

REPORT

OF THE

AUDITOR GENERAL

ON

**CENTRAL CITY DEVELOPMENT
PROJECT MANAGEMENT TRUST
ACCOUNT**

AND

**CENTRAL CITY INFRASTRUCTURE
DEVELOPMENT TRUST ACCOUNT**

1998 - 2005

AUDITOR - GENERAL OF PAPUA NEW GUINEA

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The Honourable Jeffery Nape, MP
Speaker of the National Parliament
Parliament House
WAIGANI
National Capital District

Date: 12 February, 2008

Our Reference.. 32-3-26

Action Officer:

Designation:

Your Reference:

Date

Dear Sir,

In accordance with the provisions of Section 214 of the Constitution of the Independent State of Papua New Guinea, I transmit to the National Parliament, my Report signed on 12th February, 2008 on the Investigation carried out of the Financial Management and operation of the Central City Development Project Management Trust Account and Central City Infrastructure Development Trust Account for the period commencing 1998 to 2005.

Yours faithfully,

GEORGE W. SULLIMANN
Auditor-General

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AUDIT INVESTIGATION OF THE CENTRAL CITY DEVELOPMENT PROJECT MANAGEMENT ACCOUNT AND THE CENTRAL CITY INFRASTRUCTURE DEVELOPMENT TRUST ACCOUNT - 1998 TO 2005

Introduction

On 27th April 2006, the Chairman of the Public Accounts Committee (PAC) requested the Auditor General to investigate and report on the handling of transactions with and accounting for public monies by the Central City Development Project administration and/or the Central Provincial Government in respect of the Central City Development, during the period 1998 to 2005. I considered the request to be in the best interest of the general public and directed that an investigation be undertaken by this Office in accordance with *Section 8(2)* of the *Audit Act* as requested.

Scope of Audit

An audit of the accounts and records of the Central City Development Project Management Trust Account and the Central City Infrastructure Development Trust Account was conducted in September 2006 by this Office. The primary aims of the audit was to ascertain whether the financial transactions conducted by the Trustees were in accordance with the Trust Instrument and *Sections 15 to 20* of the *Public Finances (Management) Act*.

The procedures applied were consistent with accepted auditing practices and guidelines promulgated by this Office and included compliance with provisions of the *Public Finances (Management) Act*, and the *Audit Act* and with other relevant legislation.

Conclusions

I am of the opinion that the Trustees have not met their obligations prescribed by the Trust Instrument and the *Public Finance (Management) Act*. I have found that:

- the monies in the Trust Accounts may not have been spent appropriately and for the purpose set out in the Trust Instrument;
- the contracting of projects has not met the requirements of the *Public Finance (Management) Act* and there were several occasions where contracts had been entered into outside the required processes; and
- proper accounts and records have not been maintained and it was not possible for me to confirm the validity of large payments to contractors and consulting firms,

Trust Instruments

Two (2) Trust Accounts were established in accordance with *Section 10* of the *Public Finance (Management) Act, 1995* by virtue of a circular issued by then Minister for Treasury and Corporate Affairs, Honorable Iairo Lasaro, on 3rd April 1998.

The two (2) accounts were to be known as the;

- Central Province Township Development Project Management Trust Account, and
- Central Province Township Infrastructure Development Trust Account.

Objectives of the Project

The objectives of the Central City Project were;

- to provide a place of high residential amenity for the people of the province to live and work;
- to establish a co-ordinated Central Business District for the conduct of business, especially the services provided by the Central Provincial Government;
- to ensure the security of the residents of the town;
- to provide adequate education and recreational facilities to encourage the development of youths;
- to create a logical hierarchy of roads and associated urban infrastructure to allow for well planned and serviced urban development;
- to provide adequate social and health services for the residents of the Central Province Township; and
- to incorporate wherever possible designs and services, which reduce the impact of residential development on the environment, especially solids, refuse wastewater disposal, energy and water usage.

Accounting Books and Records

Proper accounting books and records were not maintained for both trust accounts. All accounting records were maintained on Excel Spreadsheets. Hence, these did not have the usual general ledger and subsidiary ledgers

systems of double entry book keeping. This meant that the main ledger accounts comprising bank, fixed assets, term deposits, debtors and creditors control accounts, were inherently not reconciled on a monthly basis and kept under a degree of control. Consequently, timely production of proper periodic management financial reports, especially quarterly management accounts were conceivably defeated, thus starving and misleading the Project Steering committee of vitally needed financial information.

Missing documents

I could not ascertain whether there were proper controls and accountability on the transactions of these trust accounts in the absences of vital records and documents such as, material payment vouchers, receipts and payment reports and activity reports.

Documents supporting the invoices comprising signed clock cards and/or timesheets showing actual hours worked and the natures of jobs performed by both consultants and contractors were missing from the files. As such, it was not possible to validate the various payments made.

Budgetary Controls

There were no budgets prepared and used to monitor and manage the operations of the Project. It is therefore difficult to understand how the Project Management and the Steering Committee managed to ensure the operations of the Project were closely monitored and managed in an efficient and effective manner. The budget is a key management control that could be used to ensure the funds received were properly used to maximize the benefit and achieve the purpose of the Project.

Also, there was virtually no periodic monitoring done over the project from the Department of Finance. This has further reduced the effectiveness of management controls, hence the existence of uncontrolled use of money allocated to the Project.

In my view, the above missing controls have contributed significantly to the use of funds that could not be completely and accurately accounted for.

Government Grants

During the eight years from 1998 to 2005 monies totaling K12,552,400 were paid as grants by National Government, Central Provincial Government and the Department of Mining and Petroleum to this project.

A review of those grants received by the Central City Project revealed that the funding was provided on an adhoc basis with no conditions attached or required to release the funds. Funding should be based on established procedures and sound plans. There was no evidence to suggest it had followed those formal procedures. The total cost, size and timing were not known for the

proposed city. At the time of this investigation, there was uncertainty over Parliament's approval of funding and no guarantee for continuous funding for this Project.

Physical Inspection of Project Site

The independent engineer's opinion/evaluation is outstanding; the engineer's scope of works should cover the planning aspects, existence and durability. However, from the brief visit to the project site it was apparent that the total expenditure level made available did not justify the completion stage of the township buildings and the sites.

Expenditure

The lack of control over expenditures has resulted in the township not getting value for money services. Funds have been misused resulting in poor infrastructure. The buildings and site do not reflect the level of funding put through the proposed township.

Financial Statement Audits

The financial statements audits of both the Central City Development Project Management Trust account and Central City Infrastructure Development Trust accounts for the years 1998 to 2005 were done by Kolta and Associates. Kolta and Associates were never appointed by this Office to carry out the audits of these two accounts.

Any audit of public monies conducted directly without the approval and supervision of this Office is against the *Constitution* and the *Audit Act*. Such audits could be misleading and may not reflect the true circumstances surrounding the financial and management operations of the project.

Other Major Points

- There were numerous instances of transactions not properly handled to safeguard the interest of the Central City Project and to reduce costs.
- There was an ongoing conflict of interest situation. "Consultants" appointed to provide various services to the project formed the core of "Project Management Team" and were also signatories to the trust accounts. They were accountable to the Steering Committee of which they were members.
- Segregation of duties and accountabilities have not been properly identified and systematically established from the start which contributed significantly to poor management of the project.
- Key controls in the entire accounting functions were missing. Excel spread sheets were used to maintain all accounting records instead of a proper

general ledger based accounting package. Payment processes have been notably abused to allow significant "advance payments" made to the Consultants without proper invoices.

- Existence of non compliance with regards to certain aspects of: *Income Tax Act, Public Finance Management Act, Personnel Management Act and Companies Act 1997.*
- From 2000 to 2005 inclusive, there was no budget maintained as a benchmark to control expenditure and to operate within the revenues received.
- There was no evidence of formal periodic financial reporting to the Project Steering Committee and the Department of Finance.
- Payments were made in advance to FIRMS Limited and Nakita Consulting Limited over the eight years.
- Advance payments increase the risk of misappropriation and fraud because monthly invoices were generated and presented about 7 days later. They did not have supporting documents showing certification of work done.
- There was no evidence of direct monitoring and supervision of the funds provided from the Department of Finance except through representation in the Steering Committee.
- The Project Prescribed tender procedures were not followed in the appointment of the following consultants:
 - Nikita Consulting Limited;
 - Ravenpol No. 91 Limited (trading as Project Management Services); and
 - Financial Investment and Resource Management Services Limited (FIRM).
- There were certain practices of the Consultants that warranted further investigation and action which included: the basis of advance payments, over payments amounting to over K350,000 and invoices paid that had no supporting documents showing evidence of work certified and completion reports. Their certificates of compliance are yet to be produced.
- The land title of the project site is not clear and confirmation is yet to be received.

Outstanding Matters

As part of reporting, the following matters are outstanding:

- financial statements audits;
- independent expert assessment of the value of the infrastructure development by Engineers;
- confirmation of land title;
- schedules of invoices, contracts, receipts and other source documents;
- internal revenue confirmation of certain tax matters for the consultants and project manager; and
- funding approval by National Parliament

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Management Control

There were serious weaknesses noted in the overall management controls framework of the project. The major areas of concern were lack of budgetary controls and reporting to the Steering Committee and the Department of Finance. It appears that financial reports were not prepared timely and accurately to submit to the top level. Further, there was no formalized monitoring processes adopted and used by both the Steering Committee and the Department of Finance to effectively control the usage of public monies provided to the project.

The "Project Management Team" did not maintain the financial records using a proper integrated general ledger based accounting system. All transactions were simply recorded on "Excel Spread sheets" which lacked the intricacies of inherently inbuilt controls between the general ledger control accounts and the subsidiary ledgers.

The Project Management Team

The "Project Management Team" as appointed by the Steering Committee comprised Messrs Kila Ai, Peter Nicholas and Hans Euscher. These persons were also members of the Steering Committee before been appointed to the management team. They were also formally engaged as consultants through their respective firms and have been continuously providing services to the project. These consultants have been made signatories of both trust accounts. However, there was no evidence of such authority been formally approved by the Steering Committee. It must be appreciated that "conflict of interest" undoubtedly existed from the out set and prevailed throughout the life of the project. This has significantly impinged adversely on the effectiveness and efficiency of the overall management controls system.

Project Steering Committee

There were notable weaknesses identified within the functions of the Project Steering Committee, as follows:

- failure to institute annual budget and monitoring;
- nil review and authorization of the annual CPI increases for the Consultants;
- over payments to the Consultants were not identified and corrected; and
- not sensitive to the weaknesses in the management controls in the accounting aspects of the operations.

Payments in Advance

There were substantial advance payments made to FIRMS Limited and Nikita Consultants Limited. These payments were made well in advance before the invoices were received and certified by persons responsible. This occurred as a result of lack of proper management controls and the lack of co-ordination and close monitoring from the Project Steering Committee. In my view, the basis of advance payments remain to some extent largely unsubstantiated and could potentially involve misappropriation, thefts and/or fraud.

Consumer Price Index (CPI)

Total CPI increase from 2002 to 2005 was 39.4% as advised by Deloitte. Quarterly increases have been progressively added onto the base contract hourly rate of K250 to produce invoices and payment of same. Summary reconciliation of payments made to FIRMS Ltd and Nikita Consulting Limited revealed total over payments amounting to K323,383 and K52,244 respectively under the auspicious of CPI increase. Although provided for in the contracts, these CPI increases were never reviewed and authorized by the Project Steering Committee.

Missing Documents

It was of concerned that all Nikita Consulting Limited's and FIRM's invoices for consultancy services were hardly supported with relevant documents. These documents should typically show details of work performed, time committed and certification from an appropriate authority. The practice prevailed throughout the duration of their engagement to the end of October, 2005. Total payment made to these two consulting firms over the eight years amounted to K3,706,680; of which FIRMS Limited was paid K2,016,076 and Nikita Consulting Limited with K1,690,604.

Bookkeeping Services

Bookkeeping related services were introduced and maintained for the project by FIRMS Limited since 1999. An annual fee of K33,000 (K2,750 per month) amounting to K225,500 has been paid to 31 October, 2005. There was no formal contract in existence between FIRMS Ltd and the project for these services. The Project Management Team appeared to have approved this service, but there was absolutely no evidence provided to confirm approval from the Steering Committee.

Nikita Consulting Limited

Nikita Consulting Ltd is a company owned by Mr Kila Ai, the Project Manager. This consulting firm was paid a total of K1,722,106 during the eight (8) years, relating to coordination services. Examination of these payments revealed the following anomalies:

- A company search revealed that Nikita Consulting Limited was registered in early 1998 and the certification of incorporation was issued by the Investment Promotion Authority (IPA) on 30 April, 1998. The company was appointed by the Steering Committee on 7 May, 1998 but actual work started on 1 April, 1998 as approved by the Committee. The appointment of this firm took effect well in advance of its registration with IPA.
- Most of the invoices were not supported with appropriate source documents comprising authorized timesheets, details of work done and certification of same. Therefore, it is difficult to verify the basis of the payments made throughout the years.
- There were substantial advance payments made to Nikita Consulting Ltd during the eight (8) years. These payments were made well in advance before the invoices were received and certified.

Financial Investment and Resource Management Services Limited (FIRMS)

Financial Investment and Resource Management Services Limited (FIRMS), a company owned by Peter F. Nicholas who is the Project Co-ordinator was paid a total of K2,093,182 relating to consultancy services and book keeping services provided in 1998 to 2005. Examination of the payment vouchers revealed the following issues:

- All invoices were not supported with appropriate documentary evidence. It was therefore difficult to verify the basis of payments made throughout the year; and
- On several occasions, payments were made in advance to FIRMS.

The above amount includes K225,000 which was paid to FIRMS for book keeping services provided from 1999 to 2005. There is no specific contract agreement between FIRMS Ltd and the Central City Project Management to provide such services for additional fees. Also, there was no evidence of a request from FIRMS Ltd to or any directions from the Project Steering Committee to engage FIRMS Ltd to provide such services.

The contract extension signed between CPG and FIRMS expired on close of business 31 December, 2004. Thus, the next contract extension agreement for 2005 was not provided for my verification.

Project Engineer

The Steering Committee in their meeting on 7 May, 1998 had appointed Mr Raul Santa Cruz to the newly created position of Project Engineer. He was previously employed by the Central Provincial Government. There was no formal contract in place for the Project Engineer nor was there any evidence of this position been advertised in the local media. Total contract amount for the position was K190,000 per annum with no tax being deducted and remitted to IRC. The

Steering Committee clearly did not adhere to the employment procedures required under the relevant laws in PNG regarding the employment of non-citizens.

Police Security

Police personnel were engaged for the provision of security services at the Project site from 1999 to 2003 at a total cost of K238,422. There was no evidence of approval of their engagement by the Project Steering Committee. Furthermore, there was no evidence to show the terms and conditions of their engagement. This amount was split between food ration and allowance amounting to K45,000 and K193,422 respectively. Allowances paid were based on the duty roster provided by the Police Commander In-Charge. However, there were no supporting documents comprising invoices and receipts for fortnightly payment.

Overseas Travel Expenses

Two (2) payments totaling K8,661 were made to Air Niugini for a business trip taken by Mr Kila Ai to Singapore. The cash payment vouchers and invoices were missing from the file. Further, there was no evidence to show that the trip was approved by the Project Management Team or Steering Committee. Also, the purpose and outcome of trip is not known.

IBD Investments

During the years 1998 and 1999 receipts totaling K116,120 were earned from Interest Bearing Deposits (IBD) held with the banks. However, in the absence of records such as IBD Certificate, IBD registers recording movements in these IBD and other related records, we were unable to verify the interest earned on these IBDs.

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Management Control

There were serious weaknesses noted in the overall management controls framework of the accounting and operational aspects of the project. The major areas of concern were the lack of budgetary controls and absences of a proper general ledger system of accounting. Audit findings revealed serious lack of proper monitoring mechanisms in place as far as the financial management of Central City Project Management is concern.

Steering Committee

There were notable weaknesses identified within the function of the Steering Committee, as follows:

- failure to institute annual budgets and review of same;
- nil review and authorization of the annual CPI increases for the consultants; and
- not sensitive to the weaknesses in the management controls of the accounting aspects of the operations.

Project Expenditures

The following is a summary of project expenditure which raised certain doubts as to their validity;

(a) Project Management Services

Project Management Services, a private consulting firm was engaged by the project during the life time of this project. A sum of K525,056 was paid to this firm over the period of seven (7) years for consultancy services. However, we are unable to vouch most of the payments made to this firm because the relevant vouchers together with other supporting document showing detail of work done and the time spent on each job were missing. All payments made in 2001 totaling K166,750 were not supported with any payment vouchers including invoices.

(b) Bee Construction Ltd

in 1999, Bee Construction entered into an agreement for the construction of Police Headquarters, two Hiri District Offices and two H65 houses at a total cost of K417,989. However, total payment made to the company for these jobs was K499,147. Variation reports to show this cost escalation, were not made available. In the absences of such report, this could be treated as an overpayment of K81,158.

(c) Hebou Construction Limited

Over a period of four (4) years, Hebou Construction was paid a total sum of K4,418,876 for road construction and maintenance at Bautama. All payments made in 2000 and 2001 were not supported with any voucher, invoices and relevant supporting documents. These documents seem to have been selectively removed and/or gone missing from the files. No plausible explanations were provided by the Project Management for this unusually significant irregularity. As such, payments to this company could not be verified.

During 2001 payments totaling K2,537,418 were paid to Hebou Construction for construction work carried out at the project site. The contract amount for this job as approved and signed in the contract (Contract No. CCPM - 004C) was for K1,548,233. The excess payment of K989,185 is neither supported by any variation report approved by the Board and/or has any supporting documents.

(d) Unrelated Expenditure

In 2005, an amount of K7,920 was paid to Informa Australia for the cost of Mr. Kila Ai's attendance at the PNG & Australia Gas Conference in Australia. There were no supporting documents to verify the payment made. Furthermore, the rationale and benefit of this trip to the project is not understood.

(e) Consumer Price Index Increase

The Steering Committee did not review the CPI increases to make necessary assessments regarding its reasonableness and the approval of the same. While the contract had provisions for adjustment to the CPI, excessive amounts had been charged by the contractors under the pretext of CPI adjustment resulting in excess payments.

(f) Niu Ford Motors

In 2005, a new vehicle was purchased at a cost of K89,059 as replacement for a project vehicle that was reported stolen by criminals. Incident reports as well as police reports on this incident were not made available. Further, we were unable to establish if the stolen vehicle had been insured and if so, there was no evidence of any attempts made through the insurance company to recover money.

(g) Investments

During the years 1999 to 2005, Projects funds were invested with various commercial banks in Interest Bearing Deposits (IBD). Total interest reportedly earned from these investments was K871,282.

However, there were no records available to show movement of all these IBD investments. The IBD registers, if any, maintained and IBD certificates were never sighted. Thus, we are unable to verify and confirm actual amounts of interest earned from these investments.