

Terms of Reference for an Audit Review of Fisheries Development State Agreements in Papua New Guinea

1. Background

The National Fisheries Board of Papua New Guinea and the Government of PNG has resolved for the NFA to undertake a review of the cost / benefit and compliance of on-shore investment projects in PNG in the tuna processing sector.

This audit review is being undertaken as a part of the internal audit program of NFA and is therefore a confidential NFA Board document, until approved for release in full or part.

In 1995, NFA launched “PNG Tuna Investment Guidelines”, to attract onshore investment in tuna processing. The guideline included an undertaking that onshore processing investors would be guaranteed fishing opportunities to match their processing capacity. This was intended to bring in new players subject to onshore processing and remove non performing foreign fleets that were then entrenched under the 205 boat, Palau Arrangement. The State Agreement with each investor has provided that no licences could be issued until the processing facility was 75% complete and the State undertook to provide “fish for processing” at concessional rates, this was designed to subsidize the processing operations in recognition they may require support whilst they establishing themselves. The State agreements also contained a raft of duty and tax concessions including generous tax holidays. Many of the concessions are today standard in the tax and customs acts. These include export development, wages and training subsidies and double deductions. Additionally concessional access was afforded to AW to facilitate EU market access for PNG processed tuna and Foreign flagged vessels were to be reflagged within 5 years. As a key strategy in its drive to create onshore fisheries related industries, PNG has entered into contracts with a number of foreign investors in the last 2 decades.

PNG has successfully pursued this policy of promoting onshore development to create employment and add value to the tuna caught in its waters, using preferential access to the resource, as the main incentive for investment in processing. What has been evident is that each plant has demanded and been afforded increased number of licences to catch fish for processing, and also regional FSMA access “to source more fish for PNG processing”. The large increases in the locally based foreign and domestic fleets has not seen landings increase. It is however also observed a general failure to complete factories to a scale compliant with State agreements, limited landings, reducing and non-competitive exports, yet dramatically increased exports by fishing companies of whole round tuna. _ [Banks et al 2013, Timothy Numilengi, 2014 and 2015]

Studies have shown that under each Agreement the investors have seen fit to divorce fishing company operations from processing company operations, this with the result that we see concessional catches exported or more commonly not just landed in PNG at all, and processors claiming limited fish supply and high costs buying on international markets. With the fishing subsidy not going to processing, it means PNG exports are overpriced, and non-competitive, production intermittent and operations well below capacity and employment limited. The subsidized fishing benefits being transferred offshore.

As a result, the National Fisheries Board is concerned that the projects that were set up in PNG under the various State Agreements over the last 2 decades are instead clearly benefiting offshore processors with subsidised catch and that such concessions awarded are failing to deliver their intended benefits to the local community, the provincial governments and the country through increased employment, commerce, processing and PNG exports, etc. State revenues forgone are considered very significant, and benefits questioned.

It has become clear that under the Agreements provision of preferential licensed access to supply fish for processing, that the relevant contractual obligations, are not being met to process this. In almost every case onshore infrastructure in place is inadequate, for example by way of cold stores to hold raw materials pending processing or processed loins, would only allow a few days production at capacity. Clearly full production in compliance of the State agreement, is not intended, and not achieved. Additionally no plant is operating for a nominal 220-240 days a year even at even their claimed average daily output. The Agreements define a “processing day as a “bank day”, so logically 260 days a year.

At the same time, processing investors in PNG, claim no control over fishing, no ready supply of tuna, and thus being forced to buy at high prices. High input prices, mean highly uncompetitive exports, few orders, less processing, less exports, and lost jobs. Industry cites issues as being the high costs and inefficient supply of utilities and services. Also limitations on wharfs, and other infrastructure, whilst these have generally improved over the years and scales of economy gained, the outputs are at best flat.

Some Industry players have sort legal advice and state that the Government have not met their obligations under the State Agreements, and that they are concerned that enforcing the policy on concessional fishing access being only to “supply processing needs”, it will make their operations increasingly non-viable. Note: generally no clear linkage between fishing and processing companies in PNG

The Government notes the very significant revenues forgone by the State in providing subsidised fishing days to industry, with estimates of revenues forgone being at least 4x the State’s revenue from the sector by way of dividends, and that at least 2 out of 3 Mt of this heavily subsidised domestic catch is going offshore to compete with PNG. Being afforded tax free under State Agreements, even if the proceeds were returned in full, there is little benefit to the State.

The Government remains committed to a policy of promoting onshore investment, and it will be important to maintain confidence of genuine investors. This is therefore a sensitive review, requiring a balanced assessment of the respective obligations of the State and Investor, how the projects are performing and how this performance can be improved.

The Government has announced that all catch taken in Archipelagic Waters will be landed onshore and processed from 2016. (<https://www.undercurrentnews.com/2015/09/17/png-declares-100-of-tuna-caught-in-waters-must-be-processed-there/>). This actually reflects the original concession in 1995. The apparent response from domestic industry has been a stated preference to fish in the EEZ and in effect boycott AW and the obligation to process.

The projects and agreements to be reviewed in depth are:

- RD Tuna Cannery in Madang which signed a State Agreement with the Independent State of Papua New Guinea (PNG) and Madang Provincial Government in 1995;
- South Seas Tuna Corporation – with PNG and East Sepik Provincial Government and other signed in 2000;
- Frabelle (PNG) Limited - with PNG and Morobe Provincial Government signed in 2006.
- Majestic Seafoods Limited - with PNG and Morobe Provincial Government signed in 2013.
- International Food Corporation – no state agreement for tuna, previously had a State Agreement for Mackerel, but enjoys concessional tuna licences.
- Fairwell Fishing – No state agreement, and despite several proposals for onshore investment since 2000, continues to fish with no processing commitment or significant landing.
- Nambawan - Has State agreement, but plant is way behind schedule and still under construction, with fleet fishing under a 2015 commitment to land and process by SSTC, a partner in the project.

For other proposed projects where there is no performance to review, the study will examine the agreements and concessions in the light of results of the review of established projects. These pipeline projects comprise Hailisheng and Dongwon Industries in Lae – all planning to process tuna for canning; and Admiralty Offshore (PNG) Limited - a proposed fresh fish joint-venture between Rell & Renn Fishing Corporation of Philippines and Manus Provincial Government.

The consultant will be expected to liaise with NFA to meet with other PNG Government Departments, especially Investment Promotion Authority [IPA], Bank of PNG, Taxation, Customs, Department Of commerce, NMSA [Ships Registry], Immigration etc. as required to meet the terms of reference of the audit. Local accounting companies and Chamber of commerce etc. can provide details of investment concessions as published.

Consultant

Consultants are required to undertake a detailed legal and financial review of the State Agreements and the compliance with them, by both Parties. Additionally review the economic cost and benefit to the State, and recommendations on future terms of PNG processors and fishing companies whether associated or delinked, as per the following Terms of Reference:-

First Part – Agreements: Legal Process and Compliance

- a. Document the historic process for the negotiation, re-negotiation, and execution of existing State Agreements, and the Parties involved.
- b. Prepare a schedule of key provisions of each Agreement that clearly illustrates the respective contractual obligations, and conditions precedent of each Party to the Agreement.
- c. Prepare an analysis of these provisions and identify both consistencies and inconsistencies between Agreements and respective legislations e.g. Customs, Harbours Board, IPA, BPNG, Trade, Taxation, and most importantly NFA.

- d. Document the legislative provisions upon which the Agreements rely and identify any inconsistencies.
- e. Provide an opinion on the intent of the term 75% completion and ongoing implications on production.
- f. Conduct an analysis of the level of compliance by each Party to each Agreement.
- g. Prepare a detailed report on any non-compliance, or non-deliverables.
- h. Prepare a draft new State Agreement or other style of commercial agreement as considered appropriate

Second Part – Economic Performance of Each Agreement

- i. Each Agreement requires a cost-benefit analysis with a determination of the net benefits (or loss). This assessment shall include collection of the following data as a minimum.
 - a. Prepare a report that details the number of vessels approved by each agreement, numbers licensed each year, the days fished in AW, EEZ and under FSMA, the volume of catch taken, fees [if any paid each year] and the volume of catch processed onshore. [Note: by-products e.g. canned red meat, are packed for local markets, these serve to value add waste and should not be added to exports.]
 - b. Document additional concessions given associated boats to land to associated onshore facilities e.g. Frabelle Philippines vessels both discounted and given AW access to land to Frabelle PNG facility, and review compliance.
 - c. Prepare an estimate of the total value of concessions provided under each Agreement and any other concessions afforded for each year, present this against the equivalent foreign access returns. Thus documenting direct economic rents forgone.
 - d. Prepare a matrix of additional investment incentives such as exemption of import duties, wharf fees, tax holidays, subsidies, grants, etc, afforded, and where these have been provided, quantify the value of these incentives (include a discussion, to the extent possible, on how these compare with the treatment of other foreign and domestic investments).
 - e. Quantify the direct financial benefits (payments) to the local communities, provincial governments and the country.
 - f. Quantify other indirect benefits in employment, training and earnings of local businesses which have accrued to the local communities and the province as a consequence of the project.

Third Part – Financial Performance of Each Company

- a. Undertake a review of the audited accounts of each company's operations and prepare an assessment of reported profits or losses. NFA to facilitate access to data from each company, and line departments.
- b. Report on the assumed values of landed catch against benchmark tuna prices, as well as the treatment of investment depreciation, and any unusual overheads such as head office costs, or internal consultancies.
- c. Report on input pricing and costing models of processors. The practice appears to be at Bangkok price less half freight saved rather than at FOB PNG ports.

Note SSTC operates as a toll packer whereby PNG operations never owned the catch. It is understood this is being revised.

- d. To the extent possible examine transactions between the PNG companies and parent companies, and between fishing and processing companies, for any evidence of transfer pricing or other adjustments to understate the performance of the PNG fishing and processing operation.
- e. Monitor the remittances back to PNG for exports of each fishing and processing venture to estimate compliance with exchange laws of PNG, this based on NFA export records.
- f. Review any charter and service agreements where funds are remitted offshore.
- g. To the extent possible determine the retained earnings from company operations, the policies on re-investment of profits, repatriation of profits to parent companies, and payments to shareholders.
- h. Provide an assessment of whether companies [fishing and processing] have made true profits and quantify these where possible.

Fourth Part – Recommendations

- a. Discuss the historic process for the development of Agreements with particular respect to probity, conflicts of interest and best practice for procurement and negotiation, and make recommendations for future Agreements.
- b. Recommend such measures as are necessary to improve and ensure compliance with the respective Parties' obligations under each Agreement.
- c. Identify inconsistencies, weaknesses and ambiguities in Agreements and provide recommendations for their improvement.
- d. Propose recommendations for amendments to each Regulation to ensure consistency with the current operating environment, including whether changes to legislation are necessary for the avoidance of doubt in the future application of any Agreement terms.

2. Duration

The consultancy will be for a period of approximately three man months and the consultant(s) will be expected to spend a significant amount of this time in Port Moresby. He/she will also be required to travel to the project sites specifically Lae, Madang and Wewak.

3. Access to information and confidentiality

NFA will ensure that all staff co-operate fully with the consultant in providing information relevant to the study and will establish a project team for this purpose. As necessary NFA will use its powers under the Fisheries Management Act to require Parties to each Agreement to furnish full and accurate information on their activities and finances.

The consultant will be bound by the confidentiality clauses of his/her contract not to disclose any of this information. The consultant will not be permitted to discuss the project or the results of the project beyond the project team, and will not be entitled to use any output or data, directly or indirectly for any external purpose, including academic papers, presentations or media reports without the written approval of the Managing Director.

The consultant will report directly to the Managing Director of NFA. Reports will be provided to the Director of Fisheries Development of FFA for quality control and verification of payments, but these reports remain the exclusive property of NFA and will not be provided to anyone without the express permission of the Managing Director.

4. Cost

The cost of the consultancy – fees and international travel - will not exceed **US\$99,000** to be paid by FFA. The NFA will meet the actual cost of accommodation and travel within PNG, and provide an office work station with access to telephone, fax and email/internet service in their office in Port Moresby.

5. Outputs and payment schedule

The outputs of the study will be as follows:

- A detailed work plan for the assignment to be submitted within one week of arrival in Port Moresby for approval by NFA and FFA contacts;
- A brief report at the end of each month, detailing progress and any problems encountered;
- A draft final report, provided for comment to NFA and FFA contacts and allowing two weeks for their responses;
- A final report completed within one week of receiving these comments.

Payment of fees will be scheduled as follows:

- 10% on contract signature;
- 20% on approval of the work plan;
- 35% on submission of the draft report;
- 35% on acceptance of the final report.

6. Reporting contacts

All correspondence and reports are to be directed to:-

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