Case Study

Failed governance leaves a $1 million Trust with $13.14

Background

Failed governance enabled trustees to use Trust funds for their own purposes

A brother and sister who were trustees of the Parengarenga 3G Trust made over $1 million of unauthorised transfers to accounts they controlled. The transfers were in breach of the trust order and were carried out over a two-year period. The Trust's cash balance was reduced from approximately $1 million to just $13.14.

The Trust had seven trustees who were responsible for governing 511.83 hectares of forestry land. The land was valued at several million dollars both in terms of current value and future earnings potential. The purpose of the Trust was to use its funds to maintain the forest to provide income for the future generations of whānau and iwi. Revenue was generated from harvesting the forest, which happened every 30 years. A successful harvest relied on the forest being well maintained and carefully managed in between harvesting cycles.

The Trust documents were ambiguous

The Trust was governed by a document that contemplated having just one Trustee. As a result, the document provided insufficient oversight to allow the other Trustees to ensure that decisions were being made that ultimately protected the assets of the Trust.

Decisions in relation to the finances were not discussed or finalised in Trust meetings

The Trust's bank accounts required two signatories to make a transfer. The brother was a signatory, while his sister was also a signatory on all the accounts and responsible for reconciling and approving payments. The pair worked together to make unauthorised transfers to their personal or other accounts that they had control over. None of these transactions were mentioned or agreed to by the other trustees. The funds were spent on personal expenses including the funding of a gambling addiction. Throughout that time, no funds were spent on maintaining the forest. As a result, the quality of the forest deteriorated and much of the harvest had to be turned into kindling.

The dysfunctional governance led to a court order when the fraud was discovered

The local community raised concerns with the Māori Land Court regarding governance of the Trust. An investigation found that funds had been spent without the Trust's authorisation. The judgment by the Māori Land Court was that the four Trust members (including the two offenders) all of whom were family members should, be removed from the Trust. The judge also referred the case on to the Serious Fraud Office.

One trustee received five years and two months imprisonment while another received six months home detention and was ordered to pay reparations.

Case Study

Fraud Prevention Observations

Impacts	▸ The financial loss was over $1 million and the Trust was left with only $13.14. Prior to the fraud, the Trust had sufficient funds to undertake management of the second rotation forest through to harvest, and meet other ancillary ownership costs. ▸ The Trust was left with unpaid forest management bills of $100k and a forest that required urgent maintenance. ▸ To survive, the Trust was forced to sell ¾ of its harvesting rights which were estimated to be a $5 million loss in revenue. ▸ Local jobs were lost which impacted negatively on a remote community that relied on forestry for employment. ▸ Loss of resources for generations of whānau and the community, as one rotation including harvesting takes approximately 30 years.
Fraudster Personas	▸ **The Enabler –** the sister who was responsible for reconciling the accounts approved the transactions, knowing that the payments were unauthorised under the trust order. ▸ **The Deceiver –** the brother withheld key information from other trustees, which meant that they were unaware of the true financial situation of the Trust.
Red Flags	▸ Unauthorised payments - the funds were deposited into the trust account and immediately transferred into accounts controlled by the two trustees. ▸ Lack of clear processes - a lack of clear governance prevented processes from being set up and followed by the trustees. ▸ A decaying asset - the forest had not been maintained which was a key role of the Trust.

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Effective Countermeasures	This case highlights the need for **effective governance**. Effective governance includes: - having a trust deed with clearly documented processes and instructions on how to carry out those processes, - an understanding of individuals' roles within the trust, - an understanding of the legal responsibility imposed on each individual. **Effective governance** can reduce the risk of dysfunctional and unclear processes – these conditions support an environment where undetected fraud thrives. **Integrity and suitability** checks are an effective countermeasure to ensure people with adequate knowledge and training are hired for the role. In this case, the trustee roles required people to understand the purpose of governance, and who were skilled and experienced in managing a multi-million-dollar asset.
Mitigations and Responses	- The Trust was ordered to remove the four trustees who were from the same family. - New Trust orders were set in place to improve the governance of the Trust. Better governance allowed the trustees to make hard decisions. For example, they decided to sell ¾ of the harvesting rights to prevent the Trust from losing all its assets. Better governance ensured that the asset could be restored for future generations.
Link to sources	- SFO Media Release
Fraud Tags	Administrative and Support Services, Organisational Strategy and Performance, Finance, Abuse of Position of Trust.