Special Report of the Auditor General on the Misuse of Public Funds

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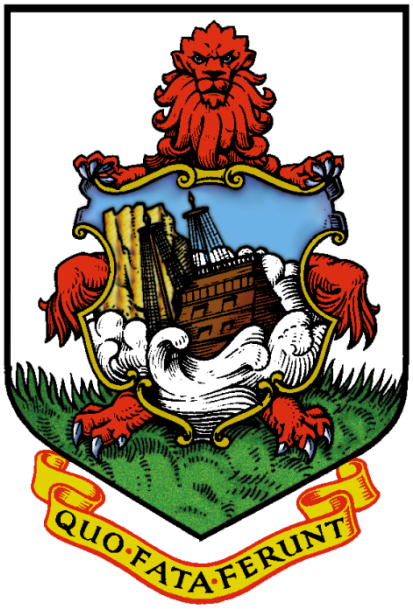

OUR MISSION

**The mission of the Office of the Auditor General,
derived from its legislative mandate, is
to add credibility to the Government's financial reporting and
to promote improvement in the financial administration
of all Government Departments and controlled entities
for which the Government is accountable to Parliament.**

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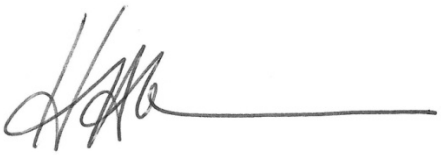
The Honourable Stanley Lowe, JP, MP
Speaker of the House of Assembly
Bermuda

Sir:

Pursuant to Section 13 of the Audit Act 1990, I have the honour to submit herewith my Special Report on the Misuse of Public Funds.

Respectfully submitted



Hamilton, Bermuda
December 2011

Heather A. Jacobs Matthews, JP, FCA, CFE
Auditor General

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1. INTRODUCTION

1.1 Auditor General's Opening Commentary

During the course of our day-to-day work, matters come to my attention that need immediate investigation and resolution. Unfortunately, such matters have become all too frequent and represent a diversion from our planned work. Although these issues may not require a lengthy investigation, they are important since they could represent a misuse of public funds or a breach of Bermuda laws. Often, these matters point to a lack of awareness on the part of Ministers, senior public servants and Board Members of the principles of good governance and the appropriate use of public funds.

In my opinion, the reporting of such misuses, lack of good governance or breaches should not be delayed until my next Annual Report, but should be brought to the immediate attention of the House of Assembly. It is, therefore, my intention to provide brief reports when necessary in the hope that the timely reporting of such incidents will have the effect of reducing or deterring similar occurrences.

Two issues that have come to my attention recently form the basis of this report:

- Inappropriate conduct of the Chairman and Deputy Chairman of the Board of Directors of the Bermuda Land Development Company Limited; and
- Inappropriate use of public funds to pay for personal legal expenses.

My predecessor previously commented on the need to improve accountability, governance and effectiveness of Government-controlled entities. His Annual Report for a number of years has consistently addressed these issues. Nevertheless, I continue to be concerned and amazed by the lack of awareness of good governance as evidenced by the subject of this report and other matters being brought to my attention.

This report also highlights the challenges we face when we are denied access to information which should be made available to us in order to complete our reports. Such information is not only vital to confirm the validity of our findings but is also vital to provide the public with accurate information on Government's stewardship of the public purse.

Restrictions on our access to information violate the provisions of the Audit Act 1990 (the "Act"). The Act provides that it is a criminal offence to fail or refuse to supply any explanation, information or assistance which I may reasonably require for the performance of my functions.

The frequency of denial of my requests suggests that there is either a fundamental misunderstanding of the role of the Auditor General or there is something to hide. This raises questions concerning the validity, completeness and accuracy of information that is actually provided. Restricted access has the potential to negatively impact our assessment of audit risk and increase the scope of our audit work. It may also lead to a reservation of my audit opinion on the financial statements.

To date, I have attempted to obtain information through persuasive methods. However, as explained later in this report, our access to information continues to be challenged. If this persists, I will bring the matter to the immediate attention of the House of Assembly and the public. In addition, I will recommend that those individuals who have infringed on my right to information be required to appear before the Public Accounts Committee.

1.2 Audit Mandate, Reporting Authority, Policies and Practices

The Bermuda Constitution Order 1968 and the Act provide the legislative mandate for the Office of the Auditor General (the "OAG"). Our audit work is conducted in accordance with our legislative mandate and our policies and practices. These policies and practices embrace the standards recommended by the Institute of Chartered Accountants of Bermuda and Canada.

Sections 12 and 13 of the Act authorize the Auditor General to present special reports to the Speaker of the House of Assembly, the Governor and the President of the Senate. Where a matter is of significant public interest, the Auditor General is required to make an immediate report in accordance with the legislation. The Act allows considerable discretion to the Auditor General in deciding the form and content of such reports to the House of Assembly.

1.3 Audit Committee

A copy of this report was submitted to the Chairman of the Audit Committee as required by Section 11 of the Act.

1.4 Acknowledgements

I wish to acknowledge the hard work, professionalism and dedication of my staff, during the conduct of the work covered in this report and its subsequent production.

Heather A. Jacobs Matthews, JP, FCA, CFE
Auditor General

Hamilton, Bermuda
December 2011

2. INAPPROPRIATE CONDUCT OF THE CHAIRMAN AND DEPUTY CHAIRMAN OF THE BERMUDA LAND DEVELOPMENT COMPANY LIMITED

2.1 Bermuda Land Development Company Limited

The general purpose of the Bermuda Land Development Company Limited (the "Company") is to manage the land entrusted to it in a manner that will integrate the land into the economic and social fabric of Bermuda. The Company also has a mandate to create opportunities for increased employment for the well-being of present and future generations of Bermudians.

The Company is a Government-controlled entity. Its shareholders (i.e. Government representatives) are the Minister of Finance and any other Minister designated by the Premier. During the period of this review, the Minister designated by the Premier as having responsibility for the Company was the Minister of Works & Engineering (retitled the Minister of Public Works as of November 2010).

2.2 Role of the Board of Directors

The Company is governed by a Board of Directors (the "Board"). Directors are elected or appointed at the Company's annual general meeting or at a special general meeting called for that purpose.

The role of the Board is to have oversight responsibility for the activities of the Company. The Board acts on behalf of its shareholders and makes overall policy decisions, but does not involve itself in the day-to-day-running of the Company.

Board members have a fiduciary responsibility to act in good faith and in the best interests of the Company. They are required to avoid conflicts of interest to ensure that the interests of the Company take precedence over personal interests. In addition, they must not use their positions for personal profit or gain. To do so is unethical and violates the principles of good governance. More specifically, a conflict of interest exists when a company does business with a director or a director has a compensation arrangement, as has happened in this case.

2.3 Board resolution to pay consultancy fees

The Board made a resolution to pay consultancy fees to the Chairman and Deputy Chairman. This matter initially came to our attention in December 2010 during the conduct of the audit of the Company's financial statements for the year ended March 31, 2010.

Our audit revealed that in early 2010, the Board gave its approval for an *"assessment of the operations of the Company"* to be carried out by the Chairman and Deputy Chairman. This approval was granted as a result of a number of concerns identified within the Company and pursuant to a suggestion by the Minister of Works & Engineering that an investigation be conducted. At this point, neither a consultancy arrangement nor a rate of payment had been approved by the Board.

Work by the Chairman and Deputy Chairman commenced on February 19, 2010. However, it was not until March 3, 2010 that the Chairman sought the Board's "recommendation to agree" to a consultancy rate for services being provided by himself and the Deputy Chairman.

At its March 11, 2010 meeting, the Board resolved that the Chairman and Deputy Chairman should submit invoices for its consideration and approval.

2.4 Consultancy fees

On March 23, 2010 the Board approved a rate of $110 per hour and agreed to the payment of *"approximately $14,000 each"* to the Chairman and Deputy Chairman for invoices submitted for the period February 19 to March 12, 2010. Invoices totaling $28,160 for this period were submitted to the Board and paid.

It was further agreed that the Chairman and Deputy Chairman would complete their investigations by March 31, 2010 and provide the Board with a detailed report. The Board resolved that invoices for the period March 13 to March 31, 2010, should be submitted for its approval.

Invoices totaling $53,680 for work done up to April 30, 2010 (and not March 31, 2010 as previously approved) were in fact submitted. However, they were not explicitly approved by the Board. Instead, they were approved by a sub-committee of the Board. Although the Company's bye-laws permit the Board to delegate any of its powers to a sub-committee, we could find no record in Board minutes that such delegation had been made.

By the end of December 2010, a total of $160,230 (Figure 1) had been paid to the Chairman and Deputy Chairman, of which only $81,840 was formally approved for payment by the Board or reportedly approved by its sub-committee. The remaining invoices totaling $78,390 were not formally approved by the Board or by its sub-committee.

Figure 1 – Consultancy Fees

	Chairman	**Deputy Chairman**	**Total**
	$	**$**	**$**
Feb – Mar, 2010 **Board approved**	14,080	14,080	28,160
Mar – Apr, 2010 **Sub-committee approved**	23,760	29,920	53,680
Sub-total	**37,840**	**44,000**	**81,840**
May – Dec 2010 **Unapproved**	36,685	41,705	78,390
Total	**74,525**	**85,705**	**160,230**

We have requested but have not been provided with written contracts or agreements regarding these consultancy services.

2.5 Board meetings where the conflict of interest was discussed

The payment of consultancy fees was discussed at six Board meetings and the conflict of interest issue was directly addressed at two of those meetings. Both the Chairman and Deputy Chairman were present as official Board members at five of those meetings including the following meetings where the conflict was discussed:

August 12, 2010 meeting: A Board member expressed concern regarding the consultancy arrangement as it appeared that the work would be *"ongoing for an indefinite period of time"*. A recommendation was made that rather than the Chairman and Deputy Chairman continuing to act as consultants to the Company *"which could be deemed as a conflict of interest"*, the compensation for those positions and perhaps all director positions should be reviewed to bring them in line with the expectations and responsibilities of these roles.

September 7, 2010 meeting: A Board member reiterated the concern that given the extent of involvement of the Chairman and Deputy Chairman in the day-to-day operations of the Company, it would be appropriate for directors' fees for both positions to be amended and approved by the shareholders. In stressing the importance of directors maintaining *"an arm's length relationship between the Board and the Company"* the member recommended that directors' fees be amended to avoid the current situation which could be *"deemed as a conflict of interest"*.

2.6 Lack of shareholder consultation

The Base Lands Development Act 1996 requires the Minister of Works & Engineering to consult the Minister of Finance before giving any direction to the Company. We were not provided with written evidence that such a direction had been given before the commencement of consultancy work or that the Minister of Finance had been consulted with respect to the content and effect of such a direction.

In fact, the Minister of Finance, as a shareholder, was not alerted to this consultancy arrangement at the Company's 2010 Annual General Meeting, even though the arrangement was already in progress.

2.7 Board's response to the Auditor General

On December 21, 2010 the Auditor General initially wrote to the Chief Executive Officer (the "CEO") of the Company and, subsequently, to the Chairman of the Board requesting that our concerns regarding this issue be raised with the Board. The Auditor General also recommended that steps be taken to terminate the consultancy arrangement and obtain repayment of the consultancy fees. The Minister of Finance was copied on this correspondence. The Chairman responded on December 21, 2010 expressing his view that the Company had every right to enter into the paid consultancy arrangement which was supported by the Minister of Works & Engineering.

On March 2, 2011, a letter was received from the CEO informing the Auditor General that the Board took the view that the Company's bye-laws allowed for such payments to its directors.

2.8 Action taken by the Premier and Minister of Finance

On December 30, 2010, the Minister of Finance as a shareholder of the Company contacted the Minister of Public Works (formerly Works & Engineering), the Ministry's Permanent Secretary and the CEO. The Minister of Finance supported the Auditor General's recommendation that the consultancy fees be repaid to the Company. The Minister of Finance also recommended that the Chairman and Deputy Chairman vacate their positions with immediate effect. The Chairman and the Deputy Chairman refused to vacate their positions and the Minister of Public Works took no action in that regard.

On February 7, 2011, almost a year after commencement of consultancy services, the Permanent Secretary of the Ministry of Public Works wrote to the CEO to confirm (retroactively) that the Minister of Works & Engineering had authorized the Company to engage the services of the Board's Chairman and Deputy Chairman:

a) to carry out a review of the finances and overall management of the Company and to complete and submit such review to the Minister of Public Works by April 2010; and
b) to manage the Company during the period of September 21 to December 5, 2010, during the CEO's absence.

It is interesting to note that this direction, like many others issued by the Minister of Works & Engineering, was not submitted to the Minister of Finance for approval as required by the legislation.

On April 1, 2011, the Premier changed the delegated responsibility for the Bermuda Land Development Company Limited from the Minister of Public Works to the Minister of Environment, Planning and Infrastructure Strategy. On May 12, 2011, at a Special Meeting of the Company, the Board was disbanded and a new Board established.

The Premier/Minister of Finance is to be commended for taking prompt action in these matters once brought to her attention by the Auditor General. However, despite the current Board's reported action to recover the consultancy fees, at the date of this report the amount remains unpaid. Equally disturbing is the fact that no one has been held accountable for these breaches.

2.9 Auditor General's closing comments

It is not clear why the previous Board felt it appropriate to approve the consultancy arrangement with the Chairman and Deputy Chairman instead of contracting with qualified third parties to provide consulting services. The consultancy arrangement placed both the Chairman and Deputy Chairman in a fundamental conflict of interest given their oversight role in the Company. The actions of the Chairman and Deputy Chairman clearly represent a breach of fiduciary duty.

One would have expected that the Company's Code of Ethics would prohibit any Board member from contracting with the Company. Indeed, we noted that the Company's previous Code of Ethics (instituted in 2002) contained such a prohibition and applied to both directors and employees.

The 2002 Code of Ethics stated that *"Bermuda Land Development Company (BLDC) Directors and Employees must avoid conflicts of interest between their private financial activities and the conduct of BLDC's business"*. It also provided that *"Directors and Employees must avoid any activity that could compromise, or appear to compromise, their judgement or objectivity in the performance of their duties with BLDC. It is critical that they conduct their employment activities objectively. This ability is compromised if they have personal interest or obligations that conflict or compete with BLDC's legitimate business interest"*.

However, the Code of Ethics was revised in 2008 and applied only to employees and not to the Company's directors. There is no indication in the minutes that such amendment, or indeed the revised Code of Ethics, was approved by the Board or its shareholders. The revision of the Code of Ethics has resulted in a contravention of established and appropriate protocols.

Equally unclear is the prior Board's failure to notify its other shareholder of the consultancy arrangement given its most important role as an intermediary between the Company's management and its shareholders.

2.10 Auditor General's recommendations

1. ***The Board should take appropriate steps to recover the consultancy fees paid to the Board's former Chairman and Deputy Chairman.***

2. ***All consultancies with the Company should be supported by formal, pre-authorized contracts.***

3. ***The Company's Code of Ethics should be updated to make it applicable to its Directors. The Code of Ethics should be clear on matters of conflict of interest and how these should be handled. Any breach of the Code of Ethics should incur a surcharge or penalty and this should be clearly identified in the Code of Ethics.***

4. ***The Code of Ethics should also be reviewed and signed on an annual basis by Directors and employees alike.***

5. ***Board members should become familiar with the Company's bye-laws to ensure full compliance.***

6. ***Board members should vigorously challenge the conduct and decisions of other members whose actions violate the principles of good governance.***

7. ***Government should define the roles and responsibilities of those directly involved in the governance of all Boards (i.e., the Minister responsible, the Board Chairman, other Board members and senior Civil Servants).***

8. ***Governance training should be developed and members of all Government Boards should be required to take such training within a reasonable period after their initial appointment.***

9. ***The Department of Internal Audit should be requested to conduct a risk assessment and internal review of governance issues.***

10. ***Best practice procurement guidelines should be followed when seeking consultancy services to ensure that value for money is achieved.***

2.11 Ministry's responses to the Special Report

Ministry responses to this section of the report are included in Appendix 1 and Appendix 2. Salient comments from the responses are discussed below:

The Ministry of Finance (Appendix 1) responded that an outside firm had been engaged to assess the company's internal controls, governance and associated policies and procedures and had made detailed recommendations, most of which had already been implemented by the Company.

The Ministry of Public Works (Appendix 2) revealed that the former Minister responsible for the Company was not in agreement with the Auditor General. In his view, the former Chairman and Deputy Chairman did not act inappropriately, based on legal advice he had received at the time. However, the Board responded that it was generally supportive of the recommendations made by the Auditor General and had already taken steps to address most of the recommendations.

Auditor General's Comment

As indicated earlier, the Premier/Minister of Finance is to be commended for taking immediate action once my concerns were brought to her attention. The new Board is also to be commended for expediting these matters on a timely basis. However, in reference to the Board's response to Recommendation No. 9, the Board should be aware that the Company falls under the purview of the Department of Internal Audit. As such the Department of Internal Audit, pursuant to the Internal Audit Act 2010, can conduct any review it deems fit at any time, in addition to follow-up reviews to assess progress.

3. INAPPROPRIATE USE OF PUBLIC FUNDS FOR PAYMENT OF PERSONAL LEGAL EXPENSES

3.1 Background

In February 2009, two cheques purporting to be payments to the Premier and to the Minister of Works & Engineering were discovered in files of the Ministry of Works & Engineering (the "Ministry"). Cabinet documents indicate that the cheques were discovered by the Permanent Secretary of Works & Engineering (the "Permanent Secretary") during the Ministry's due diligence process. It was stated that this process involved the examination of payments to Landmark Lisgar Construction Ltd. for the construction of the Magistrates Court/Hamilton Police Station project.

The cheques were subsequently found to be fabrications of original cheques issued to two vendors. The matter was reported to the Bermuda Police Service (BPS). An investigation was conducted and it was determined that no charges would be laid.

Cabinet documents also indicate that BPS representatives investigated the possible involvement of a Canadian firm of architects. This investigation was conducted in collaboration with the Royal Canadian Mounted Police and did not reveal any wrongdoing by the firm.

In April 2011, it was brought to the attention of the Auditor General that legal action had been initiated in the Ontario Superior Court of Justice on behalf of the former Premier and the Minister of Public Works. The purpose of the legal action was to sue one of the Canadian architects and a Government of Bermuda employee for $1 million each for general damages and $1 million each for aggravated and/or punitive damages plus costs. The specific charges against the two individuals were conspiracy and defamation.

3.2 Retainer Agreement

The Auditor General requested the Ministry of Finance to provide relevant information regarding the nature and extent to which such legal action affected the public purse.

The Ministry of Finance confirmed that Cabinet approved the engagement of a Canadian law firm (the "firm") to pursue the matter of the fraudulent cheques on behalf of the Government of Bermuda ("Government").

The terms of the firm's engagement are detailed in a Retainer Agreement (the "Agreement"). The Agreement, addressed to the Premier on February 25, 2010 (three months prior to Cabinet's approval), included the following terms:

a) the client is "the Government of Bermuda"; and
b) the firm will be instructed by the Premier or his designate.

The Agreement was signed by the Solicitor General on behalf of Government on June 18, 2010.

It should be noted that Cabinet approved the Agreement with a minor amendment to the fee structure and placed a ceiling on total payment. The approval was also granted with full knowledge that the Premier or his designate were the only individuals authorized to instruct the firm.

It has not been explained why the Attorney-General's Chambers ("Chambers") supported the latter stipulation allowing the Premier to instruct the firm even though the Premier had a vested interest in the outcome. However, this highly irregular and inappropriate arrangement took effect in June 2010 and continued well beyond October 2010 when the Premier stepped down.

3.3 Inappropriate use of public funds for payment of personal legal expenses

Legal work began in 2010. As a result of the work conducted, the firm submitted several invoices to the Ministry for payment. Invoices in the amount of $31,287 for the period ended June 30, 2011 were paid.

Of particular note was a payment request in the amount of $4,050 which covered the drafting and filing of a Statement of Claim, the first indication to the Auditor General that litigation was being considered.

Details of the payment indicate that:

a) the period of work covered is November 26, 2010 to December 22, 2010;
b) the invoice specifically states that the payment is for *"legal services required on an urgent basis"*; and
c) this particular payment request was approved by the Permanent Secretary of Public Works.

The legal action commenced on January 31, 2011, three months after the former Premier stepped down. The details of the action, contained in the Statement of Claim, list the names of the former Premier and the current Minister of Public Works as parties to the legal action. Government is not named as a party to the action despite the fact that the Agreement specified that the firm would act on behalf of Government.

The key issue here is that public funds were used to initiate a private legal action which is inappropriate and a direct violation of Financial Instructions. Financial Instruction 3.5 provides that *"Government funds or property should only be used for Government purposes and must not be used for personal reasons"*. Further Financial Instructions 10.4 places the onus and the responsibility on the Accounting Officer to *"ensure that Government funds are not used for personal gain or profit"*.

We could find no documentation that there had been further discussions with Chambers or Cabinet regarding the approval to commence litigation or the filing of a claim. We set out to determine who initiated the litigation and who authorized payment of a personal matter out of public funds.

In order to confirm whether amounts paid represented payments on behalf of Government or otherwise and given Chambers' role in signing the Agreement, we directed a request to Chambers. However, as explained below, we were denied access to pertinent information to answer the above noted questions.

We sought legal advice to determine if there were any statutory provision which imposes on Government a duty to pay the legal expenses of the Premier or any Minister whilst in or out of office. We were advised by our legal adviser that although Government may provide insurance coverage for *"legal costs associated with any legal action taken against a Minister or a public servant in respect of any act performed in the normal course of duty or employment"*, there is no statutory provision for the underwriting by Government of the legal cost of a Minister, servant or agent suing in a private civil action.

We, therefore, considered any such expenditure to be improper and unjustified.

Despite repeated requests to the Attorney-General, we were not provided with information which would disprove the claim that payment of personal legal expenses of the former Premier and the Minister of Public Works were made by Government out of public funds. Prior to August 31, 2011, we had not been made aware of any definitive action taken by the Ministries of Finance and Public Works or Chambers with regard to this issue. Neither were we officially advised whether legal action had been terminated and whether monies had been repaid to the Consolidated Fund.

3.4 Denial of access to information

A fundamental duty of the Auditor General is to report on inappropriate uses of public funds or any matter which is of significant public interest. This duty is enshrined in the Audit Act 1990. In order for the Auditor General to accurately and objectively report these matters to Parliament, the Act empowers the Auditor General with the right to obtain information.

Specifically, Section 14 of the Act provides that the Auditor General is entitled in the exercise of his functions:

a) to request that he be supplied with any explanation, information or assistance which he may reasonably require for the performance of his functions;
b) to require access to all property of any entity whose accounts are referred to in section 6(1), and to all records relating to those accounts; … and
c) to seek from the Attorney-General in writing an opinion on any question regarding the interpretation of any statutory provision;

and any person to whom a reasonable demand by the Auditor General in that behalf is properly directed shall comply with the demand with all reasonable dispatch.

We requested information in order to establish whether the legal action constituted a private action rather than an action on behalf of Government. We also needed to determine whether such action was funded by Government. The following chronology details our efforts to obtain substantive information on this matter:

May 2, 2011: The OAG requests the Ministry of Finance to provide relevant information regarding the nature and extent to which such legal action affected the public purse. More specifically, the Auditor General requests the Ministry of Finance to advise whether Cabinet approved the firm and to provide a copy of the Cabinet Conclusion.

May 2, 2011: The Ministry of Finance confirms that Cabinet has approved the engagement of the firm and provides a copy of the relevant Cabinet Conclusion. The Ministry of Public Works further confirms that the payments to the firm were in respect of a matter filed on behalf of the former Premier and the Minister of Public Works.

May 6, 2011: The Acting Solicitor General confirms to the Permanent Secretary that he has been instructed by the Acting Financial Secretary to terminate the engagement of the firm. He further requests the Permanent Secretary to confirm whether he had given instructions to the firm *"to bring an action in the personal names"* of the former Premier and the Minister of Public Works.

May 6, 2011: The Permanent Secretary confirms that the "Ontario attorneys were given the green light to pursue this matter in the Ontario Courts" on behalf of the former Premier and the Minister of Public Works. However, he declines to state who had given the green light. The Permanent Secretary further states that all invoices from the firm had been submitted to the Ministry for payment.

May 18, 2011: The Auditor General communicates her concern to the Acting Financial Secretary advising that the matter should be brought to the attention of the Minister of Finance. The Auditor General notes the inappropriateness of the Agreement, indicating that the Agreement did not appear to contemplate a personal legal action. The Auditor General further indicates that, since the use of public funds to initiate a private legal action represented a direct violation of Financial Instructions, the monies must be recovered and returned to the public purse.

May 19, 2011: The Acting Financial Secretary agrees to notify the Minister of Finance and to follow-up on this matter.

July 15, 2011: The Auditor General redirects her request for information to Chambers given Chambers' role in approving the Agreement on behalf of Government.

July 15, 2011: The Acting Solicitor General indicates that two files had been generated on this matter and that an additional *"litigation"* file was in the hands of overseas lawyers. The Acting Solicitor General also requests the Auditor General to confirm whether such correspondence was being sought for the purpose of Section 14 (a) or (b) of the Act.

July 18, 2011: Based on this response from the Acting Solicitor General, the Auditor General requests access to all legal correspondence on the matter.

July 21, 2011: The Attorney-General responds that the information requested is subject to *"legal privilege and the only person who can waive such privilege is the Government acting through the proper heads of Ministries or the Cabinet Secretary"*. The Attorney-General further indicates that more specific information should *"be properly directed to the person to comply with the demand"*. The Auditor General receives a similar email from the Cabinet Secretary on the same date.

July 24, 2011: The Auditor General notifies the Attorney-General that a copy of the Agreement has been obtained. The Auditor General indicates that the matter has therefore been appropriately addressed to Chambers which signed the Agreement on behalf of the Government.

With respect to the specifics, the Auditor General requests the following information:

- All Government communications to/from the firm;
- All internal Government documentation regarding the establishment of funding for the legal action;
- All internal Government documentation regarding payments to the firm;
- All Government communications to/from the former Premier regarding the legal action; and
- Any other internal Government communications regarding the legal action.

July 27, 2011: A Consultant to the Attorney-General ("Consultant") advises that the query is receiving the full attention it deserves.

August 18, 2011: On a further request from the Auditor General the Consultant advises that the matter is *"complicated and involved many parties, goes to the highest levels of Government, is plagued by documentation, involves a foreign element and raises for consideration at least one fundamental legal issue"*.

The Consultant requests the Auditor General to confirm which sections of Financial Instructions have been breached and the names of each individual by whom there was a breach. The Consultant further requests the Auditor General to confirm the version of Financial Instructions on which the Auditor General is relying as the Agreement may have been in compliance with an earlier version of Financial Instructions.

August 23, 2011: After a subsequent request from the Auditor General to the Consultant, citing the provisions of the Act in relation to requests from the Auditor General, the Consultant advises that in order to avoid being in breach of the Act, he is referring the matter back to the Attorney-General.

August 31, 2011: The Auditor General receives correspondence from the Attorney-General's external legal advisers confirming that *"the Government instructed the Canadian attorneys to commence proceedings ... The Attorney General's Chambers, as the legal advisers to the Government, assisted in this process"*.

This information which was previously not confirmed by either the Ministry of Finance or the Attorney-General is significant because it highlights the role played by Government and the Attorney-General in this legal action. It is significant because the Attorney-General entered into a private transaction which anticipated the use of public funds which is clearly a breach of Financial Instructions.

The Attorney-General's external legal advisers also confirm their agreement with the Attorney-General that the information requested by the Auditor General *"is subject to legal privilege"*. In particular, they note that *"Section 14 of the Act does not expressly override any claim for legal professional privilege"*. In other words, they maintain that the Attorney-General is not entitled to "disclose these documents to the Auditor General".

However, legal advice obtained by the Auditor General disagrees noting that although the information *"sought from Chambers is subject generally to legal privilege, that privilege applies only to those outside the parameters of the client. In this case, the client is the Government of Bermuda, of which the Auditor General is a servant of the said Government"*. By virtue of Section 102(1) of the Constitution, *"the Auditor General is a public officer who holds office in the public service in a civil capacity in respect of the Government of Bermuda"*. Hence, *"the privilege of the legal advice in question is the privilege of the Government of Bermuda of which the Auditor General is a part and should therefore be as accessible to her as to any other constituent part of the Government"*.

The question to be raised is whether the Auditor General should be denied access to information which could determine whether the interests of Government have been truly served and whether the public purse has been protected. Surely the Attorney-General would be expected to assist in this matter and support such action. If not, a further question needs to be raised, that being - whose interest is the Attorney-General protecting? In this instance, and without access to the information requested, we cannot be sure.

3.5 Auditor General's closing comments

In the absence of a response from the Attorney-General, the Ministry of Finance or the Ministry of Public Works (which authorized payments to the firm to date), it is not clear why Government has funded legal action in which Government itself has not been named. It is clear, however, that this personal matter has already consumed significant time and energy at the most senior levels of Government and at significant public expense.

In my opinion, to cover-up an abuse of public funds behind the cloak of *"legal privilege"* as opined by the Attorney-General is unacceptable and violates principles of good governance and transparency. In this case, where the fundamental financial rules which govern all civil servants have been blatantly disregarded at the highest levels in Government, appropriate sanctions should be applied including appearance before the Public Accounts Committee.

This brings into question whether I as Auditor General can rely on information emanating out of Chambers and whether I have the confidence that Government officials at the most senior level will do the right thing. At this point, the answer is a resounding no.

As a result of this denial of access to information, the option of having this matter decided in the courts has been considered. However, to avoid a lengthy and costly legal battle at public expense, I believe it best to leave the matter in the court of public opinion and to issue this report to Parliament and to the public as mandated under Sections 12 and 13 of the Act.

3.6 Auditor General's recommendations

1. ***Government financial support for the private legal action on behalf of the former Premier and the current Deputy Premier should be terminated immediately and the Auditor General should be advised when this is done.***

2. ***Appropriate steps should be taken to recover monies already paid to the firm with respect to the action. If necessary, the surcharging mechanisms provided for in the Public Treasury (Administration and Payments) Act 1969 should be applied to hold the Accounting Officer accountable for the payment of moneys out of the public purse. In addition, the offending individual should be required to appear before the Public Accounts Committee.***

3. Senior Government Officers and Ministers of Government should be educated on Financial Instructions and on the proper use of Government funds. Additionally, Senior Government Officers and Ministers need to understand the role of the Auditor General and the legislative requirement for access to all Government information.

3.7 Ministry's response to the Special Report

A response from the Ministry of Justice on this section of the report is included in Appendix 3. Salient issues addressed in this response are discussed below.

The Ministry's response highlighted a number of legal precedents to support its argument to refuse the Auditor General's request on the grounds of legal professional privilege. The response also noted that the Government is fully satisfied that the Auditor General has had access to and received all information to which she is entitled in relation to the funding.

Auditor General's Comment

I requested information in order to establish whether the legal action constituted a private action rather than being an action on behalf of Government. I also needed to determine whether such action was funded by Government. Without access to relevant documents, I was not able to conclude why Government had funded legal action in which Government itself had not been named.

The Ministry's response, oddly enough, confirmed the very information which I was seeking. In its response at Appendix 3, the Ministry confirmed that a *"personal action"* paid for out of public funds with the approval of Government was deemed to be *"for a government purpose"*. The excerpt from that response states that:

"The funding of the Ontario Action by Government was, ***in the judgment of the Government****, an appropriate course to follow in the interest of the Government, the Country and Bermuda's international reputation and in this regard, we considered the funding of this action to be for a government purpose in that the personal action was the only means by which the government could take action against those responsible for essentially attacking the Government via its Ministers.*

These very serious allegations of corruption made against the serving Premier of Bermuda as well as a present senior Minister, went to the heart of Government and therefore the funding of this action was justified as being for a government purpose. Government subsequently took the decision to terminate its retainer agreement with the Canadian law firm Lax O'Sullivan LLP on or about the 6 September, 2011.

The judgment to fund this matter was a judgment made by the Government in good faith".

This response from Chambers causes me grave concern and shows complete disregard for the concept of good stewardship of public money. I cannot comprehend how a personal legal matter could be justified by the Government and its legal adviser (the Attorney-General) as a legitimate Government matter to be funded out of the public purse. Information related to this legal matter which was deemed by the Government to be an appropriate course to follow in the interest of the Country was denied the scrutiny of the Auditor General. This legal matter bore all the elements of a private action was to be directed by the former Premier and his designate (as allowed for in the Agreement), in that:

- The Agreement was addressed to the former Premier and not Chambers as would have been expected;
- The Agreement was initiated three months before it was approved by Cabinet;
- The Agreement indicated that the client was Government, in effect binding the Government to cover the costs of any work done;
- The Agreement was accepted and signed by the former Solicitor General on behalf of Government, with minor revisions, in full understanding that the former Premier or his delegate were the only individuals allowed to direct the firm - and at public expense;
- The Agreement was still in effect when the Premier stepped down in November 2010, and as indicated above was not terminated until September 2011; and
- The Agreement led to a private legal action that commenced in January 2011, three months after the Premier stepped down. A private legal action that demanded $4 million in damages plus costs – costs that were already being funded out of the public purse.

In my opinion, this entire situation is deplorable and represents a blatant disregard for the public purse and a lack of transparency and accountability at the most senior levels of Government. The question to be asked is who will be held accountable - the answer is likely no one!

APPENDIX 1

RESPONSE FROM THE MINISTRY OF FINANCE

From: Manders, Anthony [mailto:amanders@gov.bm]
Sent: Monday, December 19, 2011 6:49 PM
To: Heather Matthews
Subject: RE: Draft Special Report - For Comment
Sensitivity: Confidential

Good day Heather,

Here are the Ministries comments on the BLDC:

The Minister of Finance, acting in her capacity as a shareholder of BLDC, sought the assistance of a local firm in assessing BLDC's internal controls, governance, and associated policies and procedures. At the conclusion of their review, they made detailed recommendations and provided an action plan for implementation of these recommendations. Most of these recommendations have already been implements by the BLDC.

The objective of the engagement was to assist the Ministry of Finance by undertaking a review of BLDC's governance including its legislation, bye-laws, minutes of the Board, policies and procedures. Additionally, the engagement reviewed BLDC's internal controls in relation to the procurement ordering process and selected related party transactions.

The Ministry of Public Works will provide details on this matter.

The Attorney General's Chambers will comment in detail on the private legal expenses section of the report.

Please advise if you require any further information.

Regards
Anthony

APPENDIX 2

RESPONSE FROM THE MINISTRY OF PUBLIC WORKS

GOVERNMENT OF BERMUDA

Ministry of Public Works

Office of the Permanent Secretary

Our Ref: 11/1/1-5-C

December 17th 2011

Ms. Heather A. Jacobs Matthews, JP, FCA, CFE
Auditor General
Office of the Auditor General
Reid Hall Penthouse
3 Reid Street
Hamilton HM 11

Dear Ms. Matthews,

Subject: Special Report of the Auditor General on the Misuse of Public Funds – August 2011

I write in reference to the above captioned Special Report regarding the *Inappropriate Conduct of the Chairman and Deputy Chairman of the Bermuda Land Development Company Limited ("the BLDC")* and the *Inappropriate Use of Public Funds for Payment of Personal Legal Expenses* in accordance with the requirements of Section 11 of the Audit Act 1990.

As these issues were unfamiliar to me, I took the liberty of meeting with the current Chairman and Deputy Chairman of the BLDC to determine what actions had been taken to address the concerns outlined in the Report since coming into office.

Additionally, I met with the former Minister of Public Works, in the presence of the current Minister of Public Works, seeking his comments as relating to the contents of the Report. Overall, the Minister had no major concerns with the exception of section 2.8 *Ministerial Responses*, which are listed below.

Accordingly, the comments to the Report are as follows:

1. ***Inappropriate Conduct of the Chairman and Deputy Chairman of the Bermuda Land Development Company Limited ("the BLDC")***

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a) Ministers Comments:

1) Based on his Union background, the Minister requested the Board procure legal advice on the consultancy roles of the Chairman and Deputy Chairman as relating to their review of the finances and overall management of the BLDC.

2) This process was followed to ensure any terminations, if required, were done properly to avoid excessive payouts to individuals at a later date – should they win any claims against the Board or Ministry.

3) The Minister was very concerned that the opinions of KPMG and Trott and Duncan were not acknowledged or accepted by the Auditor. These same opinions confirmed the actions of the Chairman and Deputy Chairman of the BLDC were in accordance with the bye-laws of the Board, as well as the Companies Act 1981.

4) It was based on the advice of these two reputable firms that the Minister found no reason to terminate anyone.

b) Current Boards Comments:

Recommendation #1 – the BLDC should recover consultancy fees paid to former Chair and Deputy.

1) The current Board, which was appointed on May 12th, 2011, carefully considered the matter of consultancy fees paid to the former Chairman and Deputy Chairman, whilst they served in their respective positions prior to May 2011.

2) In the first instance the Board noted that, prior to their appointment; BLDC received independent legal advice that the payments were not illegal and did not contravene the provisions of the Companies Act 1981.

3) The Board has also considered whether the payment of these consultancy fees represents a conflict of interest. In this regard the Board noted that the former Chairman and Deputy Chairman declared their interests to the Board Members and recused themselves from a meeting where payments to them were subsequently ratified. The Board also noted that some of the payments were approved by a shareholder.

4) The current Board did not take any specific action after it was appointed in May 2011 since it was unaware that the matter was an open item following the exchange of letters between the former Chairman, the CEO and the Office of the Auditor General in early 2011.

5) The Board was also unaware that the payments were the subject of a Special Report of the Auditor General until invited by the Permanent Secretary of the Ministry of Public Works to share their views on the Special Report in December 2011, which caused them to be surprised.

6) The status of this recommendation on December 16th, 2011 was that at a Special Board Meeting on December 14th, 2011, the Board instructed that BLDC's legal counsel review the matter and reaffirm their original advice, if appropriate.

7) In the interim, the Board wrote to the former Chairman and Deputy Chairman requesting them to repay the consultancy fees to the BLDC.

8) The Board will undertake to update the Auditor General once it has received responses on both matters and determine the course of action to take, if any.

Recommendation #2 – All consultancies should be supported by formal, pre-authorized contracts.

1) The Board agreed and noted this recommendation is already being addressed.

2) BLDC has prepared new Financial Policies and Procedures that are more compliant with Government's Financial Instructions.

3) BLDC is currently in the process of reviewing all consulting contracts to ensure they fully meet BLDC's needs – and are supported by formal contracts.

Recommendation #3 – the BLDC Code of Ethics should be updated reference conflicts of interest and penalties for breaches.

1) The Board agreed with this recommendation.

2) An update of the Code of Ethics ("the CoE") has been discussed at several Board meetings since June 2011.

3) As of December 16th, 2011 an updated CoE is under review by the Directors.

4) Subject to comments received, each Director will be required to sign the CoE upon appointment and annually thereafter.

5) The Board will consider appropriate penalties or surcharges that should be applicable in the event of a breach moving forward.

Recommendation #4 – the Code of Ethics should be reviewed and signed on an annual basis by Directors and Employees.

1) The Board agreed with this recommendation.

2) The BLDC's bye-laws will be circulated to Directors of the Board annually, and a signature sheet indicting that the Directors have read the document and agree to comply with the ethical code and conditions contained within will be produced.

Recommendation #5 – Board Members should be familiar with BLDC's bye-laws.

1) An annual governance review for new and existing Members is anticipated to facilitate this recommendation.

2) This is expected to be performed in the first quarter of 2012.

Recommendation #6 – Board Members should vigorously challenge the decisions of other members whose actions violate the principles of good governance.

1) The current Board very much agreed with this recommendation and affirms that, since its appointment in May 2011, there has been a heightened focus on governance.

2) Accordingly, challenge has been very much a part of the Board discussions.

c) Ministry Comments:

Recommendations #7 – Government should define the roles and responsibilities of those directly involved in the governance of all Boards (i.e., the Minister responsible, the Board Chairman, other Board Members and senior Civil Servants).

1) This recommendation will be forwarded to the Cabinet Office and in particular, the Assistant Secretary to the Cabinet (Committees) for consideration.

Recommendations #8 – Governance Training should be developed and members of all Government Boards should be required to take such training within a reasonable period after taking office.

1) Same as Recommendation #7 above.

Recommendations #9 – the Department of Internal Audit should be requested to conduct a risk assessment and internal review of governance issues.

1) Although this recommendation is somewhat nebulous, it will be shared with the Secretary to the Cabinet for his consideration.

GOVERNMENT OF BERMUDA
Ministry of Public Works

Office of the Permanent Secretary

Recommendations #10 – best practice procurement guidelines should be followed when seeking consultancy services to ensure that value for money is received.

1) The Ministry agreed with this recommendation.

2) Accordingly, it is envisioned this would be addressed through the newly established Office of Project Management and Procurement within the Ministry of Finance.

2. ***Inappropriate Use of Public Funds for Payment of Personal Legal Expenses.***

1) As noted in my opening paragraph, these issues were unfamiliar to me.

2) Notwithstanding, as relating to this issue, I recall withholding payment of invoices submitted from the Canadian Law Firm Lax Sullivan LLP until clarification on the matter was procured.

3) Subsequently, the Government terminated its retainer agreement with the aforementioned law firm on or about September, 6th of 2011.

4) Upon receipt of the outstanding invoices from Lax Sullivan LLP, I on the advice of the Attorney General's Chambers requested the Financial Controller within the Ministry to action the payment of these outstanding invoices, thus bringing the matter to a close.

Should you require anything further, please feel free to let me know.

Sincerely,

Randy Rochester
Permanent Secretary

cc. The Hon. Michael A. Weeks JP, MP,
Minister of Public Works

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APPENDIX 3

RESPONSE FROM THE MINISTRY OF JUSTICE

December 19th, 2011

Ms. Heather A. Jacobs Matthews, JP, FCA, CFE
Auditor General
Office of the Auditor General
Reid Hall Penthouse
3 Reid Street
Hamilton HM 11

Dear Mrs. Matthews:

SUBJECT: SPECIAL REPORT OF THE AUDITOR GENERAL ON THE MISUSE OF PUBLIC FUNDS – AUGUST 2011

We write in reference to the above captioned Special Report and offer the following comments in accordance with the requirements of Section 11 of the **Audit Act 1990**.

The Government is fully cognizant of the fact that the Auditor General is not subject to the direction or control of any other person or authority in the exercise of her functions.

The Government fully accepts that the Auditor General is entitled in the exercise and for the purpose of her functions—

-to request that she be supplied with any explanation, information or assistance which she may **reasonably** require for the performance of her functions;

-to require access to all property of any entity whose accounts are referred to in section 6(1) of the Audit Act 1990, and to all records relating to those accounts;

-to call for **reasonable** accommodation to be provided to any member of the Auditor's staff; and to seek from the Attorney-General in writing an opinion on any question

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regarding the interpretation of any statutory provision; and that any person to whom a **reasonable** demand by the Auditor in that behalf is properly directed shall comply with the demand with all reasonable dispatch **The Government** is fully satisfied that the Auditor General has had access to and has received all information to which she is entitled in relation to the funding of [name of action].

> The funding of the Ontario Action by Government was, **in the judgment of the Government**, an appropriate course to follow in the interest of the Government, the Country and Bermuda's international reputation and in this regard, we considered the funding of this action to be for a government purpose in that the personal action was the only means by which the government could take action against those responsible for essentially attacking the Government via its Ministers. These very serious allegations of corruption made against the then serving Premier of Bermuda as well as a present senior Minister, went to the heart of Government and therefore the funding of this action was justified as being for a government purpose. Government subsequently took the decision to terminate its retainer agreement with the Canadian law firm Lax O' Sullivan LLP on or about the 6 September, 2011.

The judgment to fund this matter was a judgment made by the Government in good faith.

The Government, whilst acknowledging the Auditor General's independence, cannot but note that that office like everyone else is subject to the law. The Auditor General made a request to inspect the **legal files** held by the Attorney-General's Chambers. The Auditor was advised that the litigation file in this matter was with the Ontario attorneys and that we had only legal correspondence between the Attorney General's Chambers and various Government Departments and the Ontario attorneys.

That request was refused on the grounds of legal professional privilege. In the Privy Council it was said that **legal professional privilege is a fundamental condition on which the administration of justice rested**: see B and Others v Auckland District Society and another [2003] UK PC 38.

The Privy Council observed that an authoritative exposition of the rationale of legal professional privilege is to be found in the speech of Lord Taylor of Gosforth CJ in R v

Derby Magistrates' Court Ex p B [1996] 1 AC 487, with whom the rest of the House agreed. Lord Taylor CJ described it in these words, at pp 507 and 508:

> "The principle which runs through all these cases, and the many other cases which were cited, is that a man must be able to consult his lawyer in confidence, since otherwise he might hold back half the truth. The client must be sure that what he tells his lawyer in confidence will never be revealed without his consent. **Legal professional privilege** is thus much more than an ordinary rule of evidence, limited in its application to the facts of a particular case. **It is a fundamental condition on which the administration of justice as a whole rests.** ... [It] is not for the sake of the applicant alone that the privilege must be upheld. It is in the wider interests of all those hereafter who might otherwise be deterred from telling the whole truth to their solicitors."

Legal professional privilege is not an interest which falls to be balanced against competing public interests. Lord Taylor CJ said in Reg. v. Derby Magistrates' Court, Ex p. B. [1996] 1 AC 487, 508:

> "the drawback to that approach is that once any exception to the general rule is allowed, the client's confidence is necessarily lost. The solicitor, instead of being able to tell his client that anything which the client might say would never in any circumstances be revealed without his consent, would have to qualify his assurance. He would have to tell the client that his confidence might be broken if in some future case the court were to hold that he no longer had 'any recognizable interest' in asserting his privilege. One can see at once that the purpose of the privilege would thereby be undermined."

In that case **B had been charged with the murder** of a young girl. He made a confession to the police, but afterwards he changed his story and said that his stepfather had killed the girl. B was tried and acquitted. The stepfather was then charged with the murder. At his committal for trial, **B was called as a prosecution witness. In cross-examination he was asked by the defence about the instructions he had given his solicitors in relation to his original account of what had taken place. He declined to waive privilege**.

The House of Lords **upheld B's claim to privilege**. Nothing better illustrates the importance of the doctrine of legal professional privilege.

Returning to the Auditor General's claim on the Attorney-General's Chambers for the reIease of legally privileged files: in a Canadian case, Attorney General of Nova Scotia v

Royal and Sun Alliance Insurance Company of Canada 2000 N.S.R. (2nd) Lexis 322, the Nova Scotia Supreme Court held that legal professional privilege applied to a claim by the Auditor General there, having similar statutory powers to demand documentation.

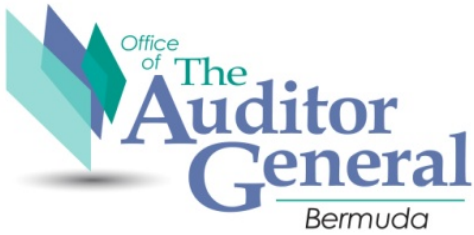
The **Government's** position is that, based on legal advice received internally within Chambers, which was supported by independent legal advice received externally, it had no option but to refuse the Auditor General's request.

The **Government** notes with regret that the Auditor-General not only rejected the claim to legal professional privileged but indeed, in doing so, referred the Acting Solicitor General and Chambers internal counsel to the provisions in the Auditor General Act 1990 referring to fines and imprisonment for non compliance with her request, as being provisions which it was her intention to invoke. It is also to be noted that the Auditor General was asked by Chambers to identify with precision the specific provisions in Financial Instructions which she had alleged had not being complied with. When serious charges are leveled that is not a surprising request. The question was never answered with the precision it merited.

It is with regret therefore that the **Government** notes that the Auditor General's disclosure appears not to have been as full and frank as might otherwise have been the case, in a matter of some considerable importance. The **Government** looks ahead to working with the Auditor General within the framework of the law and in a spirit of mutual co-operation.

Yours faithfully,

Kathy Lightbourne-Simmons
Permanent Secretary



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