



## **Performance Audit Report on the Effectiveness of the Management of the Log Export Development Levy in Papua New Guinea**





**Performance Audit on the Effectiveness  
of the Management of the Log Export  
Development Levy for the fiscal years  
2012 – 2015**

**Auditor-General's Office of Papua New Guinea**

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## OFFICE OF THE AUDITOR-GENERAL

29 September, 2017

***The Honourable JOB POMAT, MP***

Speaker of the National Parliament

Parliament House

**WAIGANI**

National Capital District

Dear Mr. Speaker,

In accordance with the provisions of Section 214 of the Constitution of the Independent State of Papua New Guinea, and the Audit Act 1989 (as amended), I have undertaken an audit examining the effectiveness of the management of the Log Export Development Levy within key government agencies in Papua New Guinea.

I submit the report of this audit and the report is titled ***"Performance Audit on the effectiveness of the management of the Log Export Development Levy in Papua New Guinea."***

Following its tabling in Parliament, the report will be placed on the Auditor-General's Office Homepage-<http://www.ago.gov.pg>

Thank you,

Philip Nauga



# Contents

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<b>CONTENTS .....</b>	<b>7</b>
ACRONYMS AND DEFINITIONS.....	10
<b>SUMMARY AND RECOMMENDATIONS .....</b>	<b>11</b>
INTRODUCTION .....	11
OVERALL CONCLUSION .....	11
KEY AUDIT FINDINGS BY CHAPTER .....	12
Administration and Processing of the Log Export Development Levy (Chapter 2) .....	12
Project Funding Requirements and Processes (Chapter 3).....	13
Monitoring and Reporting (Chapter 4) .....	14
RECOMMENDATIONS .....	14
<b>1. INTRODUCTION .....</b>	<b>16</b>
POLICY FRAMEWORK .....	16
National Forestry Policy .....	16
LEGISLATIVE FRAMEWORK.....	16
Forestry Act 1991.....	16
Customs and Tariff Act 1990 and Customs Act 1950.....	17
Public (Finances) Management Act .....	17
Administrative Guidelines for the Management of the LEDL .....	17
PNG Forestry Authority (PNGFA) .....	18
Society Generale de Surveillance Group (SGS) .....	18
THE AUDIT.....	19
Audit Rationale .....	19
Audit objective, scope and criteria .....	19
Audit Methodology .....	19
<b>2. ADMINISTRATION AND PROCESSING OF THE LOG EXPORT DEVELOPMENT LEVY .....</b>	<b>20</b>
LEDL CALCULATIONS AND BILLING PROCESSES .....	20
LEDL Calculation Rates .....	20
LEDL Billing Processes.....	21
LEDL Collection and Transfers.....	22
LEDL Collection Procedures.....	22
LEDL Transfer Procedures .....	22
LEDL Revenue Collections .....	22
CONCLUSION .....	25
RECOMMENDATION 1 .....	26
Agency Response .....	26

RECOMMENDATION 2 .....	26
Agency Responses.....	26
RECOMMENDATION 3 .....	26
Agency Response .....	27
RECOMMENDATION 4 .....	27
Agency Response .....	27
<b>3. PROJECT FUNDING REQUIREMENTS AND PROCESSES .....</b>	<b>28</b>
LEDL PROJECT PROPOSALS AND FUNDING .....	28
PROCEDURES FOR PROJECT SUBMISSION AND APPROVAL .....	28
Project Submission and Documentation.....	28
Approval of LEDL Project Submissions.....	29
Meeting Minutes of LEDL Committee.....	30
Accounting Records .....	30
APPLICATIONS OF LEDL TRUST FUNDS FOR PROJECTS .....	31
Applications of funds inconsistent with LEDL requirements .....	31
Details of LEDL Payments made missing.....	32
K5 Million LEDL funding limit .....	33
LEDL Payments in 2015.....	33
CONCLUSION.....	35
RECOMMENDATION 5 .....	35
Agency Response .....	35
RECOMMENDATION 6 .....	36
Agency Response .....	36
<b>4. MONITORING AND REPORTING.....</b>	<b>37</b>
Project Monitoring and Evaluations .....	37
Project Completion Certifications.....	37
Log Export Development Levy Committee .....	37
PNG Forest Authority.....	38
District Administrators.....	38
RECOMMENDATION 7 .....	38
Agencies Response.....	38
<b>APPENDIX 1: LEDL COLLECTION FOR THE YEARS 2012 – 2015.....</b>	<b>39</b>
<b>APPENDIX 2: FLOW CHARTS – PROJECT SUBMISSION AND APPROVAL .....</b>	<b>40</b>
<b>APPENDIX 3: FLOWCHART – PROJECT TENDERING AND PAYMENT .....</b>	<b>41</b>
<b>APPENDIX 4: LEDL PROJECT PROPOSALS EVALUATED BY PNGFA TEC AND SUBMITTED TO LEDL TRUSTEES ...</b>	<b>42</b>
<b>APPENDIX 5: SUMMARY OF TRANSACTION EXTRACTED FROM BANK STATEMENT LEDL PAYMENTS FROM THE TRUST ACCOUNT FOR THE PERIOD 2012 – 2015.....</b>	<b>43</b>

## [TABLES](#)



Table 1: Inflation and the Log Export Development Levy.....	21
Table 2: Total LEDL Collections during the years 2012-2015.....	23
Table 3: Total LEDL Collections from PNGCS Collectors Statements and total Receipts from Trust Account Records - 2012-2015 .....	23
Table 4: Records of LEDL Collections 2012-2015.....	24
Table 5: LEDL Collections – AGO Comparison of PNGCS Collector’s Statements and SGS (PNG) Ltd for the years 2012-2015 .....	25
Table 6: Schedule of LEDL Projects approved by LEDL Trustees.....	30
Table 7: Summary of Payments from the LEDL Trust Account 2012-2015.....	31
Table 8: LEDL Payments with Insufficient Details 2012-2015.....	32
Table 9: LEDL Trust Payments over K5 Million 2012-2015 .....	33
Table 10: LEDL Trust Account Payments - 2015.....	34

## Acronyms and Definitions

AGO	Auditor General's Office
ASYCUDA	Automated System for Customs Data
BSP	Bank South Pacific
CSTB	Central Supplies Tenders Board
DoF	Department of Finance
DPN&M	Department of National Planning and Monitoring
DSIP	District Services Improvement Program
JDP&BPC	Joint District Planning and Budget Priority Committee. Now called the <i>District Development Authority (DDA)</i>
JPP&BPC	Joint Provincial Planning and Budget Priority Committee Now called the <i>Provincial Development Authority (PDA)</i>
LEDL	Log Export Development Levy. A customs duty imposed at the rate of K8/m3 on the total volume of logs exported and is applicable to all exported logs under the Customs and Tariff Act 1990 except for the plantation logs and payable by the exporter to the Customs Office
MODACC	Accounting Module of the Automated System for Customs Data (ASYCUDA)
MODCBR	Customs Module of the Automated System for Customs Data (ASYCUDA)
ORD	Office of Rural Development
PNGFA	Papua New Guinea Forest Authority
PNGCS	Papua New Guinea Customs Service
PPET	Provincial Project Evaluation Team
PSTB	Provincial Supplies Tenders Board
SGS	Societe Genarale de Surveillance
TEC	Technical Evaluation Committee

# Summary and Recommendations

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## Introduction

1. The Log Export Development Levy (LEDL), (the Levy) was established by the Government in 2006, in response to concerns that many areas of the country that had been logged were being left without any tangible or durable developments after logging operations were complete. The primary objective of the Levy is to provide funds to assist in the provision of basic infrastructure and facilities for services such as health, education, law and justice, infrastructure and agricultural projects in the logging areas of PNG.

2. The Levy is a customs duty imposed on the exporter at the rate of 8 Kina per cubic metre (K8/m<sup>3</sup>) of the total volume of logs exported, and is applicable to all logs subject to the *Customs and Tariff Act 1990*, except plantation logs. Funds collected under the levy are paid into a trust account for subsequent disbursement. The *Forestry Act 1991* (as amended in 2006) establishes the Governance arrangements for the management of the trust fund, including a Committee which has responsibility for managing the trust account. The Act and related guidelines also provides the criteria for the Committee in the approval of expenditure from the Levy trust fund.

## Overall Conclusion

3. The Levy is potentially a large investment in local, logging communities. Between 2012 and 2015, more than 14 million cubic metres of logs were exported from PNG and more than K105 million has been paid into the trust account for future expenditure on projects in the logging districts. However, since the establishment of the Levy trust account in 2006, the rate of collection at K8/m<sup>3</sup> has not been reviewed or adjusted. At the same time, the rate of inflation over the last ten years means that the purchasing power of 8 kina has fallen by almost 40 percent, notwithstanding that overall levy collections have increased over the period.

4. A total of eighty-four project proposals were received and registered for Levy funding between January 2007 and January 2015. However, out of this total, the Papua New Guinea Forestry Authority (PNGFA) has only evaluated and considered twelve proposals with a total value of K24.52 million. This means that less than 25 per cent of the funds raised over the last four years have been committed to projects since the program's inception. On this measure alone, the Log Export Development Levy program is falling short of its objectives.

5. A key aspect of program design is that exporters pay the levy to the Papua New Guinea Customs Service (PNGCS) which deposits the funds into a withholding trust account. Funds from the withholding trust account are then transferred to a main trust account. The transfer from one trust account to another appears to be an unnecessary step and there has been an unexplained leakage of funds in the transfer process. The amounts deposited into the withholding account do not reconcile with the amounts received in the main trust account either cumulatively or individually in any year since 2012. The overall shortfall in the main trust account is almost K4 million. There are other weaknesses and leakages in the Levy collection system which requires immediate attention. Overall, there has been a lack of

coordination between the key agencies involved in the reporting of log export volumes and levy collections.

6. The responsibility for monitoring and reporting performance of the Levy program is shared by the Levy Committee, the PNGFA and the Provincial and Local Level Governments in the logging areas. The design of the monitoring and reporting arrangements set out in the legislation and guidelines adequately reflects the devolved nature of the project implementation and recognises that detailed monitoring at the project level is most suited to arrangements between local authorities and government agencies. However, under current arrangements, authorities at all levels have not provided the required data and central agencies have not been able to effectively monitor or report on the projects or the Levy program more broadly.

7. The conduct of this audit has been significantly influenced by one of its findings; recordkeeping and documentation. There was a lack of adequate documentation maintained by the responsible departments in relation to deposits and withdrawals from the trust fund and transfers between the funds. Neither the responsible departments nor the Committee were able to provide documentation that showed recommendations as to which project applications should be approved, and those that should be rejected. The responsible departments and the Committee also did not undertake any value for money analysis in respect to the claims made by project proponents in their applications. Such documentation is generally accepted as a key element of sound administration and accountability, and the minimum that should be maintained.

8. The AGO has made seven recommendations to improve the systems and management of the Log Export Development Levy, but there are broader lessons for all agencies in the findings. To support agency business, and meet legal and policy requirements, entities need to manage information and processes need to operate so that records can be proven to be genuine; are accurate and can be trusted; are complete and unaltered; are secure from unauthorised access, alteration and deletion; are findable and readable; and are related to other relevant records. Such documentation also would have assisted in better informing Government of the progress with the implementation of the Log Export Development Levy and is the first line of defence against allegations of maladministration or fraud.

9. In addition, in light of experience as to how the Log Export Development Levy has operated over its first ten years and the findings of this report, there would be benefit in the relevant departments and entities reviewing key elements of the program design and making recommendations to Government so as to confirm their continuing commitment to the program and also the relevance and effectiveness of program objectives.

## **Key Audit Findings by Chapter**

### **Administration and Processing of the Log Export Development Levy (Chapter 2)**

10. The AGO considers that since 2012 and the demerger of PNGCS and IRC, the Customs service now has well-documented processes for assessing and examining LEDL statements and the collection of funds into the withholding trust account. However, the delays in setting up signatories to the main trust account following the demerger reflect poorly on the administrations of both departments, as there are unexplained discrepancies in accounting for transfers in the years prior to 2012. The overall amount involved is almost

4 million kina. The existence of a withholding trust account and a main trust account is an unnecessary duplication of effort and could be contributing to the discrepancies.

**11.** Between 2012 and 2015, more than 14 million cubic metres of logs were exported from PNG. The AGO attempted to further analyse the volume and value of the levy that should have attached to these exports. However, the data was not readily available from PNGCS and analysis of the volumes exported needed to be conducted using third party records from SGS Limited. Although the SGS records are not matched against PNGCS records, the AGO identified significant inconsistencies in collections data from both entities, with levy collections somewhere between K6 million and K7 million lower than expected when compared to the volume of logs exported.

**12.** The levy was introduced by the Government in 2006 and set at 8 kina per cubic metre (K8/m<sup>3</sup>) and has not been adjusted since it commenced. However, the rate of inflation has significantly eroded its purchasing power, notwithstanding that overall collections have increased over the period. The AGO considers that a review of the levy would be beneficial to include the addition of an outturn factor to adjust for inflation particularly as the LEDL Committee has considerable influence on the direction of the projects and the funding capacity needed to support them.

### **Project Funding Requirements and Processes (Chapter 3)**

**13.** The LEDL was intended to address the problem that a significant amount of logging was taking place in various communities in PNG with little or no compensation to those communities to compensate them for the natural resources given up. The levy was a way that these communities could fund agriculture and infrastructure projects that would otherwise have been beyond the capacities of provincial and local level government. It was for this reason that the funding provided under the program was to be additional to existing funding provided under DSIP or Function Grants.

**14.** The delivery of these projects was intended to be progressed through the development and implementation of new legislative and inter-agency funding arrangements. Under these arrangements and as noted above, between 2012 and 2015, more than K106 million has been collected and paid into the trust account for expenditure on authorised construction projects. From January 2007 to January 2015, the PNGFA received and registered a total of eighty-four project proposals for LEDL funding. However, out of this total, PNGFA has only evaluated and considered twelve development project proposals to the value of K24.52 million. Direct comparisons between these two data sets are not reliable, but it can be seen that less than 25% of the funds raised in the last four years has been spent over the eight years that has elapsed since the program's inception. In part this is due to the lack of awareness of the program in the logging regions and the funds available through the levy, and in part the administration of the fund by the LEDL Committee has been ineffective, due to inadequate administrative practices.

**15.** Examples of inadequate administrative practices included decision making records not being completed, maintained or retained; the required documentation not being provided; breaches of trust account provisions in relation to withdrawals; and failure to follow program guidelines. The AGO notes that weaknesses in these matters extends to record keeping generally and a low standard of accountability and transparency by the agencies involved.

## Monitoring and Reporting (Chapter 4)

**16.** The responsibility for monitoring and reporting performance of the LEDL program is shared by the Treasury, the LEDL Committee, the PNGFA and the Provincial and Local Level Governments. Section 121A of the *Forestry Act 1991* (as amended in 2006) and the administrative guidelines for LEDL establishes the monitoring and reporting framework. The framework requires administering agencies and relevant entities to monitor and report compliance with funding conditions and project implementation.

**17.** The design of the monitoring and arrangements set out in the legislation and guidelines adequately reflects the devolved nature of the project implementation and recognises that detailed monitoring at the project level is most suited to arrangements between local authorities and central government agencies. However, under current arrangements, authorities have not provided the required data and central agencies have not been able to effectively monitor or report on the projects or the LEDL program more broadly.

## Recommendations

*Set out below are the recommendations identified during the course of this performance audit and the department's responses.*

**Recommendation 1**                      The AGO recommends that the PNGFA considers an amendment to the legislation to include an outturn estimate for the LEDL, as an adjustment for inflation and to be reviewed annually, to protect the purchasing power of the levy.

**Paragraph 2.26**

**PNGFA Response:**                      **No response**

**Recommendation 2**                      To ensure consistent and verifiable reporting of LEDL collections, the AGO recommends that PNGFA in consultation with SGS Ltd and members of the LEDL Committee, regularly reconcile their log and levy records with PNGCS to provide decision makers with accurate and up to date data.

**Paragraph 2.27**

**PNGFA Response:**                      **No response**

**PNGCS Response:**                      **Agreed.** We agreed that there was no close consultation with PNGFA and SGS concerning revenue records and reconciliations of LEDL collections. Revenue records and reconciliation were done based on PNGCS actual revenue collections for the period under review. We discussed and resolved that we will implement proper coordination with agencies concerned to ensure future LEDL collections are up to date and reconciled to each other records so there is proper reporting of LEDL revenue to the public.

**Recommendation 3**                      The AGO recommends that the PNGFA;

**Paragraph 2.28**

- (a)      Establish and maintain accurate and reliable recordkeeping systems relating to the volume of log exports at provincial headquarters to ensure an adequate audit trail; and
- (b)      Report the volume of log exports and levy collected to the PNGFA website so that stakeholders, including government agencies, the private sector and resources owners can observe the management of the country's resources in close to real

	time.
<b>PNGFA Response:</b>	<b>No response</b>
Recommendation 4 Paragraph 2.29	The AGO recommends that PNGCS examines the functions of the two LEDL Trust Accounts and consider closing the Withholding Trust Account as it duplicates the functions of the LEDL Trust Account instrument.
<b>PNGCS Response:</b>	<b>Agreed.</b> We agree that we will review the current trust instruments of LEDL Withholding Trust Account by writing to Department of Finance to amend the current trust instrument to revoke this account and transfer the administration and reconciliation of LEDL Trust Account to PNGFA
Recommendation 5 Paragraph 3.33	The AGO recommends that the LEDL Committee and Trustees: <ul style="list-style-type: none"> <li>(a) Strictly follow LEDL administrative guidelines for project submission, screening and approval before committing LEDL funds;</li> <li>(b) Commit LEDL funds only to its intended purpose specified in the Forest Act and the trust instrument; and</li> <li>(c) Establish an effective communication system with key agencies, trustees and other stakeholders for proper management and control of disbursement of LEDL funds.</li> </ul>
<b>Agencies Responses:</b>	<b>No response</b>
Recommendation 6 Paragraph 3.34	The AGO recommends that the Department of PNG Forest Authority: <ul style="list-style-type: none"> <li>(a) Establish an internal control and management mechanism in place to specifically manage LEDL funds;</li> <li>(b) Undertake an awareness campaign in the respective logging centres in the country in conjunction with District Administrations to provide information about the development projects that can be funded under the LEDL program; and</li> <li>(c) Carry out its roles and responsibilities in accordance with the relevant provisions of the Forestry Act, and Public Finance (Management) Act, and other relevant legislative, policies and guidelines.</li> </ul>
<b>PNGFA Response:</b>	<b>No response</b>
Recommendation 7 Paragraph 4.13	To facilitate effective implementation and management of the LEDL projects in the logging areas, the AGO recommends that the LEDL Committee coordinates closely with the PNGFA and the Provincial/District Administrators to ensure all development projects funded through the trust funds are monitored on a regular basis and monitoring reports are submitted on a regular basis as required by the Governing Legislation and the LEDL Administration Guidelines.
<b>Agencies Response:</b>	<b>No response</b>



# 1. Introduction

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*The chapter discusses the legal and policy framework for the establishment of the Log Export Development Levy and the institutional arrangements.*

## Policy Framework

### National Forestry Policy

**1.1** The National Forestry Policy issued by the National Executive Council (NEC) in September 1991 covers areas of the forestry management, including the forestry industry, forest research, forest training and education, and forest organisation and administration. This National Forestry Policy prescribes all the charges which may be imposed on the forestry industry, including the Log Development Levy.

## Legislative Framework

**1.2** There are three main pieces of legislation which provide the legal basis for the establishment and collection of the Log Export Development Levy (LEDL); the *Forestry Act 1991* (amended in 2006); the *Customs Act 1950* and the *Customs and Tariff Act 1990*. The Forestry Act establishes the trust accounts and provides for their management, while the Customs Acts impose applicable rates of the levy, specifies the goods on which the levy will be imposed and provides for its collection.

**1.3** In addition to the governing legislation, the *Public (Finances) Management Act* (PFMA) provides the parameters for the management of trust funds and empowers the Minister for Finance with the establishment of trust accounts. The trust instruments issued by the Minister provide the guidance for the management of trust funds. The specific provisions in the relevant sections of legislation which establish the LEDL trust account are briefly discussed below.

### Forestry Act 1991

**1.4** The LEDL was established through a 2006 amendment to Section 121A of the *Forestry Act 1991*. This Section fixes the rate of the levy at 8 kina per cubic metre (8K/m<sup>3</sup>) and sets out the collection and application procedures, in particular that the LEDL is applicable to all logs (except plantation logs) exported under item 44.03 of the *Customs and Tariff Act 1990*.

**1.5** The 2006 amendment to the Act also provided for the levy to be paid into the trust account established by the Finance Minister. It also identified the government agency that would be responsible for the collection of the LEDL and specified that the levy will be paid by an exporter to the Commissioner General concurrently with the log export duty applicable under the Customs Tariff Act. The Commissioner General is then responsible for paying the levy into the LEDL trust account.

**1.6** The Forestry Act also establishes the Governance arrangements for the management of the LEDL trust funds, including a Committee which has responsibility for approving expenditure from the LEDL trust account. The Committee members are the Secretaries of the Departments of Finance and National Planning & Monitoring, and the Managing Director of the Forestry Authority, or their nominees. The Act also provides the criteria for



the Committee in the approval of expenditure of the LEDL trust funds, namely that expenditure from the trust account shall be made only in accordance with plans for agricultural or infrastructural development projects in the logging area submitted by the relevant local level Government or Provincial Government.

**1.7** The LEDL Committee members act as trustees of the LEDL trust fund.

### **Customs and Tariff Act 1990 and Customs Act 1950**

**1.8** The responsibility for collection of the log levy is assigned to the Papua New Guinea Customs Service (PNGCS) under the *Customs Act 1950* and the *Customs and Tariff Act 1990*. Section 80 of the Customs Act 1950 (as amended in 2006) stipulates that export duties including the LEDL are payable when the goods are actually exported and the payment shall be lodged at the Customs Office.

**1.9** PNG Customs Service is the agency responsible for the administration of the LEDL Withholding Trust Account which holds the LEDL collections paid by the Log Exporters. PNGCS undertakes pre-shipment inspection jointly with Papua New Guinea Forestry Authority (PNGFA) in close consultation with an independent third party (discussed at paragraph 1.19 below) and the Log Exporter to ensure all logs exported are in accordance with the Exporter's Statement of Logs to be exported and also verifies the amount of log export duties including LEDL payable by the exporter on each shipment of logs. The PNGCS is responsible for the collection of the LEDL at its various ports in the country.

### **Public (Finances) Management Act**

**1.10** The provision of Public (Finances) Management Act (PFMA) details the procurement procedures for the expenditure of public monies for the payment of goods and services. The LEDL Administrative Guidelines note that this provision applies to the expenditure of LEDL funds. Further, the PFMA also empowers the Minister for Finance to issue trust instruments for the establishment of trust accounts to hold public monies for specific purposes. The instrument for the establishment of the LEDL Trust Account was issued by the then Finance Minister in July 2007.

**1.11** The Department of Finance (DoF) was initially assigned the responsibility for administration of the LEDL Trust account through the 2007 trust instrument. This responsibility was transferred to the Papua New Guinea Forest Authority (PNGFA) by NEC Decision in March 2013 and the subsequent issue of an amended trust instrument by the Finance Minister. As noted at paragraph 1.6 above, the Secretary of the Department of Finance remains one of the members of the LEDL Committee.

**1.12** A revised trust instrument was issued by the then Finance Minister in April 2013 and a third revision was issued in July 2013. The July 2013 version is the current Trust instrument. The Finance Minister also established a LEDL Withholding Trust Account. The purpose of the LEDL Withholding Trust Account was to hold the LEDL collections and transfer the collections to LEDL Trust Accounts.

### **Administrative Guidelines for the Management of the LEDL**

**1.13** To assist the agencies involved in the management and implementation of the LEDL, administrative guidelines for the Management of the levy were approved and issued by the LEDL Committee in 2009. The guidelines expanded on the provisions of the Forestry Act for

the management of the LEDL funds and provided details of the processes and procedures to be followed for project proposal, approval and procurement.

**1.14** The AGO noted that the initial version of the guidelines were issued in February 2009 after the LEDL became operational in 2007. The guidelines were amended in February 2014 and again in October 2015. However, the two latest amendments to the guidelines were not approved by the governing bodies; the National Forest Board and LEDL Committee. The approved 2009 version of the guidelines adequately covered the principles of the LEDL, the purpose of the fund, the criteria for the eligibility of LEDL funding, procedures for the submission and approval of the project proposals and, the monitoring and evaluation of the its implementations. However, the 2009 version does not adequately delineate the roles and responsibilities of the parties involved in these processes.

**1.15** The 2014 and 2015 revised guidelines have attempted to clarify the roles and responsibilities of agencies involved in processing submissions and the procurement process. As well, the 2015 revision was to incorporate NEC Decision Nos 163/2014 and 307/2014 on the approval for the use of the management contractor to assist the LEDL Committee in the implementation of the trust fund projects, including the provisions of secretariat services to the Committee.

**1.16** The AGO has suggested that the amendments to the guidelines be approved as soon as practicable, to avoid misunderstandings in the management of LEDL projects.

### **PNG Forestry Authority (PNGFA)**

**1.17** The PNGFA is a statutory body responsible for the administration of the Forestry Act with the objectives of providing a single, integrated authority for consultation with resource owners and for the regulation of forestry harvesting. Amongst its other responsibilities, the Forestry Authority is responsible for regulating and approval, and monitoring of the export of logs in the country. The PNGFA also coordinates with the PNGCS and an independent third party (discussed at paragraph 1.19 below) to ensure the Log Exporters pay the appropriate rates of LEDL to PNGCS before shipments of the log exports are made from each provincial shipping port.

**1.18** The Authority is also undertakes independent project monitoring visits to project sites to verify reports from districts and provinces on the implementation of the LEDL projects. A Technical Evaluation Committee (TEC) has also been established within the PNGFA to assist the LEDL Committee in the evaluation of LEDL project proposals. As noted above, the Managing Director of PNGFA is one of the members of the LEDL Committee responsible for the approval of expenditure from the trust fund.

### **Société Générale de Surveillance Group (SGS)**

**1.19** SGS (PNG Limited) is part of the world wide Société Générale de Surveillance Group, an organisation that specialises in inspection and verification services and providing independent third party verification of custody transfers of all types of commodities, including logs and sawn timber.

**1.20** SGS was contracted by PNGFA to undertake inspections of log exports under the LEDL at PNG ports.

## The Audit

### Audit Rationale

**1.21** The Log Export Development Levy (LEDL) came about upon the realisation that after the expiry of the logging projects in many areas of the country, over the years very little by way of tangible and durable development was achieved in the logging localities.

**1.22** In almost all instances, following the cessation of commercial logging operation logging roads disappeared, school buildings deteriorated, people faced diminished opportunities for earning cash income, loss of employment associated with logging operations, communities suffered from poor and worsening health status including increase in incidences of malnutrition especially in children, increase in mother and child mortality rates, etc.

**1.23** To address these issues faced by people in the logging areas, the Government through the PNG Forestry Authority has established this project financing facility to provide tangible and durable benefits to the people whose natural forests have been acquired by the State for commercial logging.

### Audit objective, scope and criteria

**1.24** The objective of this performance audit was to assess the effectiveness of the management of the Log Export Development Levy (LEDL) with particular emphasis on:-

- the legal and policy framework to establish the LEDL;
- the effectiveness of the Levy collection and transfer procedures;
- the effectiveness of project proposal and approval procedures in the application of LEDL funds; and,
- The monitoring, evaluation and reporting arrangements.

**1.25** The audit was focused on the Log Export Development Levy and did not examine other government revenue derived from Log Exports such as Royalties, the Project Development Benefit, the Log Export Tax, the Restoration Levy or other Agricultural levies. The AGO consulted with responsible agencies; the PNG Forestry Authority, PNG Customs Services, Department of Finance and the LEDL Trustees.

### Audit Methodology

**1.26** In order to meet the audit objective the audit took the following approach:

- examined the legislations, policies and guidelines that governs the establishment, operations and management of the trust account;
- reviewed the export procedure documents, PNG Customs Services reports and documents including documented reports from the SGS. Documented reports from the PNG FA were also reviewed including the management guidelines;
- interviewed relevant officers from the audited entities including field inspections and observation on the procedures involved in the actual revenue collection on the port sites and the project sites funded under the LEDL.

## 2. Administration and Processing of the Log Export Development Levy

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*The chapter discusses the calculation of the Log Export Development Levy and the billing process, as well as methods of collection and transfer procedures.*

### LEDL Calculations and Billing Processes

#### LEDL Calculation Rates

**2.1** As noted above, the Log Export Development Levy is calculated at the rate of 8 kina per cubic metre (K8/m<sup>3</sup>) of the total volume of round logs exported, excluding plantation logs. The rate was established by the 2006 amendment to Section 121A of the *Forestry Act 1991* and is reflected in the LEDL Trust Instrument.

**2.2** The calculation of the LEDL for all exported logs is automated through a system known as the Automated System for Customs Data (ASYCUDA). ASYCUDA is an electronic reporting and data processing system used by PNGCS for all import, export and excise entries lodged with Customs. However, calculations can also be done manually to confirm whatever that has been captured in the system is correct. AGO recalculations of a sample of the LEDL revenue collected at Kimbe and Vanimo Custom Ports indicated that the correct levy rate was being applied in the calculations of the LEDL received at these locations, during the years under audit review.

**2.3** The formula used for calculating LEDL has been consistently applied every year, and the AGO noted that the K8/m<sup>3</sup> rate has not been reviewed since it was established in 2006. The application of funds raised is discussed in more detail in Chapter 3. However, it is important to note here that LEDL funds are intended to be used for infrastructure and agriculture projects. A characteristic of these projects is that particularly for infrastructure, prices change over time due to inflation.

**2.4** **Table 1** below shows the inflation/deflation effects on the value of 8 kina since the levy was introduced in 2006 (using 2006 as the base year).

**Table 1: Inflation and the Log Export Development Levy**

Year	Rate of Inflation (%) <sup>1</sup>	Adjusted Value of 8 kina
2007	0.91%	7.93 kina
2008	10.76%	7.07 kina
2009	6.92%	6.58 kina
2010	6.01%	6.1 kina
2011	8.44%	5.67 kina
2012	2.25%	5.54 kina
2013	3.55%	5.34 kina
2014	5.20%	5.06 kina
2015	6.00%	4.76 kina
Average	5.56%	

Source: AGO Analysis of Bank of PNG data

**2.5** The analysis in Table 1 suggests that K8 in 2006 would purchase less than K5 worth of goods in 2015, or another way of saying it is that the value of the levy has fallen by more 40 per cent over the period. This is only an illustration of inflationary effects, as in the actual economy the prices of materials will vary from published general purpose Consumer Price Index figures. However, it is equally important to note that the inflationary effects are greater than zero. A more realistic escalation factor should be set approximately in line with the long term average of inflation; in this case about 5 and a half per cent per annum.

### **LEDL Billing Processes**

**2.6** The LEDL billing process is an integral part of the Log Export Procedures. A commercial invoice is generated from the Statement of Logs to be exported, prepared by the exporter and accompanied by the Inspection Report issued by SGS. The commercial invoice is issued to the exporter by SGS after the pre-shipment inspection carried out jointly by the Forestry and Customs officers to verify the details in the statement of logs to be exported.

**2.7** To ensure logs are exported at the prevailing market price, and that export shipments are correctly declared with respect to log volume and species, the PNGFA has developed internal procedures for exporting logs. These procedural guidelines are important because it sets out the processes involved in the control and monitoring of logs exported, and assists in the LEDL calculations and billing processes. Shipping documentation provided during the audit site visits of Kimbe and Vanimo Ports revealed the log export procedures were being followed by the responsible agencies as detailed in the PNGFA Log Export Procedures.

<sup>1</sup> Source: Bank of PNG at [www.bankpng.gov.pg/statistics/quarterly-economic-bulletin-statistical-tables/](http://www.bankpng.gov.pg/statistics/quarterly-economic-bulletin-statistical-tables/) QEB Table 9.27

## LEDL Collection and Transfers

### LEDL Collection Procedures

**2.8** The LEDL collection process begins after the requirements set out in the procedures for exporting logs are fully completed to accord with the *Customs Act 1951*, the *Forestry Act 1991*, and its regulation. The process provides that the Levy will be paid by an exporter together with the log export duty payable under the *Customs Tariff Act 1990* to the Commissioner General who pays the levy into the LEDL trust account. To facilitate the collection of export duties, Customs Ports have been established by the PNGCS in several locations throughout the country.

**2.9** The collection controls are in place whereby Custom Trade Officers who are in charge of Customs ASYCUDA system module called MODCBR to access the custom entry send online by the custom broker to confirm against the export documents produced. The ASCUDA system then allocates a receipt number for that particular customs entry and this is the final stage of all types of duties and taxes collected. During the site inspections of Kimbe and Vanimo, the AGO noted that LEDL levies imposed on a shipment of the total volume of logs exported were remitted to the PNGCS Office in accordance with the procedures.

### LEDL Transfer Procedures

**2.10** A LEDL withholding trust account was established in 2007 through a trust instrument issued by the Finance Minister to hold LEDL collections. The withholding account is held with the Bank of South Pacific (BSP) and administered by the PNGCS. The daily remittances of LEDL revenue from the Customs Ports are held in the LEDL Withholding Trust Account and at the end of each month; the funds are transferred into the LEDL operating Trust Account (also with BSP) through a direct bank transfer.

**2.11** The AGO found that there were delays in transfers of LEDL funds from the Withholding Trust Account to the LEDL Trust Account by the PNGCS for a period of two years between 2012 and 2013. The LEDL Trust Account bank statements for the above two years showed no funds were transferred for this period from the withholding trust account.

**2.12** The delay in transfer of funds was as a result of an administrative error. On 31<sup>st</sup> December 2013, the responsibility for collection of the levy was transferred from the Internal Revenue Commission (IRC) to PNGCS following a demerger of functions. However, there was a two year delay in transferring management responsibility for the fund, including signatories for the withholding account. This reflects a lack of coordination between the IRC and PNGCS which adversely affected the flow of Levy funds into the trust account, with consequential impacts on the amount of funds available for projects.

### LEDL Revenue Collections

**2.13** Review of the PNGCS monthly collector statements shows that LEDL revenue totalling K105.8 million was collected during the years 2012-2015. A summary of the LEDL revenue collected for each year are shown in **Table 2** below, and a monthly distribution of LEDL collections for the four year period is shown in **Appendix 1**.

Table 2: Total LEDL Collections during the years 2012-2015

Year	LEDL Revenue (PGK,000)	% Growth Year on Year
2012	24,408	-
2013	24,699	1.23%
2014	27,042	9.31%
2015	29,656	10.00%
<b>Total</b>	<b>105,805</b>	

Source: PNGCS monthly Collector's Statements from 2012-2015

**2.14** Table 2 shows that total annual collections of the levy have increased every year from 2012 to 2015, and the rate of growth has been significant since the demerger of IRC and PNGCS in 2012, reaching 10 per cent growth in 2015. Notwithstanding this rate of growth in collections, internal controls over the recording and accountability of the LEDL revenue are weak. In particular the AGO found there were differences between the PNGCS Total LEDL Collections and corresponding transfers from the LEDL Withholding Trust Account.

**2.15** Table 3 below provides a comparison between the total LEDL Collections from the PNGCS Collectors Statements (withholding account) and the total receipts recorded in the LEDL Trust Account Bank Statements. There are differences between years and an overall difference of K3.97 million over the period.

Table 3: Total LEDL Collections from PNGCS Collectors Statements and total Receipts from Trust Account Records - 2012-2015

Year	LEDL Withholding Trust Account (PGK,000)	LEDL Trust Account (PGK,000)	Difference (PGK,000)
2012	24,408	-	24,408
2013	24,699	-	24,699
2014	27,042	81,246	-54,204
2015	29,656	20,586	9,070
<b>Total</b>	<b>105,805</b>	<b>101,832</b>	<b>3,973</b>

Source: AGO 2016

**2.16** The AGO was unable to locate records that adequately explain the discrepancy of K3.97 million. The most likely explanation is that prior year receipts were held in the withholding Trust Account and were transferred during the period under audit review. At the same time, the lack of proper records of the receipt of the levy at various Customs Ports has contributed to an understatement in the LEDL Collectors Statement.

**2.17** As noted above, currently the levy is banked into the withholding account and then transferred to the main trust account. This duplication of effort is unnecessary and the evidence suggests there are leakages from the system. If the levy collections were accurately and consistently recorded in a single trust account, there would be no need for transfers and verification and reporting processes.

**2.18** A comparison of total LEDL Revenue collected and compared to PNGCS records as well as SGS Ltd records revealed further differences in recordkeeping between the two organisations. The comparison is shown in **Table 4** below.

Table 4: Records of LEDL Collections 2012-2015

Year	SGS Limited Records	PNGCS Records	Differences in Levy Collected SGS v PNGCS
	Log Levy Collected (PGK'000)	Log Levy Collected (PGK'000)	(PGK'000)
2012	23,708	24,409	-701
2013	24,923	24,699	224
2014	28,884	27,042	1,842
2015	29,251	29,656	-404
<b>Totals</b>	<b>106,766</b>	<b>105,806</b>	<b>961</b>

Source: PNGCS Monthly Collector's Statements and SGS (PNG) Ltd Revenue Statement Summary

**2.19** Table 4 above shows that LEDL revenue was under-stated by 961 thousand kina<sup>2</sup> in the PNGCS records compared to the records of SGS Ltd over the audit period.

**2.20** The audit found there were few PNGCS records available showing the volume of logs exported. Records of the logs exported were from SGS Ltd, a contractor to PNGCS. **Table 5** below shows the total volume of logs exported and the amount of levy that was calculated by SGS and PNGCS (difference in levy amounts is also shown in Table 3 above). However, neither the SGS record, nor the PNGCS amounts could be reconciled with the K8 per cubic metre calculation from the total volume of logs exported. AGO calculations of the amount of levy that was due to the trust fund are also shown in Table 4 above.

<sup>2</sup> Whole number differences due to rounding.



Table 5: LEDL Collections – AGO Comparison of PNGCS Collector’s Statements and SGS (PNG) Ltd for the years 2012-2015

Year	LEDL Collections				Differences	
	Total Volume of Logs Exported (m <sup>3</sup> )	SGS Records of Levy collections at 8K/m <sup>3</sup> (PGK'000)	PNGCS Records of Levy collections at 8K/m <sup>3</sup> (PGK'000)	AGO Calculation of Levy at 8K/m <sup>3</sup> (PGK'000)	AGO compared to SGS (PGK'000)	AGO compared to PNGCS (PGK'000)
2012	3,154,266	23,708	24,409	25,234	-825	-1,526
2013	3,297,384	24,923	24,699	26,379	-1,680	-1,456
2014	3,800,185	28,884	27,402	30,401	-3,359	-1,517
2015	3,869,271	29,251	29,656	30,954	-1,298	-1,703
<b>Total</b>	<b>14,121,106</b>	<b>106,766</b>	<b>105,806</b>	<b>112,969</b>	<b>-7,163</b>	<b>-6,203</b>

Source: AGO Analysis

**2.21** The LEDL receivable on each shipment of logs is dependent upon the total volume of logs exported and the correct application of the levy at the rate of K8 per m<sup>3</sup>. However, the differences in LEDL revenue reported by SGS Ltd on behalf of the PNGFA and the PNGCS for the years under audit review against the audit calculations reflected significant weaknesses in the system. Table 4 suggests that on average 1.5 million kina for each year between 2012 and 2015 was not paid into the trust fund due to these weaknesses.

**2.22** The AGO noted there was a lack of coordination between the key agencies involved in the reporting of log export volumes and prices. The AGO suggests that each agency should report and monitor LEDL revenue collections and reconcile their respective records with each other to facilitate uniformity in the reporting of LEDL collections to the public.

## Conclusion

**2.23** The AGO considers that since 2012 and the demerger of PNGCS and IRC, the Customs service now has well-documented processes for assessing and examining LEDL statements and the collection of funds into the withholding trust account. However, the delays in setting up signatories to the main trust account following the demerger reflect poorly on the administrations of both departments, as there are unexplained discrepancies in accounting for transfers in the years prior to 2012. The overall amount involved is almost 4 million kina. The existence of a withholding trust account and a main trust account is an unnecessary duplication of effort and could be contributing to the discrepancies.

**2.24** Between 2012 and 2015, more than 14 million cubic metres of logs were exported from PNG. The AGO attempted to further analyse the volume and value of the levy that should have attached to these exports. However, the data was not readily available from PNGCS and analysis of the volumes exported needed to be conducted using third party records from SGS Limited. Although the SGS records are not matched against PNGCS records, the AGO identified significant inconsistencies in collections data from both

entities, with levy collections somewhere between 6 million and 7 million kina lower than expected when compared to the volume of logs exported.

**2.25** The levy was introduced by the Government in 2006 and set at 8 kina per cubic metre and has not been adjusted since it commenced. However, the rate of inflation has significantly eroded its purchasing power, notwithstanding that overall collections have increased over the period. The AGO considers that a review of the levy would be beneficial to include the addition of an outturn factor to adjust for inflation particularly as the LEDL Committee has considerable influence on the direction of the projects and the funding capacity needed to support them.

## **Recommendation 1**

**2.26** The AGO recommends that the PNGFA considers an amendment to the legislation to include an outturn estimate for the LEDL, to include an adjustment for inflation and to be reviewed annually, to protect the purchasing power of the levy.

### **Agency Response**

At the time of finalising this report no response was received from the primary client – PNG National Forest Authority.

## **Recommendation 2**

**2.27** To ensure consistent and verifiable reporting of LEDL collections, the AGO recommends that PNGFA in consultation with SGS Ltd and members of the LEDL Committee, regularly reconcile their log and levy records with PNGCS to provide decision makers with accurate and up to date data.

### **Agency Responses**

**PNGFA response:** At the time of finalising this report no response was received from the primary client – PNG Forest Authority.

**PNGCS response:** We agreed that there was no close consultation with PNGFA and SGS concerning revenue records and reconciliations of LEDL collections. Revenue records and reconciliation were done based on PNGCS actual revenue collections for the period under review. We discussed and resolved that we will implement proper coordination with agencies concerned to ensure future LEDL collections are up to date and reconciled to each other records so there is proper reporting of LEDL revenue to the public.

## **Recommendation 3**

**2.28** The AGO recommends that the PNGFA;

- (a) Establish and maintain accurate and reliable recordkeeping systems relating to the volume of log exports at provincial headquarters to ensure an adequate audit trail; and
- (b) Report the volume of log exports and levy collected to the PNGFA website so that stakeholders, including government agencies, the private sector and resources owners can observe the management of the country's resources in close to real time.

### **Agency Response**

At the time of finalising this report no response was received from the primary client – PNG National Forest Authority.

### **Recommendation 4**

**2.29** The AGO recommends that PNGCS examines the functions of the two LEDL Trust Accounts and consider closing the Withholding Trust Account as it duplicates the functions of the LEDL Trust Account instrument.

### **Agency Response**

We agree that we will review the current trust instruments of LEDL Withholding Trust Account by writing to Department of Finance to amend the current trust instrument to revoke this account and transfer the administration and reconciliation of LEDL Trust Account to PNGFA.

## 3. Project Funding Requirements and Processes

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*This chapter considers the Log Export Development Levy Project funding requirements and the procedures for project submissions and approval, and including project implementation and management processes.*

### LEDL Project Proposals and Funding

**3.1** The requirements for the LEDL project proposal and funding are set out at Section 121A(7) of the *Forestry Act 1991*. It provides that LEDL funds can be used to finance infrastructure and agriculture projects and activities within an area where logging and export of logs from a natural forest and from which the LEDL levy has been derived. The same requirement for the application of LEDL funds is also provided in the LEDL trust instrument issued by the Minister for Finance and the Administrative Guidelines for the Management of the LEDL.

**3.2** This means that the eligible beneficiaries of the LEDL funds are resource owner groups, Local Level Governments (LLGs), Districts and Provincial Governments from logging areas. Funds are not to be used for projects outside a timbered area. The LEDL administrative guidelines also provide that project funding is dependent on the availability of funds held in the trust account for the respective timber area. The maximum threshold established of the project cost totals is less than K5 million. As well, in order to qualify for LEDL funding, project proposals submitted by the eligible beneficiaries of the fund should meet the project specifications provided in this guidelines and the DSIP Guidelines.

**3.3** The AGO noted that the requirements for the application of LEDL funds are adequately provided in the legislation and guidelines. However, during the site visits to Kimbe and Vanimo, the land owners of timber project areas informed the AGO there was a lack of awareness at the local level, of the availability of this project financing facility and the requirements to qualify for access to these funds.

### Procedures for Project Submission and Approval

**3.4** The procedures for LEDL project submission and approval are detailed in the Administrative Guidelines for the Management of the LEDL. It requires applicants from the timber areas to prepare project proposals and make submissions to District Administrators through the Joint District Planning and Budget Priority Committee (JDP&BPC) or the Provincial Administrator through the Joint Provincial Planning & Budget Priority Committee (JPP&BPC) for preliminary screening and evaluation.

### Project Submission and Documentation

**3.5** In the preliminary screening and evaluation of the project proposals, the JDP&BPC/JPP&BPC is expected to play a major role in ensuring that project specifications are met and necessary measures are undertaken to ensure the LEDL project proposal complies with the procurement procedures provided in the Public Finance Management

Act (PFMA). The Project Tendering and Payments procedure for the LEDL Trust funds is shown in the flowchart at **Appendix 2**.

**3.6** A Technical Evaluation Committee (TEC) has also been established at the PNGFA to assist the LEDL Trustees with screening and evaluations, and the recommendations of the TEC are submitted to the LEDL Trustees for their consideration and approval. The LEDL project proposal approved by the District/Provincial Administrator is submitted to the LEDL Committee for consideration and final approval. If the project proposal meets the LEDL project specification and criteria for funding, the LEDL Committee approves it for funding. A simplified version of the Project Submission and Approval procedures are shown in the flowchart at **Appendix 3**.

**3.7** The AGO requested copies of project submission documents, endorsements from the various committees, tender documents and evaluation reports from PNGFA. This information was not readily available and, for reasons that were not explained, PNGFA did not provide the necessary records for this audit. These documents are expected to be maintained by PNGFA and the Department of Finance as agencies responsible for the administration of the trust account and are an essential part of accountability for public funds. This has emphasised the need for clear guidance on what information is to be recorded and where it is to be recorded.

### **Approval of LEDL Project Submissions**

**3.8** From January 2007 to January 2015, the PNGFA received and registered a total of eighty-four project proposals for LEDL funding. Out of this total, PNGFA has evaluated and considered twelve development project proposals to the value of K24.52 million submitted for LEDL funding. The detail of the twelve LEDL project proposals considered by PNGFA is shown in Appendix 4. These project proposals had passed through the PNGFA TEC for screening, evaluation and endorsement and were forwarded to the LEDL Trustees together with their recommendations for final evaluations and approval.

**3.9** Of the total project proposals received by the TEC and submitted to the LEDL Trustees, only one project proposal with a value of K1.2 million was approved by the Trustees in 2014. However, the project has yet to be funded at the time of audit in 2015. The balance and a large majority of the LEDL project proposals were not approved due to non-compliance with the requirements of the LEDL guidelines.

**3.10** The rate of non-compliance with the guidelines reflects that, as discussed at paragraph 3.3 above, applicants were not adequately informed of the requirements for project proposals to access LEDL funding. It is clear that there is a lack of awareness of residents in the timbered areas about the availability of the project funding facility and the project proposal requirements and specifications. This could lead to eligible beneficiaries of the trust fund missing out on development in their respective localities from the harvesting of their natural resources.

**3.11** In addition to the twelve projects endorsed for LEDL Trustees approval, there were nine other project applications with the total value of K36.84 million that had been approved by the LEDL Trustees. The details of the projects are presented in **Table 6** below.

**Table 6: Schedule of LEDL Projects approved by LEDL Trustees**

	Project Name	Recipient	Amount (PGK'000)
1	Hoskins VOP Road Project	Keveloho Inc Land Group, Hoskins, WNB	1,900
2	Timber Processing Project-Wewak	Manibem Timber & Earth Moving Construction Ltd	3,200
3	Cocoa & Coconut Rehabilitation	Tavak Investment Ltd, Namatanai, NIP	240
4	Cocoa Processing & Export Project	Tavak Investment Ltd, Namatanai, NIP	2,500
5	Cocoa Processing & Export Project	Asaule Development Corporation Ltd, Kandrian, WNB	500
6	Rabaul Queen Inquiry	Asaule Development Corporation Ltd, Kandrian, WNB	8,000
7	Watut Timber Processing Project	Maya Holdings Ltd, Bulolo, MP	5,000
8	Agroforestry Oil palm Project	Alaba Development Ltd, Bialla, WNB	5,500
9	Kusha Pasi Road Sealing Project	Global Construction Ltd	9,990
<b>Total</b>			<b>36,830</b>

Source: PNGFA 2016

**3.12** The AGO was unable to determine whether all of the project proposals set out in Table 6 were approved in a formal LEDL committee meeting, comprising all of the committee members, as there were no records kept of committee proceedings. The approval of project submissions without the full attendance of the LEDL Committee and the failure to keep records of committee meetings reflected a lack of transparency in the approval of projects and the application of trust funds. This is a significant risk to the program as the LEDL Committee cannot demonstrate that it has managed the trust account effectively.

### **Meeting Minutes of LEDL Committee**

**3.13** To effectively discharge their responsibilities in the approval of expenditure from the trust account, the LEDL Trustees are expected to approve the payments in a formal meeting of the trustees and to maintain proper records. However, as noted above, minutes and other records of the trustees meetings were not available as they were not prepared and retained.

### **Accounting Records**

**3.14** The initial trust instrument issued in July 2007 allocated responsibility for administration of the trust account to the Department of Finance. However, this responsibility was transferred to the PNGFA through a 2013 NEC Decision (No 96/2013). An amended trust instrument to reflect the revised administrative responsibilities was issued in July 2013, to reflect the NEC Decision.

**3.15** There has been a lack of adequate documentation maintained by both the Department of Finance and the PNGFA in the administration of the trust fund. Accounting records (such as cashbook, revenue and expenditure ledgers) and supporting documents (such as paid vouchers, and registers of approved projects) could not be located by either entity and made available for audit purposes. As a result, there is also a lack of adequate

documentation in relation to the development of approved projects, specifically about the merits, risks and alternative options in relation to the approval or non-approval of projects under consideration. Such documentation is generally accepted as a key element of sound administration and accountability. As noted at paragraph 3.13 above, official records were not taken or maintained of LEDL Committee meetings and decisions. As a consequence, there is limited departmental documentation on the development of the key elements of the LEDL, and in particular measurements of effectiveness or value for money cannot be made.

**3.16** The lack of documentary evidence shows that the administrative arrangements in place lack structure and clarity sufficient to generate the confidence of all stakeholders in the LEDL scheme and the public. Without documentation, there is a risk that LEDL funds are being applied for unauthorised purposes.

### Applications of LEDL Trust Funds for Projects

**3.17** Analysis of bank statements revealed a total of K169.6 million was expended during the four year period (2012-2015) from the LEDL trust account. A summary of the payments made for each year are shown in **Table 7** below. Additional payment details are shown in **Appendix 5**.

**Table 7: Summary of Payments from the LEDL Trust Account 2012-2015**

Year	Payments (PGK'000)
2012	44,800
2013	3,800
2014	80,000
2015	41,000
<b>Total</b>	<b>169,600</b>

Source: 2012-2015 LEDL Trust Account Bank Statements

### Applications of funds inconsistent with LEDL requirements

**3.18** As noted in paragraph 3.1 above, expenditure of funds from the trust account can only be made in accordance with the requirements of S121A(7) of the *Forestry Act 1991* and the related guidelines that broadly provide funding for infrastructure and agricultural projects from the logging areas. However, there were two payments totalling K85 million made from the trust account which were inconsistent with the criteria for LEDL funding. The payments were;

- On 29 February 2012, K5 million was paid to the Morobe Disaster and Emergency Committee; and
- On 17 December 2014, K80 million was transferred from the trust account to the Bank of Papua New Guinea (BPNG).

**3.19** With regard to the K80 million transfer to the Bank of PNG, the AGO noted that this was to fund the Supplementary (Appropriation) Bill passed by the NEC in 2014. However, this transaction was in breach of the trust instrument, as the LEDL trust account is not part of the Consolidated Revenue Fund.

**3.20** Similarly, the nature of the payment of K5 million made from the trust account to Morobe Disaster & Emergency Committee in 2012 appears to be not related to a project. However, as discussed in paragraph 3.16 above, in the absence of supporting documents such as the paid vouchers, or evidence of LEDL Trustees approval, the AGO was not able to determine the nature or purpose of the payment.

### Details of LEDL Payments made missing

**3.21** In fifteen instances, there were limited, and in some cases, no records of payees in relation to payments made from the trust account totalling K48.55 million. Thirteen of these payments were made in 2012 and two payments in 2013. The details of LEDL payments with insufficient documentation are shown in **Table 8** below.

**Table 8: LEDL Payments with Insufficient Details 2012-2015**

No	Date	Description	Amount <sup>1</sup> (PGK'000)
1	20 Feb 12	Cheque details not recorded	781
2	8 Feb 12	Cheque details not recorded	503
3	10 Feb 12	Cheque details not recorded	3,000
4	10 Feb 12	Cocoa Processing and Export Project	2,500
5	29 Feb 12	Morobe Provincial Disaster and Emergency Commit	5,000
6	2 Mar 12	Cheque details not recorded	494
7	19 Mar 12	Maniben Timber and Earthmoving	975
8	24 Apr 12	Watut Timber and Processing Project	5,000
9	7 May 12	Cheque details not recorded	4,500
10	25 May 12	Cheque details not recorded	6,000
11	1 Jun 12	Agro Forestry Oil Palm Project	5,500
12	13 Jul 12	Global Construction	9,996
13	4 Sep 12	Cheque details not recorded	517
		<b>Sub Total 2012</b>	<b>44,766</b>
14	8 Jan 13	Cheque details not recorded	285
15	15 Jan 13	Cheque details not recorded	3,500
		<b>Sub Total 2013</b>	<b>3,785</b>
		<b>Total</b>	<b>48,552</b>

Source: AGO Analysis

Note: 1 Figures Rounded to nearest whole number.

**3.22** In the absence of source records and supporting documents relating to the application of trust funds, the AGO could not determine whether approval was granted by the LEDL Trustees for the payments and the funds were applied for the purposes intended.

**3.23** A key element of sound public administration and accountability is adequate recording or documentation of the business of government. There has been an absence



of suitable recording by the PNGFA and previously by the Department of Finance in the management of the trust fund which is not consistent with good administrative practice.

### **K5 Million LEDL funding limit**

**3.24** The LEDL administrative guidelines state that for an infrastructure and/or agricultural project to qualify for funding, the total project cost should be below K5 million. The AGO identified six payments totalling K117.37 million that were over the K5 million threshold. The limited details of the payments that were available are shown in **Table 9** below.

**Table 9: LEDL Trust Payments over K5 Million 2012-2015**

No	Date	Description	Amount <sup>1</sup> (PGK'000)
1	25 Feb 12	Cheque details not recorded	6,000
2	1 Jun 12	Cheque details not recorded	5,500
3	13 Jul 12	Cheque details not recorded	9,997
4	17 Dec 14	Fund Transfer to BPNG	80,000
5	8 Dec 15	Kand/Gloucester District	10,293
6	9 Dec 15	Aitape District	5,582
<b>Total</b>			<b>117,372</b>

Source: Extracts from 2012-2015 LEDL Trust Account Bank Statements

Note: 1 Figures Rounded to nearest whole number.

**3.25** The data in Table 9 indicates that a substantial number of payments from the trust account were not consistent with the requirements of the LEDL trust instrument. There may have been good reasons for the K5 million threshold to be exceeded on these occasions. However, in the absence of records there is a low level of confidence that controls over the account are working as intended.

### **LEDL Payments in 2015**

**3.26** Payments totalling K41.05 million were made to fifteen logging districts from the LEDL trust fund during 2015. Details of the 2015 payments are shown in **Table 10** below.

Table 10: LEDL Trust Account Payments - 2015

No	Date	Description	Amount <sup>1</sup> (PGK'000)
1	26 Nov 15	Namatanai District	2,242
2	1 Dec 15	Soe District	895
3	1 Dec 15	Abau District	3,345
4	2 Dec 15	Madang District	2,810
5	2 Dec 15	Talasea District	3,364
6	3 Dec 15	Security Electronic Service	227
7	3 Dec 15	Kavieng District	4,013
8	8 Dec 15	Finscafen District	255
9	8 Dec 15	Telifomin District	416
10	8 Dec 15	Kandrian District	10,293
11	9 Dec 15	Pomio District	3,360
12	9 Dec 15	Aitape District	5,582
13	11 Dec 15	Gazelle District	2,678
14	18 Dec 15	Middle Ramu District	409
15	22 Dec 15	Wewak District	1,160
Total			41,049

Source: AGO Analysis

Note: 1 Figures Rounded to nearest whole number.

**3.27** The payments listed in Table 10 were made to the respective District Treasuries as LEDL grants consistent with Section 3.2(c) of the LEDL Administrative Guidelines issued in 2013. This particular section in the guidelines allows the Trustees or the Managing Director of PNGFA to pay to each District Treasury from which the timber area is located, the monies receipted and derived from the LEDL for the previous year on or before 31 March each year. It also requires that these payments should be conveyed with an administrative note to the District Administrator nominating the timber area(s) from which the LEDL has been paid from and the level of funding.

**3.28** However, the AGO noted that the 2013 LEDL Administrative Guidelines was not endorsed and approved by the LEDL Trustees/Committee for implementation as discussed at paragraph 1.13 above. The Administration Guidelines in effect at the time was issued in 2009 and this version of the guideline did not provide for this arrangement. Although the LEDL Committee clearly intended to change the guidelines, the committee processes and procedures have been poor, and as a result, these payments made from the trust account to the District Treasuries in 2015 were made in breach of the guidelines.

**3.29** In addition, the respective payment vouchers were not supported with the Administrative Notes to the relevant District Administrators as required by the 2013 LEDL guidelines. Moreover, the payment vouchers were also not supported with documents such as the project proposal submissions from the respective District Administrators for

LEDL to validate the release of the trust funds, the endorsement of JDP&BPC, or LEDL Trustees approval.

## Conclusion

**3.30** The LEDL was intended to address the problem that a significant amount of logging was taking place in various communities in PNG with little or no compensation to those communities to compensate them for the natural resources given up. The levy was a way that these communities could fund agriculture and infrastructure projects that would otherwise have been beyond the capacities of provincial and local level government. It was for this reason that the funding provided under the program was to be additional to existing funding provided under DSIP or Function Grants.

**3.31** The delivery of these projects was intended to be progressed through the development and implementation of new legislative and inter-agency funding arrangements. Under these arrangements and as noted in Chapter 2, between 2012 and 2015, more than K106 million kina has been collected and paid into the trust account for expenditure on authorised construction projects. From January 2007 to January 2015, the PNGFA received and registered a total of eighty-four project proposals for LEDL funding. However, out of this total, PNGFA has only evaluated and considered twelve development project proposals to the value of K24.52 million. Direct comparisons between these two data sets are not reliable, but it can be seen that less than 25% of the funds raised in the last four years has been spent over the eight years that has elapsed since the program's inception. In part this is due to the lack of awareness of the program in the logging regions and the funds available through the levy, and in part the administration of the fund by the LEDL Committee has been ineffective, due to inadequate administrative practices.

**3.32** Examples of inadequate administrative practices included decision making records not being completed, maintained or retained; the required documentation not being provided; breaches of trust account provisions in relation to withdrawals; and failure to follow program guidelines. The AGO notes that weaknesses in these matters extends to record keeping generally and a low standard of accountability and transparency by the agencies involved.

## Recommendation 5

**3.33** The AGO recommends that the LEDL Committee and Trustees:

- (a) Strictly follow LEDL administrative guidelines for project submission, screening and approval before committing LEDL funds;
- (b) Commit LEDL funds only to its intended purpose specified in the Forest Act and the trust instrument; and
- (c) Establish an effective communication system with key agencies, trustees and other stakeholders for proper management and control of disbursement of LEDL funds.

## Agency Response

At the time of finalising this report no response was received from the primary client – PNG National Forest Authority.

## **Recommendation 6**

**3.34** The AGO recommends that the Department of PNG Forest Authority:

- (a) Establish an internal control and management mechanism in place to specifically manage LEDL funds;
- (b) Undertake an awareness campaign in the respective logging centres in the country in conjunction with District Administrations to provide information about the development projects that can be funded under the LEDL program; and
- (c) Carry out its roles and responsibilities in accordance with the relevant provisions of the Forestry Act, and Public Finance (Management) Act, and other relevant legislative, policies and guidelines.

### **Agency Response**

At the time of finalising this report no response was received from the primary client – PNG National Forest Authority.

## 4. Monitoring and Reporting

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*This chapter considers the Monitoring and Reporting arrangements for Log Export Development Levy Projects.*

### Monitoring and evaluation of LEDL Project Implementation

#### Project Monitoring and Evaluations

**4.1** Section 121A of the *Forestry Act 1991* (as amended in 2006) stipulates that the LEDL Committee shall obtain information from the Provincial and Local Level Governments that receive funds from the trust account. This information is required so that compliance with the terms and conditions of the approval process can be monitored throughout the implementation of the projects.

**4.2** The Administrative Guidelines on the Management of the LEDL also identifies agencies that should be responsible for the monitoring and evaluation of the implementation of the projects funded through the LEDL trust account. The LEDL project monitoring responsibility is entrusted to the District and Provincial Administrators with the support from Provincial Works Managers.

**4.3** The Guidelines also require PNGFA staff to undertake monitoring visits to projects and carry out independent reviews and verify reports from the districts and provinces. PNGFA is also to assist Project Management Units (PMU) in the provinces in the monitoring of the LEDL contracts and activities under implementation.

**4.4** Notwithstanding the legislative and regulatory guidance in relation to monitoring and evaluation, there was no evidence that any kind of monitoring reports from monitoring agencies have been compiled. The lack of effective monitoring and evaluation of LEDL project implementation could lead to ineffective implementation of the projects and mismanagement of trust funds.

#### Project Completion Certifications

**4.5** The 2009 Administrative Guidelines on the Management of LEDL provides that upon the completion of any project activity, the contractor shall submit a Project Completion Report to the Chairman (PMU)/District Administrator/executing agency and, in this case the District Administrator for PSTB executed projects and Managing Director – PNGFA for CSTB executed projects fulfilling all the terms and conditions of the contract.

**4.6** At the time of audit in March 2016, no single certificate of completion was made available to AGO for the projects approved and implemented since the establishment of the trust fund in 2007 to indicate that the LEDL projects were successfully implemented and the projects were completed in line with the scope planned and approved.

### Reporting Arrangements

#### Log Export Development Levy Committee

**4.7** As noted at paragraph 4.1 above, the LEDL Committee or Trustees are required by Section 121A of the *Forestry Act 1991* (as amended in 2006) to obtain information from LLGs and Provincial Governments in receipt of the monies from the LEDL trust account about the implementation of funded projects. Based on this information, the LEDL

committee is required to provide reports each six months to the Secretary for Treasury for inclusion in a periodic report by the Treasury on budget outcomes.

**4.8** However, these reports were not provided and as a result, the AGO was unable to ascertain whether such reports were submitted to the relevant authority as required. AGO further noted that there were no physical project completion reports of the K48.5 million of projects detailed in Table 8 above.

### **PNG Forest Authority**

**4.9** The PNGFA is required by the LEDL guidelines to provide quarterly reports on the physical and financial status of the LEDL to the Committee; however, such reports were not made available to audit to suggest that this requirement was complied with.

### **District Administrators**

**4.10** The LEDL guidelines requires the District administrators from the logging areas to provide quarterly management reports on the physical and financial status of the LEDL activities to the JDP&BPC and PNGFA. However, there were no reports made available to the PNGFA and as a result, the LEDL requirements have not been complied with by the District Administrators in the logging areas where projects were approved and implemented.

### **Conclusion**

**4.11** The responsibility for monitoring and reporting performance of the LEDL program is shared by the Treasury, the LEDL Committee, the PNGFA and the Provincial and Local Level Governments. Section 121A of the *Forestry Act 1991* (as amended in 2006) and the administrative guidelines for LEDL establishes the monitoring and reporting framework. The framework requires administering agencies and relevant entities to monitor and report compliance with funding conditions and project implementation.

**4.12** The design of the monitoring and arrangements set out in the legislation and guidelines adequately reflects the devolved nature of the project implementation and recognises that detailed monitoring at the project level is most suited to arrangements between local authorities and central government agencies. However, under current arrangements, authorities have not provided the required data and central agencies have not been able to effectively monitor or report on the projects or the LEDL program more broadly.

### **Recommendation 7**

**4.13** To facilitate effective implementation and management of the LEDL projects in the logging areas, the AGO recommends that the LEDL Committee coordinates closely with the PNGFA and the Provincial/District Administrators to ensure all development projects funded through the trust funds are monitored on a regular basis and monitoring reports are submitted on a regular basis as required by the Governing Legislation and the LEDL Administration Guidelines.

### **Agencies Response**

At the time of finalising this report no response was received from the primary client – PNG Forest Authority.

## Appendix 1: LEDL Collection for the Years 2012 – 2015

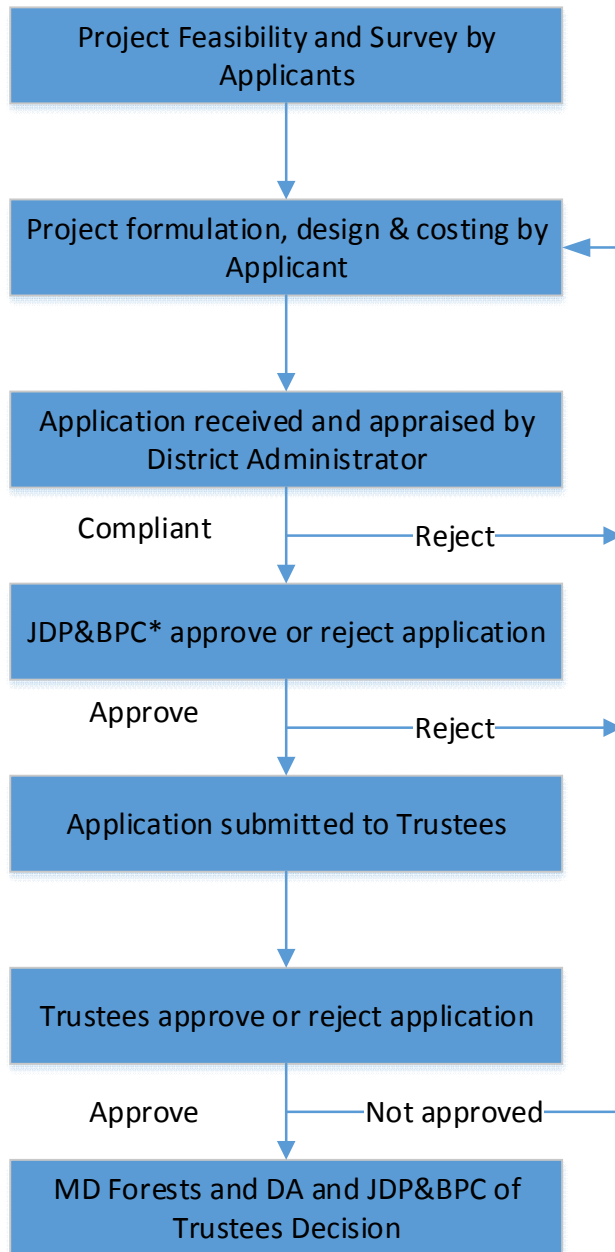
	RECEIPTS (PGK)				Total Revenue
Years					
Month	2012	2013	2014	2015	
January	2,554,073.81	1,984,939.60	1,891,318.19	2,381,850.22	8,812,181.82
February	1,705,178.27	1,954,528.47	2,004,825.72	1,653,689.27	7,318,221.73
March	2,124,476.61	1,814,673.24	2,477,745.82	2,378,108.97	8,795,004.64
April	2,221,335.30	2,302,893.67	2,536,783.07	2,029,922.56	9,090,934.60
May	2,516,383.26	2,740,832.85	2,241,833.87	2,315,891.40	9,814,941.38
June	2,072,364.50	1,985,739.90	3,039,812.83	2,299,805.48	9,397,722.71
July	1,823,328.05	1,842,349.70	2,592,628.68	1,778,623.55	8,036,929.98
August	2,068,306.17	1,611,726.54	1,558,199.40	1,940,746.66	7,178,978.77
September	1,117,760.00	1,177,828.83	1,927,863.61	2,660,930.21	6,884,382.65
October	1,728,642.62	3,085,627.31	2,521,721.60	2,455,127.73	9,791,119.26
November	1,834,361.37	1,652,631.93	1,999,610.21	3,785,496.97	9,272,100.48
December	2,642,374.05	2,545,307.68	2,249,247.04	3,975,330.03	11,412,258.80
<b>Total</b>	<b>24,408,584.01</b>	<b>24,699,079.72</b>	<b>27,041,590.04</b>	<b>29,655,523.05</b>	<b>105,804,776.82</b>

## Appendix 2: FLOW CHARTS – PROJECT SUBMISSION AND APPROVAL

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The approval of funds from the log export development levy trust fund can be accessed by following the approved Administrative Guidelines for the Management and the Use of the Log Export Development Levy.

A simplified version of the key steps involved in the processing of a project proposal and application for funding is illustrated by the flowchart below.



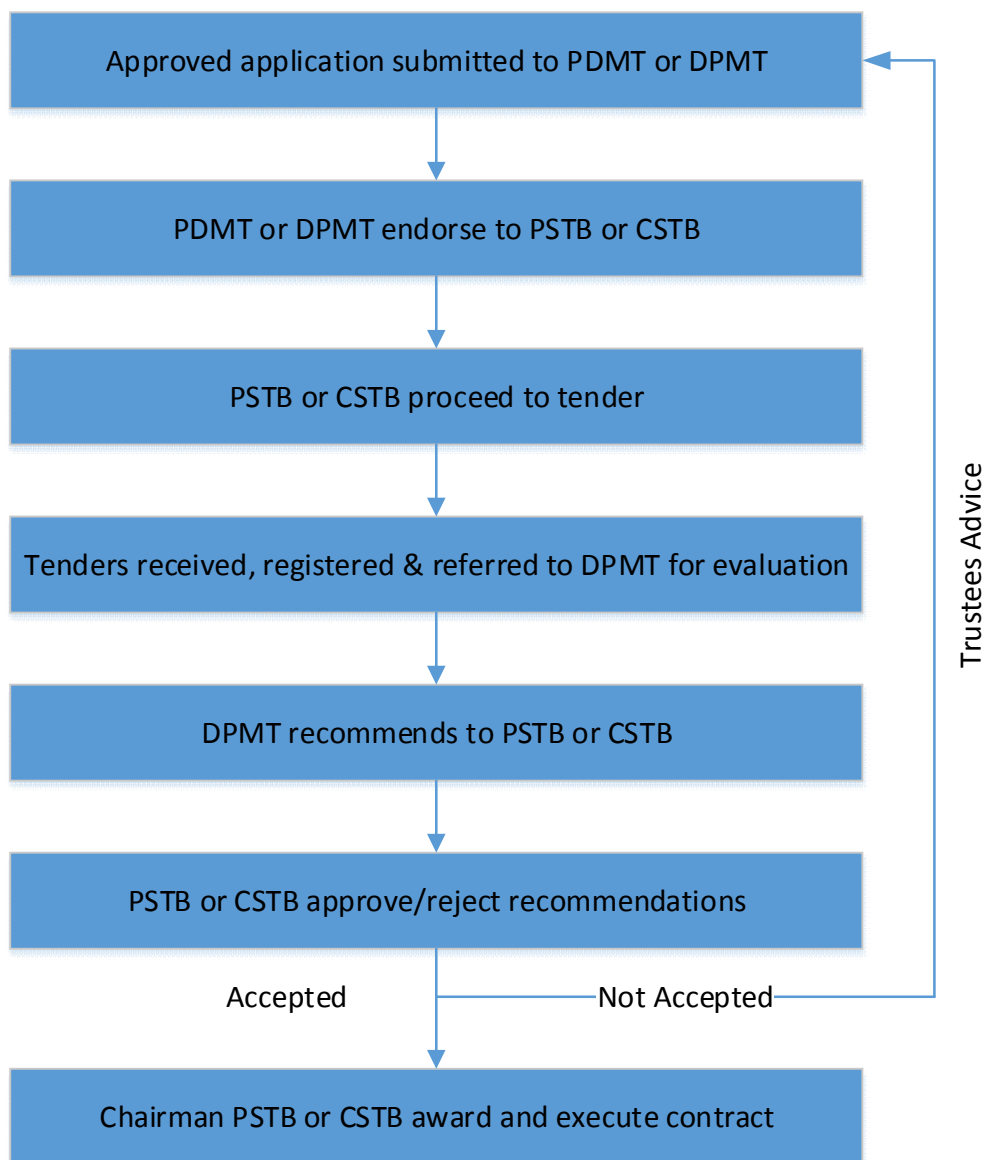
\*JDP&BPC, now called "District Development Authority"



### Appendix 3: Flowchart – Project Tendering and Payment

After a project application has been approved by the Trustees, procurement of Goods and Services may then proceed. For goods and services with total value up to K5 million is tendered by the Provincial Supply and Tenders Board (PSTB), and for total value of goods and services above K5 million is tendered by the Central Supply and Tenders Board (CSTB).

A simplified version of the key steps involved in the tendering for goods and services is illustrated below.



PDMT – Provincial Development and Management Team  
DPMT – District Project Management Team  
PSTB – Provincial Supply and Tenders Board  
CSTB – Central Supply and Tenders Board

## Appendix 4: LEDL Project Proposals Evaluated by PNGFA TEC and Submitted to LEDL Trustees

No	Applicant Name	Project Title	Project Description	Location	Amount Requested	LEDL Available (Minus 2% Admin Fee)
1	Umboi Timbers Ltd	Scooping & Documentation of road works	To built road/bridges from Gauru to Kabi. Upgrading gravelling and culverts.	Nawae/Siassi - Morobe Province	K1.2 milliom	K1, 176,000.00
2	Member for Aitape Lumi	Acquire equipment for infrustructure developments.	Funding for kit homes, firearms & vehicles.	Aitape, WS province	K1.6 million	K2,926,088.90
3	West Community Trade Ltd	Cocoa Development project	Establish Cocoa & copra buying in Kandrain Gloucester Area	Kandrian/Gloucester-Kimbe WNB	K5.7 Million	K3,902,960.74
4	Essem Eight (8) Resources Ltd	Reforestation Project	Agriculture Infrustructure	Inland Kalia/Kove LLG, Kandrian Gloucester - Kimbe	K2.8 million	K3,024,608.50
5	Miu Timbers Ltd	Cocoa Project	To cultivate & Plant Cocoa trees in the project area & surroundings.	Inland Rauto Rottok Bay	K1 million	K3,024,608.50
6	Aisor Development	Development Initiat	To purchase fishing and rice milling equipments	Ijivitari Tufi	K850,000	K885,780.84
7	Member for Talasea	Tapakasi Oil Palm Pr	A community based oil palm mini estate which will be owned by the local people	Biala, WNB	K1.6 million	K2,794,733.62
8	Manseng Incorporation Land Group	Cocoa Project	This project will create employment and embark on opportunity to sustain the cocoa industry in the project area.	Central Nakani, WNB	K2.5 million	K2,794,733.62
9	Amanab Timbers LO Association	To fund feasibility study	Feasibility study of Vanimo Tuna Loining & Cannery Project	Amanab Green river & Imonda	K1.2 & K1.8	K4,386,722.04
10	Kuwate Tuoinoluwo Sawmilling & Construction	Infrastructure & Agriculture purpose	This project is to resettle the villages since their homes were displaced with the Oil Palm Industry	Aitape Lumi	K735,000	K953,688.96
11	Hu;Jaipi LLG Incorporation	Vailala Purari Blk 1 Timbers Ltd	To fund infrustructure development - Ihu Health Centre	Kikori, Gulf Province	K1.527 Milli	K6,249,320.00
12	Marienberg LLG	Infrastructure Development	Top provide quality improved and sustainable impact infrustructure development projects for the rural communities in the area.	Esat Sepik Province	K2 Million	K1,969,259.04
<b>Total</b>					<b>K24.52 Million</b>	

## Appendix 5: Summary of Transaction Extracted from Bank Statement LEDL Payments from the Trust Account for the period 2012 – 2015

Date	Cheque No	Description of Payment	Amount (PGK)
20/01/2012	CHQ 6	Chq payment - Unknown	781,056.67
8/02/2012	CHQ 7	Chq payment - Unknown	503,032.00
10/02/2012	CHQ 8	Chq payment - Unknown	3,000,000.00
10/02/2012	CHQ 9	Chq payment - Unknown	2,500,000.00
29/02/2012	CHQ 11	Chq payment - Unknown	5,000,000.00
2/03/2012	CHQ 12	Chq payment - Unknown	493,674.14
19/03/2012	CHQ 14	Chq payment - Unknown	975,000.00
24/04/2012	CHQ 15	Chq payment - Unknown	5,000,000.00
7/05/2012	CHQ 19	Chq payment - Unknown	4,500,000.00
25/05/2012	CHQ 21	Chq payment - Unknown	6,000,000.00
1/06/2012	CHQ 17	Chq payment - Unknown	5,500,000.00
13/07/2012	CHQ 25	Chq payment - Unknown	9,996,855.00
4/09/2012	CHQ 23	Chq payment - Unknown	517,000.00
8/01/2013	CHQ 28	Chq payment - Unknown	285,440.00
15/01/2013	CHQ 29	Chq payment - Unknown	3,500,000.00
17/12/2014	Fund Transfer	Fund Transfer to BPNG	80,000,000.00
26/11/2015	CHQ 50	Namatanai District	2,241,793.00
1/12/2015	CHQ 63	Sohe District	894,691.00
1/12/2015	CHQ 38	Abau District	3,345,396.00
2/12/2015	CHQ 48	Madang District	2,810,037.00
2/12/2015	CHQ 54	Talasea District	3,364,226.00
3/12/2015	CHQ 52	Security Electronic Service	226,600.00
3/12/2015	CHQ 47	Kavieng District	4,012,853.00

8/12/2015	CHQ 42	Finschafen District	255,163.00
8/12/2015	CHQ 55	Telifomin District	415,646.00
8/12/2015	CHQ 46	Kand/Gloucester District	10,293,429.00
9/12/2015	CHQ 51	Pomio District	3,360,016.00
9/12/2015	CHQ 39	Aitape District	5,581,623.00
11/12/2015	CHQ 43	Gazelle District	2,677,623.00
18/12/2015	CHQ 61	Middle Ramu District	409,306.00
22/12/2015	CHQ 59	Wewak District	1,160,320.00
<b>Total</b>			<b>169,600,779.81</b>

