes within Rentel. This will enable direct processing of the costs into Rentel.

5.15 We were told that neither the balances coded to the clearing accounts nor the leasehold improvement costs on CGH properties are included as costs against programmes in monthly management reporting. This reflects the fact that they have not yet been recorded in Rentel.

Our view of the allegation

5.16 In our view, the financial accounting treatment of capital spending for CGH properties is appropriate. It results in the correct recognition of capital spending as fixed assets in the Corporation's balance sheet on a monthly basis.

5.17 Although some items do remain in these general ledger clearing accounts for several months (because of the nature of the projects), we consider that this does

not reflect untimely accounting procedures. However, it can mean that monthly management reporting of costs against budgeted programmes is misstated.

5.18 In our view, all programme spending needs to be reported in the month the cost is incurred. This will:

- provide timely information of costs against programme budgets; and
- eliminate any suggestion that costs may be held in clearing accounts until there is a more opportune time for them to be reflected in the management accounts.

Recommendation 1

We recommend that Housing New Zealand Corporation report all programme spending in the monthly management reports when such costs are incurred, regardless of whether the costs have been entered into Rentel or are held in a clearing account.

Recommendation 2

We recommend that Housing New Zealand Corporation reconcile each month the financial information in the management reports and the expenditure recorded in its accounting records. This would, for example, ensure that the clearing accounts (which are in capital work in progress in the general ledger) are accurately reflected in management reporting in the month the costs are incurred.

5.19 The calculation of amortisation of leasehold improvements provides a reasonable estimate for accounting purposes in the context of the Corporation's overall financial statements.

5.20 In our view, the Corporation should have a means to track leasehold property improvements on a property-by-property basis, either within Rentel or in a separate sub-ledger. While the current treatment provides materially accurate financial accounting information, GL 80.1.510.7582 will become more difficult to reconcile (even if immaterial to the total financial position) as the number of entries continues to increase.

Recommendation 3

We recommend that Housing New Zealand Corporation track leasehold property improvements on a property-by-property basis.

Costs coded to accounts at the end of the month, and reversed the following month

5.21 The contractor raised concerns about costs coded to accounts and then cleared at the end of the month and transferred to the balance sheet, only to be reversed at the start of the following month. We understand that the contractor was initially concerned that the Corporation might have been manipulating accounting results by posting reversing journal entries to transfer costs to the balance sheet each month.

5.22 The use of reversing journal entries is normal accounting practice. It is consistent with the application of accrual accounting, which underpins generally accepted accounting practice. We understand from the contractor that he no longer has concerns about this practice.

Our view of the allegation

5.23 In our view, the reversing journal entries are used appropriately as part of the Corporation's accrual accounting system, that reflects capital work in progress as part of fixed assets in the balance sheet on a monthly basis.

Alleged manipulation of results between financial periods

5.24 Sound accounting practice requires that expenditure be recorded and reported within the financial year that it is incurred. If, at the end of the financial year, further claims for work undertaken during the financial year are anticipated, an accrual should be made for such expenditure to be recorded in that financial year.

5.25 The contractor alleged that costs were manipulated by being reported in incorrect financial years. The contractor specifically referred us to 2 incidents:

1. He alleged that, at the direct instruction of the Special Programmes Manager, a quantity surveyor (independent of the Corporation) was asked to provide an invoice for work as at 30 June 2005 that had not actually been completed, for an amount of about $720,000.
2. He alleged that a journal entry was initiated by the Corporation's Wellington office for about $2.1 million, transferring costs from earlier years into the 2004-05 Modernisation programme. He expressed concern that these costs had previously been "parked" in suspense accounts rather than posted to the relevant programmes.

Incident 1: Quantity surveyor asked to provide an invoice for incomplete work

5.26 The contractor was unable to provide us with specific details, but after inquiring into this issue we consider that the contractor's allegation relates to the Greenstone Gardens project.[1]

5.27 We have discussed this allegation with the Greenstone Gardens project manager, the Special Programmes Manager, and the National Property Improvement Manager. We have also discussed some aspects of this matter with the project's quantity surveyor and the building contractor, both of whom are independent of the Corporation.

5.28 The quantity surveyor told us that he was asked by the Corporation's staff to provide an assessment of the total project construction costs – the costs to date and any costs to complete. In a letter dated 6 July 2005 (which was not an invoice), the quantity surveyor assessed the total Greenstone Gardens construction costs as:

- $6,750,000 for the core Greenstone Gardens project; and
- an additional $722,000 for associated works.

5.29 The quantity surveyor told us that the $722,000 for associated works related to both the Greenstone Gardens property and an adjacent property. During our interviews, the Special Programmes Manager expressed the same understanding, but later told us that all the additional associated works related only to the Greenstone Gardens project. The Greenstone Gardens project manager and other Corporation staff we interviewed told us that all of these costs related to the Greenstone Gardens project.

5.30 The quantity surveyor told us that he understood the information he was asked to provide was needed to complete 2005-06 budgets. He told us that, in his view, most of the work included in the $722,000 was not complete at 30 June 2005.

5.31 The Corporation's staff had a different view. The Greenstone Gardens project manager and the Special Programmes Manager both told us that the quantity surveyor had been asked by the project manager for an assessment of project costs (not an invoice) to ensure that all costs had been appropriately included at the end of the 2004-05 financial year. Their view was that the project was substantially complete by 30 June 2005, and they therefore wanted to ensure that the full cost was accrued for work they understood to be complete. They told us that, at the time of establishing whether any additional accrual was needed, they believed that the project would reach "practical completion" on 8 July 2005. In their view, there was only minor remedial work to be completed after 30 June.

1 Greenstone Gardens, at 45 Albert Street, Otahuhu, is a modernisation project. It is managed separately to the rest of the Modernisation programme because of the size of the project.

Therefore, Corporation staff thought it appropriate to accrue the total costs assessed in the quantity surveyor's letter dated 6 July 2005.

5.32 The assessment of project costs requested from the quantity surveyor was to verify the accrual. The Special Programmes Manager told us that the contractor was asked to prepare the journal entry for this accrual.

5.33 During our inquiry, Corporation staff initially referred to the Greenstone Gardens project as having reached practical completion by 30 June 2005. They have since advised that their use of the term "practical completion" was interchangeable with "substantially complete", and they were not implying that the practical completion certificate had been obtained at 30 June 2005.

5.34 While both the project manager and the Special Programmes Manager were adamant that the job was substantially complete by 30 June 2005 (and they were expecting practical completion on 8 July 2005), the practical completion certificate was not signed until 25 August 2005. Managers within the Corporation contend that any work performed after 30 June was minor, and delays were caused by other factors (such as the extent of remedial work and the weather).

5.35 We reviewed the payments made under the quantity surveyor payment certificates issued after June 2005, to see how much and what sort of work was performed after 30 June 2005. The total payments (excluding payments of retentions, which relate to work previously completed) after June amounted to a little more than $1 million. While this may indicate that a significant amount of work was completed after 30 June, we understand that this figure includes:

- a re-measure (adjustments to reflect where progress payments had underestimated actual costs); and
- some payments to sub-contractors who were slow in submitting invoices.

5.36 We discussed the extent of work completed after 30 June 2005 with the main building contractor on the Greenstone Gardens project. He told us that the work consisted primarily of:

- completing stairwells and applying fire-rated paint;
- installing signage;
- completing site works;
- some remedial and minor finishing work in 2 housing blocks; and
- installing curtains and blinds.

5.37 We discussed an estimate of the total cost of the work (excluding the remedial work, because the building contractor bears these costs) with the building

contractor. He thought that the value of work performed after 30 June was between $200,000 and $400,000. This would suggest that, of the $1 million paid under the payment certificates after June 2005, at least $200,000 related to work completed after 30 June 2005. Therefore, although payments totalling about $1 million relating to this project were made after 30 June 2005, the majority of these payments were for work that had been completed before 30 June 2005 for the reasons given in paragraph 5.35.

5.38 On this basis, it is reasonable to conclude that at least $200,000, but probably not more than $400,000, of the $722,000 that was accrued at the end of the financial year was incorrectly accrued before the work was completed. This should be seen in the context of the total project cost at 30 June 2005 (see paragraph 5.84).

5.39 The building contractor told us that most of this work was completed early in July 2005, but that the stairwell painting was not completed until near the end of August (because the fire-rated paint arrived late). The building contractor told us that he offered to "hand over" one block of housing to the Corporation close to, or shortly after, 30 June.

5.40 We would not have expected programme management staff to have accrued the full cost of the project. We would have expected staff to have considered whether any work was to be completed after 30 June 2005, rather than assuming that, because the job was substantially complete, the full costs should be accrued.

5.41 We note that the Special Programmes Manager (who told us he had no responsibility for Greenstone Gardens) was asked by the Greenstone Gardens project manager to prepare the accrual. We were told that this situation arose because the costs ultimately fell within the Special Programmes cost centre, which was the responsibility of the Special Programmes Manager, even though he was not responsible for the project. No internal documentation supported this oral request. We consider the lack of clarity about responsibilities for programme accounting, and the lack of documentation surrounding this request, to be inappropriate.

5.42 We understand that the difficulties encountered in completing the Greenstone Gardens project resulted in the Corporation seeking an independent review of the project from PricewaterhouseCoopers. The report from PricewaterhouseCoopers highlighted some process issues for the Corporation to consider on projects of this nature, and was discussed by the Board's Property Committee in March 2006.

Incident 2: $2.1 million transfer

5.43 We found it difficult to identify the $2.1 million transfer referred to by the contractor. However, we consider that the contractor was probably referring to the situation described below.

5.44 When a job is created in Rentel, 3 inputs specifying the contract type and destination codes are included. The job costs are uploaded from Rentel into the capital expenditure sub-ledger. If the 3 input codes do not match in a way that is recognisable within system parameters, the balances get uploaded into a sub-ledger suspense account. Both the suspense account and the capital expenditure sub-ledger feed into the same general ledger account, and therefore there is no misstatement in the balance sheet.

5.45 In early 2005, the Wellington-based Finance team increased its efforts to reconcile the sub-ledger suspense account. The person who had been clearing the account left the employment of the Corporation in late 2003, and in his absence the account was not cleared. In May 2005, the Finance team began to clear a balance of $1.829 million held in the sub-ledger suspense account as at 30 April 2005, for the programmes in which the contractor was involved.

5.46 We understand that the Finance team asked the contractor to identify the costs by programme, so that all costs could be allocated and cleared from the suspense account. At the time, $793,000 was identified as relating to the 2003-04 financial year, and $1,036,000 related to the 2004-05 year. However, because of the way the suspense account is accounted for (see paragraph 5.44), items relating to a previous year do not affect the current year's financial accounting results.

5.47 Based on work completed by the contractor, the amount was split between 2 programmes: Modernisation ($1,703,000) and Reconfigurations ($126,000).

5.48 In May and June 2005, an additional $435,000 in transactions ($335,000 from May and most of June, and $100,000 from the last few days in June) was miscoded, and was therefore held in the suspense account at 30 June 2005. The contractor was also asked by the Finance team to itemise the $335,000. He advised that all of this related to the Reconfigurations programme. We consider that the $2.1 million held in the suspense account that was of concern to the contractor is the initial $1,829,000 million and the subsequent $335,000 described above. Together, these add up to about $2.1 million. The contractor was not asked to provide any information about the $100,000, and we therefore consider it to be outside the $2.1 million that he was referring to.

5.49 Costs uploaded into the suspense account because they have been incorrectly matched are not recorded in reported monthly programme spending. Therefore,

although the financial accounting is accurate, management reporting on programme spending may not be. For example, the $793,000 that related to the 2003-04 financial year was reported as programme spending in the management accounts for the 2004-05 financial year.

5.50 The Finance team told us that, in May 2005, staff at the operational programme level would have been unlikely to know that incorrect coding would default to a sub-ledger suspense account rather than the capital expenditure sub-ledger.

5.51 When this issue was first raised with the contractor by the Finance team, the suspense account had not been cleared since part-way through the previous financial year. The build-up of the suspense account through 2003-04, until it was cleared in May 2005, resulted in some inaccuracies in management reporting of programme spending. The suspense account is now reconciled and monitored each month.

5.52 We reviewed reconciliations of the suspense account for each month of the 2005-06 financial year, up to 30 April 2006. The balance at 30 April 2006 was about $619,000. Operations staff have been reminded by the Finance team of the importance of getting the correct codes matching in jobs, and the incidence of jobs defaulting to the suspense account has reduced significantly since June 2005.

5.53 We understand that a system change is being prepared to prevent incorrect coding. It should stop jobs uploading into the sub-ledger suspense account.

Our view of the allegations

5.54 Given management's assertion that it understood the Greenstone Gardens project was substantially complete and would reach practical completion on 8 July 2005, it is difficult to conclude that any over-accrual was a deliberate attempt to manipulate reported results. Rather, it appears that any over-accrual may have arisen from a misunderstanding between those involved about what information the quantity surveyor was asked to provide.

5.55 Nevertheless, we consider that it is unacceptable for such a misunderstanding to occur. In our view, regardless of the availability of a suitable accounting resource, project managers should have a general understanding of accounting for construction contracts, and should understand the relationship between what is accrued and what work has been completed. Based on our discussions with the Corporation's staff, we have some doubts about whether this is the case. We have also found it difficult to obtain a common and consistent understanding of the accrual of $722,000.

Recommendation 4

We recommend that Housing New Zealand Corporation consider whether project managers need additional training on relevant accounting matters.

5.56 The financial accounting for the suspense account that we have reviewed was appropriate, and the balance sheet was correct, during the period that concerned the contractor. We consider it unlikely that there was any deliberate manipulation of results through suspense accounts (that is, by incorrectly coding jobs), as the balances in these accounts were appropriately reported for financial accounting purposes as though the miscoding had not occurred.

5.57 However, we note that the costs within the sub-ledger suspense account do not get reported against a programme for management reporting purposes until they are cleared from the suspense account. While this is not good practice, nothing has come to our attention to indicate that this was used as a deliberate means to hide programme cost overruns. As discussed previously, we consider that the Corporation should reconcile each month the financial information in the management reports and the expenditure recorded in its accounting records.

Alleged manipulation of results between programmes

5.58 The contractor worked in the Special Programmes team within the National Property Improvement team. The National Property Improvement team manages a number of programmes, including the Modernisation programme (modernisations, reconfigurations, and the Greenstone Gardens project) and Auckland Pensioner Housing.

5.59 The contractor alleged that the results of different programmes within the Special Programmes area were manipulated in 2004-05 by shifting costs between programmes. Further, he alleged that senior management at the Corporation were not only aware of, but actively encouraged, such manipulation.

5.60 When we interviewed the contractor, we sought to identify which journal entries he was referring to. The contractor gave the example of a journal entry for about $340,000, transferring costs between the Auckland Pensioner Housing and Modernisation programmes during 2005. He told us that he was instructed by his manager to process the transfer. The contractor's view was that this journal entry had no basis and that there was nothing to justify the transfer.

5.61 The lack of detail provided by the contractor made it difficult to identify the journal entry to which he was referring. We interviewed several Corporation staff, but none were able to recall such a journal transfer. However, we have identified

the journal entry discussed in paragraph 5.62, which may relate to the allegation raised by the contractor.

5.62 It is possible that the contractor's concern arose from dealings with the Wellington-based Finance team when they were trying to resolve the suspense account balance discussed in paragraphs 5.43-5.53. The Finance team queried the contractor's assertion that a suspense account item of $335,000 should be allocated entirely to reconfigurations. After the contractor left the Corporation, it was established that most of the $335,000 related to modernisations rather than reconfigurations.

5.63 However, this matter did not relate to the Auckland Pensioner Housing programme, which was specifically mentioned by the contractor.

5.64 The Corporation's staff denied knowing of, or supporting, unsubstantiated journal entries between programmes. As discussed further in paragraph 5.71, we reviewed selected internal monthly reporting information against source information and found it to be accurate.

Our view of the allegation

5.65 Without more specific information about the journal entry mentioned by the contractor, we were unable to investigate this allegation any further. Based on the possibility we identified, and our review of other monthly reporting information, we found no evidence of a deliberate attempt by management to misrepresent reported programme results.

5.66 We note that there is a degree of judgement required about what work fits into reconfiguration and what fits into general modernisation.

Recommendation 5

We recommend that Housing New Zealand Corporation complete as soon as possible the guidelines and procedures for the Modernisation programme, to provide clarity for staff about allocating costs.

Alleged manipulation of monthly management reports

5.67 The contractor alleged that monthly management reporting was manipulated for both financial and non-financial information, and that results were amended to conceal poor performance in the Auckland Modernisation programme.

5.68 The contractor also alleged that, because of "audit queries" he raised, he organised a meeting to discuss and resolve the issues, but that the meeting was stopped.

The contractor alleged that this may have been to ensure that the issues were not investigated.

Financial information

5.69 The contractor did not provide any further details about the financial manipulation of results.

5.70 We considered whether the Greenstone Gardens project was appropriately reflected in the monthly management reports, as we were aware that the project had been delayed and had incurred cost overruns. Although part of the overall Modernisation programme, the Greenstone Gardens project was reported separately in monthly management reports.

5.71 We reviewed the June 2005 monthly management reports for the National Property Improvement team and the Asset Services Group (which encompasses the National Property Improvement team reporting). We have also reviewed the Corporation's quarterly report.

5.72 Further to our consideration in paragraphs 5.26-5.42, where we reviewed the allegation of accruals being recognised before work was completed, we questioned the reporting by the National Property Improvement team and Asset Services Group. According to the management reports, the Greenstone Gardens project was on budget, when we understood that the project had incurred significant cost overruns. We considered:

- the reported actual cost for the Greenstone Gardens project for 2004-05; and
- the reporting of the budgeted cost for 2004-05 for the Greenstone Gardens project.

5.73 We expected the Greenstone Gardens project's costs for 2004-05 to have been reported as at least $7.505 million. This figure takes into account, consistent with the quantity surveyor's letter (referred to in paragraph 5.28) and our interviews with the Corporation's staff, the costs of $6.75 million, the additional associated works of $722,000, and professional costs of $33,000 (that is, for the quantity surveyor and the architect). Our expectation is based on what we understand was actually accrued, irrespective of our views on the appropriateness of the accrued amount (discussed in paragraphs 5.54-5.55).

5.74 However, in the management reports we reviewed, the costs were reported as $6.75 million. This was at least $755,000 less than we expected to see ($722,000 plus $33,000). The Corporation told us that the entire $722,000 accrual was recognised as part of the general Modernisation programme (rather than for the specific Greenstone Gardens project). We were told that, at the end of the

financial year, the breakdown of the work associated with the $722,000 was not known. On this basis, the National Property Improvement team did not want to report it as part of the Greenstone Gardens project.

5.75 In our view, the disclosure (or non-disclosure) of the costs in this project described above was inappropriate. The $722,000 related directly to the Greenstone Gardens project (according to management's assertions). As such it, along with the professional fees, should have been included as part of the reported capital cost of the project. We consider that the disclosure adopted by the Corporation understated the full cost of the Greenstone Gardens project. The Corporation was satisfied that it had appropriately accrued the $722,000 cost of the associated work, and, therefore, in our view it should have reported this as a cost of the Greenstone Gardens project rather than in the general Modernisation programme.

5.76 The staff we spoke to noted that the Greenstone Gardens project was part of the overall Modernisation budget (rather than a separate programme), therefore implying that the disclosure adopted may not have been inappropriate, as the $722,000 was still included in the total Modernisation cost figures. A decision had obviously been made to show the Greenstone Gardens project separately in the Corporation's management reporting, and this treatment should have been consistently applied in all reporting on that project. In our view, the understatement of about 11% of the total costs of the Greenstone Gardens project for the year was inappropriate.

5.77 We also queried why both the National Property Improvement team and Asset Services Group reports show the Greenstone Gardens project's budget as $6.75 million, when the Corporation's quarterly report shows a budget figure of $6.15 million.

5.78 We have been advised of 3 different budget figures for the Greenstone Gardens project:

- $6,150,000;
- $6,750,000; and
- $7,498,000.

5.79 We were told that the original budget figure for the Greenstone Gardens project was $6,150,000 and that this was before the final budget had been approved. We were also told that the number had simply not been updated in the Corporation's quarterly report.

5.80 We received conflicting explanations about the composition of the $6,750,000, although we understand that it is the revised internal forecast.

5.81 The final approved budget for the project was $7,498,000. This included $530,000 "opportunity cost" for the land. We note that this was an internally assessed budget. It was not a separately appropriated amount, but formed part of a larger Crown funding pool.

5.82 We consider it important for management reports to distinguish between approved budget figures and revised forecasts. Both are important, but they serve different purposes and should not be presented as the same within management reports. Presenting actual costs against revised forecasts may hide overruns in management reporting, as has been the effect here.

5.83 Further, including the opportunity cost of the land as part of the consideration of the total economic cost of the project would seem to cloud the actual accounting cost, as the recognised accounting cost does not include any opportunity cost. While the opportunity cost did not appear to be included in the reported budget figures, there is some risk of confusion about the allowable level of expenditure against a project.

5.84 It appears as though the project was significantly over budget at 30 June 2005. Actual costs for the year were about $7.5 million, compared with an original budget of $6.15 million and a revised forecast of $6.75 million. The costs should have been consistently reported as such.

5.85 Further, we note the total costs of the project ended up being about $8.5 million against the budget of $7.5 million. Both totals included the opportunity cost, but excluded $356,000 for costs allocated to the adjacent property. As noted earlier, the cost overruns of about $1 million and the nature of the contract led the Corporation to seek an independent review of the Greenstone Gardens project. We understand that the Corporation's concern was not so much that the cost overruns occurred nor necessarily the extent of the overruns (given the heated Auckland construction market at the time), but that the cost overruns were not reported in a timely way.

5.86 We have viewed correspondence from both the quantity surveyor and the project architects to the Corporation dating back to October 2003. The correspondence raised concerns about the inadequacy of the budget and warned that cost overruns were likely. The Corporation's response to some of these concerns was to undertake a value engineering exercise that aimed to take enough costs out of the project for it to be on or close to budget. Although the quantity surveyor's November 2004 report indicated there may still be a significant cost overrun, the

Corporation's management considered that the value engineering process was starting to take effect. This view was effectively supported by subsequent reports from the quantity surveyor, which showed a significantly improved position, although still with a level of cost overrun. It was thought that this would be eliminated by the time the project was complete.

5.87 The independent review referred to in paragraph 5.42 noted areas where the Corporation could have performed better, particularly around identifying the cost overruns earlier and the way the project was reported on, both by its external advisors and internally.

Non-financial information

5.88 We reviewed monthly management reports produced by the Special Programmes and National Property Improvement teams for June 2005 against source data. We did not find any discrepancies between Special Programmes team, National Property Improvement team, Asset Services Group, and Corporation reporting of non-financial information to the Board and Ministers.

Under-performance of the Auckland Modernisation programme

5.89 The contractor specifically referred to attempts to cover up the under-performance of the Auckland Modernisation programme. The contractor alleged that the targets were reallocated to hide the under-performance in Auckland, as internal reporting on the Modernisation programme is not detailed by area.

5.90 The Corporation sets national targets annually, with regional targets sitting underneath these. National targets are contained in the Corporation's accountability documents, and performance is reported to Parliament in the Corporation's Annual Reports, while regional targets are internal to the Corporation. The Corporation is therefore able to shift targets between regions if it becomes apparent that targets will not be met in a region.

5.91 We were told that difficulties in the Auckland region during 2005 stemmed primarily from skills shortages in the building industry, and that the Corporation's Modernisation work is not work that would be considered "glamorous" within the building industry. Consequently, in the context of a tight labour market, it was very difficult at the time to obtain skilled tradespeople for the work.

5.92 However, we wanted to know whether the Board was aware of any under-performance of the Auckland Modernisation programme. We therefore discussed the allegation with the Corporation's Internal Audit Project Manager. He told us that the regional issue had been raised with the Board's Assurance Committee as

part of the Group Internal Audit Report in April 2005. We have seen a copy of this report.

5.93 The Internal Audit Project Manager also told us that it was made clear to the Assurance Committee that the Auckland Modernisation programme was behind target, that this was primarily because of resource availability in the region, and that a contingency plan was in place to shift some of the programme to areas with spare capacity. Our external auditor, who attends Assurance Committee meetings, confirmed this account of the discussion.

5.94 No one other than the contractor recalled that the contractor had arranged a meeting to address his specific "audit queries". Corporation staff also denied cancelling any such meeting to avoid addressing the issues. Without evidence to support either position, it is not possible for us to form a view on this allegation.

Our view of the allegations

5.95 We do not consider that either the appropriate budget or actual expenditure figures were consistently disclosed in management reporting of the Greenstone Gardens project. On completion, the project costs were compared to the revised forecast for management reporting purposes. In our view, the revised forecast figure was not the only appropriate budget figure to include in management reporting, and was almost certain to show a nil or minimal variance from the actual figure.

5.96 Further, because they specifically related to that project, it was not appropriate to exclude certain costs from the disclosed actual cost when it was known that such costs had been accrued. We accept that the Greenstone Gardens project fell within the wider Modernisation programme and was not a separately funded programme. However, the decision was made internally to separately disclose information in respect of it, and that information should have been as accurate as possible.

5.97 We consider that a suitably qualified accounting resource may have helped address the issues raised in the independent review of the Greenstone Gardens project by identifying cost overruns and by providing an improved project cost reporting framework.

5.98 Other than the comments noted above for the Greenstone Gardens project, based on our discussions and review of the financial and non-financial information contained within the monthly management reports, we did not find any evidence of deliberate manipulation of the information reported to management.

5.99 We also did not find any evidence to support the allegation that there were attempts to cover up the under-performance of the Auckland Modernisation programme. The decision to shift modernisation work to areas where there was spare capacity was transparent. In addition, the Board was aware of the situation, because it was mentioned as part of the April 2005 Internal Audit report to the Assurance Committee.

5.100 When it became apparent that the Modernisation programme for Auckland would not meet its targets for the 2004-05 financial year, the Corporation decided to make up the shortfall in other areas. In other regions, the Corporation brought forward modernisations that were planned to be completed in early 2006, and completed them in 2005. These actions were entirely reasonable in the context of the Corporation's current approach to regional targets and regional reporting.

Verification of invoices under the Property Maintenance Assessment System contract

5.101 The contractor alleged that invoices for property inspections were being paid without appropriate checking of the validity of the invoice. Further, he alleged that amounts paid for property inspections exceeded the contracted amount (and gave the example of invoice payments of $5 million when the contracted amount was $3 million).

5.102 All of the Corporation's tenanted properties are inspected each year to ascertain their condition. The property inspections are outsourced to a private sector provider under the Property Maintenance Assessment System (PMAS) contract. This service provider completes a report for each property inspection and provides it to the Corporation. The report is then entered into Rentel.

5.103 Invoices under the PMAS contract are subject to the same authorisation process as any other invoice for payment at the Corporation, with invoices checked for accuracy and signed off only by managers with delegated authority.

5.104 The monthly PMAS invoices received by the Corporation between January and May 2005 showed the number of inspections and futile visits (a visit where the inspector was unable to access the property) for each region or suburb. We reviewed these invoices.

5.105 We were told that the Contract Manager checks each invoice for accuracy, then prepares a payment voucher and forwards it to the Special Programmes Manager (or other manager) for authorisation. Each invoice was accompanied by a payment voucher that was signed as being authorised.

5.106 The Corporation mentioned additional controls, including that the service provider is required to submit an annual plan that forecasts their monthly inspection schedule, and that the service provider reports on progress against the monthly forecast. The National Property Inspection team performs a twice-yearly quality assurance that involves a random selection of PMAS invoices. The quality assurance staff visit the properties to check that the inspections had been carried out and their quality. We consider these controls to be sufficient.

5.107 The new PMAS contract, effective from 1 November 2005 to 31 October 2008, has an additional control. It requires invoices to include:

- unit reference;
- street address;
- suburb;
- types of work completed;
- quantity;
- rate; and
- total.

5.108 The PMAS contract does not contain an overall maximum cost that may be charged under it each year. However, charges under this contract are based on a set cost for each inspection or futile visit depending on the location of the property, and this provides a control. There is, in effect, a natural upper limit for inspections (and therefore costs) each year. PMAS expenditure was about $1.5 million in the 2004-05 financial year, which is broadly in line with cost expectations.[2]

5.109 We obtained details of all payments made to the service provider during the 2003-04 and 2004-05 financial years from the Corporation's accounting records. The service provider supplies other services to the Corporation as well as the PMAS inspections. It is possible that the contractor was not aware of the extent of other services provided, and that this caused confusion about the amounts payable for the PMAS inspections.

Our view of the allegation

5.110 Based on the work we have undertaken, it seems unlikely that overall payments for inspections could significantly exceed contracted amounts. Further, as noted in paragraph 5.108, actual PMAS expenditure was in line with forecast expenditure in 2004-05.

5.111 We note that the Corporation has improved its system for checking payments for inspections. We do not have a view on the efficacy of the new system.

2 Based on about 66,000 properties that should be inspected each year.

Robustness of accruals within National Property Improvement team programmes

5.112 The contractor raised concerns about the robustness of the accruals process for the CGH and Modernisation programmes. In particular, he told us that he was instructed by the Special Programmes Manager not to record any accruals for the CGH programme. The contractor believed that this manipulated the results for this programme, as not all expenditure would be recorded in the correct period.

CGH programme accruals

5.113 The team the contractor was part of, the Special Programmes team (see Figure 1), provides specialist assistance for certain aspects of the CGH programme, such as the initial modification of properties. However, the overall CGH programme is part of the Housing Innovations group.

5.114 While the Rentel system automatically calculates the accruals needed at month and year end, there are times when a manual accrual may also be needed (see paragraph 5.118). We understand that a Contract Manager within the Special Programmes team was responsible for preparing month-end accruals relating specifically to the specialist services that the team provided. The Contract Manager told us that the contractor was given the job of ensuring that these accruals were completed. The contractor told us that, although CGH accruals were "part of his brief", he was instructed by the Special Programmes Manager not to record any accruals for the CGH programme. The Special Programmes Manager did not recall this instruction, but confirmed that all other CGH accruals were the responsibility of the CGH programme team.

5.115 For the 2004-05 financial year, the Corporation told us that accruals of about $750,000 were made for the CGH programme. These included accruals of about $220,000 for minor capital work (relating to the initial modification of properties) derived from Rentel that were the responsibility of the Special Programmes team. The remainder of the CGH accruals were made by staff outside the Special Programmes team. We did not see any need to review the accuracy of these accruals.

Modernisation programme accruals

5.116 The contractor did not provide us with any specific examples of his concerns about accruals for the Modernisation programme. However, we understand that his concern relates to the allegations about the manipulation of results through the transfer of costs between periods and programmes (see paragraphs 5.24-5.66).

5.117 We discussed accruals for the Modernisation programme in some detail with the Wellington-based Finance team. At the end of the 2004-05 financial year, the Finance team queried 3 accrual journal entries (in addition to those specified in other sections of this report) prepared by the contractor for the Modernisation programme. These 3 accrual journal entries might have given rise to the contractor's concerns about the Modernisation programme.

5.118 The first of the journal entries related to an adjustment to the automatic accruals calculated by Rentel. The system allows each job to be set up with start and completion dates and the contracted cost, and then automatically generates an accrual at the end of each month based on how complete – by percentage – the job is. These accruals will not be accurate if either the start or the completion dates of the job are incorrect. When this happens, a manual journal entry should be raised to correct the accrual.

5.119 At the end of the 2004-05 financial year, the contractor completed an analysis of the Modernisation programme accrual, and asked that the system-generated accrual be reduced by about $2.6 million. Later, the Finance team reviewed these calculations, and identified errors in the spreadsheet prepared by the contractor. The Finance team has since established that the correct adjustment to the Rentel-generated accruals should have been $1.4 million rather than $2.6 million (an error of $1.2 million). The errors in the contractor's spreadsheet involved him using incorrect incomplete portions of jobs and using incorrect initial Rentel accrual figures. The result was that the reduction calculated by the contractor was for more than the original amount of the accruals.

5.120 The $1.2 million error (an under-accrual) was raised with the external auditor before the 2004-05 audit report was signed. The external auditor assessed the error, and determined that no adjustment to the Corporation's financial statements was needed. There was no effect on the Corporation's net surplus, and the error was not material in terms of the affected balance sheet items (property, plant, and equipment, and accruals). However, the external auditor asked for an adjustment to be made to the Statement of Service Performance.

5.121 Because of the under-accrual in the 2004-05 financial year, the Modernisation programme started off the 2005-06 financial year with a $1.2 million charge against its budget. The issue had been brought to the contractor's attention before his engagement with the Corporation ended, but had not been fully resolved at the time of his departure.

5.122 The second and third journal entries referred to in paragraph 5.117 were transfers of costs of $321,000 and $533,000 from the Modernisation programme into the Reconfigurations programme. These journal entries related to a group of

properties that were incorrectly attached to the Modernisation programme instead of the Reconfigurations programme when they were set up in Rentel. The journal entries were posted by the Finance team at the request of the contractor, on the understanding that appropriate details would follow. The contractor did not provide to the Finance team any further details about the second transfer ($533,000).

5.123 This issue was not resolved until long after the contractor left the Corporation, taking some 9 months. The outcome was that the reclassification of costs was overstated by $491,000 because:

- the 2 journal entries contained transfers relating to the same properties, and there was some duplication; and
- the journal entries incorporated costs that did not relate only to the 2004-05 financial year.

Our view of the allegation

5.124 Regardless of whether the contractor was told not to process CGH accruals and the context of any such comment (if it was made), there was an accrual for the CGH programme automatically generated through Rentel that was the responsibility of the Special Programmes team. However, it is important that:

- a review of the accruals calculated through the Rentel system is undertaken at each reporting date, to determine whether any manual adjustments are needed to reflect the true position; and
- jobs that have not yet been entered into Rentel are reviewed to determine whether any manual accruals are needed to reflect expenditure incurred. This is especially important given that there is a delay before some of these CGH-related expenses are entered into Rentel.

5.125 Based on the later actions of the Wellington-based Finance team, there were some inaccuracies in the accrual calculations for the Modernisation programme. The inaccuracies appear to have resulted, at least in part, from errors in the contractor's own calculations. The Special Programmes Manager told us that he did not have regular formal supervision meetings with the contractor, although they worked closely together on a daily basis. The Special Programmes Manager told us that he believed that the Wellington-based Finance team oversaw the contractor's accounting work.

5.126 We have 3 concerns:

- We are aware that the Finance team is usually provided with the appropriate documentation for all journal entries. However, in some instances, such as with the pressure of getting entries through for the end of the financial year, journal entries have been processed without appropriate supporting documentation.
- The National Property Improvement team has an annual budget of about $224 million, but has no dedicated qualified accountant to ensure that accounting within that team is appropriate. A suitably qualified accountant would also provide a more seamless information and communication flow through to the Wellington-based Finance team.
- It was unclear who was responsible for the accuracy of the contractor's accounting work.

Recommendation 6

We recommend that the Wellington-based Finance team remind all business groups within Housing New Zealand Corporation what the requirements are for manual accrual journal entries, and that exceptions will not be made.

Recommendation 7

We recommend that Housing New Zealand Corporation employ suitably qualified accounting resources within the National Property Improvement team.

Recommendation 8

We recommend that Housing New Zealand Corporation clarify the ownership of, and management responsibility for, the programme accounting function within the National Property Improvement team.

Transfer of budget from the Modernisation programme

5.127 The contractor alleged that there was an unauthorised transfer out of the approved 2005-06 budget for the Modernisation programme of about $1 million, and that the transfer was not discussed with the Modernisation project manager.

5.128 From the work we undertook, we consider that this allegation refers to the under-accrual of $1.2 million discussed in paragraphs 5.119-5.121. The under-accrual meant that the Modernisation programme effectively started the financial year with $1.2 million costs already recorded against its total budget. We discussed this with the Modernisation project manager, who agreed that this is a plausible explanation for this issue.

Our view of the allegation

5.129 In our view, the alleged unauthorised transfer was the natural accounting consequence of the error in the accrual at the end of the 2004-05 financial year. Again, in our view, the matter might have been avoided if a suitably qualified accountant had been more directly involved.

Part 6
Other allegations made by the contractor

6.1 In this Part, we set out:

- our expectations; and
- our consideration of allegations made by the contractor about:
  - suppressing and "watering down" of internal audit findings;
  - a lack of contestability of the PMAS contract;
  - inappropriate reporting lines within the National Property Improvement team; and
  - the organisational culture within the Corporation.

6.2 As with the allegations discussed in Part 5, the lack of detail provided by the contractor in support of his general allegations made it difficult for us to be sure that we had adequately dealt with each of the allegations made.

Our expectations

6.3 We expected to find:

- clear accountability and reporting lines for both accounting functions and programme management;
- that management provided direction and support for staff, and undertook quality assurance and sign-off where appropriate;
- that management had appropriately considered the use of line or functional reporting structures;
- internal audit findings that were subject to an appropriate level of review, with internal auditors free to report findings without pressure to omit or "water down" issues; and
- appropriate tender guidelines to ensure that the approach to tenders was consistent with, and followed, relevant public sector procurement guidelines.

Alleged suppressing and "watering down" of internal audit findings

6.4 The Corporation's internal audit function comprises an internal auditor and a quality audit team. Some "internal" audit work is outsourced to PricewaterhouseCoopers. The external auditor, appointed by the Auditor-General, works closely with both arms of the Corporation's internal audit function.

6.5 Regardless of which source internal audit reports originate from, the Corporation's internal audit reports go through a standard quality, fairness, and natural justice process. The process includes circulating draft reports for comment on

factual accuracy. There are, inevitably, amendments made to reports because of this process. When finalised, internal audit findings are presented to the Board's Assurance Committee. Because internal audit reports tend to be lengthy documents, generally only Executive Summaries are presented to the Committee.

6.6 The contractor alleged that internal audit findings were "watered down", and pressure exerted to keep sensitive issues from being included in internal audit reports.

6.7 We put this allegation to the Corporation staff we interviewed, and all denied putting undue pressure on internal auditors. We also discussed the allegation with the Internal Audit Project Manager, PricewaterhouseCoopers, and the external auditor (all of whom attend Assurance Committee meetings).

6.8 We give credence to the views of the internal and external auditors. They told us that teams will rigorously challenge findings if they consider this necessary, but no more so than would normally be expected in an internal audit process. We were also told that there is no undue pressure to dilute or omit any issues raised in internal audit reports.

6.9 The Corporation told us that a summary of the internal audit findings is provided to the Assurance Committee, rather than the report in its entirety. We were told that this is at the Committee's request. However, each topic is discussed in detail at Assurance Committee meetings.

6.10 In addition, each of the Internal Audit Project Manager, the GM Assurance Services, PricewaterhouseCoopers, and the external auditor have individual sessions with the Assurance Committee. All told us that this provides an opportunity for them to raise sensitive issues that they may prefer not to discuss in the company of the other attendees.

Our view of the allegation

6.11 Nothing came to our attention that would indicate a specific example of either internal audit issues being diluted or undue pressure not to report particular internal audit findings. We consider it normal for draft audit findings to be challenged, and for legitimate changes to be made between draft and final reports.

6.12 The procedures around reporting to the Assurance Committee are adequate to ensure that there is an opportunity to raise all sensitive matters. The Assurance Committee is notified of issues affecting the Corporation's programmes at an operations level, such as the Auckland Modernisation programme discussed in paragraphs 5.99-5.100.

6.13 In addition, the Auditor-General requires external auditors undertaking annual audits on his behalf to comply with AG-604: *Considering the work of Internal Audit*. This standard requires external auditors to assess the work of the Corporation's internal audit function. In making this assessment, our auditors take account of several factors, including whether the head of internal audit:

- is free from the influences of operational management, and from operating responsibilities;
- has direct access to the governing body and Chief Executive, and whether they can communicate freely with the external auditor; and
- has freedom or flexibility from direct management instruction on the scope and direction of an audit.

6.14 Our external auditor has raised no concerns about the Corporation's internal audit function.

Contestability of the Property Maintenance Assessment System contract

6.15 The contractor expressed concerns about the contestability of the PMAS contract that was put out to tender in 2005. In particular, the contractor expressed concerns about:

- rollovers of the contract during the previous 4 years;
- the tender process that led to the existing PMAS private sector company being reappointed in 2005; and
- a relationship between a senior manager within the Corporation and the principal of the company holding the PMAS contract – the contractor alleged this manager was influential in the private sector company being reappointed.

6.16 We reviewed the history of the PMAS contract that resulted in rollovers for 4 years before the 2005 tender process. We spoke to staff at the Corporation to gain a general understanding of tender processes, and we considered the involvement of the senior manager in question with the tender. We also reviewed the Corporation's tendering policy and processes, assessed the robustness of the 2005 PMAS tender against these, and reviewed the independent assurance obtained by the Corporation about the PMAS tender process.

Figure 2
History of the Property Maintenance Assessment System contract

In May 2002, the PMAS contract for the North Island was awarded to a private sector provider for a 12-month term, after a restructure of contract areas. The provider had previously held the contract for the Northern Region from 2001.
In July 2002, the contract was varied to include the South Island.
In May 2003, after the contract had expired, the Corporation extended the contract to October 2003 subject to variation (adding CGH properties to the contract). In July 2003, the Corporation decided to extend the contract to April 2004.
In May 2004, the Corporation started the tender process for a 3-year PMAS contract. However, this was delayed because of a lack of internal resources, as another significant programme tender was released at the same time. The provider continued on what was effectively a month-by-month basis until the PMAS tender could be completed.
In September 2005, the tender panel recommended that the provider be awarded the tender.
In December 2005, the contract was signed. Its term was from 1 November 2005 to 31 October 2008.

6.17 The Corporation used a 2-stage tender process. A request for a Registration of Interest was publicly advertised, and 30 Expressions of Interest were received by the due date of 14 June 2004. The tender process was then delayed, evidently because of a loss of crucial staff and other work pressures. It was not until May 2005 that the Expressions of Interest were evaluated. Seven contractors were approached and asked if they wished to submit a proposal. Four tenders were received, but one did not conform to requirements and was not included in the final analysis.

6.18 Tenders for the PMAS contract closed in June 2005, which was a month later than originally planned, and the tender evaluation panel considered tenders on or about 15 July. The panel recommended that the tender be awarded to the existing provider. There were some delays in completing the evaluation process, caused partly by lack of documentation, but the National Property Improvement Manager, GM Asset Services, and Chief Executive approved the recommendation on 23 September 2005.

6.19 The tender evaluation panel consisted of 3 staff members, including the contractor – whose engagement with the Corporation ended on 8 August 2005. The contractor told us he had responsibility for preparing tender documentation and day-to-day management of the procurement process. Corporation staff told us they found significant gaps in documentation on the PMAS procurement file after the contractor left the Corporation. Additional work had to be done to address these gaps.

6.20 An "evaluation kit", which included the evaluation rules and procedures, and guidance on relative scoring, was provided to the panel. The evaluation rules and procedures required each of the tenders to be evaluated independently by each of the 3 panel members, and then for the panel members to meet and agree on the score to be included in the evaluation. If the panel members were not able to reach a consensus, the evaluation was to be put aside for a peer review. The rules and procedures also provided for the evaluations to be peer reviewed by the Special Programmes Manager and Property Improvement Support Manager. If the peer reviewers did not agree with the initial evaluation, it was to be discussed with the panel members. If a consensus could not be reached, the peer reviewers' decision would prevail and the reasons for it recorded. From the information provided to us, it appears that the panel reached a consensus that was agreed through the peer review process.

6.21 An independent reviewer from PricewaterhouseCoopers was engaged to review and observe important steps in the tender process. He told us that the evaluation process was in line with the Corporation's policy, and that he did not observe any undue pressure for the panel to recommend one tender over another.

6.22 Having reviewed the documentation, we consider that the decision to award the tender to the existing provider was appropriate, and in keeping with the weighting system and the information available to the evaluation panel, but that the process and supporting documentation could have been better.

6.23 The senior manager who the contractor alleges had undue influence over the reappointment of the existing provider was not involved in the tender process until the tender evaluation panel had made their recommendation. We found no evidence that the senior manager was involved in the assessment of the tender (although, as a line manager, he did approve the recommendation).

Our view of the allegation

6.24 We found no evidence that the previous rollovers of the PMAS contract before the 2005 tender process were anything other than commercial decisions.

6.25 The 2005 tender process followed the Corporation's tender policy, and we consider that the decision to award the tender to the existing provider was appropriate. However, there was not enough documentation detailing what took place during the tender process, and there was no clear audit trail. For example:

- The Corporation's policy requires tenders to be opened in the presence of at least 2 people. Although we were told by Corporation staff that this was complied with, there was no record that this happened.

- The panel used a weighted scoring approach to assess the tenders, but the scores were not underpinned by sufficient analysis describing how they had been arrived at. It is therefore difficult to see the basis for the scores given.
- The independent reviewer concluded that the Corporation's procedures had been "reasonably complied with", but we found no audit trail to support their findings or the work they performed. Also, the opinion given provided no assurance about the quality of the tender process. Rather, it focused on whether the process complied with procedures.

Recommendation 9

We recommend that Housing New Zealand Corporation follow the documentation requirements of its tender policy, and adequately supervise staff given responsibility for day-to-day management of tenders.

6.26 Further, while the Corporation followed good practice in using an independent reviewer, it is important that reviewers are instructed to take account of the quality of the process and properly document their findings.

6.27 We also have some concerns about the adequacy of the Corporation's procurement policy. Overall, the policy sets out an adequate process, but it provides only minimum guidance on how and when decisions should be made. For example, the policy provides for Registrations of Interest for tenders to be advertised, but there is no guidance about when this is appropriate. Similarly, the policy lists the factors to be taken into account when contracts are put out for tender, but provides no guidance about when this is appropriate.

6.28 Also, although the National Property Improvement team is using draft guidelines *(Proposed Guidelines for Tender Evaluation Using Weighted Criteria for Building Works and Maintenance Services)* that are comprehensive and reflect good practice, these guidelines are not a formal part of the Corporation's procurement policy.

Recommendation 10

We recommend that Housing New Zealand Corporation review its procurement policy and processes to ensure that they are consistent with best practice and relevant public sector procurement guidelines, and to ensure that any guidelines in use form part of that policy.

6.29 We found no reason to suspect that the existing provider succeeded with its tender because of an existing personal relationship with a senior manager in the Corporation. The senior manager was not involved in the tender evaluation panel.

Alleged inappropriate programme reporting structure

6.30 The Special Programmes team, within which the contractor worked, sits within the National Property Improvement team. The Special Programmes Manager has 6 Project/Contract Managers and the Programme Logistics Manager reporting directly to him. These Project/Contract Managers are able to call on the services of Contract Administrators, whose line reporting is to the Property Improvement Support team.

6.31 The contractor alleged that the Modernisation project manager was prevented from dealing directly with a contractor with a crucial delivery role in the Modernisation programme. The contractor also raised concerns that the Contract Administrator working on the Modernisation programme did not report to the project manager.

6.32 We discussed this matter with various Corporation staff, including the Modernisation project manager.

6.33 We understand that the Modernisation programme team was created after a restructure of the Asset Services Group in 2004. A management decision was made that, while the new team gained experience, the day-to-day management of one important contract would remain with the Contract Administrator. The Contract Administrator was managing this contract when the Modernisation programme team was created. These decisions meant that a matrix form of management operated.

6.34 We were told that this was meant to be a transitional situation for the 2004-05 financial year. However, at the end of this time, the Corporation decided that the Contract Administrator should continue to be the point of contact for the provider, while remaining part of the Property Improvement Support team. The role of the Modernisation project manager was made clear to the provider at this time.

6.35 We were also told that it is the Corporation's intention to have a single point of contact for their programme providers, and there was a preference that the existing point of contact for this contract remains unchanged.

Our view of the allegation

6.36 The issues raised involve management decisions about the structure of reporting requirements and contractor relationships. This is outside the mandate of the Auditor-General, and it is not a matter for us to express a view on.

Organisational culture

6.37 The agreed list of allegations signed on 23 November 2005 said that the contractor felt bullied by the approach of some managers.

6.38 Although this is an issue more within the mandate of the State Services Commissioner, we did discuss this allegation with the contractor. We understand his concern arose out of staff reactions after he expressed concerns about the Corporation's practices, and that he believed that he had been told to "apologise or go".

6.39 We also asked a number of Corporation staff about the contractor's allegation and about bullying in general. Regardless of job, location, or position, no one reported any experience or awareness of bullying (either direct or indirect) in the Corporation's workplace.

6.40 Our view, based on our discussions with those involved and our review of the e-mail correspondence, is that the contractor's concern arose out of differences of opinion with staff members that perhaps were not handled or managed in the most appropriate manner. There is a distinction between strong management and workplace bullying.

6.41 We also analysed the Corporation's Staff Satisfaction Survey (August 2005). The survey results can be analysed down to team level, and the survey covers the period that the contractor worked for the Corporation. We therefore assessed the results for the relevant teams. Survey respondents remained anonymous, and the survey was carried out by an independent organisation. None of the teams concerned had negative overall findings.

6.42 Based on the results of our interviews and the information in the Staff Satisfaction Survey, we did not find any basis to refer the contractor's allegations to the State Services Commissioner.

Part 7
Use of Crown funding and third party revenue

7.1 We mentioned in our terms of reference for the inquiry that we intended to report on the extent to which there was clarity and transparency around the Corporation's use of Crown funding and third party revenue.

7.2 The Corporation's revenue comes from 2 main sources:

- public money appropriated by Parliament, and paid to the Corporation through the Department of Building and Housing, for:
  - housing policy advice, research, and evaluation;
  - education, support, capacity building, and other services which the Corporation obtains from other agencies, to support better housing for target groups;
  - housing related services provided by the Corporation, including home ownership initiatives, community renewal, and healthy housing;
  - subsidies for the Corporation's tenants to compensate for the difference between assessed income-related rents and market rents;
  - payments to the Corporation (and other providers) to compensate for the difference between the cost of funds and the rate at which funds are lent, and provide write-offs for loans; and
  - capital injections to give effect to government policy decisions around stock acquisition, modernisation, and other housing interventions; and
- third party revenue received directly by the Corporation from, for example, tenants and mortgagees.

7.3 It is important for a Crown entity in the Corporation's position to have a clear understanding of the different sources of revenue, and for that understanding to be reflected in its financial management and accountability reporting.

7.4 None of the issues we investigated related specifically to the distinction in revenue sources, although staff who we would expect to be aware of the distinction, such as those in the Finance area, were aware of it.

7.5 We did not find any evidence to suggest any problems in this respect, and do not discuss the matter elsewhere in our report.

Appendix 1
Inquiry terms of reference

11 April 2006

Background

The Board of Housing New Zealand Corporation (HNZC) has asked the Controller and Auditor-General to inquire into certain allegations made by a contractor of HNZC, and the steps taken by HNZC in response to those allegations resulting in a settlement agreement with the contractor.

The allegations were of 3 main types:

- that certain accounting practices in respect of HNZC's housing modernisation and maintenance programmes were inappropriate and produced misleading financial results;
- that certain inspection activities in respect of HNZC's housing modernisation and maintenance programmes were carried out inadequately, or not at all; and
- that the contractor was subjected to bullying by other staff in response to his allegations.

The settlement agreement dated 14 December 2005 involved a payment by HNZC to the contractor of $3,000 in full and final settlement of all claims the contractor might have against HNZC, in return for, among other things, the contractor's agreement not to communicate publicly or privately any of his concerns in respect of HNZC or other parties, including through communications with any Minister, MP, journalist, radio or television station.

The Board of HNZC has undertaken publicly to initiate an inquiry into the above matters, so as to ensure "total transparency" and for the purposes of reporting to the responsible Ministers and the State Services Commissioner. The Board has invited the Controller and Auditor-General to undertake the inquiry. The Auditor-General is the statutory auditor of HNZC and is an independent Officer of Parliament. He has agreed to undertake the inquiry on the basis set out in these terms of reference.

The inquiry

The inquiry will examine:

- The allegations made by the contractor in an agreed statement of facts dated 23 November 2005, and any other allegations by the contractor that the Auditor-General considers it desirable to investigate.

- The events leading up to the signing of the settlement agreement dated 14 December 2005, including (without limitation):
  - how HNZC negotiated the agreement, how the terms of the agreement were arrived at, and what advice HNZC took in respect of the agreement;
  - what the payment of $3,000 was for, at whose initiative it was negotiated, and how it was calculated;
  - how the agreement was authorised and, in particular, whether the Chief Executive Officer of HNZC authorised the agreement or was aware in advance of its terms; and
  - HNZC's policies and procedures in respect of the making of protected disclosures, and whether the contractor was aware of them.
- HNZC's process for developing its internal audit programme and how priorities were determined, including whether the issues raised by the allegations were appropriately included in the programme, what priority these were given and how these were determined.
- Such further matters arising out of the inquiry as the Auditor-General considers it desirable to investigate.

- The Auditor-General intends to report to the Board of HNZC on:
- his findings and conclusions in respect of the allegations relating to HNZC's accounting practices and inspection activities, and the adequacy of HNZC's responses to those allegations;
- the extent to which there is clarity and transparency around HNZC's use of Crown funding and third party revenue;
- his findings and conclusions in respect of any other allegations made by the contractor and the adequacy of HNZC's responses to those allegations;
- his findings and opinions in respect of the settlement agreement and the events which preceded it; and
- such other matters arising from the inquiry that the Auditor-General considers it desirable to report on.

The Auditor-General aims to report to the HNZC Board by 19 May 2006. The Board will then report to responsible Ministers prior to public release of the report.

During the inquiry the Auditor-General will consult, as necessary, with the State Services Commissioner in relation to any allegations that relate to matters of integrity and conduct of employees within the state services. If the Auditor-General considers that any such matters would more appropriately be investigated by the Commissioner, he will report that fact to the Board of HNZC and to the State Services Commissioner.

Our mandate

The inquiry will be conducted under sections 17 and 18(1) of the Public Audit Act 2001 (the Act), which authorise the Auditor-General, respectively:

> *with the agreement of a public entity, [to] perform for that entity any services of a kind that it is reasonable and appropriate for an auditor to perform;*

and

> *[to] inquire, either on request or on the Auditor-General's own initiative, into any matter concerning a public entity's use of its resources.*

The Auditor-General's report to the Board will be under section 21 of the Act, which authorises the Auditor-General to:

> *report to a Minister, a committee of the House of Representatives, a public entity, or any person on any matters arising out of the performance and exercise of the Auditor-General's functions, duties and powers that the Auditor-General considers it desirable to report on.*

Appendix 2
The settlement agreement

14 December 2005

Hello

The suggested settlement with you is as follows (subject to Chief Executive approval ~~approval~~ (now given))

1. Housing New Zealand Corportation (HNZC) will pay you the sum of $3000 in full and final settlement of any claim you might have against it or it's employees or or it's employees, on the following terms.

   (a) You agree not to communicate publicly or privately any of your concerns in respect of HNZC or it's employees or or it's employees including through communications with any Minister, MP, journalist, radio or television station.
   (b) HNZC may deduct the sum of $400 from the said sum of $3000 in payment of outstanding toll calls made by you for personal use with HNZC equipment.
   (c) The payment of the said sum of $3000 (less $400 for tolls) is not an admission of any wrong doing by HNZC or it's employees or . or it's employees but a practical measure to conclude its dealings with you.
   (d) You will not approach HNZC or it's employees or or it's employees again in respect of your concerns but you will assist HNZC (if required) during your lunch breaks to conclude its investigations of the matters raised by you as set out in my email of 23 November 2005.
   (e) This agreement will be kept confidential. In the event you breach this agreement in addition to any other right of HNZC the $3000 will be repaid to HNZC immediately.
   (f) HNZC and it's employees will not provide a reference for you.

HNZC will ensure

   (a) The matters raised in the email of 23 November will be the subject of a review which will be the responsibility of HNZC's General Manager Assurance Services to ensure these matters are concluded to the satisfaction of HNZC's external auditors

Yours faithfully

General Manager
Assurance Services

Agreed by
14 /12/05

Payment before the 23rd of December 2005

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- Department of Conservation: Planning for and managing publicly owned land
- Ministry of Agriculture and Forestry: Managing biosecurity risks associated with high-risk sea containers
- Annual Plan 2006-07 - B.28AP(06)
- Foundation for Research, Science and Technology: Administration of grant programmes
- Management of the West Coast Economic Development Funding Package
- Management of heritage collections in local museums and art galleries
- Central government: Results of the 2004-05 audits – B.29[06a]
- Progress with priorities for health information management and information technology
- The Treasury: Capability to recognise and respond to issues for Māori
- New Zealand Police: Dealing with dwelling burglary – follow-up report
- Achieving public sector outcomes with private sector partners
- Inquiry into the Ministry of Health's contracting with Allen and Clarke Policy and Regulatory Specialists Limited
- Maritime Safety Authority: Progress in implementing recommendations of the *Review of Safe Ship Management Systems*
- Inquiry into certain aspects of Te Wānanga o Aotearoa
- Cambridge High School's management of conflicts of interest in relation to Cambridge International College (NZ) Limited

Website

All these reports are available in PDF format on our website www.oag.govt.nz. They can also be obtained in hard copy on request – reports@oag.govt.nz.

Subscription for notification of new reports

We offer a subscription facility for people to be notified by e-mail when new Reports and Latest News are added to our website. The link to this subscription service is in the Reports section and also in the Latest News section of the website.

Sustainable publishing

The Office of the Auditor-General has a policy of sustainable publishing practices. This report is printed on environmentally responsible paper stocks manufactured under the environmental management system ISO 14001 using Elemental Chlorine Free (ECF) pulp sourced from sustainable well-managed forests. Processes for manufacture include use of vegetable-based inks and water-based sealants, with disposal and/or recycling of waste materials according to best business practices.

Office of the Auditor-General
Private Box 3928, Wellington

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

E-mail: reports@oag.govt.nz
www.oag.govt.nz