

## Papua New Guinea Sustainable Development Program Review

Stephen Howes and Eric Kwa<sup>1</sup>

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<sup>1</sup> Dr Stephen Howes is Professor of Economics and Director of the Development Policy Centre at the Crawford School of the Australian National University. Dr Eric Kwa was an Associate Professor in the School of Law of the University of Papua New Guinea and was recently appointed as the Secretary for the Constitutional and Law Reform Commission.

# Executive Summary and Summary of Recommendations

## Introduction

This review has been undertaken between June and December 2011. It has involved three visits to Port Moresby, two to the Western Province, two to Singapore, and one to Melbourne and Canberra.

SDP is a unique organization. It was incorporated in Singapore on 11 October, 2001 following the decision of BHP to exit the Ok Tedi mine, and the decision of the Government of PNG to keep the mine open. BHP gave its 52% stake in OTML – Ok Tedi Mining Limited – to SDP, a new entity, registered in Singapore. SDP became fully operational in 2004.

SDP's Rules require it to allocate two-thirds of its income to a Long Term Fund to be spent only after mine closure. One-third of its income is to be allocated to expenditures for "sustainable development" prior to mine closure: one-third of this is to be for the benefit of the people of the Western Province (WP), in which the Ok Tedi mine is located; and two-thirds for the benefit of the people of PNG.

SDP is run by a board of seven members. Three of these are nominated by BHP, one is nominated by the PNG Treasury, one by the Bank of Papua New Guinea, one by PNG Chambers of Commerce and Industry, and one (a resident of Singapore) is selected by the Board.

SDP operates under its Articles of Association and Program Rules. The Program Rules require the company to have an independent review every three years. Section 18.3 of the Rules state that the Review should examine whether:

- (i) the Program's operations continue to conform to the Objects and these Rules;
- (ii) the Program is managed efficiently and effectively; and
- (iii) the impact of the Program is documented and taken into account in the future development of the Program

This guidance provides the framework for our review. In addition, we look at the ongoing relevance of some of the Rules. This is beyond our terms of reference, but was suggested to us and makes sense given the many changes in circumstance which have taken place in recent years.

The last review of SDP was undertaken in early 2007 by Professor Dwight Perkins. When Professor Perkins was writing, SDP was still in an early and formative stage, and his review was appropriately forward-looking. Since then, much has happened, and this review is both backward- and forward-looking.

## **Operating environment**

PNG and especially the Western Province continues to present a difficult operating environment, where capacity is often low, corruption is a serious problem, and risks are high. But the past few years have also been ones of rapid change for the environment within which SDP operates:

- The resource boom in PNG has led to much higher profits for Ok Tedi, and so much more income for SDP than originally envisaged. Between 2002 and 2005, SDP received some US\$293 million in dividends from OTML. In 2010 alone, SDP received \$338 million.<sup>2</sup>
- The likely prospect of Ok Tedi mine continuation to 2022 or beyond is of fundamental importance. It will increase the funds available to SDP by extending its revenue stream by a decade or longer. It will push back the time when the Long Term Fund can be spent, since this fund can only be tapped after mine closure. And it has made a number of projects which SDP has been promoting more viable, since they will be able to draw on support from the mine for a much longer period.
- The revised compensation agreement of 2007 has changed the way SDP provides benefits to communities affected by the Ok Tedi mine. Projects which count towards SDP's K21.5 million annual commitment to these communities have now to be approved not only by SDP but by representatives of the communities as well.
- The recent change of national government in PNG has put in place, at least for the time being, a government which is more positive and pro-active in its attitudes towards SDP.

## **Overview of activities**

SDP has three main areas of responsibility. It manages an inter-generational fund, the value of which passed the \$1 billion mark in 2010. It is the major shareholder in Ok Tedi. And it runs a development program with annual expenditure exceeding \$100 million for the first time this year. (If one views SDP as an aid donor, it would probably be PNG's second largest.) This expenditure is on a wide range of activities, large and small, in the Western Province and elsewhere in PNG. Details of these activities are provided in the main text. SDP operates as an implementer of projects, as a shareholder of various subsidiaries, and as a funder of grant applications.

## **Conformity with and relevance of rules**

In general, compliance with the Rules is high. There are two main matters which require attending to.

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<sup>2</sup> All dollars are US\$ unless otherwise specified.

First, the Program Rules give an important role to the Advisory Council. The Advisory Council is to have 5-7 members, and is to meet at least quarterly, and annually with the Board. Its role ranges from advice to monitoring to dissemination.

The Advisory Council did not meet at all in 2011. The primary problem would seem to be that it is not clear how the role of the Advisory Council differs from that of the Board, and therefore how it can add value.

One possibility would be to amend the Rules to abolish the Council. A more positive approach would perhaps be to explore whether the Advisory Council could help fill the communication and ownership gap which sometimes exists between SDP and key stakeholders. We propose that the Advisory Council be reconstituted to include not only independent, eminent persons (as at present) but also senior national and provincial government representatives. Thus constituted, regular interaction of the Advisory Council with SDP management could improve communication flows and openness. And while it is unrealistic to expect the Advisory Council to advise on all projects, they could on the community programs under the CSDP (Community Sustainable Development Program).

Second, spending on development programs and on administration are well within prescribed limits. The divide between spending of benefit to the people of Western Province and spending of benefit to the people of PNG has also been kept within the mandated limits. However, there is a tendency to classify projects as national even when many of the benefits will flow to the Western Province. For example, the Daru Port has been classified as a national project, where clearly many of the benefits would flow to the Western Province. This requires a re-examination.

Concerning the relevance of the rules, the main issue requiring consideration is the fact that, under Program Rules, the Long Term Fund cannot be spent until Ok Tedi closes. With the mine-life extension proposed, this may not be till 2022 or even later. The Fund is already bigger than anyone envisaged it to be, and it is only going to keep growing. To illustrate, assuming a 4% real return, and annual real income to SDP from Ok Tedi dividends of \$200 million a year, of which two-thirds are added to the Long Term Fund every year, by 2022 the Long Term Fund would be worth \$3.7 billion. At that point of time, a 4% return would be \$133 million, double the one-third of income (\$66 million) that could be spent under current rules (on development spending) in preceding years (that is, prior to mine closure).

We discuss alternative spending rules in the text which would allow for smoother and more front-end-loaded spending profiles.

Rules governing the expenditure from the Long Term Fund are more ambiguous than those governing the use of the Development Fund. Clearer direction on the use of the Long Term Fund would help, for example, by imposing the same one-third, two-third rule used for the Development Fund.

We are not in a position to give firm recommendations on these issues, and indeed it is not our role. We simply recommend that they be given active consideration.

SDP's governance arrangements have served it well, and its independence from government, though sometimes a source of tension, is widely recognized as a strength. For long-term viability, we recommend consideration be given to delegation by BHP of its Board nomination role to a third party committed to the principles of SDP's operations, and to embedding this in the Articles of Association. We also suggest that opportunities be sought to include one or more persons from the Western Province on the SDP Board.

### **Efficiency and effectiveness**

The second task we are called on to perform is to judge whether “the Program is managed efficiently and effectively.” Overall, SDP's achievements to date are many and varied, especially considering the difficult operating environment in PNG in general, and in Western Province in particular. Many of the activities which SDP is attempting have simply not been attempted before, such as rural electrification in Western Province, or sustainable native logging.

SDP has three main areas of responsibility and achievement. First, it has responsibly managed a large inter-generational fund, which it has carefully protected and invested conservatively, in line with Program Rules. The Long Term Fund has achieved an annual return of 4.9%, and weathered the Global Financial Crisis well, containing the negative return in 2008 to only -2.6%.

Second, SDP has responsibly and proactively discharged its duty as a majority share-holder of PNG's most important mine, in particular by promoting the prospect of an environmentally-responsible mine extension. Clearly the Ok Tedi mine has done very well financially over the last decade. On the environmental front, nothing can be done to reverse the environmental damage already done (prior to SDP's creation). However, two major investments have been made to reduce further environmental damage. First, although waste and tailings are still dumped into the river, dredging of the river takes place further downstream so that further sedimentation does not occur. (Dredging began in 1999.) Second, since 2009 a sulphur concentrate is extracted from the tailings and piped 130 km down to a location where it can be safely buried.

Third, SDP has delivered real results on the ground through its development spending. Not surprisingly, some projects have done much better than others. SDP operates in a high-risk environment, and one should expect failures as well as successes. To its credit, SDP has played a wide-ranging catalytic role setting in motion a number of large projects the potential returns from which, if realized, would be a large multiple of the costs incurred. This role is particularly important: SDP seems to be filling a gap in mega-project development which neither any other donor nor the government is addressing. The Purari hydro and other power projects seem to us to be especially promising as ways to help solve PNG's chronic power shortage. Through the development of subsidiaries such as Western Power, SDP has enhanced PNG's implementation capacity.

However, all this is not to say that there is no room for improvement. A number of issues are addressed in the main text and summarized below.

**Sustainability:** All aid agencies and many governments struggle with sustainability. SDP is no exception. Promoting sustainability requires a realistic assessment of post-construction financing

needs, a willingness to provide long-term, annual funding if necessary, and experimentation with different institutional structures. We recommend that SDP make a realistic estimate of recurrent expenditure obligations, and make this the first charge on its annual development expenditures.

**Commercial ventures:** SDP's goal to form partnerships with other businesses is the correct one, but experience shows it is not an easy goal to achieve. As the majority or sole owner of all but one of its subsidiaries, proactive management of its subsidiaries is particularly important. We recommend that SDP hire a Commercial Manager to manage its subsidiaries.

**Relations with government:** Relations with the Western Province Provincial Government have been problematic. SDP has also sometimes been criticized by some senior members of the national government. However, in our meetings with national government ministers and senior bureaucrats, we found a positive attitude to the organization. The current PNG government is especially keen to develop a partnership with SDP in the area of power supply. Relations with government therefore present a mixed picture. The strengths should be built on, and the weaknesses in the relationship addressed. PNG's governments – national and provincial – need to look on SDP as a valuable asset and partner. SDP needs to continue to demonstrate that it can deliver results. Various interlocutors commented on a perception of “under-delivery” which surrounds SDP. The telecom towers should go a long way towards cementing a more positive image of the organization in the Western Province, and the power projects under planning could do the same nationwide.

**Relations with non-government partners:** We commend SDP for its work with the churches, and other non-government partners.

**Risk profile and management:** SDP is engaging in a high-risk environment. Some past decisions may not have reflected adequate scrutiny. We note and welcome recent strengthening of risk management on various fronts, including through the strengthening of internal audit, and urge the deepening of these initiatives.

**Spread of activity:** Over time, SDP has taken on an increasingly wide range of activities. This may be spreading its management and oversight capacities too thinly. We recommend at the current time a reduced rather than expanded spread of activity. We suggest that a moratorium be placed on new areas for funding, and that existing areas be reviewed to see if any can be consolidated or exited from.

**Overlap:** In some cases there seems to be an overlap of activities between SDP and companies in which it has an ownership stake. Some rationalization would be sensible.

**Ok Tedi:** The achievement of key SDP goals requires close cooperation between it and OTML, the Ok Tedi mine company. SDP cannot and should not dictate terms to OTML, but we do see scope for greater cooperation between the two organizations.

**Decision making and execution:** This was the issue on which we received the most feedback. Comments we heard repeatedly were that issues drag on, that the resolution of problems takes too long, that decisions are not clearly communicated, and that timetables are unrealistic. It was

widely acknowledged that things are improving. The Board is becoming more streamlined, and engaging in less micro-management. Management has been strengthened, especially under the current CEO, and with the appointment of a COO. Nevertheless, problems concerning decision making and execution remain.

In part, the issue may be the ever-widening range of activities which SDP is undertaking. To this extent, the consolidation of activity we recommend above would also help improve execution and reduce delays. In addition, we suggest that the clarity of Board decisions could be improved. A final recommendation is that SDP management should continue to be strengthened. In particular, at this time of great labour shortage in PNG due to the resource boom, it may be necessary to hire expatriates to fill skill gaps. In our view, the principle should be to get the very best person for the job, and pay them as the market demands. SDP's mission is so demanding, its projects so complex, and its potential so great that it should be willing to pay enough to get the best.

### **Documentation of impact**

Finally, the Program Rules require us to assess the extent to which the “impact of the Program is documented and taken into account in the future development of the Program”.

It is to its credit that SDP produces an Annual Report, holds an Annual Report Meeting, and has taken recent steps to improve reporting and communications, including through a more visible media presence.

Nevertheless, one cannot say at this stage that the impact of SDP activity is documented. Evaluation is particularly important for SDP because of its high level of independence. This is a good insofar as it avoids harmful interference, but it needs to be ensured that accountability is not undermined. The way to ensure accountability is through public evaluation. From this point of view, the triannual independent evaluations (of which this is the second) required under the Program Rules are very important. However, the three-year review process would be more effective if there was a base of evaluation material to build on. A review such as this cannot on its own hope to establish the impact of individual programs.

We have a number of recommendations by which performance in this area can be improved. They are summarized below, along with the report's other recommendations.

### **Summary of recommendations**

#### ***In relation to conformity with and relevance of rules***

1. Reconstitute the Advisory Council to include senior representatives of key national and provincial government bodies (such as the Department of Planning, and the WP Provincial Administration), and give it specific responsibility for advice on community projects.
2. Review the basis which is used to distinguish between national and Western Province development projects, and recategorize expenditures accordingly.

3. In light of mine extension, consider alternative options for disbursement pre and post mine-closure, and develop simpler expenditure rules to guide expenditure from the Long Term Fund.
4. Give consideration to delegation by BHP of its Board nomination role to a third party committed to the principles of SDP's operations, and to embedding this in the Articles of Association. Seek opportunities to include one or more persons from the Western Province on the SDP Board.

***In relation to efficiency and effectiveness***

5. Make a realistic estimate of recurrent expenditure obligations, and make this the first charge on SDP's annual development expenditures.
6. Hire a commercial manager to oversee SDP's subsidiaries.
7. Reduce rather than expand the area of SDP's activities. Place a moratorium on new areas for funding, and review existing areas to see if any can be consolidated or exited from.
8. Seek opportunities for rationalization of activities between SDP and companies in which it has an ownership stake.
9. Explore avenues for greater cooperation and risk-sharing between SDP and OTML
10. Improve the clarity of communication between Board and management. Strengthen management, if necessary by hiring more expatriate staff, given PNG's acute and growing skill shortages.

***In relation to documentation of impact***

11. Undertake periodic independent and public evaluations of a random sample of all community and community-type projects (this would include education, health, water, rubber and other community projects).
12. Undertake periodic independent and public reviews of important programs (e.g., forestry, microfinance).
13. Appoint an M&E (monitoring and evaluation) officer or consultant to drive an M&E agenda, and aim for, say, one public, independent evaluation every year.
14. Publish and place on the internet this and the last (Perkins) SDP review, and the Melanesian NGO Centre for Leadership CSDP evaluation.
15. Redesign the Annual Report to enhance the focus on results, and to provide a balanced history rather than an optimistic snapshot.

16. Simplify the organizing structure for the Annual Report along the lines suggested in the body of the report, with, as is increasingly happening, reporting against quantitative targets, and goals from earlier years.
17. Ensure that OTML report its performance annually against Global Reporting Initiative (GRI) standards, including for the environment.
18. Include in the team appointed to undertake the next tri-annual review specialists in sovereign wealth fund management and mine operations as well as development.

# 1. Introduction

To begin, we would like to thank all of those who have assisted us undertake this review by patiently answering our questions and offering their views. We value these contributions – much of what is presented in this report is drawn from them. (A list of interviewees is annexed.) Special thanks also to those who helped arrange our meetings and visits, Susil Nelson, Fae Maso and Lalatute Avosa of SDP and Cleo Fleming of ANU's Development Policy Centre.

## *Process*

The review began in June 2011 when Stephen Howes participated in the June 9-11<sup>th</sup> Board meeting of the SDP and the Annual Report Meeting. Both reviewers then participated in a round of discussions in Port Moresby and a visit to the Western Province (Kiunga and Tabubil) in the week of July 4<sup>th</sup>. We subsequently participated in a round of meetings and tele-interviews in Melbourne and Canberra the week of August 22<sup>nd</sup>. Eric Kwa visited Telefonin to participate in the commissioning ceremony for one of the SDP telecom towers on October 13<sup>th</sup>, and both reviewers had a final round of discussions in Port Moresby the week of November 14<sup>th</sup>, visiting the Cloudy Bay Timber Yard/Mill at 9 Mile, Port Moresby on November 18<sup>th</sup>. Eric Kwa also visited the South Fly region of the Western Province, including Daru, in early June on another SDP assignment, which also proved useful for this review.

We have also had access to recent Board minutes, and other reports. We presented draft reports to SDP Board Meetings in Singapore on September 9<sup>th</sup> and December 1<sup>st</sup>, and this final version reflects comments received on those earlier drafts.

## *Approach*

SDP operates under its Articles of Association and Program Rules. Both documents can be found on the SDP Website. The Program Rules require the company to have an independent review every three years, and set out the areas which the review should cover. Specifically, Section 18.3 of the Rules state that the Review should examine whether:

- (i) the Program's operations continue to conform to the Objects and these Rules;
- (ii) the Program is managed efficiently and effectively; and
- (iii) the impact of the Program is documented and taken into account in the future development of the Program

We use this guidance to provide the framework for our review. In addition, we look briefly at the ongoing relevance of some of the Rules. This is beyond our terms of reference, but it was suggested to us and it makes sense given the many changes in circumstance which have taken place in recent years.

The structure of the report is as follows. The next section provides the context, and the section after that gives an overview of the operations of SDP. The three sections following provide our response to each of the three aspects of the Program Rules.

The last review of SDP was undertaken in early 2007 by Professor Dwight Perkins. When Professor Perkins was writing SDP was still in an early and formative stage, and his Review was appropriately forward-looking.<sup>3</sup> Since then, much has happened, and this Review needs to be both backward- and forward-looking.

## 2. Context

### *The PNG Sustainable Development Program*

SDP is a unique organization. We are not aware of any parallel to it anywhere else in the world. SDP was incorporated in Singapore on 11 October, 2001 following the decision of BHP<sup>4</sup> to exit the Ok Tedi mine, and the decision of the Government of PNG to keep the mine open. BHP gave its 52% stake in OTML – Ok Tedi Mining Limited – to SDP, a new entity, registered in Singapore. SDP became fully operational in 2004.

SDP is run by a board of seven members. Three of these are nominated by BHP, one is nominated by the PNG Treasury, one by the Bank of Papua New Guinea, one by PNG Chambers of Commerce and Industry, and one (a resident of Singapore) is selected by the Board. The BHP Directors are known as “A-Directors” and the three PNG-institution nominees as “B-Directors.” To be binding, majority decisions need to have the support of at least one A- and one B-Director.

SDP’s Rules require it to allocate two-thirds of its income to a Long Term Fund to be spent only after mine closure. One-third of its income is to be allocated to expenditures for “sustainable development” prior to mine closure: one-third of this is to be for the benefit of the people of the Western Province; and two-thirds for the benefit of the people of PNG.

Amendment to the Program Rules requires the agreement of both BHP and the Government of PNG (through a document signed by a Minister). (See Articles of Association, Clause 8)

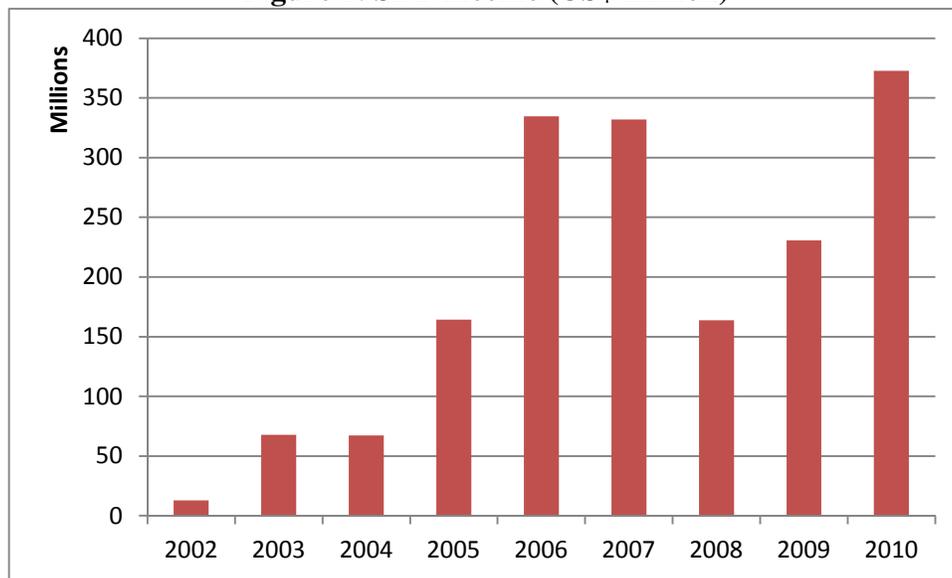
Figure 1 below shows the rapid growth in SDP income, which is due in large part to the high growth in world prices for the copper, gold and silver which Ok Tedi produces.

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<sup>3</sup> “The main focus of this report, therefore, has been to try to understand the strengths and weaknesses of that forward-looking program that is being planned and implemented.” (pp. 4-5 of the 2007 Perkins Review)

<sup>4</sup> Throughout the report, we use the name ‘BHP’ rather than ‘BHP-Billiton’ as the company is now called

**Figure 1: SDP income (US\$ million)**



There is currently one vacancy on the SDP Board following the retirement last year of Jim Carlton, one of the BHP nominees. All Board members have held their position since the creation of SDP except for the current PNG Treasury nominee, Rex Paki, who joined in October 2011, replacing Lawrence Acanufa, who in turn joined the Board after the untimely death of Sir Ebia Olewale. The Board Chair is Professor Ross Garnaut (a BHP nominee). Other Board members are: Tricia Caswell (another BHP nominee), Lim How Teck (the Singapore-based member), Don Manoa (Chamber of Commerce and Industry nominee) and Jacob Weiss (the Central Bank nominee)

David Sode, formerly PNG's Tax Commissioner, is the CEO of the PNG SDP. He is the second CEO, taking over from Robert Igara, who was the CEO from the inception of SDP until 2008. A Chief Operating Officer, Tamzin Wardley, was appointed in January 2010. SDP has a total of some 65 staff. The main office is in Port Moresby, but there are also SDP staff based in Kiunga in the Western Province, and a small office has recently been opened in the Ok Tedi town of Tabubil.

SDP has a substantial, controlling or 100% ownership of a number of subsidiaries and joint ventures, as detailed below:

- Ok Tedi Mining Limited (OTML). SDP now has a 63% share of OTML. This is discussed further below.
- PNG Microfinance Limited (PML). SDP has an 81% share of PML, a microfinance corporation.
- Western Province Sustainable Power (Western Power). SDP owns Western Power which undertakes rural and town electrification projects, and also owns SDP's telecom towers in the Western Province.
- Cloudy Bay Sustainable Forestry. SDP owns Cloudy Bay, which is a sustainable forestry company.

- Energy Development Limited (EDL). SDP has a 50% share of EDL, which is a joint venture with Origin Energy, and which is preparing various large power generation projects.<sup>5</sup>
- Star Mountain Institute of Technology (SMIT). SDP owns SMIT, which is now running what was the OTML technical training centre, and which is planning to become a major provider of tertiary education, and technical and other education and training services, based in Tabubil.
- OTFRDP (Ok Tedi Fly River Development Program). SDP has a 25% equity share in the OTFRDP, which is responsible for implementation of projects in the mine-affected areas of Western Province using compensation and other funds. The other share-holder is OTML.

There are also two SDP subsidiaries, created in the mid-2000s, which have been subsequently wound up, PNG Sustainable Energy Limited (SEL), and PNG Sustainable Infrastructure Limited (SIL). SIL was 100% SDP owned. Our understanding is that over time the justification for a fully-owned subsidiary to oversee non-commercial infrastructure asset creation (such as road building) was seen to be lacking. SEL was a joint venture with the Australian engineering and development consultancy firm, SMEC. It was responsible for various power projects. But SMEC lacked a strong capital base, and there was a perception that the management it provided performed inadequately. SMEC's interests were purchased by Origin Energy in 2008, and the joint venture reformed as Energy Development Limited, which is showing great promise.

### ***PNG and Western Province***

It is assumed that the reader has a basic familiarity with Papua New Guinea. PNG is currently experiencing a resource boom, with rapid growth in both the mining and the non-mining sector. Government revenue is also growing rapidly. Unfortunately, international indicators show that PNG is also experiencing growing corruption. PNG did enjoy a decade of political stability, but that has now come to an end. There has just (August 2011) been a change of government, but the legitimacy of that government has been subject to a court challenge, and in any case there are elections scheduled for July 2012.

The Western Province borders Indonesia. It is PNG's largest province in terms of area, but also its least densely populated. The total population of the Western Province is approximately 150-200,000. Accessibility is an enormous problem in the Western Province, with large parts of the province accessible only by boat or air. It was put to us that logistics are about 30-40% of total project costs in the Province. Western Province would sit at the bottom of any league table of PNG provinces in terms of human development. The Western Province government (known as the Fly River Provincial Government) is relatively well-resourced (thanks to the Ok Tedi mine), but service delivery is poor, even by PNG standards, and government capacity is weak.

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<sup>5</sup> EDL takes responsibility for power generation projects greater than 10MW, and Western Power for those below that limit. Western Power has a license for the retail distribution of power throughout PNG. It is the only entity other than the government-owned Papua New Guinea Power Limited to do so.

The capital of Western Province is Daru, in the south, famous for its recent cholera outbreak. The government administration now largely resides in the northern town of Kiunga, which is connected to Tabubil, the Ok Tedi base, by road.

The Ok Tedi mine dominates not only the Western Province economy, but also its politics. Questions around whether the mine should continue, the environmental damage it has done in the past, and compensation for that damage are preoccupations among the province's MPs.

Western Province is particularly resource rich, and is currently the subject of extensive mining and petroleum exploration. In particular, a number of operations to extract gas from the province are now in the exploration and planning stage.

### *Ok Tedi*

The Ok Tedi mine commenced operations in 1982. Environmental problems dogged the project from an early stage, when a dam intended to store tailings from the mine on site failed, and the operation commenced the deposit of the mines' waste and tailings into the Ok Tedi River (a tributary of the Fly River, which flows down the length of the Western Province). This caused sedimentation (with resultant flooding and dieback<sup>6</sup>). It also introduced the risk of acid formation because of the presence of iron sulphide in the waste and tailings. Following various court challenges, BHP decided to withdraw from the mine and granted its shares in OTML to SDP. At the time of BHP's withdrawal, SDP had 52% of OTML's shares, the Government of PNG 30%, and the Canadian company INMET 18%. In January 2011, INMET sold its shares to OTML, so increasing the proportions of the shares held by SDP and the PNG Government. Now SDP owns 63% of OTM, and the Government 37%. (Half of the Government's share (18% of the OTML) is for the national government, and half is held in trust for the Western Province Government, landowners and stakeholders. The Board of OTML is now chaired by the SDP Chair. There is one government representative on the Board. Two other Board members are appointed through a process that requires nomination by SDP and approval by the Government (an approval which can be rescinded even after appointment). The OTML CEO is also a Director.

As part of the mine continuation agreement after BHP's exit, it was agreed that PNG SDP would indemnify the State and BHP against environmental claims related to Ok Tedi. Since a compensation package was agreed for local communities at the time of mine continuation, such an indemnity would apply only to new environmental damage.

Also as part of the original mine continuation package, a compensation package was agreed to for environmental damage already caused. Fundamental to this agreement are the CMCAs (Community Mine Continuation Agreements) with eight groups of villages affected by the mine in the Western Province – essentially the villages at the mine and those along the Fly River right down to the ocean's edge. These eight groups make up over half the population of the Western Province.

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<sup>6</sup> OTML reports indicate that some "1,670 km<sup>2</sup> has been affected by dieback while 27% of this area (451 km<sup>2</sup>) has undergone some form of recovery." (2009 OTML annual environmental review).

The compensation package was reviewed and revised in 2007. As part of this new package, SDP committed to provide K21.5 million annually to be spent as approved by and for the benefit of the CMCA groups.<sup>7</sup>

The 2007 agreement also led to the creation of the Ok Tedi Fly River Development Program (OTFRDP). OTFRDP was created in 2009 by putting new governance arrangements around the pre-existing Ok Tedi Development Foundation, which was established by OTML in 2002, and which has tax-free status. OTFRDP is 75% owned by OTML, and 25% by SDP. Under the agreement, OTML will divest its ownership prior to mine closure to reputable organizations.

OTFRDP has a substantial staff (about 50), and substantial income. In addition, to the K21.5 million from SDP, the Government provides to the CMCAs 6% of OTML's dividends, and OTML has undertaken to provide K324 million between 2007 and 2013.

The new 2007 agreement with the nine CMCAs aimed to give them more control over decision making. Accordingly, OTFRDP has an Advisory Committee with representatives of the eight CMCA areas, the Western Province Government, and the churches. Projects must be approved by the Advisory Committee before they can be approved by the Board.

OTFRDP's first CEO was appointed in July 2009, and it prepared a business plan in 2010. In August 2011, OTFRDP issued its first call for tender for a range of feasibility studies from the provision of ferry services, to road and bridge construction, to relocation, to health services improvement.

The continuation of Ok Tedi, which the creation of SDP, among other things, allowed, has been of enormous importance for the PNG Government, as equity and taxes from Ok Tedi have been major sources of revenue, especially with the current high commodity prices.

Mine closure was originally planned for 2012, but with current high prices the mine is expected to run under current licence conditions until 2015. Further mining beyond 2015 is also now envisaged to be profitable. However, this would require a partial shift from open-cut to underground mining, and this in turn would require new legislation, since it represents a change in mining operations. (Ok Tedi operates under legislation specific to it.) Preparation is now underway for an extension of mine life under these new conditions until about 2022, though quite likely at lower production levels. Although no firm decisions have been made – the extension would require not only government support and new legislation, but also a new deal with affected communities – and there is some opposition to the mine extension (most notably from Western Province MPs), most stakeholders think that an extension is likely. Indeed, we were informed that the mine could be profitable until at least 2030.

As noted, Tabubil is the town around which Ok Tedi is based. It is not easy to access (the only road access is from Kiunga, and flights are frequently diverted due to weather conditions), but is a thriving, peaceful and well-maintained town (often referred to as the best in PNG) with a population of some 25,000, including adjacent settlements and villages. Ensuring the future of Tabubil post-mine closure is one of SDP's main objectives.

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<sup>7</sup> Strictly speaking, K21.5 million or 2.5% of SDP's 52% equity share, whichever is greater.

## *Summary*

SDP operating environment is a mix of continuity and change. PNG and especially the Western Province continues to present a difficult operating environment, where capacity is often low, corruption is a serious problem, and risks are high.

But the past few years have also been ones of rapid change for SDP and the environment within which it operates. The main changes can be summarized as follows:

- The resource boom in PNG has led to much higher profits for Ok Tedi, and so much more income for SDP than originally envisaged. To illustrate this, between 2002 and 2005, SDP received some US\$293 million in dividends from OTML. In 2010 alone, SDP received \$338 million, that is, more than in the 4 years 2002-2005 combined.<sup>8</sup> The resource boom has also led to improved prospects for the resource-based projects which SDP has been promoting.
- The prospect of Ok Tedi mine continuation to 2022 or beyond, although linked to the resource boom (since it is driven by high commodity prices), is worth stressing separately since it is of such fundamental importance. Mine extension will first of all increase the funds available to SDP by extending its revenue stream by a decade or longer. Second, it will push back the time when the Long Term Fund can be spent, since this fund can only be tapped after mine closure. Third, it has made a number of projects which SDP has been promoting more viable, since they will be able to draw on support from the mine for a much longer period. This is particularly true of projects to sustain Tabubil, but also of the Daru port.
- The revised compensation agreement of 2007 has changed the way SDP provides benefits to populations affected by the Ok Tedi mine. Projects which count towards SDP's K21.5 million annual commitment have now to be approved not only by SDP but by the OTRDP Advisory Committee.
- The recent change of national government in PNG has put in place, at least for the time being, a government which is more positive and pro-active in its attitudes towards SDP.

## **3. Overview of operations**

This section provides a basic overview of key aspects of SDP operations over the review period, under the following headings: Long Term Fund, Ok Tedi oversight, and development programs. We divide the third up into a number of categories: large and (potentially) transformational projects; other, smaller projects in the Western Province; other, smaller projects outside of the Western Province; and new projects under consideration.

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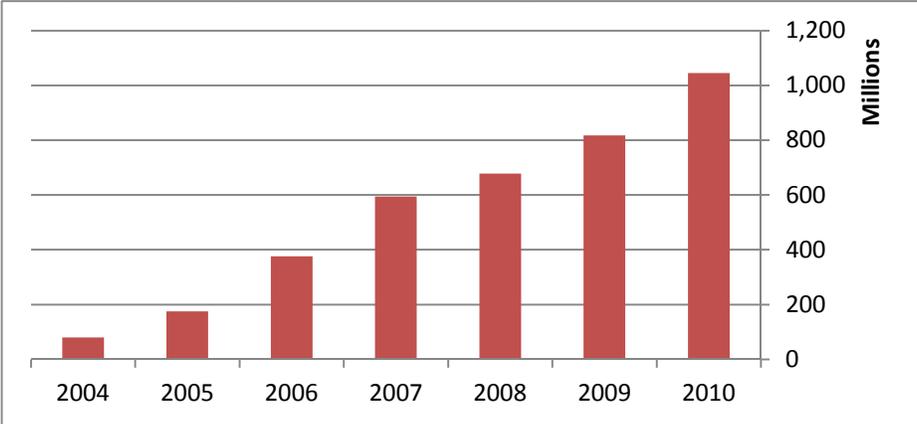
<sup>8</sup> We were informed that at the time of the creation of SDP, the modelling suggested that the Long Term Fund would have \$300-400 million at the time of mine closing. The Perkins Review in 2007 predicted that if high prices continued, the Long Term Fund might reach as high as \$1 billion by the time of mine closure. This level has in fact already been reached.

This section is intended to be largely descriptive, and to set the scene for the following three sections which are the core of our evaluation.

**Long Term Fund**

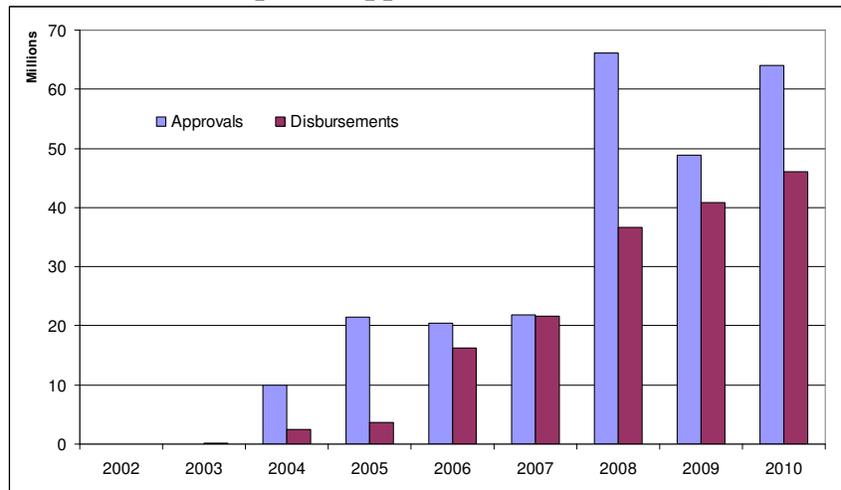
The Long Term Fund has grown rapidly, passing the the \$1 billion mark in 2010. It has achieved an annual return of 4.9%, and weathered the Global Financial Crisis well, containing the negative return in 2008 to only -2.6%. Four professional fund-managers have been in charge of the management of the Fund (more are being brought on board), under guidelines approved by the Board, and under close supervision of one Board member, and financial expert, Dr Jacob Weiss. Recently, a staff member has been recruited to SDP to oversee the Fund Managers under Dr Weiss’ tutelage.

**Figure 2: End-year value of the Long Term Fund (US\$ million)**



Development expenditure (that is, expenditure on development, prior to mine closure) has also risen sharply (Figure 3). Disbursements lag approvals (many of which are in relation to multi-year projects), but both have grown rapidly. Estimates for 2011 have expenditure at \$100 million. If one views SDP as a donor, it would probably be PNG’s second largest, a long way behind Australia (at \$A450 million) but ahead of any other bilateral, multilateral or non-government donor.

**Figure 3: Annual development approvals and disbursements (US\$ million)**



### ***OTML (Ok Tedi) oversight***

One of SDP's most important responsibilities is its oversight of operations at Ok Tedi. Clearly the Ok Tedi mine has done very well financially over the last decade. On the environmental front, nothing can be done to reverse the environmental damage already done (prior to SDP's creation): a large shelf of sedimentation is moving down the river, causing flooding as it goes.

However, two major investments have been made to reduce further environmental damage. First, although waste and tailings are still dumped into the river, dredging of the river takes place further downstream so that further sedimentation does not occur. (Dredging began in 1999.) Second, since 2009 sulphur concentrate is extracted from the tailings and piped 130 km down to a location where it can be safely buried. This reduces the risk of acid poisoning of the river. Statistics released by OTML show that the average annual percentage of sulphur in the tailings has fallen from 3.22% in 2004 to 0.82% in 2009 (the year the sulphur extraction began). In 2011, there was a rupture of the pipe, leading to localized spillage. OTML ceased mineral processing for over a month, and then commenced to mine in low-sulphur areas with the aim of keeping this ratio below 1%, and developed a sulphide storage facility at the mine pending restoration of the pipeline.

SDP supplements its oversight of OTML with an active participation in projects of particular interest. For example, it is undertaking with OTML a study on the future impact of sedimentation-induced flooding in the Western Province.

SDP also has advocated for and provided early financing for studies relating to the continuation of mine-life after 2012. SDP supports mine-life extension provided that informed consent from local communities can be obtained, and provided that it can be shown that there will be no incremental environmental damage from extension.

### *Large, transformational projects*

SDP labels its highest-impact projects as ‘transformational’. We use the same label, though we think a larger number of projects that SDP is promoting are potentially transformational and so deserve this label.<sup>9</sup>

**Daru port and related projects:** The SDP Board has long held that establishing a port at Daru is essential for the development of the province. A project to create a port has been under preparation for several years. In 2008, after an initial feasibility study, a joint venture was created with a Malaysian partner, UEM, and bids were issued for construction, but the project did not proceed as the tender costs were higher than expected and the global financial crisis led to the withdrawal of the joint venture partner.

Currently, a second round of geotechnical surveys is underway, as is the search for a replacement partner with experience in port management to invest in and manage the port. Discussions with potential users of the port are also underway. The mine-life extension has made OTML a potential customer, and new gas projects may also want to use the port. (SDP commissioned a study into stranded gas fields in the Western Province, which has assisted in the development of the Talisman project now underway to evacuate that gas.) As part of its broader development efforts centred around the port, SDP is also planning an industrial center at nearby Oriomo (resource processing is seen as a good prospect) and is undertaking a feasibility study for a road (infrastructure corridor) which would ultimately connect Daru in the south and Kiunga in the north. We were informed that some \$40 million has been spent on port preparation to date. Construction costs itself would be in the hundreds of millions, and SDP’s position is that the project would not proceed without an strategic partner.

**Purari Dam and other large power projects:** EDL, a joint venture of SDP and Origin Energy, is undertaking feasibility and related studies related to several power projects:

- The construction of a hydro dam on the Purari River in the Gulf Province. Power from this project could be used to help solve power shortages in PNG, to support industrial activity at Oriomo/Daru, and for export to Australia
- The rehabilitation and expansion of an existing hydro project (the Yonki in Eastern Highlands Province), the power from which would feed Lae and major resource projects in Madang and Morobe Provinces.

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<sup>9</sup> Only Daru and related developments (Oriomo Industrial Centre, Cross Border Economic Trade Links, Infrastructure Corridor, Gas Commercialization) and the large hydro projects are listed in the Annual Report as transformational. This seems to us to be an overly narrow definition of what is transformational. The telecom tower network in the Western Province is transformational, SMIT would be transformational, and the continuation of Tabubil along commercial lines would also be transformational compared to the counterfactual of its closing. The microfinance institution, PML, if it succeeds, will also be transformational. Cloudy Bay Sustainable Forestry, if it succeeds, will not in itself be transformational, but will be a model of a transformational approach to forestry development and management in PNG.

- A large gas project (at Stanley) which would replace Ok Tedi's diesel and provide power for parts of the Western Province. (This project had been shelved in 2008, but is under consideration again given the prospect of mine-life extension.)
- The construction of a gas power plant from the Southern Highlands gas fields and its linking to the Highlands Grid. This project had been pursued earlier, but government permission was not at that time forthcoming. Now the national government is supportive of the project, and it is back under preparation.
- A new hydro scheme outside of Port Moresby to increase power available to the Port Moresby grid over the medium to long term.

There is strong government support for these projects.

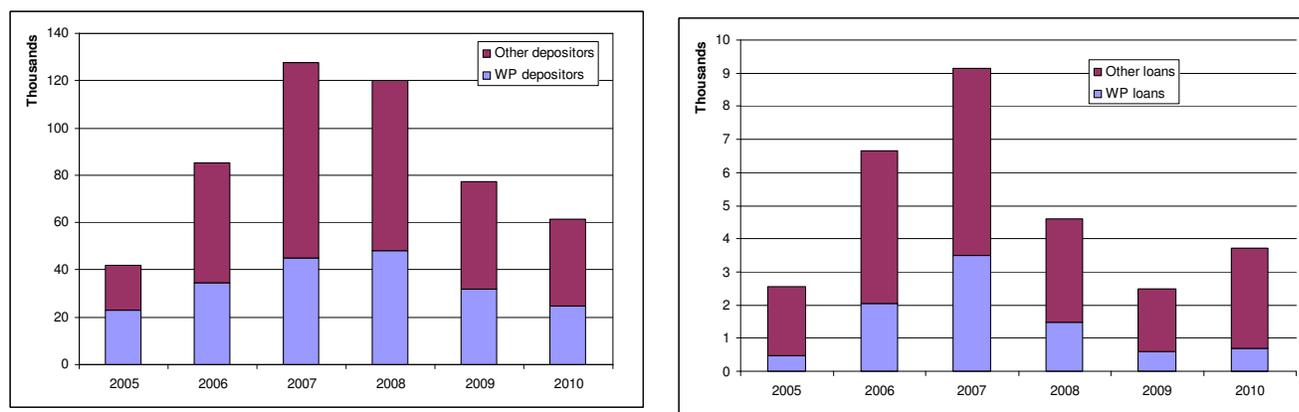
**Tabubil Futures:** The Tabubil Futures project is primarily about ensuring a future for the town of Tabubil after mine closure. It involves transitioning the town away from its current “mine-owned” status. This will require multiple shifts, including most fundamentally a new governance structure. To ensure continued good governance, it is proposed that Tabubil continue as a corporate town, but not under OTML “rule”. For example, the development company, OTFRDP (jointly owned by OTML and SDP), might take over responsibility for town management. Such a change would require legislative backing at the national level. In any case, there are also a large number of smaller changes required for sustainability post-mine-closure, such as the introduction of user-fees (e.g. electricity has been provided free in Tabubil by OTML). It also involves the development of alternative economic activities, including in education (see below). A first step in this process was the commissioning of an extensive set of studies by Cardno under the heading of Tabubil Futures. The project is now being carried forward by a small team based in Tabubil, with the assistance of specialist consultants, who are undertaking various preparatory activities and more detailed feasibility studies. Initial steps in the weaning of Tabubil from OTML include the handing over of the management of the OTML hospital to the Divine Word University starting next year, and the handing over of the OTMP technical training centre to the Star Mountain Institute of Technology, on which see below.

**Star Mountain Institute of Technology (SMIT):** The Star Mountain Institute of Technology is a new venture, 100% owned by SDP, which has taken over the OTML technical training centre. It plans to commercialize and expand the services provided by the training centre, and offer them nationally. It will manage school education in Tabubil and a School of Conservation, Heritage and Environmental Management. It will also offer courses on behalf of other universities. Divine Word University will run a program of medical education focused on rural services using the Tabubil Hospital as its teaching hospital. And the University of PNG and Divine Word University are planning to introduce PNG's first graduate program for teacher education (a Diploma of Education). SMIT is currently tendering for construction of a new campus at Tabubil. Apart from the various teaching staff, SMIT has a small staff of 4.

**PNG Microfinance Limited (PML):** PML was created in 2005 out of the offices initially established by OTML to distribute payments to landowners. SDP initially owned 49% of PML, with the Bank of the South Pacific owning 32% and IFC 19%. The creation of PML was itself a significant achievement. It was PNG's first microfinance institution, and IFC's first equity investment in PNG. It met a key objective for SDP, namely to provide banking services to the

people of PNG. In 2010, BSP pulled out (as it intended to proceed with its own rural banking initiative), and SDP's share of PML increased to 81%. PML has some 60,000 depositors, and a deposit base of some K39 million. SDP had ambitious targets for PML, including a target of 1 million customers by 2015. However, PML has had a difficult history, including incidents of fraud, which has weakened its financial position. Its number of depositors has fallen in recent years, as the figure below shows. The number of loans PML made rose very rapidly in the early years (again as shown below), but this turned out to be problematic, and had to be scaled back. PML has seven branches in the Western Province (out of a total of 12), and most of these are loss-making. In recognition of this, SDP provides PML with an ongoing financial support in the form of a Community Service Obligation payment.

**Figure 4: Figures on PML depositors and loans, WP and elsewhere in PNG**



It was intended to bring in the Indian microfinance institution, BASIX, as a majority (62%) shareholder of PML, but unfortunately BASIX has run into problems of its own in India. However, a senior BASIX executive has recently joined as a CEO. PML has also benefited from technical assistance provided by the IFC. The company is expecting to prove its profitability, including through the connection of branches to a single, real-time IT network. PML faces competition from another microfinance institution created with ADB backing, Nationwide Microbank, and now from BSP's Rural Banking Service, as well as from the increasing use of mobile banking. PML's future is uncertain. It would like to expand to urban centres outside of Western Province, which would improve its profitability, but it needs to improve its financial position first.

**Telecom towers:** Until this intervention by SDP, Western Province had been excluded from PNG's mobile revolution. The province was too sparsely populated to make it profitable for PNG's mobile providers to erect telecom towers there. So SDP financed tower construction (through its wholly-owned subsidiary, Western Power). Digicel won the contract to construct 58 towers, but does not own the towers, which belong to SDP through Western Power. Digicel is using the towers to provide a mobile service to the Province. Bemobile is not as yet, though there is capacity for it (and for community services) to do so. The project is substantially complete, and a large part of the province now has mobile coverage. Digicel will maintain the towers in lieu of a usage fee. The project is now being extended to the neighbouring Gulf and Sandaun

Provinces.<sup>10</sup> The vast majority of the people in WP and Saundau are very thankful to SDP for providing this vital service to them. On a trip to commission the tower in Telefomin, one of the reviewers asked the people what they thought about the telecom tower. Everyone was ecstatic and praised SDP for delivering telecommunication services to the people of Telefomin.

### *Western Province projects*

SDP sees the establishment of sustainable alternative livelihoods and better living standards for the people of Western Province as a central part of its mission.

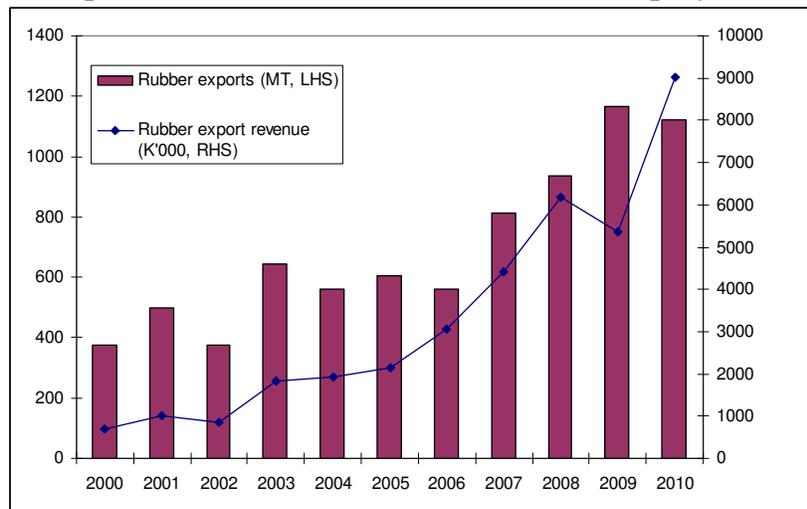
**Hatchery:** In recent decades, the stock of barramundi, which used to be prolific in the Fly River, has fallen precipitously. In response to this, SDP has constructed a hatchery in Daru to restock the Fly River. The project, preparation for which commenced in 2005, was delayed for several years, but finally completed last year at a cost of K20 million. Although a small number of fish were bred in the hatchery (25,000 fingerlings compared to a capacity of 500,000), the hatchery is currently not working due to technical problems. The previous project manager for the hatchery has left (to head up OTFRDP), but the position of project manager has now been filled. A challenge still to be faced in relation to this project is to test whether local feedstock can be found for the fingerlings, as the cost of imported feed from Australia is prohibitive. Another strategy being pursued is to encourage local communities to adopt sustainable practices in relation to the catching of barramundi. Overall, this is a worthwhile project if the hatchery delivers at capacity, and can be sustained over time.

**Rubber:** SDP has assisted rubber growers in the Lake Murray area in Western Province in a very large and successful program to plant new and more rubber trees. This project will be expanded to other parts of the Western Province. It builds on an existing OTML-supported program: OTML (now OTFRDP) covers the collection costs (by boat) of the tapped rubber. The growth of the program is demonstrated by the rubber export and revenue in Figure 5 below. 70% of the export value is returned to the almost 10,000 growers involved. Currently about 6,000 hectares in Western Province are planted with rubber. The plan is to bring this to 10,000 hectare by 2017. Along with the rubber recently planted this would make the entire operation sustainable without subsidy by bringing exports to 6,000 tonnes and revenue, at current prices, to K 30 million.

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<sup>10</sup> Earlier, in the area of telecom, work was done by SDP to bring in Singtel into PNG. However, permission from the PNG Government was not forthcoming, and, with the entry of Digicel, the idea was understandably dropped.

**Figure 5: Exports and revenue under the SDP rubber project, 2000 - 2009**



**Health, education and other community projects:** SDP has supported the improvement in the Western Province of health and education services through a number of programs. The WP Health Improvement Program (K10.5 million) provides church-run health services in the province with capital funding. Similarly the WP Education Improvement Program (K13.5 million) provides church-run education services in the province with capital funding. SDP also:

- provides scholarships to top WP secondary-school students to study in Australia (and will soon provide national scholarships)
- assisted in the 2010 emergency cholera response
- supports, under the WP component of the Community Sustainable Development Program (CSDP, explained below), small-grant projects, mainly again through churches (by the end of 2010, K11.2 million had been committed for 53 projects), and
- is preparing a multi-year US10 million health sector intervention in the Western Province

**Roads and airports:** SDP has constructed two roads in the Western Province: Gre-Drimgas (28 kms, K34 million) and Kiunga-Kokonda (28 kms, K34 million). SDP is also funding the rehabilitation of the Daru airport and has restored five dysfunctional WP airstrips.

**Water supply:** SDP has provided water supply for a number of villages in the Western Province. It has also designed and offered to fund the rebuilding of the deteriorating water and sewerage system in Daru (which is critical to control cholera). This offer was finally accepted after the recent cholera outbreak, though negotiations are still underway with the PNG Water Board.

**Power:** SDP has provided the 31 villages along the Kiunga-Tabubil road with diesel-based electricity. Western Power has also taken over the diesel-based power supply in Kiunga. (The envisaged Stanley power project would replace diesel by gas-based power.) In both Kiunga and the villages, Western Power charges for electricity using pre-paid meters. According to its WP Strategy, SDP has committed to deliver renewable energy projects as well as safe water and sanitation for all the villages of the Western Province by 2013.

### *Other national projects*

**Roads:** SDP has provided counterpart funding to the World Bank for its National Roads Maintenance Rehabilitation Project. SDP is also financing the rehabilitation of part of the Magi Highway in Central Province.

**Health, education and community projects:** SDP undertakes a number of such projects outside of the Western Province, including

- Bougainville Education Rehabilitation Program (K2 million) in support of capital investments for church-run schools
- Bougainville Health Rehabilitation Program (K2 million) in support of capital investments for church-run health centres, and
- the CSDP small grants program which has allocated K21 million in support of 134 projects across 19 provinces.

**Forestry:** SDP's major intervention into forestry has been through the acquisition of Cloudy Bay Sustainable Forestry, a sustainable forestry venture based in the Central Province. Prior to its acquisition, Cloudy Bay won a licence for a concession in the Central Province with the requirement to do 100% local processing. In 2007, SDP bought an 80% share, and it is now the sole owner. Cloudy Bay is recognized to have enormous potential, in particular to demonstrate that sustainable forestry with local processing is profitable in PNG. (In general, logging in PNG is not carried out on a sustainable basis, and a large volume of logs are exported.) However, it is still loss-making (with monthly costs of K3 million and revenue of about K2 million). As explained to us by the current Cloudy Bay management, problems have included: the earlier purchase of inappropriate and sub-standard mills; disputes with landowners over the ownership of timber; slow approvals by Government; skill shortages; and wet weather. Cloudy Bay now has an environmental forestry certification, and plans to boost its exports on this basis. It also plans to expand into the building kit market. Cloudy Bay also acts as a construction company in its concession area for SDP.

The company's performance is improving. The old management was removed and new management (and a new Chair) inducted in 2008. The new management believes it should be breaking even by the end of next year. SDP provides Cloudy Bay with support to tide it over in the interim.

Cloudy Bay also undertakes building and joinery projects, and acts as a construction company in its concession area for SDP. It has recently spent a substantial amount of money to rehabilitate and modernise its processing plant at 9 Mile, Port Moresby. It is envisioned that the company will improve its output and increase its revenue from this modern facility in 2012.

SDP earlier bid for a concession in the Western Province, based on stringent requirements of sustainability, but was unsuccessful, despite being ranked the top technical bidder. SDP is challenging this decision in the courts. Cloudy Bay still plans to move into Western Province, not through a concession but through an alternative mode of working (timber authority process) in which landowners provide the timber to be processed by Cloudy Bay.

SDP also has its own forestry program, with a forestry specialist employed to explore the suitability of eaglewood.

**Oil palm:** SDP supports the World Bank Smallholder Agricultural Development Project which in turns supports oil palm smallholder production in Oro and West New Britain, through roadwork and a credit facility.

**Rural electrification:** Western Power is also active in rural electrification outside of the Western Province, principally through mini-hydro projects, especially in Bougainville.

### *New projects under consideration*

Two new types of projects are under consideration:

**Commodity boards:** Many farmers in PNG would be better served if their boards (for coffee, cocoa, etc.) worked better. The proposal here is to provide counterpart funding for World Bank projects in rehabilitation of coffee and cocoa.

**Conservation management:** The proposal here is to work with various conservation groups and local communities to improve conservation efforts in PNG, as well as developing a strategy for leadership, education and implementation in the Western Province.

## **4. Conformity with and relevance of rules**

We turn now to the first of the three dimensions along which we are required to conduct our review. We follow our discussion of conformity with Program Rules by a discussion of the relevance of the Rules, for the reasons given in the introduction. Our treatment of conformity is selective. In general, compliance with the Rules is high. However, there are two matters which require attending to.<sup>11</sup>

### *Advisory Council*

The Program Rules give an important role to the Advisory Council. The role of the Advisory Council is set out towards the front of the Rules, after only the role of the Board and that of the CEO have been detailed. The Advisory Council is to have 5-7 members, and is to meet at least quarterly, and annually with the Board. Its role ranges from advice to monitoring to dissemination. Among other things, the Advisory Council is to “provide feedback to the CEO in relation to project proposals put to the Company for funding.”

The Advisory Council did not meet at all in 2011. The primary problem would seem to be that it is not clear how the role of the Advisory Council differs from that of the Board, and therefore how it can add value. Under one interpretation, SDP should have two governing bodies, one executive (the Board), and one advisory (the Advisory Council). However, even if this is what

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<sup>11</sup> There are also some small ways in which compliance could be improved. These Annual Reviews are meant to be every three years. The Annual Report is meant to be distributed a month before the meeting to discuss it.

the Rules intend, it does not make sense given how much bigger SDP is than earlier assumed, and how diverse its activities. If every decision has to be put through two governing bodies, the result will be paralysis. The fact that, as noted later, the Board is very active only makes the role of the Advisory Council more problematic.

At the same time, there is a strong rationale for an active Advisory Council, one which extends well beyond the issue of compliance. As we note later, a major problem facing the SDP is that not enough is known about its activities. There is only partial reporting back to appointing organizations, and in any case the appointing organizations do not cover the spectrum of relevant stakeholders. There has sometimes been a lack of national or provincial ownership of SDP projects. An active Advisory Council, properly constituted, could go a long way to addressing these problems.

One possibility would be to amend the Program Rules. In what follows, we recommend a way forward for the Advisory Council regardless of whether the Rules are amended. If the Rules are amended, it should be, we think, in the direction set out below. If the Rules cannot be amended, we nevertheless recommend that the directions below be followed, and that it be regarded that the Rules are being complied with in spirit if not in letter.

We also note that there is an opportunity to act because the term of several current members of the Advisory Council has expired or is set to expire.

The Advisory Council could help fill the communication and ownership gap which currently exists between SDP and key stakeholders. The Council already has a requirement for Western Province landowner representation. There could also be, we recommend, representatives of the WP Government, Planning Department, and possibly other central Government departments, such as the Department of Provincial and Local Government Affairs. We see no reason why the senior staff of these key stakeholder organizations should not themselves be on the Advisory Council. Indeed, we would propose that the Advisory Council include a mix of independent, eminent persons (as currently constituted) and senior national and provincial government representatives.

Thus constituted, we recommend two roles for the Advisory Council. The first would be regular interaction with SDP management. Such interaction (involving both reporting and feedback) would certainly improve communication flows and openness. At least one of these meetings should be, as the Rules prescribe, with the Board. It would make sense to do this at the time of the Annual Report Meeting. We would expect that the organizational burden of these meetings would be worth it in terms of engagement with key stakeholders.

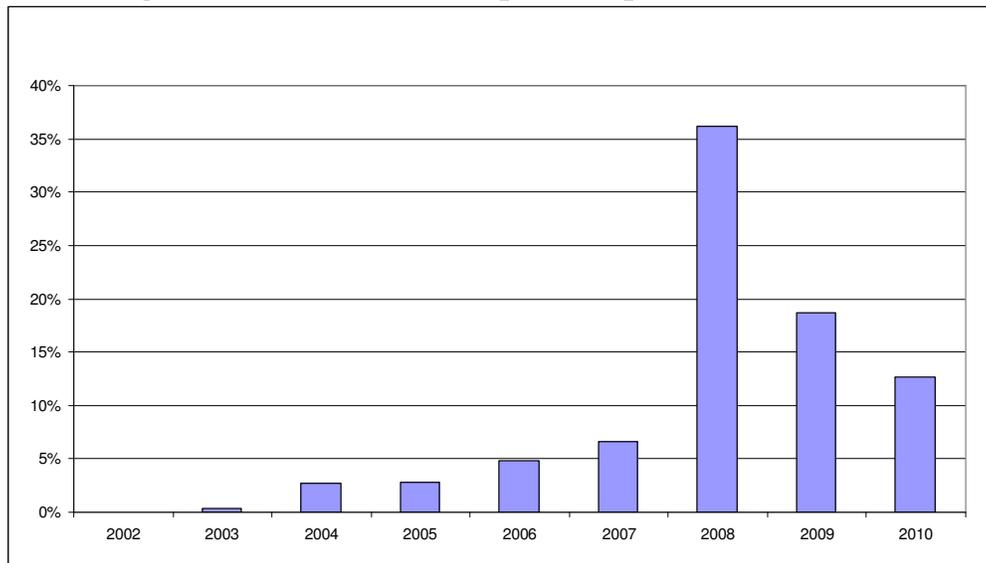
Second, while it is unrealistic to expect the Advisory Council to advise on all projects, they could on the community programs under the CSDP. Already, the Board has delegated decision making in relation to the CSDP to a sub-committee consisting of two PNG board members. Prior reference of projects to the Advisory Council could be a logical next step. If management did not agree with advice received by the Council in relation to a specific project, it could take it to the Board. Otherwise, approval by the Board would be automatic.

Such reforms could reduce the burden on the Board, empower the currently moribund Advisory Council, promote conformity with Program Rules in a practical and constructive way, and enhance national ownership and stakeholder engagement in respect of SDP.

### ***Funding limits***

This section deals with the various funding limits laid down in the Program Rules, and uses data compiled from successive Annual Reports to test compliance. The funding limit for spending on development programs has been adhered to. Indeed, in most cases, funding has been well below the prescribed limits. Development expenditure exceeded one-third of income (after operating costs and contractual obligations) only in one year (2008), when income was much lower than expected (Figure 6). There is a healthy balance in the Development Fund, into which the one-third to be spent on development prior to mine closure is initially placed. In the 2011 budget, the (start-of-year) balance on the Development budget is shown at a healthy \$270 million (compared to a cumulative development spend of about \$140 million).

**Figure 6: The ratio of development expenditure to income**

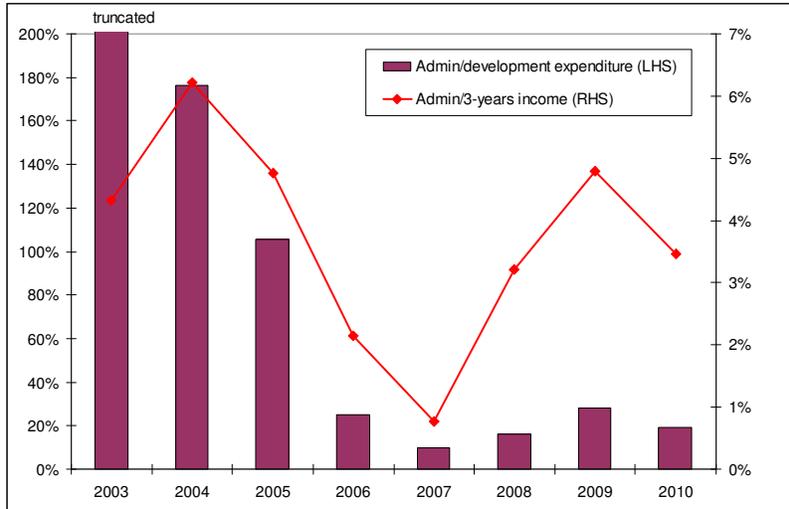


Note: As per the Rules, operating costs and contractual obligations are netted from income. The resultant ratio should not exceed one third on a cumulative basis.

The Rules also require that “Operating Expenses attributable to the operation of the Company (but not to the running of the Program)” should be no more than 15% of the average annual income of the program over the preceding three years. We proxy these operating expenses by the amounts given in the annual report under administration and governance. The actual ratio, shown in the figure below, is well below 15% (Figure 7). Spending on administration relative to development spending has also fallen, from in excess of 100% in recent years to under 20% in 2010 (and presumably significantly lower again in 2011 with the acceleration in development spending this year). The ratio is nevertheless high by the standards of government donor agencies. However, PNG is an expensive place to do business, and the ratio also reflects the

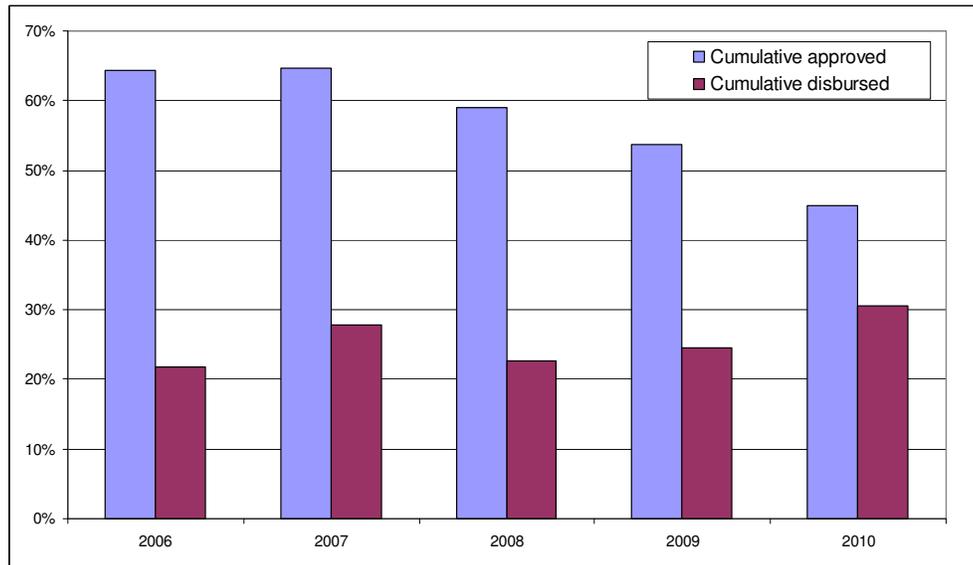
complexity and long gestation periods of the operations SDP is preparing and implementing, as well as the costs of managing the Long Term Fund.

**Figure 7: The ratio of operating costs to development expenditure and to 3-years’ average income**



The distribution of spending of benefit to the people of Western Province (“WP” spending) and spending of benefit to the people of PNG (“national” spending) has also been kept within the confined limits. As the figure shows, in terms of approved amounts, the spending on Western Province is greater than 1/3 of the total development spending, but in terms of disbursement it is less (Figure 8). The higher ratio in terms of approved spending is not in itself a problem as approved spending to both categories is still below the limit. The Development Fund (mentioned earlier) is split into two, using the two-thirds, one-thirds rule. The 2011 budget we were given shows that in September 2010, the Western Province Development Fund had a balance of \$105 million and the National Development Fund a balance of \$165 million.

**Figure 8: The ratio of “WP” to “national” spending for cumulative approvals and disbursements**



The definition of whether an activity is allocated to WP or national is done, as is appropriate, on the basis of where the benefits will flow rather than on the basis of location. According to the budget documents we were given, funding of the telecom towers, the Daru airport, the infrastructure corridor around Daru (and ultimately up to Kiunga in the north), the Daru Port and associated pyrite and gas projects (possible port users) are all counted as national projects. We are not convinced by this classification. For example, it was often put to us in our consultations that the Daru Port was critical for the development of the Western Province. The Perkins Review also underlined the importance of the Daru Port to the development of the Western Province. Development of the Daru Port could clearly also have national benefits. But to charge it entirely to the National Development Fund seems inappropriate given that a large part of the justification for the port is to promote Western Province development. With regard to other projects, such as a feasibility study for a road all the way to Kiunga from Daru, or the telecom towers, the balance of benefits seems even more skewed to the Western Province.

### ***Relevance of the Program Rules***

In this section we examine the relevance of the Program Rules, given the changes summarized in Section 2. It may be difficult to change the Program Rules given that this requires both Government and BHP consent. At the same time, one never knows when a window of opportunity might arise, and so it is worth keeping such issues under consideration.

We have already discussed the role of the Advisory Council, and do not repeat that discussion here. Rather we focus on the Long Term Fund and on the issue of governance.

**Long Term Fund:** Under the Program Rules, the Long Term Fund cannot be spent until Ok Tedi closes. With the mine-life extension proposed, this may not be till 2022 or even later (possibly 2030). The Fund is already bigger than anyone envisaged it to be, and it is only going to keep growing. Assuming a 4% real return, and annual real income to SDP from Ok Tedi

dividends of \$200 million a year, of which two-thirds are added to the Long Term Fund every year, by 2022 the Long Term Fund would be worth \$3.7 billion. While these numbers are purely illustrative, they do indicate the impact which mine extension could have on the Long Term Fund. Under this example, in 2022, a 4% return would be \$133 million, double the one-third of income (\$66 million) that could be spent under current rules (on development spending) in preceding years (that is, prior to mine closure).

Alternative spending rules would allow for smoother and more front-end-loaded spending profile. One alternative, if the Rules could be changed, would be for all Ok Tedi dividend income to revert to the Long Term Fund, and to allow, say, 4% of the Fund's balance to be spent annually. This would imply that slightly less money could be spent now (about \$40 million), but the amount would build up gradually (to about \$130 million at the time of mine closure).

Another option would be to allow all income to revert to the Long Term Fund and to allow 4% of the Fund's balance to be spent annually, and some amount of the capital base, say 2.5% as allowed in the original Program Rules. That would allow spending to continue at roughly current levels (\$79 million) and more spending in subsequent years (up to \$180 million in 2022). The difference is that the Fund would not operate as an annuity.

We are not in a position to give firm recommendations on these issues, and indeed it is not our role. We simply recommend that they be given active consideration.

The rules governing the use of the Long Term Fund seem much less clear than those governing the use of the Development Fund, where there is a clear rule of 1/3 for the people of Western Province, 2/3 for the rest of PNG. For the Long Term Fund, the Rules state that proceeds must be divided between these two groups "in proportions to be determined by the Board at the time of Mine Closure with the objective of minimising the dislocation in the Western Province of PNG caused by Mine Closure and assisting with other aid agencies and developmental groups in the maintenance of expenditures on services and support for Sustainable Development Purposes within the Western Province of PNG at the level funded by OTML and its associated entities before Mine Closure."

Operationalizing this would require the Board to calculate how much OTML is spending in the Province for sustainable development purposes (in itself a complex task). Even then, SDP is not obliged to replace the entire amount since it can take into account assistance from other aid agencies and development groups (including presumably the large trust funds which OTML is funding for use after eventual mine closure). This seems too discretionary and complex. Much clearer direction on the use of the Long Term Fund would help, for example, by imposing the same one-third, two-third rule used for the Development Fund.

There is the prospect, without the need for any rule changes, of Long Term Fund income being invested in large SDP-sponsored projects. However, the Board would have to decide that these are "low-risk investments" (as per para. 10.5 of the Program Rules).

**Governance:** Overall, governance arrangements have served SDP well. It has been able to preserve its independence, and safeguard its funds. Compared to what has happened to

government funds (on and off-budget) in PNG over the same period, this is a major achievement. However, three points were made to us which are worthy of consideration, but whose implementation would require a change in the rules.

First, it was queried whether it was appropriate for BHP to continue to nominate Board members. With BHP wishing to re-enter the PNG mining sector, conflicts of interest might arise. There is also no doubt that SDP is still perceived by some as a BHP instrumentality, and that this gets in the way of constructive partnerships. BHP could on its own delegate its Board member appointment role to a third party or this could be institutionalized by amendment to the SDP's Articles of Association. We recommend consideration be given to such a move, and to embedding it in the Rules, provided that the party which took up the nominating role was itself committed to the principle of SDP existing outside of government structures.

Second, it was suggested to us that the Western Province should be able to nominate a Board member. We are sympathetic to this position, given Western Province's special status in the SDP set up. Until the death of Sir Ebia, there was at least one person from the Western Province on the Board. Now there is not even that. We understand that SDP is considering including the Provincial Administrator as an additional Board Member. We also recommend that opportunities be sought to include someone from the Western Province as the Board is renewed. Our comments concerning the reactivation of the Advisory Council are also relevant in this regard.

Third, there is the issue of whether Board members should have a tenure limit. They don't currently. Board renewal is an important goal, discussed in the next section, but it should be addressed by the Board rather than prescribed by Rules (especially given the difficulty of changing the Rules once set).

#### **Summary of recommendations in relation to conformity with and relevance of rules**

- 1. Reconstitute the Advisory Council to include senior representatives of key national and provincial government bodies (such as the Department of Planning, and the WP Provincial Administration), and give it specific responsibility for advice on community projects.*
- 2. Review the basis which is used to distinguish between national and Western Province development projects, and recategorize expenditures accordingly.*
- 3. In light of mine extension, consider alternative options for disbursement pre and post mine-closure, and develop simpler expenditure rules to guide expenditure from the Long Term Fund.*
- 4. Give consideration to delegation by BHP of its Board nomination role to a third party committed to the principles of SDP's operations, and to embedding this in the Articles of Association. Seek opportunities to include one or more persons from the Western Province on the SDP Board.*

## 5. Efficiency and effectiveness

The second task we are called on to perform is to judge whether “the Program is managed efficiently and effectively.” SDP’s achievements to date are many and varied, especially considering the difficult operating environment in PNG in general, and in Western Province in particular. Many of the activities which SDP is attempting have simply not been attempted before, such as rural electrification in Western Province, or sustainable logging. SDP has responsibly managed a large inter-generational fund, which it has carefully protected and invested conservatively, in line with Program Rules. It has also responsibly and proactively discharged its duty as a majority share-holder of PNG’s most important mine, in particular by promoting the prospect of an environmentally-responsible mine extension. It has delivered real results on the ground through its development spending (the telecom towers, and many social sector projects, for example). It has also played a wide-ranging catalytic role setting in motion a number of large projects the potential returns from which, if realized, would be a large multiple of the costs made. This role is particularly important: SDP seems to be filling a gap in mega-project development which neither any other donor nor the government is addressing. The various power generation projects seem to us to be especially important, as they hold the promise of helping to solve PNG’s chronic power shortage. And through the development of subsidiaries such as Western Power, SDP has enhanced PNG’s implementation capacity.

However, all this is not to say that there is no room for improvement. A number of issues are addressed in the subsections below.

### *Sustainability*

It is fair to say that sustainability has been a much bigger challenge than it was expected to be. It is telling that at one point in 2009 the SDP Board ruled against financing any more road construction until a solution was found for who would maintain the road. That ban has since been lifted, and SDP is itself now funding maintenance of the roads it has built in the Western Province.

There are in fact a range of cases where SDP, despite its intention to avoid such a situation, is engaged in funding recurrent costs. Electricity is another example. We were told that users are charged by Western Power K1/kWh (or in some cases K0.80), but that actual costs are about K4/kWh (though this will fall once diesel-based power is substituted by gas). SDP also funds PML on an ongoing basis to provide banking services to Western Province.

In at least one other case, the sustainability challenge has been institutional rather than related to funding. We saw that solar lighting installed around South Fly was no longer used. Households had not made payments after installation. And when the special bulbs broke, no replacements were available.

All aid agencies and many governments struggle with sustainability. In the case of SDP, promoting sustainability requires a realistic assessment of post-construction financing needs, a

willingness to provide long-term, annual funding if necessary, and experimentation with different institutional structures.

### ***Commercial ventures***

Partnerships with other businesses have been less successful and durable than envisaged. SDP's business model has revolved around "support[ing] others to do what they do best." But of all the subsidiaries SDP now has, it is a majority or sole owner of all but one, EDL. There seems to be no clear or single reason for this, and it does not mean that the objective is not a worthy one, but it is suggestive of the difficulty of the task which SDP is undertaking.

It was sometimes suggested to us that SDP should return to a more grant-giving role consistent with this supportive role it itself originally envisaged. This would have its attractions, and is already the mode used for community projects. However, it is often said of PNG that the binding constraint on development is not financial resources but capacity, and SDP has certainly made a significant contribution to PNG's capacity through the various subsidiaries it has set in play.

One consequence of the dominant role that SDP has to play amongst its subsidiaries is that the quality of the management of those subsidiaries becomes even more important. It was put to us that SDP should have a commercial manager to sit on the Board of its subsidiaries. We endorse this recommendation, and understand that it has also been agreed to by SDP, though the position has not yet been filled. We also suggest that SDP be willing to pay what the market will bear for such a position, and that, if necessary, international and expatriate markets be tapped (this issue is further discussed below).

One related problem is the moral hazard one that potential private sector partners (whether equity partners or suppliers) may view SDP as a soft touch, since it has deep pockets, and lacks a profit motive. SDP is aware of this risk, which only strengthens the case for tough oversight, whether through contractual provisions and their enforcement, or through vigilant supervision of subsidiaries.

Finally, we note that one possibility which SDP hasn't explored yet is the Enterprise Challenge Fund model, where companies submit pro-poor and innovative project proposals for risk sharing with a development donor. AusAID has just completed an ECF pilot in PNG and the Pacific, and SDP may wish to consider co-financing a follow-on ECF in PNG.

### ***Relations with government***

Relations with the Provincial Government have been problematic. The Western Province Governor, Dr. Bob Danaya, is a persistent advocate for the closure of Ok Tedi, and the exit of SDP. SDP to its credit prepared in 2010 a Memorandum of Understanding for SDP and the WP Government to sign, but in the end the WP Governor was not willing to sign it. Relations are better at the working level, including with the Western Province Administrator.

SDP has also sometimes been criticized by senior members of the national government. However, in our meetings with the Treasurer and the Minister for State-owned Enterprises, we

found a much more positive attitude to the organization. Many in PNG have come to realize the limitations of the public sector in PNG and are happy to see other agencies working outside of government towards common goals. The current PNG government is especially keen to develop a partnership with SDP in the area of power supply.

There is a common perception that SDP is “under-delivering.” The only way to counter this is to demonstrate by results, and the communication of those results, that it is a useful partner. The telecom towers should go a long way towards cementing a more positive image of the organization in the Western Province, and the power projects if they come to fruition should do the same for the organization nationwide. The reactivation of the Advisory Committee along the lines recommended earlier should also help. The greater presence of SDP in the Western Province is also a very constructive step.<sup>12</sup>

Government, both national and provincial, should also reach out to SDP. We are not saying this doesn't happen, and the new national government which came to power this year seems to have in fact very high expectations of SDP on a range of fronts. Rather our point is that constructive engagement needs to be pursued consistently and over time. SDP is a well-resourced and well-intentioned entity, that wants to work for the development of PNG. The elected governments of PNG should look on it as an asset rather than rival or foe. If they did, they would get a greater return from SDP projects, as delays would be much reduced, as would risks.

### ***Relations with non-government partners***

We commend SDP for its work with the churches, and other non-government partners. In our 2010 review of Australian aid to PNG we criticized the Australian aid program for ignoring church health facilities in particular. SDP has not made this mistake, and the payoffs seem to be high. Everyone speaks highly of the church projects, and we were impressed by our own visit to a church hospital near Kiunga. In particular, we note that working with churches helps SDP solve the problem of sustainability. Facilities have at least some recurrent funding, and they put it to good use. But they lack capital and equipment, which SDP can provide.

### ***Risk profile and management***

Many of the endeavours in which SDP engaged are extremely high risk. This is particularly true of the larger projects in which SDP is engaged. It is true of the Tabubil Futures project, the Daru port, and the Purari hydro project. It is also true of the forestry, hatchery, and microfinance projects. That they are high risk does not mean they should not be undertaken. They are also very high return. But it does mean that a high level of scrutiny and management will be required. This goes to issues of spread of activity discussed below.

It has also been suggested to us and, though it is disputed by some, it seems to fit the facts that insufficient scrutiny and/or risk management was applied in relation to some of these high-risk

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<sup>12</sup> A micro level example of the importance of consultations came to us from our visits to Kiunga, where credible sources, sympathetic to the principle that people should pay for electricity, complained of inadequate consultation prior to the installation of pre-paid meters in individual homes, and the loss of goodwill this had caused.

activities, in particular in earlier years in relation to Cloudy Bay, PNG Microfinance Limited, and the Daru hatchery.

We note and welcome recent strengthening of risk management on various fronts, including through the strengthening of internal audit, and urge the deepening of these initiatives as well as, as mentioned above, the appointment of a commercial manager within SDP.

### ***Balance of projects***

There are strongly divergent views on the appropriate balance of projects SDP should be undertaking. Some feel that SDP should be focusing on the plight of the ordinary person in Western Province or PNG and providing basic services: roads, education and health. Others feel that its core business is the transformational projects, especially Daru and Tabubil. The Program Rules are very broad on this point, and allow the Program Company to go in any direction it chooses. It is not surprising it ends up doing some of each. The main risk is not that it chooses the wrong sort of projects, but that it tries to do too many projects, as we discuss below.

### ***Spread of activity***

Over time, SDP has taken on an increasingly wide range of activities. Spending has increased rapidly in recent years. Spending for 2011 is estimated at about \$100 million, up from \$40 million in 2010. The portfolio continues to expand, with further areas now under consideration for funding, including conservation projects and commodity-board interventions. Whereas health interventions had been confined to church partnerships, now SDP is also undertaking a program of partnership with the WP Government. Many of these projects are quite small. For example, the new health partnership is for \$10 million over five years, and is spread over five components.

This spread of activity carries the risk that it may be spreading SDP's management and oversight capacities too thinly. PNG SDP includes a number of small teams of about 3 to 4 that are trying to bring into fruition enormously complex projects: the construction of a new port, the creation of a new institute of learning, the transformation of a major town, and so on. Based on our interactions, many of these teams, especially those with an implementation capacity, perceive themselves to be understaffed.

There is also the practical point that, recent income growth notwithstanding, SDP's revenue cannot be expected to continue to grow, so that a greater number of activities will mean less funding for each.

Overall we feel that some patience would be warranted and, as is now recognized within SDP, some consolidation is needed. SDP is going to be around for decades and decades to come. It needs to focus its activities to increase their speed of delivery and prospects of success.

### ***Overlap***

In some cases there seems to be an overlap of activities. SDP has a forestry subsidiary, Cloudy Bay, and also a forestry program. SDP has an active community-level program in the Western

Province; so does OTFRDP. For instance, OTFRDP recently advertised for a consultancy to undertake a feasibility study for improving health systems in some of the CMCA areas, while SDP itself is embarking on a new Western Province health partnership. Some rationalization would be desirable. In the case of forestry, there seems to be a straightforward case for consolidation. The case of the Western Province is more complex, in part because OTFRDP does not have a province-wide mandate. However, some greater division of labour is surely sensible. For example, at least in the CMCA areas, OTFRDP could be responsible for all construction, and therefore roads and bridges. And OTFRDP could stay out of the social sectors, or use SDP as its agent for work in this area.

### *Ok Tedi*

OTML is also more profitable than ever. SDP can also take credit for its promotion of mine-life extension, which has the potential to deliver massive financial benefits for PNG without additional environmental cost.<sup>13</sup> We discuss the need for improved reporting in relation to Ok Tedi in the next section. Here we tackle another issue. In some of the core tasks SDP has set itself, OTML is a key player. SDP needs OTML cooperation if it is to bring its vision for Tabubil into reality. SDP needs OTML to use the Daru Port if the port is to be profitable. SDP and OTFRDP (75% owned by OTML) need to cooperate if effective services are to be delivered to the Western Province. Greater alignment between SDP and OTML would help SDP achieve its objectives more easily and effectively. Despite SDP's dominant ownership position, it is not in a position to dictate terms to OTML. Nevertheless, we do see scope for greater collaboration between the two organizations.

### *Decision making and execution*

We have left the issue on which we got the most feedback to last. Comments we heard repeatedly were that issues drag on, that the resolution of problems takes much too long, that decisions are not clearly communicated, and that timetables are unrealistic.

It was widely acknowledged that things are improving. The Board is becoming more streamlined, and engaging in less micro-management. Management has been strengthened, especially under the current CEO, and with the appointment of a COO. Nevertheless, problems concerning decision making and execution remain.

We did see or hear of several examples of this sort of problem for ourselves. From the feedback we received from interlocutors, it seems that there was a loss of corporate memory between the initial port work (both geotechnical and partner selection) pre-2008, and the work currently underway. We also saw the difficulty of reaching a deal with PML on SDP's ongoing subsidy.

In part, the issue may be the ever-widening range of activities which SDP is undertaking. To this extent, the consolidation of activity we recommend above would also help improve execution and reduce delays. In addition, we have two other recommendations based on feedback received.

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<sup>13</sup> Clearly, the likely environmental impact of a mine extension is beyond our expertise to judge. It will clearly require careful study and monitoring. However, we have not seen challenged the general argument that Ok Tedi's incremental environmental impact is now within acceptable bounds.

One is that the clarity of Board decisions could be improved. If the Board is overruling management recommendations, the staff need to know this and adjust their behaviour accordingly. A second is that SDP management should continue to be strengthened. In particular, at this time of great labour shortage in PNG due to the resource boom, it may be necessary to hire expatriates to fill skill gaps. In our view, the principle should be to get the very best person for the job, and pay them as the market demands. SDP's mission is so demanding, its projects so complex, and its potential so great that it should be willing to pay enough to get the best.

Finally, on a different but related matter, all we spoke to agreed that while the stability of membership had served SDP well, it was time to work on an appropriate and graduated turnover of the Board.

***Summary of recommendations in relation to efficiency and effectiveness***

5. *Make a realistic estimate of recurrent expenditure obligations, and make this the first charge on SDP's annual development expenditures.*
6. *Hire a commercial manager to oversee SDP's subsidiaries.*
7. *Reduce rather than expand the area of SDP's activities. Place a moratorium on new areas for funding, and review existing areas to see if any can be consolidated or exited from.*
8. *Seek opportunities for rationalization of activities between SDP and companies in which it has an ownership stake.*
9. *Explore avenues for greater cooperation and risk-sharing between SDP and OTML*
10. *Improve the clarity of communication between Board and management. Strengthen management, if necessary by hiring more expatriate staff, given PNG's acute and growing skill shortages.*

## **6. Documentation of impact**

Finally, the Program Rules require us to assess the extent to which the "impact of the Program is documented and taken into account in the future development of the Program".

The Annual Report does provide regular public reporting, and this is commendable. However, it hardly goes at all to the issue of impact. Its analysis is very largely in terms of what new projects have been taken up, and what progress has been made with ongoing projects.

The Annual Report Meeting, at which the Annual Report is presented, is a great forum for communications. The large turn-out at these meetings is evidence of the interest in SDP. The fact

that all Board members face the audience and that there is a question-and-answer session is an excellent accountability mechanism.

There have also been some recent moves to improve reporting and communications. The CEO has been active in the press in recent months. A documentary has been commissioned to examine the impact of the mobile towers. We also note the use of more quantitative targets, such as full electrification of the Western Province by 2013. These certainly aid reporting and accountability, but have to be realistic if they are to be useful.

Despite these advances, one cannot say at this stage that the impact of the Program is documented. Evaluation is particularly important for SDP because of its high level of independence. It is clear from our consultations that none of the organizations which nominate members to the SDP Board require those members to report back to it, except BHP, and BHP informed us that it deliberately runs a policy of not directing its nominated Board members. SDP therefore is very independent. This is good insofar as it avoids harmful interference, but it needs to be ensured that accountability is not undermined. This requires transparent reporting, and independent, public evaluation. SDP's financial reporting is of a high standard. The triannual independent evaluations (of which this is the second) required under the Program Rules are a very important and welcome accountability mechanism. However, the three-yearly reviews would be more effective if there was a base of evaluation material to build on. A review such as this cannot on its own hope to establish the impact of individual programs.

We were provided with one evaluation, a July 2009 evaluation commissioned by the SDP of the CSDP and undertaken by the Melanesian NGO Centre for Leadership. This evaluation makes for interesting reading, but it is a very ambitious attempt to understand the impact of the projects on community dynamics.

The many community and church projects which SDP undertakes through the CSDP and other health and education programs would be ideal candidates for a much simpler impact evaluation. Such an impact evaluation would attempt to answer basic but critical questions such as:

- Is the equipment/capital provided by SDP to organization X in year Y still in use?
- Is it in good condition?
- What is it being used for?
- What are the benefits associated with it?

Such evaluations could be undertaken annually, across a randomly selected group of projects. This would provide a very useful basis for evaluation, accountability and learning. Likewise, many of the other infrastructure and agricultural projects undertaken by SDP could be regularly, externally evaluated.

We recommend a monitoring and evaluation officer be appointed, or a specialist be put on a retainer, to undertake and oversee this work, and that an appropriate budget be provided for it.

SDP could also do more to make its evaluations public. The Perkins Review is not available on the internet, and the version we were given has 'confidential' written on the front page. The

Melanesian Centre evaluation is not public either. We strongly recommend that these two evaluations be put on the internet, and that this Review also be put on the internet once finalized.

SDP has much to gain from building up an objective body of evidence on its work, as we are confident that the results will be in general positive (as the two above-mentioned reports are). They will provide a solid basis for communication to stakeholders. As we noted earlier, we often heard the comment that SDP needed to do much more to communicate its success. Some suggested to us that this was the organization's major challenge.

We also note that the mode in which the Annual Report is written can leave the reader confused. There is sometimes little continuity from year to year. For example, in the case of the Daru port, in 2008 the focus is on the joint venture with UEM, but from 2009 onwards, there is no mention of the joint venture. There is also a tendency to stress the positive to the extent that no negatives can be mentioned. The hatchery project seems to fit into this category. Its progress is always reported in positive terms, and yet it never seems to deliver to near its full potential. Recently, the Annual Report has introduced the good practice of reporting against goals from earlier years. This is a good practice, but the consequence must be the acknowledgement of shortfalls where they exist. Agreement with PNG Water on a plan for Daru, for example, is not the same as delivery of water and sanitation for Daru.

One possibility would be for the annual report to adopt a traffic light system. Programs progressing well, and in line with expectations, could be given a green light. Those with some delay and problems could be given a yellow. Those with serious problems could be given a red. Another suggestion would be for the Annual Report to focus more on results. This could be done both informally, by going back to completed projects, and formally by summarizing the proposed evaluations.

On other minor point about the Annual Report is its format. Projects are reported under a large number of headings: transformational, infrastructure, industry, social investment, and mine impacts. These headings include both Western Province and other projects, yet the distinction between the two is to be a very important one for SDP and its stakeholders. The mine impact projects mainly concern the CMCA funding, which are very similar to and of the same nature as other Western Province roads, health, education and community funding. We recommend instead a three-fold division. It is the same one we have used in this report, and it is the one (broadly speaking) used in the Perkins report as well. It divides projects into: large/transformational;<sup>14</sup> (other) Western Province projects; (other) national projects.

In general, we suggest that the Annual Report focus more on results than inputs, and give a longer-term, less disjointed perspective on activities.

OTML reporting could also be improved. Environmental management has itself clearly improved at Ok Tedi, and detailed environmental reporting is provided to the Government annually. However, we do note that OTML has been promising to use the internationally-recognized Global Reporting Initiative (GRI) standards for some time, but has failed to do so

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<sup>14</sup> As noted earlier, we suggest a broader, more encompassing definition of transformational projects.

consistently. This year, OTML has once again committed to providing GRI reporting, starting in 2012.

Finally, given the greatly increased scope of SDP activity, we recommend that a larger team be appointed to do the next tri-annual review, and that it include specialists in sovereign wealth fund management and mine operations as well as development.

***Summary of recommendations in relation to documentation of impact***

- 11. Undertake periodic independent and public evaluations of a random sample of all community and community-type projects (this would include education, health, water, rubber and other community projects).*
- 12. Undertake periodic independent and public reviews of important programs (e.g., forestry, microfinance).*
- 13. Appoint an M&E (monitoring and evaluation) officer or consultant to drive an M&E agenda, and aim for, say, one public, independent evaluation every year.*
- 14. Publish and place on the internet this and the last (Perkins) SDP review, and the Melanesian NGO Centre for Leadership CSDP evaluation.*
- 15. Redesign the Annual Report to enhance the focus on results, and to provide a balanced history rather than an optimistic snapshot.*
- 16. Simplify the organizing structure for the Annual Report along the lines suggested in the body of the report, with, as is increasingly happening, reporting against quantitative targets, and goals from earlier years.*
- 17. Ensure that OTML report its performance annually against Global Reporting Initiative (GRI) standards, including for the environment.*
- 18. Include in the team appointed to undertake the next tri-annual review specialists in sovereign wealth fund management and mine operations as well as development.*

## **Annex: Interviewees**

### **Stakeholders**

1. Hon. Don Polye, Treasurer
2. Hon Sir Mekere Marauta, Minister for Public Enterprises
3. Simon Tosali, Secretary, Department of Treasury
4. Hon. Bob Danaya, MP – Governor for Western Province
5. Hon. Boka Kondra, MP – North Fly MP
6. Eugene Kambut, First Secretary, Office of the Member of North Fly
7. Hon. James Ukin, Deputy Governor and President Kiunga Rural LLG
8. Bishop Gillies Cotes, Diocese of Daru-Kiunga
9. Meremi Maina, Managing Director, Maru Marines, Daru.
10. Dr Adeline Sittler, Medical Superintendent, Rumginae Hospital
11. Loi Bakani, Governor, Bank of Papua New Guinea
12. Deputy Governor, Bank of Papua New Guinea
13. David Conn, President PNG Chamber of Commerce and Industry
14. Ian Wood, Vice President, BHP

### **SDP Advisory Council**

15. Betty Lovai, Chairperson, PNGSDP Advisory Council
16. Blassius Iwik, Member of PNGSDP Advisory Council

### **SDP Board**

17. Ross Garnaut, Chair
18. Lawrence Acanufa, former Director
19. Tricia Caswell, Director
20. Lim How Teck, Director
21. Donald Manoa, Director and Acting CEO, Western Power
22. Jacob Weiss, Director
23. Jim Carlton, retired Director and Chair, PML

### **SDP and Subsidiaries Management and Staff**

24. David Sode, CEO
25. Tamzin Wardley, COO
26. Vera Arova, CFO
27. Camillus Midire, Chief Programs Officer
28. Aloysisi Aihi, Head Transformational Projects
29. Lawrence Stephens, Program Manager, Community and Social Investments Program
30. John Kassman, WP Towers Project
31. Trevor Davison, Director, SMIT
32. John Wyllie, Director, Tabubil Futures
33. Susil Nelson, Manager, Corporate Governance
34. Potaisa Hombunaka, Agriculture Program
35. Michael Poesi, Forestry Program
36. David Freedman, Economist
37. George Matthew, Managing Director, PML

38. Manager, Kiunga PML Branch
39. Ken Baxter, Chairman, EDL
40. Tony Carbry, CEO EDL
41. Lalatute Avosa, Head, Western Province Regional Office
42. Mike Janssen, Managing Director, Cloudy Bay
43. Michael Kiap, Mine Impacts Unit
44. Mark Vassarotti, Consultant

**OTML and OTFRDP**

45. Nigel Parker, Managing Director, OTML
46. Musje Werror, General Manager Corporate Relations, OTML
47. Ian Middleton, CEO, OTFRDP