



Cook Islands Audit Office

Special Review Report

Acquisition of Sand Pump by the Ports Authority



PARLIAMENT OF THE COOK ISLANDS

PARLIAMENT PAPER NO. 25

Speaker of Parliament
Parliament of the Cook Islands
Nikao, Rarotonga
Cook Islands

Sir,

I have the honour to present the Special Review Report on the Acquisition of the Sand Pump by the Ports Authority.

Hon. Sir Dr Terepai Maoate, KBE
Deputy Prime Minister
Minister Responsible for the
Office of Public Expenditure Review Committee and Audit.

COOK ISLANDS



COOK ISLANDS AUDIT OFFICE

P.O. Box 659
Avarua, Rarotonga
Cook Islands

Phone: (682) 21-231

Fax: (682) 25-231

Email: perca@auditoffice.gov.ck
<http://www.auditoffice.gov.ck/>



30 May 2008

Speaker of Parliament
Parliament of the Cook Islands
Nikao
Rarotonga

Honourable Speaker

Pursuant to Section 33 of the Public Expenditure Review Committee and Audit Act 1995-96, I have the honour to submit my report on the Acquisition of the Sand Pump by the Ports Authority.

Following its delivery and presentation to Parliament, the report will be placed on the Cook Islands Audit Office's website (<http://www.auditoffice.gov.ck/>).

Paul R.S. Allsworth
Director of Audit

OFFICE OF PUBLIC EXPENDITURE REVIEW COMMITTEE AND AUDIT

AUDIT SUMMARY

My review into the Ports Authority's acquisition, and proposed disposal, of the 'Sand Pump' has identified fiscal practices that are unacceptable in the public sector.

This report highlights several anomalies that require the immediate attention of the Minister and Chairman of CIIC, and Chairman of Ports Authority, specifically in respect to ensuring that the Ports Authority is required to immediately implement, and strictly adhere to, proper documented Financial Policies and Procedures.

There is an urgent need, given the level of capital works and development currently being undertaken by this State Owned Enterprise ('SOE'), to establish rigid procedural steps that must be followed before the Ports Authority enters in to any further significant capital contracts.

The Audit Office recommends that it should be a mandatory requirement for all SOE's to establish, and abide by, a comprehensive Financial Policies and Procedures Manual. This document, as a minimum, should be consistent with that disseminated by the Ministry of Finance and Economic Management ('MFEM') to all Crown Funded Agencies. Noting that, an SOE equivalent will need to additionally encompass various financial matters distinctive to commercial organisations.

It is of serious concern to me that the Ports Authority, designated to operate in a profitable business-like manner, does not practice fiscally responsible management.

Overall, this Special Review has identified major deficiencies in the management of the Ports Authority resources. Aside from the lack of fundamental financial policies and procedures, some of the Audit Office's key concerns are scheduled below:

- The former Chairman (Don Beer Jnr) and the former General Manager (Andrew McBirney) effectively took the decision to purchase a Sand Pump into their own hands and failed to comply with any form of good governance when they committed the Ports Authority to the Sand Pump acquisition;
- The Ports Authority did not make an appropriately informed decision to purchase (or subsequently sell/retain) the Sand Pump, nor did the statutory corporation undertake any form of substantive risk analysis to ensure that the SOE's resources were not subject to an unacceptable level of risk;
- The Sand Pump, originally costing \$400,000 (and closer to \$500,000 when recognition of repair, borrowings interest and other costs are captured), has never reached Aitutaki. That is, three years after the Sand Pump was allegedly purchased to dredge in Arutanga Harbour, Aitutaki it remains haphazardly stored on land at the Avatiu Harbour, Rarotonga.
- Furthermore, the Ports Authority (specifically the former Chairman and General Manager) were acting beyond the responsibility of the SOE when they committed to the major purchase of an asset that they intended to hire out for beach restoration and beautification. This is far removed from the core business or responsibility of the Ports

Authority; and

- The material financial loss, half a million dollars (before accounting for disposal), suffered by the Ports Authority as a result of this inappropriate capital purchase at the whim of Don Beer Jnr and Andrew McBirney has had a severely detrimental impact on the Ports Authority's financial position. Such poor financial behaviour and mismanagement of public resources, by the SOE former Chairman and former General Manager, should never be allowed to be repeated.

This Special Review raises serious concern about the involvement of Cook Islands Investment Corporation (CIIC) in the acquisition, particularly in respect to the prior Chief Executive Officer's (CEO) role. CIIC, CEO at the time, Tarita Hutchinson prepared the Ports Authority 'Proposal for Borrowing' which was submitted to Westpac Banking Corporation to secure funding requirements. The Financial Projections disclosed in the Borrowing Proposal are extremely removed from the actual performance of the Sand Pump. The Audit Office's correspondence with the previous CEO remains unanswered (after further follow-up) and the Ports Authority is unable to provide any indication as to how the grossly overstated revenue projections arose.

Overall, a half million dollar financial loss suffered by government purely due to extremely poor pre-acquisition analysis (of any type) cannot be permitted to recur. The half million cost does not take into account the lost opportunity cost, i.e. how the Ports Authority could have instead better utilised this money.

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1 EXECUTIVE SUMMARY

- 1.0.1 In September 2003 the Ports Authority committed to the acquisition of a Sand Pump initially costing approximately \$396,150, i.e. just below four hundred thousand dollars.
- 1.0.2 The purchase of this significant asset by a State Owned Enterprise ('SOE') was identified for review by the Director of Audit. This Review forms part of the Audit Office's statutory duty under the Public Expenditure Review Committee and Audit Act 1995-96 section 27(g) to:
"pursue any concern that arises in respect of the management of public resources which in its opinion justifies further investigation".
- 1.0.3 On 21 January 2006 the Cook Islands Herald, page 2 headline, read '**Controversial Sand Pump to be sold**'. This article confirmed that the Ports Authority, in less than two years since the arrival of the Sand Pump in March 2004, was intending to dispose of this significant state owned asset.
- 1.0.4 This newspaper article prompted further calls of concern from the public to the Director of Audit. The main area of unease voiced by the public related to the unsuitability of the particular Sand Pump acquired along with concerns regarding the actual intended use of the Sand Pump by the Ports Authority.
- 1.0.5 Subsequently, the Director of Audit has received various complaints from the public regarding a number of issues primarily in respect to poor management and abuse of public sector resources by the Ports Authority Board and Management.
- 1.0.6 Accordingly, this matter became the subject of a Special Review by the Audit Office.

1.1 Major Audit Findings

- 1.1.1 This Special Review has identified a **number of significant areas of concern** which must be addressed by the Ports Authority to ensure the effective, efficient and economic use of public sector resources under this SOE's control in the future.
- 1.1.2 It is the Audit Office's intention that highlighting these key findings will assist the Ports Authority to implement steps to ensure that optimal return and value for money is continuously strived for in the future. This will require appropriate financial policies, procedures and controls to be immediately adopted and properly adhered to by the company.
- 1.1.3 In respect to the Sand Pump Review the Audit Office reports the following major findings:
- a. The Ports Authority **did not make an appropriately informed decision** to purchase the Sand Pump.

At all times, where significant crown assets (or funds) are involved, a full

analysis of all feasible alternatives should be fully evaluated before commitment to any single option is approved or endorsed by the Board of Directors.

This did not occur.

- b. The Ports Authority **did not perform a detailed risk analysis**, prior to committing to the purchase of the Sand Pump.

It is critical, when contemplating an acquisition of this magnitude, that comprehensive risk analysis is completed before entering into any form of obligation with a supplier. Risk analysis is required to ensure that state owned resources are not subjected to an unacceptable level of risk.

This did not occur.

- c. The Ports Authority invested heavily in capital expenditure partly for work **outside of their core business**.

Beach beautification, renourishment and replenishment is not the responsibility of the Ports Authority.

In line with Government policy, sand removal and work of this nature is intended to be contracted out to the private sector, not personally undertaken by the Ports Authority.

- d. The Ports Authority **did not comply with acceptable Financial Policies and Procedures**.

The ad hoc process, followed by the former Chairman and former General Manager from initiation to completion of this purchase, was vastly removed from effective responsible fiscal management.

As a matter of urgency the Ports Authority MUST establish, and fully comply with, proper comprehensive documented financial policies and procedures. Given the frequency, and level, of capital commitments entered into by the Ports Authority it is imperative that appropriate financial policies and procedures, similar to those issued by the Ministry of Finance and Economic Management (on behalf of the Cook Islands Government), are implemented immediately.

This is paramount to ensuring that contestable, transparent and accountability procedures are in place for all future significant capital investments and transactions.

- e. The Ports Authority (and as a result, the 'Crown') has suffered **significant financial loss** as a direct result of poor management by the former Chairman and former General Manager in committing to this significant capital transaction which, after three years, has failed to perform as intended

and remains haphazardly dry docked at the Avatiu Harbour compound.

- f. The Ports Authority **has not made an appropriately informed decision** to retain or sell the Sand Pump, given its non-performance to date.

- 1.1.4 Aside from the failings of the Ports Authority, the Audit Office acknowledges that Cook Islands Investment Corporation ('CIIC'), to whom all SOE's are accountable, neglected to satisfactorily guide the Ports Authority in this matter.
- 1.1.5 It was inappropriate for Tarita Hutchinson, the then Chief Executive Officer ('CEO') of CIIC, who prepared the Ports Authority's Proposal for Borrowing, not to substantiate the figures presented in the report to Westpac Banking Corporation with the Ports Authority. The revenue budget figures were completely removed from the actual results and Audit has been unable to determine how such grossly inaccurate revenue estimates were arrived at.
- 1.1.6 Neither the former Chairman, nor the former General Manager, could advise where the figures depicted in the Financial Projections had come from, that is they could not explain the assumptions made by CIIC to arrive at the forecast revenue and expenditure amounts used to obtain Westpac bank funding for the Sand Pump acquisition. Audit notes the former CEO of CIIC, Tarita Hutchinson, has not responded to any of the written enquiries directed to her by the Audit Office in this regard.
- 1.1.7 Audit observes that Ms Hutchinson's estimates of Sand Pump revenue were seventeen times higher than the actual income received in 2005. That is, against budgeted income of \$267,681 actual income received was \$14,286, only 5% of what was budgeted for. It would appear the Borrowing Proposal figures were simply constructed to meet external lending requirements and no rational basis was applied, at any level, as to the reasonableness of the calculated results.
- 1.1.8 Whilst responsibility for the transaction must rest with the Board of Directors of the Ports Authority, CIIC's involvement was two-fold. As referred to above, CIIC actively assisted in the funding of the acquisition with the former CEO of CIIC preparing the Proposal for Borrowing and all of the financial performance estimates herself.
- 1.1.9 Secondly, because the Ports Authority was unable to raise the funds in their own name, CIIC facilitated the borrowing for the Sand Pump through a loan in the name of CIIC. Hence, the production of such poor quality budgets by the previous CEO of CIIC is of even more concern in that this was endorsed by the CIIC Board, i.e. approval of lending to the Ports Authority via CIIC based on unrealistic financial estimations.
- 1.1.10 The Audit Office strongly recommends that the attached report is read in its entirety to obtain an understanding of all matters considered as part of this Special Review.

1.2 Key Recommendations

1.2.1 It is imperative that the Ports Authority and CIIC properly consider the matters raised by Audit and promptly take appropriate steps to ensure negative findings are prevented from recurring in the future.

1.2.2 At the conclusion of each section of this report Audit has recommended actions required to rectify the situation or has suggested procedures be implemented to make certain the inappropriate action taken in respect to the acquisition of the Sand Pump is not repeated in any future capital transaction entered into by the Ports Authority.

1.2.3 In respect to areas demanding significant attention, Audit recommends the following:

- A mandatory requirement for a full analysis of all feasible options to be undertaken before committing to any single alternative, when acquisition or disposal of a significant SOE funds/assets is involved.
- Similarly, a comprehensive assessment of all areas of risk must be properly assessed to ensure crown resources are no longer placed at an intolerable level of risk.
- The Ports Authority must focus on their core business as stipulated in the Ports Authority Act 1994/95 which clearly reflects the role of the company as determined by Government *“to promote, encourage and assist in the development of commercially viable and efficient ports in the Cook Islands”*.
- There is an urgent need, given the level of capital works and development currently being undertaken by this SOE, to establish rigid procedural steps that must be followed before the Ports Authority enters into any further significant capital contracts.
- The Ports Authority (and other SOE's) must introduce and adhere to comprehensive documented financial policies and procedures to prevent the recurrence of such poor financial decision making. The *‘Cook Islands Government Financial Policies and Procedures’* manual is required to be adhered to by all Ministries and Crown Agencies. In the absence of such a manual, SOE's must be required to implement a similar financial manual.
- CIIC must review their role and responsibilities in respect to active involvement in SOE capital acquisitions. If CIIC is to continue to assist in the preparation of ‘Proposals for Borrowing’ to be submitted to commercial lenders, it is imperative that CIIC ensure they provide reasonably accurate budget material that has been appropriately considered and not simply assemble figures to ensure lending criteria will be met, and approved. This is fiscally irresponsible.

1.2.4 As referred to above, it is important that this Audit Office Special Review report is read in full to ensure an understanding of all recommendations for improvement that have been suggested by the Audit Office.

2 INTRODUCTION

- 2.0.1 In September 2003 the Ports Authority committed to the acquisition of a Sand Pump costing \$396,150, i.e. just below four hundred thousand dollars.
- 2.0.2 The purchase of this significant asset by a State Owned Enterprise (“SOE”) was identified for review by the Director of Audit as part of his statutory role to pursue any concern that arises in respect to the management of public sector resources.
- 2.0.3 On 21 January 2006 the Cook Islands Herald, page 2 headline, read “**Controversial Sand Pump to be Sold**”. This article confirmed that the Ports Authority, in less than two years since procuring the Sand Pump, was intending to dispose of this significant state owned asset.
- 2.0.4 This newspaper article prompted further calls of concern from the public to the Director of Audit. The main area of unease voiced by the public related to the unsuitability of the particular Sand Pump acquired along with concerns regarding the real intended use of the Sand Pump by the Ports Authority.
- 2.0.5 Accordingly, this matter became the subject of a Special Review by the Audit Office.

3 BACKGROUND

- 3.0.1 As advised by Andrew McBirney, former General Manager of the Ports Authority in correspondence dated 24 February 2006:

“The idea/concept for the Ports Authority to purchase the Sand Pump originated from preliminary enquiries between Sykes New Zealand and the Environment Services and Ministry of Works.”

“Sykes New Zealand put together a prototype and presentation which was presented to Environment Services and Ministry of Works for consideration. However, the cost of the machine was close to \$1million which could not be funded from the local budget.”

- 3.0.2 The Ports former General Manager continued, in response to the Audit Office’s enquiries as to where the idea/concept for the Ports Authority to acquire a Sand Pump originated from, to state that:

“Really, the idea was hatched from Sykes’ contact with the Ministry of Works and Environment Services and was followed through by the Chairman and myself”.

- 3.0.3 The Chairman of the Ports Authority, at the time of acquisition of the Sand Pump, was Don Beer Jnr.
- 3.0.4 Environment Services, and Ministry of Works, were contemplating the purchase of a Sand Pump to assist with beach restoration and beautification work in the Cook

Islands. This objective is far removed from the responsibility of the Ports Authority.

3.0.5 No documented financial procedures were followed by the Ports Authority in the purchase, and associated borrowings, for this significant acquisition.

3.0.6 Accordingly, the following background information is sourced from the Minutes of the Meetings of the Ports Authority Board of Directors. The 2003 Board comprised:

- Don Beer Jnr Chairman;
- Kikore Charlie Snr (deceased);
- Teariki Kamana;
- Makiroa Mitchell; and
- Teariki Rauru.

3.0.7 Additionally, Andrew McBirney (as General Manager) and Diane Scott (as Board Secretary) attended the monthly Board of Directors Meetings.

3.0.8 The initial commentary evidencing that the Ports Authority was considering the purchase of a Sand Pump was recorded in the Minutes of the February 2003 Board of Directors Meeting.

3.0.9 Following on from a discussion regarding the 'Avarua Sea Surge Problem', the Minutes from the Board Meeting on 28 February 2003, record:

"It may be worth our while to buy a pump to operate off a barge to keep on top of the problem both here and in Aitutaki. \$765,000 was quoted for a similar barge requested by Environment Service. Possibility of an Aid Donor being found to fund this. Chairman to follow up."

3.0.10 The matter arose again at the following Meeting of the Board of Directors. The Minutes of the Ports Authority Board dated 27 March 2003 simply state that the:

"Sand Pump was again discussed in detail. A quote was received from overseas. It's between \$200,000 to \$300,000."

3.0.11 There was no further comment in the Minutes on the concept of the Ports Authority purchasing a Sand Pump until the July 2003 Board Meeting Minutes, some four months later.

3.0.12 The Agenda for the 31 July 2003 Board of Directors Meeting listed 'Item 8' as 'Dredging Equipment'.

3.0.13 The bullet point Minutes from that meeting, confirmed as a true and correct record of the proceedings of the 31 July 2003 meeting, record:

- *"Arutanga build up of sand is getting serious. Don had two meetings in Auckland with Sykes and costings for two options tabled and explained. The machine will also be essential for Avarua dredging and sand can be sold for cost recovery;*

- *Machine can also be used elsewhere on a commercial basis;*
- *CEO and Technical Team need to check out details to recommend back to Board;*
- *Approval is needed from CIIC to borrow money to buy the machine;*
- *Kamana's point of view that Government should also contribute to this purchase was discussed but not adopted by the majority."*

3.0.14 Subsequently, the Minutes of the Ports Authority Board Meeting on 31 July 2003 show the following motion was moved (Teariki Rauru), seconded (Kikore Charlie Snr) and approved by the majority:

"Moved that the machine be purchased subject to favourable report from CEO and technical team and approval from CIIC to borrow the funds to buy the Asset."

3.0.15 Liaison with the proposed supplier, Sykes New Zealand Limited ('Sykes'), continued and in early September 2003 a **verbal** order was placed with the company for a pontoon mounted Dragflow and Jetting Pump, that is no formal written contract of supply was ever entered into (refer section 9.0 below re: Breach of Ports Authority Legislation).

3.0.16 Sykes 'Production Schedule' for manufacture of the Sand Pump formed part of the 30 September 2003 Board of Directors Meeting Agenda attachments. This schedule indicated **Design Work had commenced mid September 2003** and anticipated the Sand Pump would be packaged and dispatched to Rarotonga in December 2003.

3.0.17 As previously referred to, the Board Minutes and correspondence between the supplier and the Ports Authority, represent the only documentation available surrounding the purchase and commitment to this \$400,000 asset. That is, there was:

- **No** written expert reports obtained;
- **No** financial forecasts prepared;
- **No** documented review of alternative options available;
- **No** documented supplier due diligence undertaken;
- **No** analysis of the impact the debt servicing would have on the business;
- **No** favourable written report was produced by Andrew McBirney and the technical team as specifically required per the 31 July 2003 Board Approval and
- **No** written agreement for purchase entered into between the supplier and purchaser.

3.0.18 Subsequently, a Proposal for Borrowing was prepared to meet the requirements of the Financier. This document, dated 2 December 2003, was completed some three months after the purchase had been committed to in September 2003.

3.0.19 That is, the only financial forecast undertaken in respect to the Sand Pump was completed three months after the Sand Pump order had been placed with Sykes and manufacturing had commenced.

- 3.0.20 It would appear, given the timing of the Proposal that the 'Ports Authority Proposal - Borrowing for Sand Pump' was prepared solely to meet the lenders requirements. Audit considers this extremely inappropriate, fiscally irresponsible and most unsatisfactory.
- 3.0.21 The Proposal for Borrowing was prepared by Tarita Hutchinson, then Chief Executive Officer ('CEO') of Cook Islands Investment Corporation ('CIIC'). The Ports Authority former General Manager, and former Chairman, were unable to advise where the figures shown in the Revenue Analysis and Cost Analysis disclosed in the Proposal prepared by CIIC had been derived from.
- 3.0.22 The revenue estimates stated in the Proposal for Borrowing are vastly removed from the actual results. CIIC's figures suggested revenue of \$267,681 would be earned in 2005. Actual revenue earned was \$14,286, **\$250,000 (95%) less than that budgeted for**. Despite the level of this discrepancy, Audit observes that the Borrowing Proposal passed to Westpac Banking Corporation ('Westpac') states, in respect to sand sales 'our conservative estimates'. The revenue estimates provided to the lender were clearly not conservative.
- 3.0.23 Audit reviewed CIIC's work paper file which provided no insight as to where the unrealistic level of revenue figures had come from. Tarita Hutchinson has failed to respond to Audit's written queries in this regard.
- 3.0.24 Westpac Banking Corporation ('WBC') approved the borrowings and a Loan Agreement between WBC and CIIC (effectively on behalf of the Ports Authority) was signed on 22 March 2004 by John Short, former CIIC Chairman and Tarita Hutchinson, former CIIC CEO. The \$350,000 loan agreement provided for a six year loan period commencing from the date of advance.
- 3.0.25 The Sand Pump arrived into Rarotonga, via the Southern Express V47, in March 2004.
- 3.0.26 Since the March 2004 arrival, the Sand Pump has not left Rarotonga. For the majority of the past three years, it has been haphazardly stored in the open in the Avatiu Harbour compound.

4 SPECIAL REVIEW OBJECTIVES

- 4.0.1 The objectives of the Sand Pump Special Review were determined focusing on fulfilling the Audit Office's statutory duties.
- 4.0.2 The Public Expenditure Review Committee and Audit ('PERCA') Act 1995/96 requires that the Audit Office pursue any concern that arises in respect to management of public resources. The acquisition and likely disposal, of the Sand Pump is considered to be of serious concern given the obvious inability of the Sand Pump to perform combined with the level of public funds committed to the purchase.
- 4.0.3 It is intended that the recommendations from this review will guide and assist CIIC, Ports Authority and ultimately Parliament to implement procedures to ensure the

effective, efficient and economic use of all other significant SOE resources in the future, particularly those resources under the management of the Ports Authority.

4.0.4 The specific objectives identified for the Sand Pump Special Review included:

- Determine whether an informed decision to purchase the Sand Pump was made by the Ports Authority, i.e. ensure that comprehensive cost/benefit analysis and consideration of all alternatives was completed before committing to the acquisition;
- Ascertain whether appropriate risk analysis was undertaken by the Ports Authority, and obtain comfort that identified risks were satisfactorily alleviated, before entering the Agreement to Purchase the Sand Pump;
- Consider whether the Sand Pump acquisition was an appropriate capital investment for this Statutory Corporation to make and in line with the core business of the Ports Authority;
- Consider whether the purchase process followed by the Ports Authority was consistent with best business practice. That is, as stipulated in Cook Islands Government's Financial Policies and Procedures, was the acquisition process contestable, transparent, accountable, and completed at arms length.
- Assess whether the Sand Pump acquisition represented 'Value for Money';
- Determine whether an informed decision to retain or sell the Sand Pump has been made by the Ports Authority given its non-performance to date; and
- Address any other related matters of significance as may be identified during the course of this Audit Office Special Review.

5 SPECIAL REVIEW SCOPE

5.0.1 The scope of the review is primarily from early 2003, when the possibility of purchasing a Sand Pump was first recorded in the Port Authority's Board of Directors Meeting minutes.

5.0.2 Audit has monitored movement of the Sand Pump throughout 2006 and observes the Sand Pump has remained dry docked on port land in Avatiu Ports compound to date.

6 SPECIAL REVIEW APPROACH

- a. Obtained a general understanding of the nature of the purchase and concerns raised by the public;
- b. Met with Andrew McBirney (former General Manager) and Don Beer Jnr (former Chairman) of the Ports Authority and subsequently met with the following Ports Directors:

- Teariki Kamana;
- Makiroa Mitchell; and
- Teariki Rauru.

Additionally, Audit met with Diane Scott who was the Board Secretary at the time the Sand Pump acquisition was approved in July 2003.

- c. Interviewed various people in Rarotonga with knowledge of the Sand Pump, including, but not limited to:
 - Julian Dashwood – former Chairman of the Board and Director, CIIC
 - Tai Herman – former Director, CIIC
 - John Tangi – former Director, CIIC
 - Nooroa (Bim) Tou – former Chairman, Ports Authority
 - Tony Armstrong – former General Manager, Ports Authority
 - Don Silk – former Harbour Master, Ports Authority
- d. Wrote to Tarita Hutchinson (former CEO of CIIC), John Short (former Chairman of CIIC) and Dr Woonton (former Prime Minister and Minister of CIIC) seeking their responses to various enquiries regarding their involvement in the acquisition;
- e. Wrote to Kevin Carr, former Financial Secretary, to obtain an understanding of MFEM's involvement, if any, and reviewed Financial Secretary's 'Sand Pump' file;
- f. Telephone interviewed and subsequently met with representatives of the Sand Pump supplier, Sykes New Zealand Ltd;
- g. Reviewed all documents made available to Audit including:
 - All documentation provided by the Ports Authority, CIIC and MFEM;
 - Quotation, invoices, brochures and correspondence from the Supplier;
 - Cabinet Minutes, submissions and attached reports;
 - Ports Authority and CIIC Board of Director Meeting Minutes;
 - Media Releases;
 - Ports Authority Proposal – Borrowing for Sand Pump;
 - All Borrowing Documents provided to Westpac; and
 - Various other assorted documents and information obtained during the Review.
- h. Completed a thorough review of the financial forecast generated by former CEO of CIIC, Tarita Hutchinson with particular focus on the reasonableness of estimated figures;
- i. Considered the appropriateness of the due diligence undertaken by the Ports Authority;
- j. Considered various areas of risk identified and evaluated whether the measures engaged by the Ports Authority to minimise these risks was appropriate;
- k. Documented supplementary issues identified from consideration and analysis of the information gained by completing the review; and

- I. Formulated recommendations to assist the Ports Authority, CIIC and Parliament in addressing unfavourable matters identified as part of this Special Review.

7 SPECIAL REVIEW PERSONNEL

- 7.0.1 The Director of Audit appointed Louise Wittwer, Audit Advisor, to undertake this Special Review.
- 7.0.2 Louise Wittwer is a New Zealand qualified Chartered Accountant and Internal Auditor; and a United States qualified Certified Fraud Examiner. She has extensive experience in reviews of this nature.

8 SPECIAL REVIEW FINDINGS

- 8.0.1 Review findings, analysis and subsequent recommendations follow in order of the individual objectives identified earlier in this report.

8.1 Determine whether an informed decision to purchase the Sand Pump was made by the Ports Authority, i.e. ensure comprehensive cost/benefit analysis and consideration of all alternatives was completed before committing to the acquisition.

- 8.1.1 In evaluating whether the Ports Authority made an 'informed decision' to purchase the Sykes Sand Pump Audit reviewed:
- a – the level of cost/benefit analysis performed;
 - b – alternatives the Ports Authority considered;
 - c – the utilisation of expert advice;
 - d – clarity of the purpose/reason for acquisition;
 - e – consideration of logistical issues; and
 - f – level of due diligence performed on the supplier.
- 8.1.2 The above matters are those which audit believe, at an absolute minimum, the Ports Authority needed to have fully considered before making an 'informed decision' to purchase this significant capital item.

Cost/Benefit Analysis Performed

- 8.1.3 Nothing more than a 'back of the envelope' calculation was performed by the Ports Authority in the way of cost versus benefit analysis. That is, a simple comparison was made between the one-off costs of getting a contractor to dredge part of the Arutanga Harbour, Aitutaki (\$250,000) or spending \$450,000 to purchase a Sand Pump. No further analysis was undertaken.
- 8.1.4 The auditor responsible for this review wrote to the former General Manager on 10 February 2006 stating: *"I have been unable to sight any documented feasibility assessment, cost/benefit evaluation, risk assessment, etc undertaken by the Ports Authority prior to acquiring the Sand Pump"*.

8.1.5 In Andrew McBirney's response to this statement from Audit he advised:

"The Ports Authority has a fiscal responsibility in ensuring it gets value for such an undertaking and the decision to buy the Sand Pump was made on this basis; spending \$250,000 once or spending \$450,000 for a Sand Pump that would in essence not only be available for the Ports operations in Aitutaki but also for the commercial and private sectors, as expressed by people in Aitutaki."

8.1.6 Audit is uncertain why the Ports Authority thought they had any obligation to acquire a Sand Pump for use by the commercial and private sector in Aitutaki. This is well outside their business scope as determined by the Ports Authority Act 1994-95. (Refer paragraph 8.3 below).

8.1.7 On 16 February 2006, the General Manager noted that: *"The Ports Authority quote obtained to dredge part of the Arutanga Harbour was \$250,000 (can be confirmed by Henry Ariihee)"* and subsequently on 24 February 2006 confirmed that *"The quote of \$250,000 was a verbal one given by S&T Contractors"*.

8.1.8 No substantive consideration of the two scenarios was evaluated. However, it is of greater concern to Audit that no proper cost/benefit analysis was performed in respect to actually acquiring the Sand Pump.

8.1.9 No computations, of any form, were prepared prior to ordering the Sand Pump, to obtain any form of comfort that the benefits of the significant purchase outweighed the cost.

8.1.10 Committing public funds, in excess of \$500,000, to the purchase of an asset having performed no cost/benefit analysis is fiscally irresponsible and reflects very poor managerial behaviour.

8.1.11 The Audit Office observes the only financial analysis on the Sand Pump undertaken, in any form, was included in the 'Borrowing Proposal' prepared by Tarita Hutchinson, former CEO of CIIC. This document, dated 2 December 2003, was prepared three months after the order was placed (and manufacturing and assembly commenced) with Sykes. The 'Borrowing Proposal' was constructed to meet Westpac's lending requirements.

Alternatives or Options Available

8.1.12 No documented review of alternatives available to the Ports Authority was prepared to assist in ensuring a 'well informed' decision to purchase was made.

8.1.13 No formal review of options available was undertaken and no alternative suppliers were considered.

8.1.14 Common and best business practice would see a range of alternatives considered before entering into the acquisition of a capital item of this magnitude.

8.1.15 However the Ports Authority failed to:

- a – call for tenders to dredge the Arutanga channel;
- b – call for tenders to provide a Sand Pump; or
- c – advertise in the South Pacific/Australasia region for an appropriate second hand Sand Pump.

8.1.16 Throughout discussions and correspondence with Audit, consistent with comments made to the media, the then General Manager and Chairman have maintained that the

“Ports Authority decided to buy it after looking into the cost of dredging the harbour channel at Aitutaki using a digger.”

8.1.17 There is no evidence to show the Ports Authority did anything in considering the cost of dredging, other than getting one local verbal quote that is, no public tender was issued nor were any other contractors approached in this regard.

8.1.18 It is of significant concern, especially given the Ports Authority is not in the business of construction, that no real consideration was even directed at utilising the services of a private sector company to perform the dredging required in Aitutaki.

8.1.19 Audit is further dismayed that the Ports Authority entered into a purchase agreement for an asset initially costing \$400,000, increasing to \$500,000 with recognition of related costs, without going to tender.

8.1.20 Such blatant disregard of generally accepted government practice, requiring the tendering out of all major capital projects, certainly raises concerns as to what the former General Manager and Chairman had to personally gain from the contract entered into (refer paragraph 8.4 below).

8.1.21 Audit is aware that the Ports Authority frequently call for tenders but we have been unable to obtain any satisfactory explanation as to why this usual procedure was avoided in this instance, especially given the large amount of capital expenditure to be incurred.

8.1.22 Furthermore, based on the evidence provided to Audit, no consideration or effort was given to determining whether there may be a suitable second hand pump available to fulfil the Ports Authority needs. The Audit Office confirmed, with a former local Harbour Master, that there are second hand Sand Pumps available that may have satisfactorily met the needs of the Ports Authority. However, the Ports Authority took no steps to determine what the ‘second hand’ market for Sand Pumps was like.

8.1.23 Given the reluctance, for whatever reason, of the Ports Authority to:

- a - tender the dredging alternative, or
- b - tender for a Sand Pump

it is not surprising that the SOE also failed to consider advertising for a second hand pump in the South Pacific/Australasia region.

8.1.24 It is certainly of concern to Audit that the Ports Authority made no endeavour to determine whether a neighbouring South Pacific or Australasia port or private contractor may have had a suitable Sand Pump available for purchase or hire. During various discussions with the former Ports General Manager and Chairman they frequently referred to their close working relationship with neighbouring ports yet at a time like this when an email or contact may have provided alternatives no such step was taken.

8.1.25 Audit observes, given the half million final price tag of acquiring the Sykes Sand Pump, that the Ports Authority could quite possibly have sourced a second hand pump or potentially hired one from further abroad than the South Pacific, still at a significantly lower cost than the new untested prototype purchased from Sykes.

8.1.26 Audit has been unable to substantiate why Don Beer Jnr and Andrew McBirney were simply not interested in considering alternative suppliers or second hand equipment and instead without any formal process of selection awarded the Sand Pump sale to Sykes, without tender.

8.1.27 Audit observes that when the Board approved the purchase, on 31 July 2003, it was:

“Moved that the machine be purchased subject to favourable report from CEO and technical team and approval from CIIC to borrow funds to buy the asset.”

8.1.28 A report was never forthcoming from the CEO (General Manager) and no ‘official’ technical team was formed.

8.1.29 As per Andrew McBirney’s letter of 16 February 2006 to Audit, he stated:

“I advise that there was no official ‘technical team’ and the CEO did not present a written report.”

8.1.30 For the former Chairman and General Manager to proceed to order the Sand Pump, without fulfilling the specific stipulation of the Board of Directors that it was only to occur if a favourable report was forthcoming, makes a mockery of seeking the Board’s approval at all. This occurrence may suggest that they may have misled the Board.

8.1.31 Audit was unable to identify any reprimand action taken by the Board in light of this direct action against the Board’s specific request.

Utilisation of Expert Advice

8.1.32 As confirmed in the General Manager’s correspondence to Audit dated 24 February 2006:

“No experts were involved or consulted.”

8.1.33 It is common business practice, that when consideration is being given to incurring an asset of momentous cost, that the purchaser seeks ‘expert’ assistance to ensure the

appropriateness of the asset to meet the user's needs.

8.1.34 As referred to above, the Ports Authority took no steps to obtain any expert advice, from anyone internal or external to the organisation. That is, no approach was made to any of the likes of the following:

- within the Ports Authority (e.g. John Fallon, Harbourmaster);
- within Rarotonga (e.g. Tony Armstrong, former General Manager; Don Silk, former Harbourmaster); or
- within the South Pacific (e.g. professional experts from New Zealand or Australia).

It is most unfortunate that the former Chairman and former General Manager selected themselves as experts in this case, resulting in the spending of half a million dollars on an asset which has never made it to the harbour it was specifically acquired for (Arutanga, Aitutaki) and has remained haphazardly beached in the Avatiu harbour compound for the past 15 months, unable to effectively dredge at all.

Clarity of the Purpose/Reason for Acquisition

8.1.35 Audits review found no evidence of any specific formulated consideration given to the actual reasons for purchase other than general discussions regarding the need to sort out Arutanga Harbour. Before an acquisition of this magnitude could proceed one would expect significant analysis of the actual intended use of the machinery to be undertaken, therefore providing a tool to determine what the specific requirements of the Sand Pump were to meet the Ports Authority's needs.

8.1.36 Audit findings indicate a lack of clarity as to the purpose/reason for acquisition.

8.1.37 Various documentation and correspondence reviewed by Audit suggests the 'reason for purchase' was actually a lot wider than simply to clear the sand build up in Aitutaki's harbour.

8.1.38 It appears to Audit that the focus for acquisition seemed to change depending on whom the Ports Authority was liasing with as illustrated by example in paragraph 8.1.41 below.

8.1.39 Throughout this review, and consistent with comments made to the media, the former Chairman and General Manager have maintained the Sand Pump was purchased for the dredging of the Aitutaki Harbour where sand has built up in the channel making it difficult for boats to get in at any time other than high tide.

8.1.40 In this regard, Audit emphasises that three years since acquisition nothing has yet been done at Arutanga Harbour to alleviate the problem of sand build up. The Sand Pump has never made it to Aitutaki and no alternative actions have been taken. This in itself raises genuine concern as to the validity of the actual need for the Sand Pump in the first place. That is, three years on, the supposed key reason for purchase remains unattended to and boats continue to frequent Aitutaki.

8.1.41 By way of example, to illustrate the possibly 'confused' purpose for acquisition, Audit

refers to the following:

a – 24 November 2003, Correspondence from Andrew McBirney to Unakea Kauvai at the Bank of the Cook Islands re:

“A Finance Package for the Purchase of a Sand Pump. Due to the accumulation of sand in the harbours at Avatiu, Avarua and Aitutaki the Ports Authority have identified equipment that can be a very useful tool to carry out the above works and also for beach restorations around the island.”

The Ports, as discussed in detail in section 8.3 below, should not be in the business of beach restoration. This is completely outside the functions and powers of the Ports Authority as conveyed upon them under the Ports Authority Act 1994/95.

Additionally, by the side, Audit notes that this letter (and those sent to ANZ and Westpac) were not initiated until three months after the Sand Pump was ordered. Again, reflecting very ad hoc management of the purchase process by the Ports Authority management team. Finance obviously should have been secured before the contract for purchase was entered into.

b – 2 December 2003, the ‘Borrowing Proposal’ prepared by CIIC refers to the following:

“to improve the efficiency of the Ports Authority in managing the build up of silt in the ports under its control”.

The ‘SWOT’ (strengths, weaknesses, opportunities, threats) analysis goes on to record:

“strengths – Good potential client base through contacts with Government Entities.”

“threats – Government policy is for the private sector to perform this type of work if it is willing so competition from Ports may be perceived as against the spirit of private sector growth.”

overall – We will need to seek Government endorsement to enter into borrowing and endorse the Ports Authority entry into this business, which is ad hoc to the Ports Authority general business”

Again, the above references to client base and ad hoc business do suggest that dredging the harbour was only one of the reasons for purchase and instead the Ports Authority, or at least the General Manager and Chairman, were keen to use the Ports Authority’s resources to undertake activities specifically allocated for private sector businesses.

c – 17 February 2004, Correspondence from Andrew McBirney to Tapi Taio, then Minister of Finance re: Concession for Import Levy on the Pump. Aside from referring to the removal of sand in harbours Andrew McBirney stated:

“There is keen interest been expressed by the community in undertaking beach renourishment programmes on coastal areas where erosion has been severe.”

As previously noted, it is not the Ports Authority's responsibility to provide machinery for renourishing coastal erosion. As indicated above, this matter is further considered below in section 8.3.

d – 8 May 2004, Don Beer Jnr advised the media:

"It's an absolutely ideal machine for a beach replenishment programme."

8.1.42 The above examples assist to illustrate the lack of clarity for reason of purchase.

8.1.43 Audit Office is at a loss to understand why the Ports Authority, who is tasked with developing commercially viable Ports, is focusing on provision of beach renourishment services.

8.1.44 Given the examples referred to above, it is apparent that the Sand Pump was never solely intended for the dredging of harbours under the Ports control. Audit could find no evidence that the additional beach restoration/renourishment/replenishment activities were taken into consideration in any way when determining the specifications of the Sand Pump.

8.1.45 That is, to make an informed decision to purchase the right machinery for the job at hand the Ports needed to be very clear in what the purpose of acquiring the Sand Pump was. The information reviewed by Audit showed a lack of clarity as to what the intended actual purpose of acquiring the Sand Pump was and accordingly contributed to the reason for the Sand Pump not performing, i.e. it was unable to meet the demands placed upon it due to the poor initial planning pre-order process.

Consideration of Logistical Issues

8.1.46 In Audit's opinion there was very little, if any, consideration given by the Ports Authority as to 'how' the Sand Pump would actually operate meaning that when it did arrive in Rarotonga the Ports Authority encountered problem upon problem.

8.1.47 When purchasing an extremely specialised piece of capital equipment of such dimensions, it is imperative that the following matters be considered:

- a – the portability of the asset;
- b – how the actual asset will be operated (i.e. manned);
- c – the ease of obtaining parts when required for repair and/or maintenance; and
- d - meeting the ongoing demands of maintenance.

8.1.48 The Sand Pump weighs approximately 20 tonnes meaning it takes considerable time, at a considerable cost, to move the Sand Pump from one location to another. This means that moving the Sand Pump from Avatiu to Avana or Rarotonga to Aitutaki are not small tasks and come at a significant cost in terms of time, labour and expense.

8.1.49 Audit observes it is not just the size of the actual machine but also the size of the pipes

used to transfer the sand from the lagoon to the shore that are extremely cumbersome and heavy to move.

8.1.50 It does not appear, the sheer difficulties in moving the Sand Pump, were contemplated at any level by the Ports Authority before entering into the purchase of this significant Crown Asset.

8.1.51 Likewise, Audit's findings are that there has been no recognition given to the highly specialised skills required to operate the Sand Pump. Subsequently this resulted in the 'ferrying' of the few nominated staff who could man the Sand Pump from Avana back to Avatiu on boat days, i.e. when a cargo boat was berthed for unload.

8.1.52 Such methods of personnel management are inefficient, with significant time being required to 'set-up' and 'pack-up' the pump whenever a boat arrived in Avatiu.

8.1.53 Two further logistical factors, which again appear to have been overlooked by the Ports Authority prior to purchase of the Sand Pump, relate to the sourcing of parts for repairs and/or maintenance along with actually performing the repairs and maintenance.

8.1.54 Audit acknowledges there is frequent air and shipping services to the Cook Islands but parts continually took excessive periods to arrive onshore, again increasing the 'down' time of the Sand Pump.

8.1.55 The specialised, and complicated, nature of the Sand Pump required skilled personnel to both fit new parts and to ensure that scheduled maintenance was properly adhered to. Sykes accentuated that it was paramount that frequent maintenance occurred to ensure that the Sand Pump retained its value.

8.1.56 Audit requested information regarding a 'Repairs and Maintenance Log' for the Sand Pump. In response, on 1 March 2006, Andrew McBirney advised:

"A maintenance schedule will be formulated based on the attached documents for our staff to complete."

8.1.57 That is, there was no regular documented maintenance schedule in place for the first two years of ownership but subsequent to Audit raising the issue the General Manager advised that a maintenance schedule would be formulated.

8.1.58 Audit observes that discussions with the Supplier, Sykes, highlighted the absolute need for timely and regular maintenance to ensure the Sand Pump retained its value and was kept in good working order. Audits concerns regarding "Possible Inadequate Asset Preservation" are addressed specifically below in Section 9.0 of this report.

Supplier Due Diligence

8.1.59 'Supplier Due Diligence' refers to performing checks to establish that the potential supplier is an appropriate company to do business with before entering a material contract for supply with them. One of the purposes of completing thorough due

diligence on a supplier is to establish whether or not the proposed manufacturer can deliver to the specific needs of the purchaser.

8.1.60 As confirmed by the former General Manager in his written response to enquiries by the Audit Office:

“There was no documented due diligence undertaken”.

8.1.61 Audit has not been able to ascertain, in any substance, the nature of the relationship between Sykes management and the former Chairman and General Manager of the Ports Authority.

8.1.62 However, Audit acknowledges (with concern) that it is very disconcerting that an entity would enter into a verbal contract for \$400,000 (before associated costs) without having performed any type of formal due diligence on the supplier.

8.1.63 The Audit Office was advised that the then Chairman and General Manager had visited Sykes in New Zealand on two occasions but no documentation could be produced to support any suggestion that actual due diligence had been performed.

8.1.64 The issues addressed above, namely:

- a – the level of cost/benefit analysis performed;
- b – alternatives the Ports Authority considered;
- c – the utilisation of expert advice;
- d – clarity of the purpose/reason for acquisition;
- e – consideration of logistical issues; and
- f – level of due diligence performed on the supplier.

clearly evidence that an 'informed decision' to purchase the Sand Pump was not made by the Ports Authority.

Recommendations

8.1.65 At all times, where significant crown assets (or funds) are involved, a full analysis of all feasible alternatives should be fully evaluated before commitment to a single option is approved or endorsed by the Board of Directors.

8.1.66 Additionally, in future when considering the suitability, or not, of any given alternative it is imperative that other issues including seeking expert advice (when the matter is outside your skill-set), clarity of the purpose/reason for acquisition (especially when public funds of half a million dollars are being invested) and supplier due diligence are appropriately considered.

8.1.67 Audit observes that the Chairman continually referred to “the Agreement” and the supplier being “bound by the terms of our contract” but the Ports Authority never entered a formal written sale and purchase contract (refer Breach of Ports Authority Act 1994/95 in section 9.0 below).

8.1.68 The lack of financial competency of both the former General Manager and the Chairman in committing half a million dollars without any formal written agreement can best be described as grossly negligent behaviour.

8.1.69 It is paramount that Government, possibly via CIIC, take steps to immediately implement proper financial policies and procedures to be adhered to by the Ports Authority and all other SOE's when acquiring significant capital items.

8.1.70 Audit recommends CIIC undertake a review to ensure every SOE either already has, or is otherwise requested to immediately implement, proper documented fiscal procedures to ensure there is no recurrence of this material waste of public resources.

8.2 Ascertain whether appropriate risk analysis was undertaken by the Ports Authority, and obtain comfort that identified risks were satisfactorily alleviated, before entering the Agreement to Purchase the Sand Pump.

8.2.1 There was no risk analysis performed by the Ports Authority before verbally ordering the \$400,000 Sand Pump from Sykes in September 2003.

8.2.2 Audit enquiries confirmed that no risk analysis whatsoever was undertaken by the Authority before committing public funds to capital expenditure of this significant magnitude.

8.2.3 No documented consideration could be sighted to provide any evidence that the Ports Authority had given any thought to the risk of:

a – the Sand Pump not being able to function properly with the type of terrain to be encountered in Cook Islands waters;

b – the effects of choosing not to engage an expert for advice on the suitability of the product purchased;

c – inability of the Ports Authority to maintain qualified staff to operate, maintain and relocate, the heavy and specialized machinery;

d – continuous difficulties due to the physical remoteness of the Cook Islands in respect to:

- Training of staff;
- Time delay in receiving parts for repairs and maintenance;
- Lack of operational expertise on island; etc.

e – being unable to readily, and cost effectively, move the 20 ton plus piece of equipment and ancillary pipes;

f – entering a completely new business venture outside of the Port Authority's area of expertise, instead of applying prudent measures and engaging a 'service provider' to attend to the problems in Arutanga's harbour; and

g – significant financial loss, given that half a million dollars of public resources were at stake.

Audit emphasises that, at a minimum, the above obvious risks should have been identified by the Ports Authority and appropriate measures taken to alleviate each of these risks, to an acceptable level, before entering into a Sale and Purchase Agreement with Sykes.

8.2.4 If the above-mentioned risks could not be satisfactorily alleviated then the Ports Authority should never have proceeded to enter the contract for purchase of the Sand Pump.

8.2.5 A review of the risks identified above would suggest to an objective assessor that the risk level associated with the Sand Pump project was at an unacceptable level for a Crown Entity to tolerate. That is, unless appropriate risk management tools could be utilised to reduce the risk to an acceptable level (when utilising crown monies) then it is likely the Sand Pump acquisition would not have proceeded if proper risk analysis had been undertaken.

8.2.6 Audit observes that the issue of 'risk' was at least raised by CIIC in their 'Borrowing Proposal', albeit some months after manufacturing and assembly of the Sand Pump commenced.

8.2.7 The SWOT (strengths, weaknesses, opportunities, threats) analysis documented by CIIC included the following weaknesses and threats:

"Weaknesses

- *No technical expertise in managing this type of machinery;*
- *No operational expertise in managing this type of business; and*
- *Maintenance, servicing and parts not readily available (need to be flown in and may result in delays).*

Threats

- *Others looking to enter the market;*
- *Machinery breakdowns requiring technical expertise; and*
- *Government policy is for the private sector to perform this type of work if it is willing, so competition from Ports Authority may be perceived as against the spirit of private sector growth.*

8.2.8 CIIC's Borrowing Proposal also noted that the Ports Authority would need Government to endorse their entry into this business, due to it being ad hoc to the Port Authority's general business.

8.2.9 Subsequent to the identification of the above 'weaknesses' and 'threats' by CIIC, the Ports Authority should have followed up with a risk alleviation project establishing measures to satisfactorily minimise the risk for each weakness and threat raised. However Audit notes, given the Borrowing Proposal was written 3 months after the Sand Pump was ordered, this comment is somewhat superfluous.

8.2.10 In this regard the Borrowing Proposal simply acknowledged that:

"The Ports Authority should ensure the following measures are put in place to appropriately manage risk:

- *Insurance coverage for replacement cost;*
- *Insurance coverage for loss of income and public liability; and*
- *Back up processes in the event of operator unavailability.*

- 8.2.11 In respect to insurance of the Sand Pump, Audit found that the insurance had been allowed to lapse for a one year period commencing 1 December 2004.
- 8.2.12 In an effort to minimise total insurance costs to the Ports Authority, the General Manager recommended to the Board that insurance of the Sand Pump be terminated. This was documented in the minutes of the Board of Directors meeting on 22 December 2004.
- 8.2.13 Accordingly, the Sand Pump insurance was cancelled. Termination of the insurance policy obviously ended the risk cover this was providing to the Ports Authority.
- 8.2.14 However, of equal concern to Audit is the fact that this termination of insurance breached the loan agreement with Westpac/CIIC. This matter is referred to in detail as a supplementary issue below at Section 9.0 of this Special Review Report.
- 8.2.15 The Ports Authority's action, of terminating the Sand Pump insurance, indicates that despite CIIC's recognition of the requirement to put measures in place to appropriately manage the risk associated with the Sand Pump, the Ports Authority chose to discard their recommendations/advice.

Recommendations

- 8.2.16 As stated to above, when considering the requirements to make an 'informed decision' to purchase, it is also critical that with any significant capital acquisition a comprehensive risk analysis evaluation is undertaken.
- 8.2.17 Audit reiterates that the importance is not just in identifying the risks but in identifying measures to manage or alleviate the risks to a level of tolerance acceptable within the public sector.
- 8.2.18 Audit firmly recommends that thorough risk analysis must become a compulsory task to be properly addressed in the future before any significant capital acquisition can be made from public resources.

8.3 Consider whether the Sand Pump acquisition was an appropriate capital investment for this Statutory Corporation to make and in line with the core business of the Ports Authority.

- 8.3.1 In determining whether the Sand Pump acquisition was an appropriate capital investment for the Ports Authority to make it is necessary to consider the following matters which should have significantly impacted on the decision making process of the Ports Authority.
- 8.3.2 In order of priority, consideration should have been given to the:
- a – Ports Authority Act 1994/95;
 - b – Statement of Corporate Intent;
 - c – Strategic Plan; and
 - d – any relevant Board Policies.

Ports Authority Act 1994/95 ("Ports Act")

8.3.3 Part II of the Ports Authority Act addresses the 'Functions and Powers of Authority'. Section 20 defines the 'Objectives and Functions of the Authority' as stated below:

"Section 20(1) The objectives of the Authority are to promote, encourage and assist in the development of commercially viable and efficient ports in the Cook Islands to which this Act shall apply".

"Section 20(2) The functions of the Authority are to establish, improve, maintain, operate and manage ports facilities in connection with the operation of any port, and to carry on such other types of business as may be approved by the Minister."

8.3.4 That is, the Act stipulates that the core business, or the key objectives, of the Ports Authority is to promote, encourage and assist in the development of commercially viable and efficient ports. The Ports Authority is responsible for the Avarua, Avatiu and Arutanga ports.

8.3.5 Audit's interpretation of the Ports Authority statutory obligations do therefore include attending to such matters as silt build up in the harbours, where as a result, boats are prevented from entering ports at ease as (we are advised) is the case of Aitutaki.

8.3.6 However, as recorded in section 8.1 above, Audit's opinion of the Port Authority's intention to enter the beach beautification, renourishment and replenishment plan was beyond the business or objectives of the Ports Authority.

8.3.7 Audit observes that though the Ports Authority does have an obligation to ensure boats and barges can enter Ports under its control the issue in question is whether the 'capital investment' of half a million dollars to remove sand build up was appropriate.

8.3.8 That is, the methodology applied to resolving the silt build up problem in Aitutaki appears to be 'off track'. The Ports Authority is not tasked with performing capital works themselves. It is Audit's opinion that capital work of this nature should be contracted out to experts in the private sector.

8.3.9 Audit observes, this was briefly considered by the Ports, with respect to utilising S&T Contractors but the decision was instead made to spend an additional \$250,000 and do it themselves, and nothing ever got done. Three years after purchasing the Sand Pump to primarily resolve the silt build up problem in Aitutaki the Sand Pump has not got to Aitutaki and no other new initiatives have been implemented to deal with the problem in Arutanga Harbour.

8.3.10 This certainly raises concern to Audit as to the validity of the General Manager and Chairman's claim that the Sand Pump was required urgently in 2003 to address the Aitutaki problem when, as yet, over three years later nothing has been done in Aitutaki and boats seemingly continue to come and go.

8.3.11 In summary, it was within the Port Authority's statutory scope to consider and attend to problems with entry to the Arutanga port, however the Ports Authority itself is not in the

business of performing capital works and entering this new line of business came with substantial risk. Unfortunately the Ports Authority will suffer material financial loss from this decision for a period of years as it writes down the value of the now defunct Sand Pump 'asset'.

Statement of Corporate Intent

8.3.12 As confirmed by the former General Manager the Statement of Corporate Intent of the Ports Authority makes no reference to an objective in respect to beach restoration.

8.3.13 In no part of this document is there any reference to:

- a - performing large capital works themselves; or
- b - becoming involved in the beach restoration business.

8.3.14 This key corporate document should guide the Management and Board of Directors in their management of the Ports Authority's business. It appears to have been most inappropriately completely overlooked on this occasion.

Strategic Plan

8.3.15 Audit has been unable to obtain any form of business or strategic plan for the relevant period, i.e. 2003/2004, however we have reviewed the 2005/2006 Strategy and Business Plan.

8.3.16 The SWOT (strengths, weaknesses, opportunities, threats) analysis, included in this post acquisition plan, schedules the Sand Pump under 'weaknesses'.

8.3.17 Audit followed up this 'weakness' classification with Andrew McBirney who advised:

"The Sand Pump was identified as a weakness in the Business Plan as it was under utilised and as a result the Board at the time thought it should be sold."

8.3.18 Audit is dismayed the Sand Pump was recognised as a weakness because it was under utilised yet it has never made it to Aitutaki to perform the function it was reportedly acquired for.

Board Policies

8.3.19 Audit was unable to establish via any documentation reviewed, including Board minutes, whether the Board had specifically made a policy to enter into performing capital works in-house.

8.3.20 Discussions with Board members, provided varying reasons for the acquisition of the Sand Pump when Audit posed the question to them – *"Why did the Ports Authority purchase the Sand Pump?"*. Responses received are scheduled below:

a – Teariki Kamana – *"There was no one reason, a combination of ministerial involvement, Aitutaki sand build ups and beautification."*

b – Makiroa Mitchell – *“We needed the sand pump to suck the silt build up out of Avatiu Harbour as the nearby landowners land kept flooding.”* And

c – Teariki Rauru – *“To remove sand at Avarua Harbour, Ngatangija Harbour, build Aitutaki marina and remove sand in Aitutaki.”*

8.3.21 Audit observes that Kikore Charlie Snr was a member of the Board at the time the Sand Pump was approved for purchase; however he was deceased at the time this review commenced.

8.3.22 The above records the Ports Authority Board Member’s varying views as to why the Sand Pump was acquired.

8.3.23 In the absence of any formal documented Board policies with regard to capital works each situation must be looked at on a stand alone basis and as per the minutes of 31 July 2003 the Board did sanction this acquisition. Albeit with the caution that approval was contingent on a favourable report from the CEO and Technical Team. As referred to above, Andrew McBirney confirmed no technical team was formed and no report was ever issued.

Recommendations

8.3.24 The Audit Office has been unable to satisfy themselves that the purchase of the Sand Pump was an appropriate capital investment for the Ports Authority to make.

8.3.25 A number of factors contribute to this conclusion, but the overriding issue is that the Ports Authority is not in the business of performing construction/capital works in-house. Accordingly, Audit is unable to sanction this acquisition which appears to be outside the SOE’s core statutory business.

8.3.26 Audit recommends that, as is consistent with the practice of other SOE’s, the Ports Authority should ‘contract out’ to the private sector all material construction type work, i.e. take a ‘facilitative role’ in significant capital work of this nature.

8.3.27 Further Audit recommends that the Ports Authority redirect their focus to that of ensuring that their core operational objectives are met, being to promote, encourage and develop commercially viable ports.

8.3.28 As referred to in the Proposal for Borrowing, the Sand Pump business was ad hoc to the general core business of the Ports Authority and goes against Government policy, that is for the private sector to perform this type of work.

8.4 Consider whether the purchase process, followed by Ports Authority was consistent with good business practice. That is, as stipulated in Cook Islands Government’s Financial Policies and Procedures, was the acquisition process contestable, transparent, accountable and arms length?

8.4.1 It is not mandatory that the provisions in the Cook Islands Government Financial Policies and Procedures (‘CIGFPP’) manual are adhered to by SOE’s but it is expected, given their inherent commercial focus, that these organisations will have

proper systems of accountability in place and operate within the principles of good fiscal management.

8.4.2 A review of the purchase process followed by the Ports Authority in acquiring this significant capital asset shows that the process was:

- not contestable;
- not transparent;
- no accountability; and
- not necessarily arms length.

all in breach of the principles of good financial management as per the CIGFPP.

8.4.3 As referred to in Section 8.1 above, the purchase of the Sand Pump from Sykes was not contestable. No tender for supply was offered and all that Audit has been able to ascertain, given the lack of any type of formal documentation, is that the contract was simply 'handed' to Sykes.

8.4.4 The purchase process was not transparent. No one, aside from the former Chairman and General Manager, had any real knowledge of the acquisition process until after the order was placed with Sykes. The Sand Pump verbal contract for supply was entered into 3 months before CIIC prepared the financials for the acquisition finance and several months before Cabinet approved the loan documentation.

8.4.5 Audit was unable to substantiate any accountability throughout the purchase process. The only reference observed was the Ports Authority Board of Directors requirement that the purchase only proceed on the basis of a favourable report from the General Manager and Technical Team. However, as mentioned earlier, Andrew McBirney confirmed there was no technical team formed and no formal report was produced by the General Manager.

8.4.6 That is, the then General Manager and Chairman simply placed the order with complete disregard for the prerequisite demands placed upon them by their Board.

8.4.7 It is of considerable concern to Audit that the former Chairman and former General Manager clearly considered themselves as unaccountable to anyone – their Board, (and consequently) the Government and the tax payers of the Cook Islands.

8.4.8 It is of further concern that former Chairman and former General Manager appear to be ignorant as to the vulnerable position their actions placed the Ports Authority in by entering into a contract of this nature, and cost, on a purely verbal basis.

8.4.9 Audit has been unable to determine the exact relationship between Sykes, its employees and the former Chairman and General Manager of the Ports Authority. Given Don Beer Jnr and Andrew McBirney's decision to avoid calling for tenders for the Sand Pump and therefore failing to provide others with the opportunity to supply does signal favouritism, however no concrete evidence of this has been obtained and perhaps the Ports Authority personnel simply behaved in an extremely unprofessional

manner.

8.4.10 With any material capital purchase, made from public funds, perception is important. The perception, in this instance, is that the acquisition may not have been an arms length transaction without favouritism as the procedures followed lacked contestability, transparency and accountability.

8.4.11 In every aspect of good business practice the procedures, better stated as 'lack' of procedures in this case, followed by Don Beer Jnr and Andrew McBirney clearly and significantly shows irresponsible fiscal management.

Recommendations

8.4.12 Under no circumstance should any capital acquisition of this size be permitted, by any form of Crown Entity, without publicly tendering for supply.

8.4.13 A proper system providing for the key attributes of contestability, transparency and accountability must be instilled to all Crown Agencies and SOE's when material purchases are being made from public funds.

8.5 Assess whether the Sand Pump acquisition represented 'Value for Money'.

8.5.1 As documented above no cost/benefit analysis was undertaken by the Ports Authority. Likewise, no 'Value for Money' ('VFM') computations were performed prior to placing the Sand Pump order with Sykes in September 2003.

8.5.2 Accordingly, Audit has considered the direct costs involved in the acquisition, to determine an estimated 'total cost' of the Sand Pump to the Ports Authority.

8.5.3 A calculation of this nature needs to incorporate the following additional expenses, on top of the purchase price, which are all directly attributable to the Sand Pump acquisition:

- a – Finance Costs (i.e. the cost of borrowing including interest, bank fees, etc.);
- b – Freight Costs (i.e. the cost of transporting the Sand Pump to Rarotonga); and
- c – Insurance Costs.

8.5.4 An actual total cost of the Sand Pump is scheduled below:

Cost of Sand Pump	\$352,650
Finance Costs	\$119,200
Freight Costs	\$44,000
Insurance Costs (for the period of loan)	<u>\$48,000</u>
Total Actual Cost of Sand Pump	\$563,850

8.5.5 Audit highlights the above computation does not capture any ongoing costs of operation, for example repairs and maintenance.

- 8.5.6 The 2005 Sand Pump revenue estimates, included in the Proposal for Borrowing, recorded estimated income of \$267,681. Actual income generated from the Sand Pump for the 2005 financial year totalled \$14,286, i.e. 5% of that budgeted for.
- 8.5.7 The total revenue generated (\$14,286) in 2005 included revenue earned from Sand Sales and the single commercial user to have utilised the Ports Authority's dredging service.
- 8.5.8 As per Andrew McBirney's correspondence of 1 March 2006:
- "I confirm that Avana Condos was the only commercial enterprise to hire the machine."*
- 8.5.9 The above illustrates that an outlay of \$563,850 for the Sand Pump generated external revenue of \$14,286 in the first full year of operation.
- 8.5.10 Of greater concern to Audit is the fact, as reiterated several times in this report, that the Sand Pump never made it to Aitutaki to complete the Arutanga harbour dredging it was initially purchased and intended for.

Recommendations

- 8.5.11 The purchase of the Sand Pump clearly did not represent 'Value for Money'.
- 8.5.12 Audit reiterates our numerous recommendations above. It is imperative that proper pre-acquisition financial computations are required to be completed before committing to any further form of significant capital expenditure by the Ports Authority, especially given the level of public resources under the control of this SOE.
- 8.6 Determine whether an informed decision to retain or sell the Sand Pump has been made by the Ports Authority given its non-performance to date.**
- 8.6.1 The Ports Authority appears to currently be 'in limbo' regarding their decision in respect to the future of the Sand Pump.
- 8.6.2 That is, it would appear, an 'Informed Decision to Retain or Sell' has not specifically been made and in the interim the Sand Pump remains lying idle in the Avatiu harbour compound.
- 8.6.3 Audits findings reveal that currently the Sand Pump is neither for sale nor being utilised by the Ports Authority. As previously mentioned above, the Sand Pump has now been inactive for over one year and when it was in operation it performed limitedly and poorly.
- 8.6.4 It is the Audit Office's opinion that the Sand Pump purchased is inappropriate for the requirements here, i.e. it is incapable to readily operate in the way the former Chairman and General Manager envisaged it would.
- 8.6.5 Correspondence from Andrew McBirney dated 16 February 2006, in response to Audit

enquiries regarding the sale/retention of the Sand Pump, recorded the following:

"The decision to sell was made by the previous Board (the new Board was appointed on 1 January 2006). The new Board has considered its options and resolved to keep the sand pump in the meantime and will commence operations in the Port of Avatiu soon after the cyclone season. Thereafter it is intended to move the machine to Aitutaki to undertake its original purpose".

8.6.6 Audit observes that the decision to sell, referred to above by the former General Manager, was a decision made by the Board under the then chairmanship of Bim Tou. Bim Tou's tenure on the Board was only for a few months, with Don Beer Jnr Chairman either side of his appointment.

8.6.7 Andrew McBirney further elaborated, stating:

"The sand pump was identified as a weakness in the Business Plan as it was under utilised and as a result the Board at the time thought it should be sold."

8.6.8 His closing remark, in respect to the possible sale of the sand pump, was:

"If the sand pump is sold we will ensure that the process is contestable and transparent."

Recommendations

8.6.9 Audit recommends the current Board of Directors give priority to determining the future of the Sand Pump as it is currently not utilised and continues to weather the conditions of being stored outside in the Avatiu Harbour compound.

8.6.10 As with any significant capital item of this nature, with age its value diminishes. Accordingly, if the Sand Pump is to be sold the process for sale should be commenced immediately to prevent any further unnecessary devaluation of the asset.

8.6.11 Alternatively, if the Sand Pump is to be retained by the Ports Authority and bought back into operation steps should be taken to commence this process in as timely a manner as possible.

9 OTHER MATTERS OF SIGNIFICANCE IDENTIFIED WHILST PERFORMING THIS SPECIAL REVIEW

9.0 During the course of this Special Review the following additional matters of concern to Audit have surfaced:

1. Lapse of Insurance causing Breach of Formal Lending/Lease Agreements;
2. Breach of Ports Authority Act 1994/95; and
3. Possible Inadequate Asset Preservation.

9.1 Lapse of Insurance causing Breach of Formal Lending/Lease Agreements

9.1.1 At the Board of Directors meeting on 22 December 2004 the former General Manager suggested that the 'dredge' insurance cover be discontinued reducing the Ports Authority's total insurance premium by \$8,000, from \$78,000 to \$70,000 for the year ended 1 December 2005.

9.1.2 As detailed in the Board Minutes, the recommendation for removing the 'dredge' insurance cover was accepted by the Board and accordingly, on 21 January 2005, Andrew McBirney wrote to the Ports Authority's insurers (Willis New Zealand Limited) advising of the cancellation of the insurance policy cover for the sand dredge.

9.1.3 This action resulted in a breach of the 'Agreement for Lease of Assets' between CIIC and the Ports Authority. The Ports Authority was unable to raise finance in its own capacity resulting in CIIC agreeing to enter into the loan with Westpac and then lease back the assets to the Ports Authority via a formal 'Agreement for Lease of Assets' document.

9.1.4 Clause 1.5 of the Agreement for Lease of Assets, dated 22 March 2004, states:

"The Authority shall insure the assets against all normally insurable risks ... "

9.1.5 For the year, 1 December 2004 to 1 December 2005 the Ports Authority was in breach of the above condition of their Agreement with CIIC. Effective 1 December 2005, the Ports Authority reinstated the insurance cover over the Sand Pump.

9.1.6 In addition, as a result of the Ports Authority's insurance breach with regard to the 'Agreement for Lease of Assets', a further breach resulted in respect to the terms of the lending Agreement between CIIC and Westpac.

9.1.7 As per the signed Letter of Acceptance, between CIIC and Westpac, the 'Terms and Conditions' of this document require that:

"An insurance policy must be taken noting Westpac Banking Corporation as mortgagee on Policy to insure the full value of all items (including the sand pump and barge) covered in the security documents and remain current for the term of this facility".

9.1.8 Audit notes that the period of loan was six years from the date of advance meaning the

period when insurance lapsed was well within the term of the loan facility.

9.1.9 The 'Terms and Conditions' of the loan from Westpac go on to state, (in bold),:

"It is the Corporation's responsibility to ensure that full insurance cover is maintained at all times until the loan is fully repaid."

9.1.10 Audit was unable to ascertain why CIIC failed to ensure that insurance was not permitted to lapse during the loan period.

9.1.11 Audit recommends that both the Ports Authority, and CIIC, need to implement administrative procedures to make certain that all 'Terms and Conditions' of contracts entered into are properly adhered to.

9.1.12 Should anything have happened to the Sand Pump and ancillary items during the year in which no insurance cover was in place Audit notes that CIIC's Agreement does place onus back on the Ports Authority by inclusion of the following:

"If the Authority defaults in its obligations under this clause it shall be liable for any loss or damage which may occur to the assets ..."

9.2 Breach of Ports Authority Act 1994/95

9.2.1 As referred to on numerous occasions in the main findings above, the Ports Authority placed a verbal order for the \$400,000 Sand Pump with Sykes. This action is specifically in breach of the statutory requirements of the Ports Authority Act 1994/95.

9.2.2 Section 22 of the Act states that:

"The Board may enter into contracts with any person ... for the purchase or construction of machinery or appliances of any kind, and any other contracts necessary for the purpose of carrying out the functions for which the Board has been constituted."

9.2.3 Section 23 of the Ports Authority Act further states that:

"Every such contract shall be in writing and shall specify the work to be done or executed, the materials to be furnished, the price to be paid for the same, the time or times within which the work is to be completed, and the penalties to be suffered in case of non performance thereof ..."

9.2.4 Finally, on this matter, Section 24 stipulates that:

"Any contract which if made between private persons must be by deed shall, if made by the Authority, be in writing under the seal of the Authority."

9.2.5 The actions by the former General Manager and Chairman to verbally formalise the contract for purchase, without any written contract (as required by Section 23) or the common seal of the Authority (as required by Section 24) indicates serious disregard

for their statutory responsibilities.

9.2.6 Audit recommends the Ports Authority Board of Directors immediately review their legislation and immediately implement thorough administrative and internal control procedures to prevent such breaches of their primary legislation recurring.

9.3 Possible Inadequate Asset Preservation

9.3.1 Audit records their lack of comfort in respect to the level of ongoing maintenance of the Sand Pump.

9.3.2 The dredge has now been stored in the open at Avatiu Harbour compound for well in excess of a year and though some on land 'running' of the machine may have been undertaken we are unable, due to the Sand Pump not entering the water over this extensive time, to determine whether the Sand Pump is still in good operating order.

9.3.3 In February 2006, the former General Manager advised that the Sand Pump:

“will commence operations in the Port of Avatiu soon after the cyclone season. Thereafter it is intended to move the machine to Aitutaki to undertake its original purpose”.

9.3.4 Audit observes that fourteen months down the track the Sand Pump has not been moved from its uncovered storage area in the Ports Authority compound fence boundary alongside the Gas Centre roadway at Avatiu harbour.

9.3.5 As referred to under Section 8.1 above, Audit confirmed that no maintenance schedule had been established as at 1 March 2006, i.e. two years after possession of the Sand Pump was taken.

9.3.6 Audit recommends that the Ports Authority should, as a matter of priority, take all steps possible to preserve the value of the Sand Pump. In line with Sykes advice, it is paramount that frequent repairs and maintenance be undertaken to ensure that the Sand Pump remains in working order and retains its value.

9.3.7 A full analysis of the maintenance to date should be documented and a comprehensive ongoing maintenance scheme implemented immediately.

9.3.8 In conclusion to this report, recent photographs of the Sand Pump are attached on the following two pages.



Photos of the Sand Pump at the Avatiu harbour compound.

Photos were taken by Audit on Wednesday, 7 March 2007.



